

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1026 SCOMM 28: JOINT GAS PIPELINE COMMITTEE, 1981-82 1026

1 all the traffic will bear as far as pricing and profits
2 are concerned. Senator Stevens raised an interesting
3 question some years back during D-2, and I don't know
4 what the answer is, I've never gone out to search it, but --
5 Stevens told other members of Congress during the hearings
6 that Alaska retained ownership of all the oil produced from
7 State leases, and I never did find out at what point he
8 determined that he thought the oil changed hands - it would
9 be interesting to find out that question. It might open
10 Pandora's box - maybe we own the oil until such time
11 as it is refined. The most onerous tax is the windfall
12 profits tax we have, of all taxes, and the strange part of
13 it is that the oil companies asked Congress for that tax.
14 Congress did not make an allowance, and I see little reason
15 why Alaska should correct that situation after being kicked
16 in the head by the oil industry. I don't think the
17 legislature should necessarily be all that kind and easy
18 and willing to respond. Now the gas producers want
19 windfall profits and deregulations that was so eminently
20 successful for enormous profits for the oil industry.
21 I wonder what percent of profits were available to Alaska
22 when the oil was \$3 a barrel. No doubt it was a much
23 higher percentage that it is today. In treating the oil
24 companies fairly, in which -- somehow Alaska has treated
25 the oil companies unfairly, I didn't know that the oil

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1 companies dealt in fairness. I thought they dealt in
2 corporate self-interest, legally or illegally. I see little
3 reason for Alaska to treat the oil companies any
4 different than they treat one another. Exxon was embarrassed
5 by its high profits in 1975. What were Exxon's profits
6 this last year? I would guess that they are 3, 4, 5 times
7 as high as they were in 1975. Exxon said 25% share, and it
8 attributed that to the State, actually I think -- gave another share...
9 I notice that Exxon did not say they were getting that
10 little. What their real share is might be interesting
11 to find out. Taxation is one of the tools that the
12 federal government provided the State to protect the
13 State's corporate interest. Alaska has used it very lightly.
14 Alaska has not yet brought the total federal Alaska
15 share in line with world practice. The Anchorage Chamber
16 of Commerce's allegation about the effects of taxes --
17 well, I think the last lease sale, where we have royalty
18 bids that exceed our current take from Prudhoe Bay on a
19 percentage basis, royalties of 30%, 40%, 50%, 60% were
20 bid. And that's not very large in respect to the
21 Prudhoe Bay leases were last held. Very high royalties
22 were bid there. Oil has been discovered in the North
23 Slope on an 80% royalty lease. Stability in prices -
24 well, I agree with the oil companies. Maybe you should give
25 them stability in prices, stability in the marketplace.

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1 I believe that they were probably making as little as --
2 smaller than this, but let's suppose that they were making
3 in \$3 oil, they were making \$.50 to \$1 at the outside.
4 Maybe the State of Alaska should take everything but that -
5 that way they would have their stability. Of course, if the
6 legislature felt magnanimous, they might increase it for
7 inflation. That way it would probably be at \$1, \$2.50,
8 and then take everything above that. That would give them
9 stability. That's another way to look at stability.
10 After all, it was sufficient profit in those days, provided
11 for inflation. There's a attributive -- about coal taxes
12 and how the coal industry will have to fight the same
13 thing. I hope so. I don't see any way that the legislature
14 can possibly set a tax which will be equitable today and
15 still remain equitable 20 years from now when coal
16 begins to come into its own. The legislature in those
17 days will have to battle, just as the legislature is
18 today, and just as the legislature did 30 years ago -- the
19 canned salmon industry. It's the same thing, just the
20 names and the people and the industry has changed.
21 There's a man here by the name of Coffee from the
22 Anchorage Chamber of Commerce. He was talking about his
23 father being a member of that legislature in the early
24 days. My father served in the legislature from 1930 or 31
25 to about 1945 at the time of his death. It was the

1 longest undefeated record of continuous service in the
2 legislature at that time. I think Bill Egan eclipsed it
3 later on and then Butrovitch. As I remember it, Coffee
4 said that -- how they fought for the canned
5 salmon industry. As a matter of fact, Coffee's father
6 was on the other side in a very critical vote in those
7 days. I notice that he now claims that he was on the
8 finally prevailing side. The United Kingdom increased
9 its taxation from 87% to 90% in the North Sea. I would
10 like to point out that was the seventh tax increase in
11 the last 18 months. Further I would like to point out
12 that it was done by the Conservative government led by
13 Conservatives - in short, we see the way a genuine
14 conservative functions to protect the assets of his or
15 her company, in this case the assets of the United
16 Kingdom. The tools that were used were the basic tools
17 of government - taxation and appropriation. Appropriation
18 which the State of Alaska has not used. The Oil and
19 Gas Journal and others predicted all kinds of dire things
20 in banner headlines. Now we find buried deeply in the
21 Oil and Gas Journal the statement that despite the new
22 round of tax increases, the demand for offshore rigs will
23 continue to be tight even though there will be a number of
24 new additional rigs added to the supply during the next
25 year. Bringing England's taxation a little closer to home,

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1 the Queen of England owns a majority interest, a major
2 interest I should say, in British Petroleum to the Bank
3 of England which in turn controls a majority interest in
4 SOHIO who owns more oil in Prudhoe Bay in Alaska than all the
5 rest of the Alaska combined - Alaska producers combined.
6 Prudhoe Bay is the most profitable oil field in the history
7 of the world. There are bigger oil fields which produce
8 more oil more cheaply, but those are owned by countries
9 which have long since prevented the rape of their national
10 interest. Only in the United States has this rape still
11 permitted, and only in Alaska is it so great. For the
12 above reasons, I would like to suggest that Alaska
13 undertake a tax equalization program to bring the total
14 tax on Prudhoe Bay into line with the United Kingdom's
15 tax on North Sea production. I'd like to suggest
16 that the legislature take more than just a safety net
17 for Lipton's income tax. I will speculate that Alaska's
18 severance tax will have to be tripled or quadrupled overall,
19 to bring the overall Alaska, federal tax rate, royalty, etcetera,
20 up to the English total take in the North Sea oil.
21 Further, I suggest the Committee undertake an educational
22 program to make, not only Alaska public aware of royalty,
23 taxes and ownerships required by other nations, but also
24 export the oil tax informational programs to every other
25 oil producing state so the citizens can see the relationship

1 between other countries, what other countries are doing,
2 and what is done in the United States. Alaska should
3 not continue to approach oil taxation with the Viet Nam
4 war type philosophy. If the oil companies are going to
5 continue to beat the legislature over the head then the
6 legislature should respond. The legislature should
7 fight back not only with informational program --
8 with a very severe risk to the oil companies if they
9 lose the struggle over Alaska obtaining its fair share
10 of the oil barrel, they should suffer the penalty.
11 If this group gives up, the legislature gives up, one
12 dime to the oil companies, you will encourage them to
13 come back next year with even a more determined, harder
14 program. Thank you for the opportunity to appear.

15 MR. GARDINER:

16 Thank you. Questions from the Committee members?
17 Representative Randolph.

18 MR. RANDOLPH:

19 Mr. McCutcheon, you mentioned something about Senator
20 Stevens -- I don't think you were too clear on your
21 numbers. Maybe Alaska still owned oil until it's
22 refined - would you expand on that to the extent you
23 can? If there's any possibility that being a viable
24 suggestion, what do the oil companies, in fact, get for
25 the \$900 million back in '68?

1 MR. MCCUTCHEON:

2 I didn't hear the last part of your question. I'll repeat
3 what I know about the Stevens ... It was during the
4 D-2 hearings on the land claims. Stevens was explaining
5 to the members of the committee that Alaska was unique
6 because of its constitution, and it retained ownership of
7 the oil. That puzzled me. I never understood what it
8 was and I've never really pursued it, but it might be an
9 interesting thing for someone to pursue.

10 MR. RANDOLPH:

11 One other question, Mr. Chairman. Mr. McCutcheon, if
12 you owned - such as people do all over the United States -
13 a piece of an oil field, personally, what type of tax
14 structure would you suggest the State impose upon you.

15 MR. MCCUTCHEON:

16 The same one the oil companies would. Same one, same
17 kind, same way the oil companies would.

18 MR. RANDOLPH:

19 The oil companies can't impose taxes.

20 MR. MCCUTCHEON:

21 I know. I would take all the traffic would bear, same way
22 they do.

23 MR. RANDOLPH:

24 Thank you.

25

1 MR. GARDINER:

2 Questions from other Committee members? Thank you, Jerry. Okay,
3 that brings us to Commissioner Williams who we -- the first day
4 we said we would bring back for Committee members to
5 have further opportunity to ask the Commissioner
6 questions. I know some members specifically did have questions; they may
7 have forgotten them in the time span here. I understand the Commissioner
8 does have some comments. I'll let him go ahead with
9 that first.

10 COMMISSIONER WILLIAMS:

11 As soon as I get all my goodies sorted out here,
12 Mr. Chairman. Well, Mr. Chairman, there have been a
13 number of comments that have been made by speakers who
14 have followed me that may well have led to a number of
15 questions by the Committee. My comments mostly are in
16 anticipation of those questions that may have been
17 provoked. Perhaps it might be shorter for me to make
18 my responses or answer the questions that I believe
19 were, in fact, raised by a number of the points by
20 other witnesses, and then answer the questions --
21 although if you would rather, I could answer the
22 questions that the Committee has.

23 MR. GARDINER:

24 Go ahead, and if members have questions at the time
25 the Commissioner is discussing them, we can break in at

1 that point, and take anything additional.

2 COMMISSIONER WILLIAMS:

3 One of the first ones was with respect to the testimony
4 of Carl Bauman relating to the interest deduction for
5 Amerada Hess. That was a situation where a parent loaned
6 money to the subsidiary and, under our regulations --
7 he said that was unfair, that they should be entitled to
8 get a deduction because other companies, whose parents
9 went to the market and borrowed money from third parties
10 and are paying interest to third parties, are entitled to
11 a deduction. The statute that, Section 30, AS 43.21.030,
12 speaks, when you are talking about pipeline income, in
13 terms that the taxable income attributable to the
14 transportation of oil in a pipeline engaged in interstate
15 commerce in Alaska shall be determined by the Department
16 and shall be the amount reported, or that would be
17 required to be reported, to the Federal Energy
18 Regulatory Commission, or its successors, as net
19 operating income. In the legislative history of the bill
20 there was some discussion about what net operating income
21 meant because it is also used for gas pipelines, and, in
22 fact, the so-called bottom line which is what's used for
23 the tariff calculation, doesn't actually use the term
24 net operating income either for pipeline
25 companies, oil pipeline companies, nor for gas pipeline

1 companies. It refers, instead, in one case, I think, to
2 net carrier income and, in the other case, to net
3 operator income. There's a whole series of accounts
4 and schedules for gas pipelines and oil pipelines that
5 Federal Energy Regulatory Commission and its predecessors,
6 the Interstate Commerce Commission which had oil pipelines,
7 and the Federal Power Commission which had gas pipelines --
8 they had this big elaborate schedule of different
9 accounts, it's a system of accounts. It's uniformly
10 applied. That is what this was referring to. We start
11 with that net operating income, and it says here - less
12 those portions of interest -- this is the statute now
13 continuing on -- taxable income is: net operating income
14 less those portions of interest and general administrative
15 expense attributable to the pipeline transportation
16 of oil in the State, except that the taxable income shall
17 also include taxes on, or measured by, income. By
18 analogy in the production area, the interest expense for
19 a producer, a company that only produced oil, was
20 deductible -- it's limited, however, in a way so that you
21 exclude intercorporate transactions. In other words, if
22 I, as the XYZ Oil Company, had enough working capital,
23 cash, available in my corporate treasury that I could
24 lend to my producing subsidiary, the interest expense
25 would not be counted. If I went, instead, to the marketplace

1 and borrowed and so I, as the overall corporate enterprise,
2 am paying to a third party, that interest expense is
3 deductible. It's just a question, then, of how much
4 wealth you had in your treasury. We apply the same
5 principle in the case of these pipelines which I think is
6 consistent, in fact, with what the legislative intent was.
7 If there are any questions on that I'll pause for them here -
8 otherwise I will continue on.

9 MR. COLLETTA:

10 Commissioner, but isn't that making an assumption -- not
11 really an assumption but what you are doing is clarifying
12 or classifying who you can borrow money from. Borrowed
13 money should be borrowed money.

14 COMMISSIONER WILLIAMS:

15 When the IRS looks at consolidated returns they have the
16 provision that they too can exclude income that is -- or
17 interest expense that is between affiliates. It is
18 nothing new. It exists in Chapter 20 for regular taxpayers.

19 MR. GARDINER:

20 In the case of Amerada Hess, did they -- they borrowed it
21 from their parent company -- was that, did the parent
22 company go borrow it from somebody else? Was that a
23 pass-through?

24 COMMISSIONER WILLIAMS:

25 No. It wasn't a pass-through.

1 MR. GARDINER:

2 Was there actual borrowing on internal capital?

3 COMMISSIONER WILLIAMS:

4 That's my understanding.

5 MR. GARDINER:

6 Further questions on that? Go ahead, continue.

7 COMMISSIONER WILLIAMS:

8 The 50:50 odds was just a thing that got mentioned a
9 couple of times. I just would like to say that for my part
10 I don't necessarily view them as being 50:50. I think
11 the odds run in our favor. The concern that I have,
12 however, is that we cannot deny the fact that there is
13 a significant chance that we could lose the litigation.
14 I don't know -- in my opinion it doesn't rise to the level
15 of 50%. But the point is that the consequences are so
16 severe if we do lose, we do have to make the refund,
17 that we should not take the gamble. I would like to
18 reemphasize that. But I would like to disavow, or
19 disassociate myself, with any sort of implicit endorsement
20 of a 50:50 assessment of the case.

21 MS. FAHRENKAMP:

22 Commissioner Williams, there's one part of this that
23 really bothers me. We had 3 recommendations of what
24 could be done in case it was, whether it was 50:50,
25 51:49, 60:40, whatever the odds are, but I notice there

1 was never anywhere mentioned that any of the reports that
2 we have of a fourth alternative - of sitting down at
3 the negotiating table and see what could be done.

4 What is your opinion on this?

5 COMMISSIONER WILLIAMS:

6 The problem -- well, obviously if you can control the
7 situation through a settlement so that you eliminate
8 the risk of litigation altogether, that is preferable,
9 probably, to any other alternative simply because then
10 you have reduced you risk of lose essentially to zero
11 by agreement.

12 MS. FAHRENKAMP:

13 Well, Mr. Chairman, then my question is, if that is
14 preferable, or could be preferable, I don't understand
15 why there has not been any saying let's sit down and talk.
16 This is what's bothering me. I see a strong possibility
17 that this could be done, and I see no action on the
18 part of the administration in any way to encourage it.

19 COMMISSIONER WILLIAMS:

20 Mr. Chairman, well, I will certainly apologize to you
21 if you haven't seen it because there have, in fact, been
22 efforts. The problem is that there's not a great deal
23 of sentiment, as reflected in the joint statement, to
24 cut back in the amount of dollars from the 30% share, or
25 thereabouts, that the State is taking. There are

1 constraints, then, imposed that -- we ran an idea by,
2 for instance, the Governor did, and I think that this is
3 general knowledge, certainly it is from the people I
4 know, that within a few hours of when that idea was
5 floated by some legislative leadership there was a list
6 signing up a majority of the members in the respective
7 house where this list was circulated, opposed to the
8 idea of cutting revenues in exchange for settlement.
9 If that only took a couple of hours to gather up
10 signitures to a pledge like that, that's a very fruitless -
11 looking alley in which to pursue very much further, it
12 seemed to us. Now, if you are telling-- if there's been
13 a reversal of that position there, I'm certain that we
14 can talk. But ...

15 MS. FAHRENKAMP:

16 Mr. Chairman, I think I'll run my own list. Just see if (indisc.-cough)

17 MR. RANDOLPH:

18 Yes, Commissioner, along the same lines, I think the
19 representative from Exxon indicated to this Committee
20 that they were somewhere in the ballpark of a 50:50
21 split from what the tax is to what it used to be,
22 they would be willing to sit down and talk about that.
23 To follow up on Senator Farenkamp's question, what's
24 the administration's position, not taking into consideration
25 the legislative input you think you might have. After

1 answering that, if the administration's position is that
2 you articulated a moment ago, if I understood it
3 correctly, the need is to keep the amount of revenue
4 we're presently getting. You also said it was about --
5 that there had been efforts made to negotiate this
6 what is there to negotiate if that is, in fact, the
7 administration's and the legislature's, position?

8 COMMISSIONER WILLIAMS:

9 Dollars and cents, I suppose. It would be a question
10 of how far back people are willing to draw from
11 \$5.9 billion.

12 MR. RANDOLPH:

13 My question is, what is the administration's position?

14 COMMISSIONER WILLIAMS:

15 The administration's position is that there are four
16 acceptable types of solution. One is to escrow the
17 entire amount at stake which would be a total of
18 \$2.5 billion by this time next year, and proceed to
19 litigate - that's a responsible course of action
20 because at least that way we will have the money
21 available that if we lose we can pay it. The second is
22 that we adopt some sort of backstop which reduces the
23 risk overall because there is some additional risk
24 introduced by the type of tax that we have with the
25 corporate income tax over and above the basic risk

1 inherent in -- are we overreaching ourselves in this
2 level of revenue that we are taking from this industry?
3 So that's a second possibility. Third possibility
4 would be a settlement which presumably requires greater
5 compromise in terms of the dollars and cents. The
6 second one may not require any compromise in dollars
7 and cents, and in fact, this Sponsor Substitute
8 reflects that second approach. It's not necessary,
9 in fact, to sacrifice any dollars and cents.
10 Despite what the fiscal note says, and despite the
11 testimony against the opportunity for the legislature
12 to adjust the millage, it is very possible for the
13 legislature, in fact, to adjust the millage so that
14 everything is restored to the status quo, and, in fact,
15 there is not an increase or a decrease in the revenues
16 that are being generated or protected. The third is
17 a settlement. The fourth approach, which I guess
18 I, in introducing this, I said they were acceptable --
19 the fourth one is not an acceptable. That's to do
20 nothing. That's to allow an impasse. And that is
21 irresponsible. It's the worst possible thing that
22 could happen.

23 MR. RANDOLPH:

24 My question was that the representative of Exxon told
25 us that they would be willing to sit down if somebody on

1 the Committee asked them at what point would you think
2 negotiations could take place or would result in something
3 that that negotiation would settle. They said somewhere
4 between, halfway between where we are and where we
5 were. Is the administration's position -- is there any
6 room in the administration's position to negotiate?
7 I mean, if the administration's position is that
8 there is no room to compromise what we are getting from
9 the current situation, then my question is how can
10 you arrive at a settlement at all? That concludes
11 that option, doesn't it?

12 COMMISSIONER WILLIAMS:

13 The question can be turned around, too, and ask is
14 the legislature willing to settle because it cannot
15 be done without legislation. If that legislation is
16 not to be forthcoming -- the answer to your question
17 is neither branch, I think, can proceed unilaterally
18 without the other. If there is a willingness on the
19 part of the legislature in both houses, a majority,
20 to proceed, that's evidence to the Governor, I would
21 suspect, that we would get instructions to proceed together.
22 If that's not forthcoming or if the cost of settlement
23 appears to be unsatisfactorily high, then we have got
24 a vehicle that represents, from my point of view
25 probably, the next best alternative.

1 MR. MALONE:

2 Mr. Chairman, this discussion over settlement, I think,
3 is interesting because it's always, I suppose, a
4 possibility. I think the joint statement that was
5 issued by legislative leadership and the Governor on
6 March 18th is, probably, the context in which I view
7 this as being discussed. The relative shares of the
8 value of the oil, approximately right as they are
9 now. Coming down to this question here. I don't know
10 if the Commissioner wants to comment on this or not but
11 if he wants to -- it seems to me under the present
12 situation the taxpayers are saying, we don't like your
13 tax and we think we may prove it unconstitutional,
14 file suit in the courts. It isn't necessarily, it
15 seems to me, the most likely case to negotiate from
16 from the State side unless there's a potential
17 liability there. It seems to me that removing that
18 liability, or at least reducing it -- reducing the
19 liability probably makes a better atmosphere for
20 negotiation. I don't know if you want to comment on
21 that or not, Tom?

22 COMMISSIONER WILLIAMS:

23 Well, that's basically the nub of the question. We've
24 seen in the past that attempts by an administration to
25 negotiate unilaterally, and then present to the

1 legislature: here, this is a settlement, we have agreed
2 with the oil industry. First of all, the legislature
3 is not receptive to having terms dictated to it - take it
4 or leave it, here it is. There are questions that people
5 have, legitimate questions, about various terms in there
6 and perhaps in the opinion of a majority of the legislature,
7 on certain issues the administration has made an error.
8 That's not proven to be an enormously successful
9 avenue, where the administration attempts to go ahead
10 of the legislature without a clearcut feeling about
11 the legislature's views. We get back then to the
12 consensus points which was a fairly overwhelming
13 endorsement of the present level. And that's why I
14 was asking whether Senator Farenkamp is aware of the
15 reversal of position, because if there is I'd like to
16 know. But as far as I know, we are essentially still
17 in a situation that people feel comfortable with the
18 present level of tax, and that necessarily means, then,
19 we are preceding in this direction until ...
20 That's what it means.

21 MR. MALONE:

22 Mr. Chairman. As Commissioner of Revenue, you and other
23 members of the administration have the responsibility
24 of upholding and carrying out the State laws, don't you?
25

1 COMMISSIONER WILLIAMS:

2 Yes, sir.

3 MR. MALONE:

4 One of those State laws is Alaska Statute 43.21.

5 COMMISSIONER WILLIAMS:

6 Yes, sir.

7 MR. MALONE:

8 That's what I thought. So this proposal that we have,
9 S.S.H.B. 200, I think it's been pretty well discussed - it's
10 aimed at protecting the revenues that are generated
11 through 43.21. It is your recommendation that this is a
12 practical way to do it. Is that correct?

13 COMMISSIONER WILLIAMS:

14 That's correct.

15 MR. MALONE:

16 I'd like to ask one other question that goes back
17 something I was unable to touch on the other day.
18 In S.S.H.B. 200, Commissioner, you have section 6 -
19 it starts on page 5 of the bill, dealing with
20 petitions to the Department on the fair representation of
21 the extent of a corporation's business activity in
22 the State. Could you go over again why this section
23 is in the bill?

24 COMMISSIONER WILLIAMS:

25 Yes I could. The reason that's in there is -- relates

1 back to the Multistate Tax Compact in Chapter 20.
2 Alaska is a member of the Multistate Tax Compact.
3 AS 43.19 is the chapter where the Compact is codified
4 in Alaska statutes. The Compact provides that the
5 Commissioner may, in fact, in a circumstance where
6 the standard 3 factor formula, contemplated in the
7 Compact, fails to represent fairly or equitably
8 the extent of a taxpayer's business in the taxing state,
9 that the Commissioner may modify the standard
10 apportionment, either by replacing factors, reducing
11 the number of factors, according different weights
12 to the factors, or by going to separate accounting.
13 Part of the legal theory of the case has been, in
14 fact, that the Commissioner has the discretion under
15 the Multistate Tax Compact, that he could have come
16 to a sult very similar to the one, in fact, that's
17 embodied in AS 43.21. It seems appropriate, where
18 you have a circumstance, that you have a clear
19 demonstration that the standard approach, whether that's
20 the standard approach embodied in 43.20 or whether
21 it's the standard approach embodied in 43.21. When
22 you have a circumstance that it becomes manifest that
23 that standard approach is failing to represent the
24 extent of a taxpayer's business in this state, that you
25 have authority to modify that. This makes it clear that

1 the provisions of the Compact apply to Chapter 21.
2 We believe they do already. It's an issue that has
3 been raised in the lawsuit. I should make it clear
4 that the Compact does in fact apply to income taxation
5 under Chapter 21 just as it applies to income
6 taxation under Chapter 20. It is not intended to do
7 anything more than that, and it's not intended to
8 vest the Commissioner with carte blanche to rewrite
9 the tax laws of the State.

10 MR. MALONE:

11 It is my understanding that it's the position of the
12 Department of Revenue and the Department of Law, that
13 is that State executive branch that, in fact, the
14 Department of Revenue has its authority at present.

15 COMMISSIONER WILLIAMS:

16 That's our position.

17 MR. MALONE:

18 Have any corporations that are being taxed under 43.21
19 applied for any sort of relief under that power?

20 COMMISSIONER WILLIAMS:

21 Not to my knowledge.

22 MR. MALONE:

23 From your earlier remarks, this meaning the previous
24 one, I understand that there is a claim being made
25 in the lawsuit that this type of relief is denied.

1 COMMISSIONER WILLIAMS:

2 We have adopted a regulation pursuant to the authority
3 in the Compact and the general authority under Chapter 5
4 of AS 43, and under 43.21, that affords the opportunity
5 to have relief before the Commissioner, and that
6 regulation is being challenged in the court on the
7 basis that there is no statutory authority for it.

8 MR. MALONE:

9 But there hasn't been any -- there have not been petitions
10 for substantial relief under that regulation under
11 existing law, is that correct?

12 COMMISSIONER WILLIAMS:

13 The position of the plaintiffs in the case has been,
14 I now will defer to them if they wish to amend my
15 characterization of it.- the position, as I understand
16 it, is that the lack of statutory authority for the
17 regulation renders it a nullity. Therefore there is
18 no mechanism to afford the relief, and they must go to
19 the court to seek redress.

20 MR. MALONE:

21 Mr. Chairman, in spite of the arguments that are being
22 raised about the lack of relief available, have
23 corporations filed petitions containing information
24 as to why they might need such relief?
25

1 COMMISSIONER WILLIAMS:

2 I'm not sure where the thrust of that is going.

3 MR. MALONE:

4 In other words, it seems to me, as I understand it,
5 that it is a department of the state executive branch,
6 charged with carrying out the laws of the State, this
7 sort of relief is available under our current law.

8 This is a clarification of it in S.S.H.B. 200.

9 COMMISSIONER WILLIAMS:

10 That's correct. It makes explicit what we believe is
11 already there.

12 MR. MALONE:

13 So that, as I understand it, the executive branch, the
14 administration, would invite petitions for relief under
15 our current law that would also be spelled out more
16 clearly in section 6 of this bill, but people are
17 claiming it is not available without applying for it
18 first. Is that correct?

19 COMMISSIONER WILLIAMS:

20 That's correct. People are claiming that it is not
21 available, that there is no authority for granting
22 the relief. Therefore it is not available.

23 MR. MALONE:

24 But the position of the State administration is that
25 it is available.

1 COMMISSIONER WILLIAMS:

2 That is correct.

3 MR. MALONE:

4 Thank you.

5 MS. FARENKAMP:

6 Mr. Chairman, in light of the remarks by one of my
7 colleagues concerning the joint press conference, etcetera,
8 as far as the amount of monies to be gotten or maintained
9 from our resources, the statement was made a couple of
10 times that 30% was a fair number, and many times it was
11 referred to all our resources. I would just like to
12 know from Commissioner Williams if he feels we will be
13 asking coal industry and hard rock mining industry or
14 any of our other resource industries for a 30% for the
15 State.

16 COMMISSIONER WILLIAMS:

17 I think we will see an evolution towards higher rates
18 that will be demanded of other industries, other
19 extractive industries. Bear in mind that we did not
20 start at 30% with the oil industry either. With
21 development you have critical periods where the initial
22 investment must be given an opportunity to pay out.
23 I don't think it is appropriate, for instance, to impose
24 at this stage a 30% severance tax on coal, or a combination
25 of severance tax and royalties so we achieve instant parity

1 with oil and gas. But I would not be surprised to see
2 in the future that a nominal, initial tax rate that
3 would be imposed on coal or other mining industries
4 over time would be increased as the State increasingly
5 calls on those and as fledgling industries grow and
6 become stronger and better able to support the tax
7 burden. I think you will see increases over time.

8 MS. FAHRENKAMP:

9 One other question, Mr. Chairman, and then I will finish.
10 A couple of times during your first testimony, and
11 during the testimony we have heard all year long,
12 we've heard reference to this litigation and the
13 possibility, very good possibility, of litigation if
14 we adopt 200 or any other that we would adopt-- what
15 do you see as the cost of the litigation? Do you
16 have any guesstimate as to what that will be in the
17 next decade or two decades to the State?

18 COMMISSIONER WILLIAMS:

19 You mean attorney's fees and that?

20 MS. FAHRENKAMP:

21 Yes. Do you have any ballpark figure at all?

22 COMMISSIONER WILLIAMS:

23 I don't know. I would think it would be on the order of
24 a few million dollars, but I don't know.
25

1 MR. COLLETTA:

2 Mr. Chairman. Just a couple... Tom, I'm still a little
3 confused as to when the change of attitude really
4 occurred. I know where the legislative attitude came
5 from, but the administration's, because -- just seems
6 to me that the Governor proclaimed not only to the
7 legislature but to the State as a whole in his budget
8 message that at that particular point in time he was
9 really concerned about this lawsuit and wanted monies
10 put aside. Now, all of a sudden, we are not any longer
11 putting monies aside -- we are finding another way to
12 get to it. I don't have any quarrel with identification
13 of what is supposed to be the fair share. I do the
14 method. This is what really disturbs me, I think, the
15 most is that if a commodity is worth something, then
16 have the courage to say so. But this mickey mouse trying
17 to find another way to get what you say and you really
18 believe is this fair share - it doesn't seem right.
19 If you want the same dollar value, do we have the guts
20 to say we are going to impose a 35% severance tax on a
21 commodity. I don't know. All I know is that 200 -- you
22 made a comment to Representative Malone on his question,
23 that you think this is an acceptable way to protect the
24 revenues as -- the amount of revenues, that we currently
25 get. Is it a better way than Chapter 21?

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1 COMMISSIONER WILLIAMS:

2 This combination now?

3 MR. COLLETTA:

4 Yes. Why don't we just outright repeal 21 and try to
5 implement this then? If this is supposed to be better?

6 COMMISSIONER WILLIAMS:

7 You could.

8 MR. COLLETTA:

9 Well, I don't know. I'm asking. -- I don't know.

10 MR. GARDINER:

11 I think one of the things in the report that was done
12 for us did explore other alternatives. One of the
13 options that I know some other legislators were looking
14 at specifically was the option of raising the severance
15 tax to what they felt -- the level that would have
16 achieved the same amount of revenue as about 19%,
17 and go back to some modified income tax Chapter 20 type,
18 or something -- an income tax that wouldn't bring in
19 but a small portion that's brought in under 43.21.
20 So that was one of the options looked at, and that
21 certainly there are arguments in favor of that option
22 as there are in this one. One of the things, I think,
23 you have to consider is that just because someone drags
24 you into court doesn't mean they are right. The State
25 of Alaska has been dragged in over oil and gas taxes

1 on everything we've done. We've never lost any case of
2 any substance over oil and gas taxes, and just because
3 somebody takes you into court, I don't -- as a private
4 citizen, if somebody drags you into court, does that
5 mean you just fold? Because somebody dragged into
6 court, you are supposed to be scared or something?
7 I think that one of the things that as been brought out
8 too, in looking at this, is that really, probably, the
9 income tax is one of fairest taxes. I think some
10 people have objected to this reserves tax in that they
11 don't know what the future rate is going to be, and
12 that may be a decent argument -- I, personally, am
13 content with 43.21 and I think we ought to keep it in
14 place. I think it is the fairest tax and it recognizes
15 some differences that an increase in severance tax
16 wouldn't realize, and it realizes some differences that
17 ad valorem or increased royalties or other things
18 might have been. We have to back and look why people
19 recommended to us in the legislature, finally after
20 many years of study, did pass an income tax. But I
21 think there was long a recommendation that we should
22 have some modification of our existing corporate income
23 tax to structure an income tax more properly, reflected
24 how the oil and gas industry really worked as
25 multinational corporations mainly. If they give up in the

1 suit, then we wouldn't have to do all this.

2 MR. COLLETTA:

3 Mr. Chairman. If I could, I guess -- Commissioner,
4 what I'm really driving for is -- it seems that the
5 bill is predicated on dollar values, not on percentage.
6 You know we are striving to maintain a dollar balance.
7 What if there's a decrease in price? What occurs after
8 '85 when we reach the peak and we start to decline?
9 You haven't addressed it. This percentage is ours;
10 we're saying this many dollars are ours. It just seems
11 that each time there has been an increase in the price,
12 our dollar value appetite has gotten bigger. Maybe we
13 will be looking for an additional \$77 million when the
14 last outcry bid doesn't come to pass
15 because we are looking again at the dollar values,
16 not a percentage of what it is. I don't know if you
17 follow what I'm saying. See, we are striving to protect
18 \$6.7 billion, not a percentage of the commodity.

19 COMMISSIONER WILLIAMS:

20 First, the last. I disagree with that figure. \$6.7 --
21 I don't know over what time period that is but ...

22 MR. COLLETTA:

23 I don't either, Commissioner. That's what your revenue
24 projections were for this year that we heard earlier in
25 the year.

1 COMMISSIONER WILLIAMS:

2 My forecast has never been that high. It was \$6.061 billion
3 at its highest. It is now \$5.9, and the OPEC meeting
4 is not concluded. We reserve the right to reassess
5 our position after the conclusion of that. \$6.7 is one
6 of those mythic numbers that was circulating in the
7 halls, but we are not responsible for it. The second is
8 that one of the reasons that this bill proposes not to
9 abolish 43.21 is that, in fact, a lot of people do
10 believe that the approach embodied in 43.21 represents a
11 sound and fair and equitable way of attributing and
12 measuring the income that is earned from operations
13 in Alaska. It took, you recall, several sessions of
14 legislative deliberation before, in fact, taxes were
15 passed in this area, and 43.21 came to be. It is our
16 belief that time does not really allow a comprehensive
17 review and analysis of that basic structure. Yet we are
18 looking at a tax that is generating, we anticipate, a
19 billion dollars a year, or more in the future. To take a
20 year out and deliberate is going to mean that instead of
21 \$1.5 billion at stake now there will be \$2.5 billion
22 at this time next year. \$3.5 billion if there is a
23 deadlock next year and it goes to the next legislature.
24 That gets to be very, very difficult - increasingly
25 difficult, both for the oil companies as well as the State,

1 to modify the collision course that we are on in the
2 courts. At that particular time you have essentially
3 locked yourself into the option of litigation to a
4 conclusion because neither side can afford to back away.
5 The ingredients simply are not there. Also, I don't
6 think that we have really attempted to preserve dollars
7 figures here - that was the purpose of the high case and
8 the low case analysis -- is to show that the proportions
9 hold up under the backstop whether the price is high
10 or whether the price is low. That the reserves tax does
11 vary in its size and rough correlation to one's expectations
12 about prices. Consequently, rather than this being a
13 structure that's designed to produce X dollars regardless
14 of what percentage of the gross that may be, I say that
15 this is an unusually designed to preserve X percent
16 regardless of whether the dollar size increases or
17 decreases because of what OPEC can do.

18 MR. GARDINER:

19 Commissioner, do you have some other points? I wanted to
20 give Mr. Taylor some time today too.

21 COMMISSIONER WILLIAMS:

22 I did have a few.

23 MR. HALFORD:

24 Commissioner, I've got one question that kind of intrigues me.
25 I don't know if there is any significance to it at all.

1 When you change from full implementation of Chapter 1
2 to a reserves tax, what happens in terms of the companies
3 themselves? Now they are in different situations in
4 terms of what they hold in reserves and what they are
5 producing and where their reserves back up the
6 production. Is there any reallocation in who pays
7 this theoretical same net dollar that you're claiming
8 that we get?

9 COMMISSIONER WILLIAMS:

10 First, let me answer that in several stages. When you look
11 at Prudhoe Bay, the production interest is in very
12 close approximation to the interest in the overall
13 reserves so that I don't believe you are going to see
14 distortions there. Now, one thing that is going to happen
15 is that you do have some taxpayers up there that are
16 not corporations at Prudhoe Bay who, as individuals or
17 as fiduciaries - trusts - they are exempt from income
18 tax because Chapter 20 no longer applies to individuals
19 or trusts. They will be subjected to a reserves tax.
20 And so there is that change that will occur with respect
21 to those smaller interests at Prudhoe Bay. They will have
22 a reserves tax whereas now they have no income tax
23 because they are not a corporation. And 21 only applies
24 to corporations. In the Cook Inlet, it is possible that
25 we could have some differences, but we don't believe they're

1 likely, and we don't believe that if they do occur they
2 are going to be gross distortions or radical changes.
3 The oil fields there are well along in their productive
4 lives. The assessed value of the platforms, and the
5 onshore facilities supporting those, are still fairly
6 high. This does provide that we carve out that assessed
7 value under the hardware tax. That gets carved out
8 from the value of the reserves. So I think we will
9 probably see in most cases there very little residual
10 value left to attribute to the reserves once the value
11 of the hardware, in fact, is taken care of. In other
12 words, in the interaction between 43.56, the present
13 hardware tax, and 43.58, the reserves tax, most of the
14 burden is already under 43.56. I don't think there will
15 be a lot of property tax burden imposed under Chapter 58
16 then for the reserves tax. This may mean that on some of
17 the smaller interests owners there that the backstop is
18 not, in fact, fully backstopping the amount of income
19 tax that a small taxpayer may be paying. I believe that
20 they are sufficiently small taxpayers that we are only
21 talking in the scale of millions, or possibly 10 million
22 of exposure as opposed to \$8 billion or \$9 billion
23 is what we are looking at the overall exposure under
24 Chapter 21. That failure to fully backstop an individual
25 circumstance in the Cook Inlet, I think is an affordable

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1 risk that we can tolerate. I don't see how we can, in
2 fact, provide any sort of backstop that fits perfectly
3 like a glove to the circumstances of every single
4 individual corporation because they are in different
5 circumstances. Some corporations, for instance, under
6 Chapter 21 like book income, which is what we are using
7 now for the formula approach. We attribute book income.
8 The majority would prefer to see it changed over to
9 federal taxable income which is one of the warts features
10 in here. It would change over to federal taxable income.
11 But there are at least a couple of taxpayers who would
12 rather keep it as it is. In light of that it is
13 impossible, then, you can see by way of that example,
14 to fit everybody perfectly. But I think those that
15 are not perfectly accommodated -- you know, it does
16 not work an undue hardship on them, and does not
17 unduly expose our revenues to risk.

18 MR. HALFORD:

19 In section 1 of the proposed bill, it adds in the
20 State, in regard to corporations engaged in transportation --
21 it's a transportation section -- but it adds the words
22 in the State. I wonder what significance of adding those
23 words in there is.

24 COMMISSIONER WILLIAMS:

25 Because if a corporation were producing in Oklahoma and

1 pipelining only say, between Oklahoma and Chicago --
2 they have no Alaska production income. They have no
3 Alaska pipeline income -- the problem then that is
4 presented by what to do with that type of industry is
5 really absent here. It's only if they are engaged in
6 that type of activity within the State that it is
7 important. Also, the earlier -- in the past, there was
8 reference to the OCS. This makes it also clear that
9 production and the pipeline transportation, if that
10 occurs in the OCS, is not going to automatically trigger
11 that they subject to 21. They actually have to engage
12 in that activity within the State. And although I
13 haven't read the opinion, there may well be language
14 in the Louisiana case that the US Supreme Court just
15 announced today, ~~there may be language in that case that,~~
16 since Louisiana lost, it may well be that we would be
17 prevented from attempting to reach into the OCS anyway.
18 This just makes it clear that we are talking about
19 within our jurisdictional borders engaging in this
20 taxable type of income.

21 MR. HALFORD:

22 Is there any change there in that versus any previous
23 interpretations? Or is that the way the State's always
24 held that to be?

25 COMMISSIONER WILLIAMS:

 Well, earlier we did look at the fact that if a company

1 had OCS operations we would include, in looking at
2 the apportionment aspect of, section 40 of Chapter 21,
3 that we would include their property and payroll in the
4 OCS in the numerators which attributes, therefore, income
5 to Alaska. The numerators are ratios -- if you take
6 the average of the ratios and that tells you how large
7 a slice of the pie you get. Since you include something
8 in the numerator, it increases the slice that you are
9 going to have slightly. That effect was in the law as
10 originally passed. I don't think it should be in there.
11 This makes it clear that it's not in there.

12 MR. HALFORD:

13 Just one more question. I've asked this of a previous
14 witness. With the consideration in the last session
15 of the unitization regulations, and also the
16 consideration of how the leases are put together
17 work commitments and all these other things,
18 seemed to be designed to encourage production and
19 development. I wonder if you feel that is consistent
20 with choice of a reserves tax, say, versus an increase
21 in severance tax to pick up a security blanket if you
22 want to call it that?

23 COMMISSIONER WILLIAMS:

24 I don't think it is inconsistent. Earlier it was testified
25 that the reserves tax is greatest in the early years because

1 reserves are greatest. And therefore the tax acts as a
2 decelerator on development. I disagree with that. I
3 think that if you look at Prudhoe Bay again, as an
4 example, it didn't start at 1.5 million barrels a day.
5 It started at the very first with about 300,000 a
6 day while they were filling the pipeline. But the initial
7 stable production, once the pipeline was filled, was
8 600,000 barrels a day. It was then increased gradually
9 up to 1.2 million barrels a day, and then they found
10 about this special chemical compound that Conoco was
11 selling that would reduce friction in the pipeline --
12 it could go at something over 1.3 million barrels a day.
13 And finally they've added pump capacity so that they can
14 in fact move at the full maximum efficient rate from
15 the reservoir of 1.5 million barrels a day. This has
16 happened over a period since June 20, 1977, when the
17 first production entered the pipeline. Now, if we were
18 valuing that, the big income from today at today's full volume
19 level is discounted by this discount factor several years
20 back so it does not loom as large as the income from that
21 first year which is a lower volume, hence a lower degree
22 of gross income. I think that as you go through you will
23 see -- in fact if you were to plot assessed value on a
24 vertical axis and time on a horizontal axis, you would
25 see a rise initially through time that the assessed value

1 would rise reflecting the fact that the field is being
2 developed and that production levels are increasing.
3 It would then stabilize. And then it would eventually
4 start to decline reflecting the fact that you can see
5 when flush production is over and the decline in
6 production rates are about to begin. That will then be
7 picked up several years in anticipation in your reserves
8 tax analysis. It sort of runs -- it's like a hill.
9 It starts off, runs up, is level a little bit at the top,
10 and then it starts running down reflecting the fact that
11 eventually you have to be producing less and less as
12 the reservoir is depleted.

13 MR. HALFORD:

14 If I were in business and had the power to make a decision.
15 Say you had the capacity to produce 200,000 barrels
16 a day, but as soon as I started to produce, even at
17 the rate of 10,000 barrels a day, I would be subject to
18 a producing reserves tax and the pipeline capacity didn't
19 have the capacity to take that 200,000 barrels a day,
20 wouldn't it be to my advantage to put off production
21 for maybe a couple of years until the pipeline capacity
22 were available to remove that reserve as rapidly as
23 possible?

24 COMMISSIONER WILLIAMS:

25 No, because one of the things you have to look at in

1 assessing, that I would have to look at or that my
2 assessor would have to look at, in assessing the property
3 is the state of development. In other words, we would
4 not say that, oh, boy, there's a billion barrels here
5 and it's worth \$20 a barrel in the ground. Therefore
6 it's worth \$20 billion. No, we would look at the state
7 of development of the field. What is it going to produce?
8 What is the income it is going to generate? If it can
9 only produce 10,000 barrels a day for all of this year,
10 and next year go to 20,000 barrels a day, and then the
11 following year go to 75, and finally in the fourth year
12 go to 200,000 - that shapes the income that we are looking
13 at. We value it on the basis of the expected income
14 that the reserves are going to produce - that's one of
15 the standards explicitly stated that we will look at.
16 It's a dominant one, in fact, because there are very few
17 comparable sales that you can hang your hat on for anything
18 else. What it will mean is that, you know, you are not
19 going to be valued -- if your field is only capable today
20 of producing 10,000 barrels a day, and it is 5 years
21 before it can produce 200,000 barrels a day, then we are
22 not going to value it on the assumption that you, in
23 fact, are producing 200,000 barrels a day today and will
24 tomorrow. We have to, instead, look at reality. It can
25 only produce 10,000. So we would value it on the basis of

1 10,000 with an increase through time, whatever is realistic,
2 until it is capable of going up to 200,000 barrels
3 a day. Now there is a different question, and that is,
4 during the course of the year if I have a field that,
5 let's say it is going to start out at 10,000 barrels
6 a day and go up to 200,000 over a 5 year period. But if
7 I bring it into production in March, I'm going to be
8 put on the supplemental assessment roll, whereas if I
9 wait until July I will be put on the main roll for the
10 next tax year. Then I'm looking at a difference of being
11 picked up in two years versus being picked up in only one
12 year. If I do it in March I will be put on the supplemental
13 roll for this year plus I will be picked up again on
14 the next year's roll as of July 1. If I waited until
15 July 1, I'd only fall on that assessment roll. To avoid
16 that sort of inconsistency, which was a point, in fact,
17 that was made by the witness for Atlantic Richfield,
18 you should have proration - if you come in in March, you
19 have March, April, May and June - 4 months - that you are
20 in production, assuming it was March 1. So you should
21 have 4/12's or 1/3 of the assessed value then be placed
22 on the supplemental roll for that year. That way you
23 won't care which month it is you start operating in.
24 It's a different effect from the one that you were
25 describing in your question though. But that's -- the

1 second point is a good one, is a recommendation that I
2 would make to you - to provide for proration.

3 MR. RANDOLPH:

4 Yes, Commissioner. I want to make a very short statement,
5 I think, and then, maybe, ask a couple of questions.

6 It seems to me that we are asking all -- it will be
7 short -- we are asking all of the wrong questions. We
8 are assuming, and what really scares me is the State's -- we
9 are assuming the State's almost absolute right to enshrine
10 in State law and policy that right to tax whomever they
11 want about whatever they want. You and I have been
12 through that before on another issue, but it is exactly
13 the same issue. And it is that same issue as it was
14 with the individual income tax. The only difference is
15 that here you've got the big, bad oil companies that we
16 can really get to, and not very many of them vote, so we've
17 got a little different political situation than we
18 had otherwise. But what really concerns me very sincerely
19 is that we are, in fact, establishing here in Alaska --
20 and we all admit that someday we disagree on when, but
21 someday the oil and gas is not going to be around. It is,
22 in fact, the non-renewable resource. If all of this --
23 assume that things were as they are in other states now,
24 most of the states like Ohio, Pennsylvania, etcetera, had a
25 broadbased ownership, certainly much more broadbased than

1 we have, literally thousands if not millions of individual
2 Americans own direct interest in oil and gas -- and if
3 we had this same State policy, I'm wondering if we would
4 even be seriously discussing the same State tax policy
5 that we are here discussing today and have been over the
6 course of these hearings, if a large percentage of
7 Alaskans had a direct interest in the oil and gas fields.
8 My question is, I think, is there anything -- at what
9 level does the State, you know, either the administration
10 or the legislature, have to stop. The present administration
11 and the present legislative leadership have determined
12 30% is about right. What's to preclude them from
13 deciding that 40% or 50% is about right? And when we
14 get to the point that we run out of gas and oil what's
15 to preclude them from shifting this burden to whatever,
16 that might affect, literally, tens of thousands of Alaskans.

17 COMMISSIONER WILLIAMS:

18 Mr. Chairman. If I may just say, it sounds like
19 Representative Randolph has made a good case for spending
20 limitation.

21 MR. RANDOLPH:

22 I've always been for that.

23 COMMISSIONER WILLIAMS:

24 I think that, in terms of the question about the stability
25 at this particular level with this particular industry,

1 that there are three parties at interest here - there's
2 the State, there are the oil companies, and there is the
3 federal government. And none of us can ignore the other.
4 Roughly 30% translates into just a shade less than a
5 third. I don't think that it is going to be easy when you
6 have three parties to justify why one should get half
7 and the others be penalized accordingly. So I think there
8 will be -- just logic suggests to me, as well as the fact
9 that the public has a lot of common sense -- that if you
10 try to go much over a 30% level, it really is inappropriate.

11 MR. RANDOLPH:

12 Mr. Chairman. We had a witness earlier, and I don't have
13 any idea whether his testimony was accurate or not,
14 Mr. McCutcheon, that indicated that in a number of
15 political entities around the world that the tax structure
16 is substantially higher than it is here.

17 COMMISSIONER WILLIAMS:

18 But Great Britain is not constrained by a federal
19 constitution. Great Britain can impose a level of taxation
20 that they wish without accounting to a higher authority.
21 The State of Alaska is not in that position.

22 MR. RANDOLPH:

23 Your basic answer is that we have three relatively
24 powerful entities - the industry, the federal government,
25 the State government - and somehow they are going to work

1 this out.

2 COMMISSIONER WILLIAMS:

3 Right. I think they will have to because if the State
4 and the federal government get too excessive the loser is
5 going to be the oil industry. It is conceivable that
6 the entire economics could be destroyed for them, and
7 they cease -- certainly the State cannot put it to the
8 feds and the -- I think there are limitations left over
9 from what was originally intended by the Founding Fathers
10 on the federal government and its ability to restrain
11 us. How vestigial those may be, I hope we never have to
12 find out.

13 MR. VASKA:

14 Thank you, Mr. Chairman. Mr. Williams, the testimony
15 that we have heard in the last week basically addressed
16 the issue of the taxation 43.21. And the charges were
17 said that this was in fact an unfair tax on the industry,
18 and that the oil industry should not be treated any
19 differently than any other industry. Could you comment
20 on what it is that you meant last week when you said that
21 there were some unique factors involved in the commodity
22 and didn't go into the explanation of why the oil industry
23 is different from any other industry in the State, and
24 therefore, rates a different tax rate.

25 COMMISSIONER WILLIAMS:

Well, first of all, it is an extractive industry. The

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1 traditional approach to income taxation is based on
2 trade, steel mills, or whatever, or stores, or whatever
3 it may be, but -- the idea that the property and the
4 payroll and the sales all are adequate measures reflective
5 of the extent of the business activity within your
6 State. And so if you take the average of these three
7 factors and look at the worldwide business that these
8 will tell you what slice is fair to attribute to your
9 State. Where it breaks down with the oil industry is,
10 first of all, the oil industry is very capital intensive.
11 The return on capital and the return on sales is not
12 very different from what it is for other industries -
13 it's just that capital and sales are very much larger for
14 the oil industry than it typically is for the other.
15 For payroll, for instance, the industry has profit per
16 dollar spent on employee pay that is, depending on the
17 particular year you look at, somewhere between 4 and 6
18 times greater than what the average industrial corporation
19 has in the United States as profit per payroll dollar that
20 it pays out. Certainly, then, payroll as one of the
21 standard three factors, is something that is an
22 inappropriate measure here. Second, too, you have --
23 there's a profound difference between running an oil
24 field, or for that matter any other extractive industry,
25 and running a steel mill. When I have a steel mill, the

1 land -- I bought the land, I used the land and the value
2 of the building is included in my land factor. But when
3 I am all done running a steel mill in a hundred years,
4 or whatever it may be, someone can knock that steel mill
5 down and the land is still there. But after 40 years
6 when the field has been producing and finally it is shut
7 in, the oil is not there. Something that was in the land
8 has been taken from it. That's a difference. Finally,
9 when you look at this particular industry, perhaps
10 unlike other extractive industries, the -- well, all you
11 have to do is look at the profit and loss statements of
12 the corporations. You find that they don't report their
13 big earnings out of refining and marketing. They very
14 often have losses in those areas. They have their
15 profits reported to their own stockholders out of their
16 production operations largely. Perhaps they also run --
17 for vertically integrated corporations they may have
18 tanker fleets that are profitable. But lately tankers have
19 not been a terribly good investment in the past decade.
20 They may have pipelines, which are regulated, they are
21 guaranteed a rate of return through the tariff mechanism.
22 But again, as a contribution of profit to the overall
23 enterprise, it is nothing compared to the profit that is
24 generated out of the production side. And what do we have
25 here? We don't have a great deal of refining, we don't have --

1 well, we do have a big pipeline, and we do have a great
2 deal of production. And so what has been done is, under
3 Chapter 21, is to say, well, let's look at what those
4 profits really are. We can identify what the production
5 is here. We can identify what the pipeline transportation
6 is up here. And we can ascertain what the profits are
7 from that, and that's what 21 does, Chapter 21.

8 MR. COLLETTA:

9 Tom, section 1 of the bill -- your discussion of profits
10 reminded me of that, and it's a follow up to Representative
11 Randolph's question as to what attitude we'd have if a
12 great amount of this production were in private ownership.
13 Doesn't section 1 do that? 7(i) of the Alaska Native
14 Claims Settlement Act doesn't mandate us to do anything.
15 It mandates them to distribute. So why are we excluding
16 70% of private developed oil from Chapter 21.

17 COMMISSIONER WILLIAMS:

18 We don't. In the first instance the oil income to the
19 regional corporation is 100% under this bill - 100%
20 attributable to that regional corporation. Now, it is
21 required by law to distribute 70% of that. So we allow
22 that 70% to be a deduction, since it is not really
23 the corporation's - it's the corporation's as a fiduciary
24 or whatever it may be, but it is obliged to distribute that
25 among all the regional corporations. The question here,

1 in section 1, is how shall the oil be taxed by the
2 recipients of that distribution who are not themselves
3 the owners of the property, and who are not themselves
4 engaged in the management of the royalty or otherwise
5 engaged in the control and use of that property. They
6 are simply the passive recipients of it. How is it to
7 be treated to them? Are they going to be under
8 Chapter 21, or Chapter 20? This says that unless they're --
9 that it would be treated under Chapter 20. I would
10 suggest that if a corporation is already under Chapter 21
11 that the income should be treated to that corporation
12 under Chapter 21 as well. Logic would say that you should
13 have that consistency. But the basic idea, here, is, in
14 fact, not to say that Native regions get treated
15 differently from any -- or private entities get treated
16 any differently than the major oil companies. The
17 question really is, in this part which is being answered
18 here, is what about the recipients? The people who are --
19 to who it is required to go? The regional corporations and
20 then the village corporations and their turn, of each
21 region. How is that to be taxed? It goes back -- I've got
22 a picture, that chart that I showed in my first testimony.

23 MR. COLLETTA:

24 But Tom, couldn't you make the argument that you are
25 assuming the Congress mandated the corporate entity that

1 they created, to pass through its earnings to its
2 shareholders. What's so different than the private
3 structure? They pass through their profits to recipients.

4 COMMISSIONER WILLIAMS:

5 This doesn't go to the shareholders of the -- this is not
6 a dividend distribution. This 70% goes to other
7 regions. I doubt very much that Nenana would like to see
8 other regions own its stock, or that Sealaska would like
9 to see other regions own its stock. Its stock is owned
10 by its members.

11 MR. COLLETTA:

12 Philosophically if you can exclude 70% of it, why don't
13 you exclude it all?

14 COMMISSIONER WILLIAMS:

15 I think that's an oversimplification. It fails ...

16 MR. COLLETTA:

17 The bill excludes 70 of it. Doesn't it? That's the way I
18 read section 1. 70% is under Chapter 20. 30% is under
19 Chapter 21.

20 COMMISSIONER WILLIAMS:

21 Once again, Mr. Chairman, I don't want to protract this
22 into a debate that doesn't progress. But under Chapter 21,
23 the Native corporation, the regional corporation that owns
24 mineral interest, is taxed on a 100% of the income. Every
25 single penny. \$10 million, let's say, comes from oil on

1 ANCSA lands to a regional corporation. That's gross
2 income to this regional corporation of \$10 million.
3 Now if you look on page 4 of the bill at line 16 through 19,
4 we find the recognition that 70% of that \$10 million,
5 or \$7 million, will be required to be shared and, thus --
6 that's a deduction because the corporation that -- the
7 original Native corporation, the region, can't keep it.
8 It's -- that's an obligation. It's an expense that it has
9 by virtue of existing. So the 30% it retains is, in fact,
10 the net 30%, just the same as if it were gross income
11 minus operating expenses. Just the same as if it were gross
12 income minus severance taxes. Or gross income minus
13 property taxes. This is a statutorily imposed obligation -
14 the same as a tax. The federal government imposed this
15 one. It said you distribute the 70%. And so that is
16 a deduction. Logically it is a deduction. The 30% that
17 remains is their net production income. When we go back
18 to section 1, the question is what happens to the income
19 now that 70% is being divided out? It's been allowed as
20 a deduction under Chapter 21. It's being divided out now
21 among the regions who in turn are going to divide it out
22 among their villages. How is it to be taxed for them?
23 Under Chapter 20 or under Chapter 21?

24 MR. GARDINER:

25 Commissioner, just one question, maybe, but different on this.

1 Do these two sections that we're debating back and forth
2 here, will they have the effect of changing the status
3 quo of anybody's tax bill right now? Is this what the
4 Department is requiring of corporations now, or is this
5 some new status?

6 COMMISSIONER WILLIAMS:

7 No. This will preserve equality of treatment. Everybody
8 is still going to be paying 9.4% on the income they are
9 getting.

10 MR. GARDINER:

11 But I mean presently the corporations are distributing it,
12 and presently they are being taxed in the manner that you
13 are discussing?

14 COMMISSIONER WILLIAMS:

15 The question has not really come before us, but that's,
16 in fact, the position that the Internal Revenue Code
17 has adopted, I understand, in a letter opinion that was
18 given to the Cook Inlet Region.

19 MR. COLLETTA:

20 Tom, you could almost parallel that thing to the reserves
21 tax, right? Same type of deduction?

22 COMMISSIONER WILLIAMS:

23 No. The reserves tax is very different. This is where you
24 have a real problem, now. Section 21 (d) of the Native Claims
25 Settlement Act -- this is federal law -- says: real property

1 interests conveyed pursuant to this act to a native
2 individual, a native group, or village, or regional
3 corporation, which are not developed or leased to third
4 parties, shall be exempt from State and local real property
5 taxes for a period of 20 years after the date of enactment
6 of this act, provided that municipal taxes, local real
7 property taxes, or local assessments, may be imposed upon
8 leased or developed real property within the jurisdiction
9 of any governmental unit under the laws of the State;
10 and provided further that; easements, rights of way,
11 leaseholds and similar interests in such real property may
12 be taxed in accordance with State or local law. Now notice
13 there are three times that there are references to taxes
14 at the State or local level. First is with respect to the
15 undeveloped and unimproved properties. Those are exempt for
16 20 years from State and local property taxes. Then there's
17 the exemption, or the proviso, that says municipal taxes,
18 local real property taxes or local assessments may be
19 imposed upon leased or developed property. And then it
20 talks about easements, or third party interests, in the
21 property may be taxed in accordance with, quote, State or local
22 law. You find reference to the State specifically, both in
23 the first one and in the third one, but not in the middle
24 one - the one that says that you can have property taxes on
25 the developed property. In the first one, if it's

1 undeveloped, it's clear we're (indisc.--coughing) for 20
2 years. In the second one, it is clear, to me, that
3 municipalities and other local taxing jurisdictions can.
4 But the State, being absent there, but present in the
5 references to the taxation structure in the previous
6 clause, and in the clause immediately following, suggests
7 that the State cannot itself impose property taxes on these
8 reserves. And, in fact, earlier versions of the bill
9 provide even stronger evidence that that is the intent of
10 Congress. If that's, in fact, the case - and I believe
11 it is - we can't tax those reserves even if we passed the
12 law saying we could. All we'd do is get a lawsuit that
13 we'd lose. That's why we exempt, then, the Native reserves
14 from the tax because section 21 (d) stands in the way of it.
15
16

17 MR. GARDINER:

18 I'd like to give Mr. Taylor a chance to also ...
19 ... questions and testimony. I said I wouldn't do so.
20 If we could conclude here.
21

22 COMMISSIONER WILLIAMS:

23 ... if can conclude? Yes, quickly then I will. First,
24 there was testimony that you should -- at the same that
25 you are contemplating this, provide an exemption for the

1 first \$150,000 of all corporations' taxes. This was an
2 appeal from Mom and Pop. Why, my mom and pop, I think, in
3 the last 10 years are lucky to get \$150,000 net after
4 costs. And I think that the great majority of people
5 here, whether their parents live here or whether they
6 live outside, a \$150,000 a year is a pretty good operation.
7 Now, there may be some folk's moms and pops, but to
8 haul out motherhood, apple pie and mom and pop, in defense
9 of \$150,000 exemption is just downright misleading.
10 And moreover, it's dangerous because you carve out then so
11 much of the corporate tax base that you give rise to
12 a new challenge, a new legal theory on which to challenge
13 the income tax or whatever other tax structure you have,
14 I don't think that's advisable. Certainly it should not
15 be piggybacked on to this bill in the expectation that
16 this one is veto proof, because it raises a substantial
17 question. I am not going to recommend to the Governor
18 trading one bad -- or one lawsuit, for another one that
19 may be worse. Not with these amounts at stake -- not with
20 these amounts of money at stake. Second point, quickly,
21 is only consumers pay taxes - that also was a statement
22 by Mr. Fisher. That's true where the cost of goods are --
23 or the price of goods are based on the cost of producing
24 them. We are not living in a world in oil and gas where
25 that's the case. The price is dictated by a cartel, a

1 monopoly, or technically an oligopoly - a group of
2 people acting together to control prices because they
3 control the supply. That group is meeting in Geneva
4 right now. They call the price. And whether we have a
5 tax or not doesn't make any differences to what the
6 public is going to see when they pull in to the gas
7 pump, or when the fuel truck drives up and fills your tank.
8 It's going to be what OPEC decides. That's going to be
9 your prime determinant. And our taxes are not going to
10 have an effect on that. The -- I've already covered the
11 thing about possible proration during the first year when
12 reserves are brought on stream. That was a very good
13 point that was made by the witness for Atlantic
14 Richfield, and I would support a change that would
15 recognize that. There was also a point made about
16 how oil companies have been generous supporters of
17 the arts and culture and other things up here. Perhaps
18 they should get a credit for their donations. But it is
19 irrelevant to the consideration about what the fundamental
20 tax structure ought to be. And that's essentially the
21 end of my remarks.

22 MR. GARDINER:

23 Thank you, Commissioner.

24 COMMISSIONER WILLIAMS:

25 Thank you, Mr. Chairman.

1 MR. GARDINER:

2 Mr. Taylor. It did take some time to get back to you, but...

3 MR. TAYLOR:

4 That's all right. I'm here to stay a while.

5 MR. GARDINER:

6 ... sort of trying to let everybody have their piece.

7 I don't know if you had any further comments. I'm trying

8 to recall exactly where we let off, but I just remember

9 I did cut you off to get some other out-of-town people.

10 So, if you ...

11 MR. TAYLOR:

12 I guess the only further comment I might make, Terry, just

13 because I've been sitting in the hearings too, and I've

14 heard quite a bit of discussion about the increased level

15 of activity of the oil industry in Alaska. Just to put

16 that in perspective, because I think it's put out of

17 perspective a lot of times. I'd like to -- I looked up

18 some numbers on exploration activity. In 1980 the entire

19 industry drilled 21 wildcats in Alaska, penetrating about

20 1.6 million feet of depth, since the number of wells

21 doesn't always mean much. In the great oil producing

22 state of Nebraska, there were 315 wildcats and about 2.3

23 million feet of depth. State after state has much more

24 exploration activity than Alaska. Less than 1% of the

25 rigs available for deep exploration are up here. Yet

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1 Alaska has about 40% of the potential. So the level of
2 activity is dismally small compared to the potential in
3 the State.

4 MR. GARDINER:

5 You would think this whole argument -- the numbers that people
6 use on both sides is sort of irrelevant. Alaska's --
7 I mean, to go out and drill a hole in the Gulf of Alaska
8 or up on the North Slope or out on an icepack, I mean,
9 that's different than doing 315 in Nebraska. It seems to
10 me that the State probably was remiss in the past years,
11 say, between Prudhoe Bay discovery and recent years
12 and really not getting any new acreage out. But on the
13 other hand, we didn't have all the State acreage available.
14 We still only have 40 million acres of State land out of
15 hundreds of millions of acres. It seems like we've turned
16 a corner. And I don't hear so much criticism of the
17 Department -- we took a look ourselves earlier at whether
18 there was enough people in the Department to get these
19 leases out on schedule. We've had the Beaufort Sea and
20 the Cook Inlet, and there's other ones on the books, so
21 it seems like sort of an old argument that both sides keep
22 trying to bring up to prove one thing or the other.

23 MR. TAYLOR:

24 Well, I hope we've turned the corner to some extent. And I
25 was very encouraged that we did have the Beaufort lease sale,

1 including the State leases. But at the same time, I
2 think we've missed the boat a little bit. I brought up
3 the other day that 5 years ago when we moved up here we
4 moved, a district exploration office. We had about three
5 geologists working full time looking for potential on land
6 in Alaska. Two years ago they moved out. For two years
7 we have not had 3 good exploration geologists just looking
8 for things in Alaska. And there's no question that
9 the level of activity might have been different if that
10 was not the case. My point is that the investment climate
11 that's perceived by the business community makes one
12 big difference in what happens.

13 MR. GARDINER:

14 Do you think with, instead of looking back and beating
15 the past to death with what has actually happened in
16 the last two years and what we, sort of, can look at
17 happening as a trend that we are, you know, moving
18 ahead on our leasing system. You know, we've heard
19 testimony that about you can't find geologists and all
20 this competition, and everybody is moving new people in,
21 and all this. Representative Cotten says everybody is
22 moving, somebody's moving people in his district and
23 buying up all the houses or something. It seems we
24 ought to be looking ahead instead of looking back. I
25 mean, how do the companies feel about what they see

1 happening with leasing both State and federal and
2 Native lands over the next 2, 3, 5 years, however many
3 you plan ahead.

4 MR. TAYLOR:

5 Well, we are very optimistic about it. You are talking
6 about looking ahead, Exxon drilled two wildcats last year
7 on the North Slope. Next year we are gearing up to
8 drill 4 wildcats, and we are moving in 20-25 people to
9 do that. You know, I hope that in a few years we'll be
10 drilling 50 instead of 4. One of these days I can get
11 the coal company interested in looking up here at the
12 Beluga coal fields which I'm convinced is a good future
13 potential thing. But I haven't been able to talk
14 Exxon Coal into getting very interested yet.

15 MR. GARDINER:

16 Are they busy in Montana?

17 MR. TAYLOR:

18 They are busy in Montana. No, they are busy in Wyoming.
19 We are not busy in Montana. Montana is the one that
20 has a 30% severance tax. We've started two mines recently
21 in Wyoming, and nothing in Montana.

22 MR. GARDINER:

23 Do Committee members have questions? Mr. Taylor, did you
24 have some any other points you wanted to bring up?

25 MR. TAYLOR:

 I might bring out just one more point that Representative Malone

1 was talking about - the administrative relief provision
2 on the Chapter 21. At least in Exxon's case, it would
3 have been very difficult early on for us to apply for
4 administrative relief because we were not the ones that
5 filed that suit - the State filed the suit against Exxon.
6 In addition to that, we were told that if we sought relief
7 that it would not be available, and in spite of both of
8 those things, just recently, we did in fact see ...

9
10 (end tape side 1)

11
12 (Mr. Taylor continuing)... is that we did not file a lawsuit
13 before we filed for relief, we were sued and we responded
14 to that suit which is kind of a different thing.

15 MR. VASKA:

16 Approximately how much in taxes did Exxon pay the State
17 of Alaska in 1980?

18 MR. TAYLOR:

19 Can I ask my guy back here that knows numbers like that?
20 Do you have a guess? Probably the Chapter 21 liability
21 for us, if -- are you asking total?

22 MR. VASKA:

23 Total taxes.

24 MR. TAYLOR:

25 Total taxes. Well, the Chapter 21 was probably for us
\$120, \$130 million, and severance tax was higher than that -

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1 probably \$150. I don't know exactly what the total is.
2 \$400 - \$500 million or more.

3 MR. VASKA:

4 How does that compare with how much profits Exxon made
5 in Alaska?

6 MR. TAYLOR:

7 I don't know our profitability in Alaska. I know that
8 the -- well, our profitability in Alaska was less than
9 the taxes we paid in Alaska.

10 MR. VASKA:

11 That's the total federal and State taxes?

12 MR. TAYLOR:

13 No. Total State. The State's share is bigger than our
14 share. So the taxes we pay are bigger than our profits.
15 This is the only place in the whole country I've ever
16 worked in an oil field where the taxes are considerably
17 higher than the operating expenses to keep Prudhoe Bay
18 operating. Way higher. Most oil fields' taxes are a
19 line down here and the operating are the big part of it
20 here. The tax line is the biggest number on there.

21 MR. VASKA:

22 You can't give me a round house figure on what the profits
23 are, were?

24 MR. TAYLOR:

25 It's -- whatever our profits were, you know, in Alaska or

1 other than total company is proprietary - I'm not at
2 liberty to divulge that if I knew. But all I know is
3 that the State's share is higher than our share.

4 MR. VASKA:

5 Considerably higher or ...?

6 MR. TAYLOR:

7 Well, if you look at the total industry, and we figure
8 out about like the total industry, the State's share of
9 total, now that includes royalty, right now is a little
10 over 30%. And our share of the net income after operating
11 expenses is about 25%. And the federal government takes
12 the other 45%. That's the distribution of the net income
13 under current tax law.

14 MR. VASKA:

15 Because of how the price of oil is set, and if Chapter 21
16 were repealed, the revenues generated by Chapter 21
17 would then be listed in the profit margin of the ledger
18 because the market does not control the price of oil.
19 We have had testimony that OPEC sets the price of oil,
20 so therefore, if 21 were repealed the ledger would
21 change from Chapter 21 taxes to whatever that level is
22 to profit. It's my assumption that there is no
23 savings to the consumer in the long run because of that.

24 MR. TAYLOR:

25 Well, I don't think that is right at all. I agree that

1 the current level of oil prices is set basically by the
2 OPEC cartel. The key point is what is the replacement
3 cost. The reason they are able to set the cost at that
4 high price is because there is a worldwide shortage
5 of developed oil. Just like in the grocery store or
6 any place else where you really have to pay the
7 replacement cost, not the cost of producing it. In the
8 long term that's the way it works out. And the consumer,
9 I disagree with what Tom said, the consumer does end up
10 paying all taxes and whatever has to be invested to get
11 any product in a free enterprise economy. That's the
12 only way it can work.

13 MR. VASKA:

14 While you are maintaining the same arguments that the
15 Libertarian Representative maintains that consumers pay
16 the tax, I think you also have to assume that the enterprise
17 reaps the profits and not the consumers.

18 MR. TAYLOR:

19 ... the enterprise? What do you mean, the enterprise?
20 The corporation.

21 MR. VASKA:

22 The corporations make the profit and not the consumer.

23 MR. TAYLOR:

24 The shareholders of Exxon Corporation make the profits
25 from Exxon Corporation. Anybody that wants to be a

1 shareholder can share in the profits.

2 MR. PARR:

3 Mr. Chairman. Maybe I misunderstood you a minute ago -
4 I'd like to clarify it. I think you said it is not
5 necessarily so that if the tax were reduced that you
6 wouldn't see a reduction in price to consumer. Did
7 I understand you correctly?

8 MR. TAYLOR:

9 Say that again. I'm not sure I understood your question.

10 MR. PARR:

11 Someone previously had said that a reduction in price
12 would not mean a -- a reduction in tax would not mean a
13 reduction in price to consumers. And you said you
14 don't think that is necessarily so.

15 MR. TAYLOR:

16 Over the long term, a reduction in tax or a reduction in
17 operating expense will mean a reduction in the cost to the
18 consumer. Over the long term, an increase in our cost to
19 find oil in deeper horizons or out in the Beaufort Sea
20 or the Bering Sea will represent an increase in cost to
21 the consumer - in the long term. I agree that in the short
22 term, the price of gasoline is not going to be affected
23 by what happens to Chapter 21.

24 MR. PARR:

25 I think you answered my question because I was going to ask
if Chapter 21 were repealed, and assuming OPEC doesn't

1 change their prices, they've decided to hold steady for
2 a while - how soon and how much could people expect to
3 see their gasoline price go down? What you just said,
4 that is not going to happen in the short term, at least.
5 It might be for the long term.

6 MR. TAYLOR:

7 No, I don't think so. In spite of substantial profits
8 of Exxon Corporation, and SOHIO and ARCO have substantial
9 profits too, we're -- our profits last year, since
10 everybody alludes to them and doesn't really talk about
11 it, is \$5.6 billion. We invested \$8 billion last year
12 in 90 plus percent in energy development. We're going to
13 invest \$11 billion this year. We still need capital
14 to make these large investments. And the profits is
15 where it comes from.

16 MR. GARDINER:

17 Further questions? Thank you very much, Mr. Taylor. I
18 think this concludes our hearing. Members of respective
19 houses will return to their respective corners, and
20 come out with their (indisc.).

21
22 (meeting adjourned 2:30 p.m. May 26, 1981)
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I, CARLA B. SEIBEL, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 26, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and
affixed my notarial seal this ____ day of July, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/20/84

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SCOMM

28:9

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524
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6 TRANSCRIPT OF PROCEEDINGS

7 JUNE 11, 1981
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*Contains
June 11-24, 1981*

16 COMMITTEE PRESENT:

17 Representative Bill Ray, Chairman
18 Senator Ed Dankworth
19 Senator Don Bennett
20 Representative Terry Gardiner
21 Representative Anthony Vaska
22 Representative Patrick O'Connell
23
24
25

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P R O C E E D I N G S

6/11/81

1
2
3 MR. RAY:

4 ... this is the Free Conference on House Committee
5 Substitute for Senate Bill 524 Finance amended in the
6 House. Members of the Committee from the Senate side:
7 Senator Dankworth, Senator Bennett, Senator Ray. On the
8 House side Representative Gardiner, Representative Vaska
9 and Representative O'Connell. Sir?

10 MR. GARDINER:

11 I'd like to move and ask unanimous consent that Senator Ray serve
12 as the Chairman of the Free Conference Committee.

13 MR. RAY:

14 Is there an objection? So ordered. The first order of
15 business -- I've taken the privilege of asking Commissioner
16 Williams, please, to come and identify yourself, sir, and
17 give us more or less a sectional analysis of the House
18 Committee Substitute for Senate Bill 524.

19 COMMISSIONER WILLIAMS:

20 For the record, my name is Tom Williams. I'm the
21 Commissioner of Revenue. I'm here to testify on H.C.S.S.B.
22 524...

23 MR. RAY:

24 Commissioner, I might as well stop you right now. It is
25 my feeling, as a Chairman, that I am going to allow any

1 member of the Committee to interrupt any witness at any
2 time if they have a valid question pertaining to the
3 information. Go ahead, sir.

4 COMMISSIONER WILLIAMS:

5 I think that is fine. I'd like to talk to you briefly
6 about the context that this bill is in, namely, the
7 litigation, and what the stakes are; describe in very
8 brief form what the options seem to be; and then to go
9 through with you how this bill works. At issue, of course,
10 is the large majority of money that we are collecting
11 under the oil and gas corporate income tax, which is
12 Chapter 21 of Title 43. I'll often refer to it as
13 Chapter 21. The risks are, that since this law was enacted
14 in 1978, the United States Supreme Court has decided two
15 cases: one is Exxon versus Wisconsin, and the other is
16 Mobil Oil Corporation versus Vermont - which leave a
17 question about the constitutional validity over the method
18 of separate accounting, which is incorporated in Chapter 21.
19 While we believe we will win the case, the stakes present
20 in the case are very, very, high. Using our low case
21 numbers, we find that they will be over \$5.1 billion through
22 1985, which is the time period when we would expect to have
23 the litigation finally adjudicated. In addition to that
24 would be over \$1.3 billion worth of interest, at 10%...

25 MR. RAY:

What was that figure, sir?

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1 COMMISSIONER WILLIAMS:

2 \$1.3 billion. So in a sense, this is a \$6.4 billion
3 question. The risks are that if we lose the case, we'll
4 have to refund almost all that money. If I may,
5 Mr. Chairman, I'd like to from time to time go up to the
6 charts and flip them over and -- at this time I'd like to ...

7 MR. RAY:

8 As long as you stay pertinent to the subject, sir.

9 COMMISSIONER WILLIAMS:

10 Thank you. At this time I would like to briefly run through
11 the basic types of options that we have available at this
12 time. There are four basic approaches, as you can see
13 there.

14 MR. RAY:

15 Excuse me, Senator Bennett?

16 MR. BENNETT:

17 Commissioner, before you proceed -- two questions if I
18 might, real quick. You say that we would have to refund
19 most of that money. What is most? And could you elaborate
20 upon why it is just most instead of all that's involved?

21
22 COMMISSIONER WILLIAMS:

23 Well, it is conceivable that if the worst came about we'd
24 have to refund everything. If the court ruled that Chapter
25 20 applied if 21 was struck down, then we'd have to refund

1 probably 85% of it.

2 MR. BENNETT:

3 My final question is, does this figure include the cost
4 of litigation?

5 COMMISSIONER WILLIAMS:

6 No, it does not.

7 MR. BENNETT:

8 What would the cost of litigation be
9 if it took the course that litigation takes?

10
11 COMMISSIONER WILLIAMS:

12 Well, compared to the billions of dollars, it would be
13 small. In absolute terms, it would run several million
14 dollars, I would expect.

15 MR. BENNETT:

16 Thank you.

17 MR. RAY:

18 Proceed, sir.

19 COMMISSIONER WILLIAMS;

20 Thank you. So we have four basic options, then, about
21 types of action that can be taken at this time. First, is
22 a backstop tax - the basic idea of a backstop tax would be
23 to have some other tax that does not have the question that
24 has been raised by the Mobil and Exxon cases decided by
25 the Supreme Court. This tax would, instead, be a tax that

1 has secure legal precedent and would be much, much safer
2 from the legal challenge. The second option would be a
3 settlement package - legislation that would allow the
4 companies to settle the case, walk away from it. And, of
5 course, that would provide security, then, for not only
6 the revenues that the companies have paid in, but would
7 provide security for the revenues that they would
8 continue to pay in in the future.

9 MR. RAY:

10 I know, sir, that you are not a practicing attorney - you're
11 the Commissioner of Revenue. If there was a settlement,
12 would it take 100% of the people on the Slope, or could
13 a minority position come in and sue and then if they won the case
14 it would obligate us to pay everybody at the same time?

15 COMMISSIONER WILLIAMS:

16 I think that while you cannot prevent the people who are
17 not parties in the litigation from suing at a future time,
18 I think you can bind the present parties to the litigation
19 so that they would not get a refund regardless of what the
20 outcome was of that lawsuit. Now, of course, if there
21 was a fundamental change in federal law they preempt,
22 really, passed legislation affecting our structure, well,
23 that's the supreme law of the land under the federal
24 constitution. There's nothing we can do about that.
25 But we can bind the parties to the present lawsuit so that
their amount, which represents over 90% of what's being

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1 paid ...

2 MR. RAY:

3 What do they call that? Would they call that agreeing
4 without prejudice? Is that ...

5 COMMISSIONER WILLIAMS:

6 They would be dismissing it with prejudice...

7 MR. RAY:

8 ... with prejudice.

9 COMMISSIONER WILLIAMS:

10 ... so that they could not raise the constitutional issues
11 again.

12 MR. RAY:

13 You'll have to excuse -- I'm not an attorney, and so
14 there are some of these things that I'm not too familiar
15 with.

16 COMMISSIONER WILLIAMS:

17 I shouldn't profess to be one either. I haven't practiced
18 in a long enough period of time. I'm familiar with the
19 idea.

20 MR. RAY:

21 Continue, sir.

22 COMMISSIONER WILLIAMS:

23 Thank you. The third option would be to set the money
24 aside. Obviously, if we don't set the money aside, we
25 don't have a backstop tax, and we don't have a settlement,

1 then we have a real risk of having to come up with billions
2 and billions of dollars around 1985 in the event that we
3 lose. The important thing to remember - it doesn't matter
4 what our odds are of winning or losing. We only get one
5 shot. So if we lose, we lost. We can't come back
6 multiple times on this issue and get to the expected value.
7 If I think that we've got an 80% chance of winning, or
8 someone else thinks it's a 60% chance of winning, it doesn't
9 matter. If we've lost, we lost. And we have to come up
10 with the money. To set the money aside over the interim
11 and not spend it is one way to be able to afford to cover
12 ourselves in the event that we should lose. Then we would
13 be able to make the payments back that would be required
14 by the court. Obviously, then, we would continue to
15 litigate the present law. And there are certain
16 strategic or technical amendments to -- some of which
17 alleviate inadvertent inconsistencies in the law. Others
18 would eliminate certain issues that are really peripheral
19 issues in the case, and it's better just to clean them
20 up and have the case go on its basic merits which is can
21 you have separate accounting or can't you.

22 MR. DANKWORTH:

23 Commissioner Williams, you've said that regardless of what
24 our chances are in court - whether they are good or bad -
25 it's still a risk, that if we lose, if it's 80 to 20 and we

1 lose, we still have to pay it back. You get one shot. You
2 still have to return this \$6 billion.

3 COMMISSIONER WILLIAMS:

4 That's correct.

5 MR. DANKWORTH:

6 Then if we put in the backstop -- oh, for goodness sakes.
7 I hope that jackhammer doesn't start right now. If the
8 backstop tax is in place, now, are you absolutely sure
9 that that statement is still true that we have 100% chance --
10 we know that there will be a suit filed against the
11 backstop. Now, are you satisfied that we'll have 100%
12 chance of winning that? Or will number 3 still be
13 necessary to protect the fiscal integrity of the State by
14 having some money in escrow in case we lose that one?
15 Or do you think we should take that 20% chance that we
16 might win?

17 COMMISSIONER WILLIAMS:

18 I don't think any lawsuit is 100% in any party's favor.
19 So even with the backstop tax, there would be some risk.
20 The basic risk is, is the 30% share that Alaska is taking
21 too much under the federal constitution. That risk would
22 remain regardless of what tax structure you have. If you
23 had a lawsuit that risk would be present. The backstop
24 tax, though, I think, does eliminate additional risk that
25 has been introduced in the income tax area as a result of

1 the Exxon and Mobil cases. So to that extent, it cuts down
2 significantly - at least in half, I would say - our chances
3 of losing and having to make this massive refund. But
4 there still would be the outside chance.

5 MR. DANKWORTH:

6 Well, that's the point that, I think, Commissioner, I wanted
7 to make, is that -- to get your opinion on. If the backstop
8 goes in, it may lessen our losses to some regard in the
9 first case. But, I guess, the question is, is even with
10 the backstop, now we would have two lawsuits instead of
11 one, most likely. And I think I can reasonably predict
12 that that probably will happen. But now we have two
13 lawsuits. One probably makes us more comfortable with
14 the first, the second does. But from a purely fiscal
15 point of view, in looking after the State treasury, are
16 we so sure, and are the odds so good, and would we
17 normally in a good fiscal approach to things put the
18 State in a position where we would continue to spend the
19 money even though there is 5%, 10%, 20% chance of losing
20 in that case? I guess I'm back to my question, when
21 we are at risk is number 3 -- do you still see a need
22 to put some of this in escrow, or are you satisfied the
23 State would be in a sound fiscal position to continue on
24 without any backup money?

25 COMMISSIONER WILLIAMS:

Well, the backstop tax is like having a pair of suspenders

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1 instead of only one suspender. If you wanted to escrow
2 as well as have a pair of suspenders that would be wearing
3 suspenders and a belt. You could do it. I don't know
4 that I would recommend that it's necessary to put the
5 belt on when you have a pair of suspenders.

6 MR. RAY:

7 Commissioner, perhaps if we are faced with a loss of
8 6.4, maybe we should increase the tax and put that money
9 into escrow to accommodate our 6.4 loss in case that we
10 would lose it.

11 COMMISSIONER WILLIAMS:

12 Well, that's a possibility. In effect, as we'll see, that's
13 in effect what the backstop tax does, except it doesn't make
14 the companies cough up the money twice on a current
15 basis.

16 MR. RAY:

17 And then they could sue us in 1985, and we could figure
18 out something by 1990 when they come back again. Thank
19 you, sir.

20 COMMISSIONER WILLIAMS:

21 The fourth option is to do nothing. Which is an option.
22 Inaction is itself a choice. However, as you can see,
23 I've put an X through it on the chart. That is the one
24 clearly, absolutely, unacceptable option for us to take.
25 That's the worst that we can do. That's going to a crap

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1 shoot with over \$6 billion of the public's money and
2 rolling the dice. And I don't think that we can responsibly
3 do that. Certainly we are absolutely opposed to a course
4 of inaction at this time. I think that the other 3 are
5 options that are viable. Doing nothing is the one option
6 that we cannot take. Turning, then, to the basic idea
7 of the present legislation ...

8 MR. RAY:

9 Just one question, sir. When you say the settlement -- the
10 settlement you are referring to is the settlement only
11 on this specific case and not on the royalty case and all
12 the rest of them. You would just get the settlement of
13 the one that they are -- in the particular area, and then it
14 leaves the rest of them viable cases - right?

15 COMMISSIONER WILLIAMS:

16 That's correct.

17 MR. RAY:

18 Thank you.

19 COMMISSIONER WILLIAMS:

20 So now to the basic concept of this bill, again -- once
21 again I'll have to flip the chart. I hope this picks me
22 up. This tries to illustrate what the basic idea is in
23 the backstop approach. This red area here, including the
24 dotted lines, represents the income stream that we
25 receive in any given year under Chapter 21, which is the

1 subject of the lawsuit, and is what we might have to
2 refund if we lost. Among the changes that we propose in
3 the bill is to allow a deduction for the windfall profit
4 tax, and to make certain strategic or technical changes to
5 remove what I called warts on the bill, that right now
6 really raise extraneous issues, ancillary issues.
7 And so to leave the lawsuit clean, in terms of can you
8 have separate accounting or not. There's no point in
9 having the case be decided on some finnarky issue off
10 on the side and not on the basic merits of can you have
11 separate accounting. So these two things would represent
12 a change from the present level of tax down to some
13 lower level that would be paid under Chapter 21. The
14 backstop tax is a property tax on oil and gas reserves.
15 It also produces, in gross, represents as much revenue
16 as Chapter 21 would have represented before we took
17 the warts off and before allowing the windfall profit
18 tax. The payment under Chapter 21 gives rise dollar-
19 for-dollar for a credit against the reserves tax. The
20 excess of the reserves tax over the credit is a payment
21 to the State. The combination is that you have this
22 much being paid under Chapter 58, the reserves tax; this
23 much being paid under Chapter 21, the income tax; and
24 between the two, it adds up to the same size as what
25 would be collected under Chapter 21, as it reads right now.

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1 That's the basic concept of the reserves tax backstop.
2 Now, if there's a change in the amount that is paid, either
3 as a result of judicial decision or an audit or whatever -
4 this goes up or down in the amount that is paid on the
5 income tax. There's provision in the bill dollar-for-
6 dollar for a change in the credit. So if this goes up,
7 the credit goes up, and they owe less up here under the
8 reserves tax. Similarly, if this goes way down, the
9 credit goes way down, and the remaining reserves tax
10 liability that has to be paid goes up. That's basically
11 how the credit mechanism works. Now, we've done a
12 fiscal note -- the bottom line, we've done two cases -
13 a low price case and a high price case which are not
14 particularly revenue forecasts in and of themselves.
15 They are to illustrate whether the reserves tax works
16 as a backstop for the income tax. Does it have the
17 revenue generating potential to completely backstop over
18 \$1 billion a year of income tax payments? The answer is,
19 yes. If we start at 30 mills for the first tax year,
20 then go to 25 mills, which is the default rate right now -
21 if the legislature fails to set the millage at a different
22 level, it will be at 25. So if we are at 25 mills through
23 these two years and then drop down to 20 mills in 1985,
24 you'll see that we have all gained in the next fiscal
25 year over Chapter 21 under the reserves tax. The reserves

1 tax would come out \$7 million over. There would be small
2 reductions in each of the next years which can be
3 eliminated by fine tuning the millage rate. But if the
4 millages stay at 25, 25 and then goes down to 20, you'll
5 see that over the period we are looking at, while the
6 lawsuit is pending, it would be a net failure to cover
7 of only \$164 million out of the \$6.4 billion. So essentially
8 over 95% of the revenue is backstopped under the low
9 price.

10 MR. RAY:

11 Your figures are in millions then?

12 COMMISSIONER WILLIAMS:

13 Those figures are in millions, yes. Now looking at the
14 high price case. This is more optimistic in terms of the
15 assumptions about how oil prices will increase. You can
16 see that, here, this time, it ends up being plus
17 \$483 million. Again, the same assumptions about millages -
18 30 mills in the first year, 25 the next two, and then
19 dropping to 20 in 1985. That produces overall an
20 increase in the tax liability of \$483 million. These are
21 the figures that are in the fiscal note. And I'd just
22 like to show in the low price case some of the backup about how
23 these are developed. This is what we project in the low
24 price case would be collected under the present income tax.
25 No warts, no windfall profit tax - just what we have on the

1 books now. \$1,142 million in fiscal year '82. With the
2 warts and the windfall profit tax, that would drop to
3 \$787 million in fiscal year '82. The new reserves tax
4 would generate \$601 million in that payment part - that
5 top box that I showed in the first draft, \$601 million.
6 There'd be retroactive provision for the warts and for
7 the past windfall profit taxes to clean those up - and
8 the net change is \$11.149 billion. The difference is a
9 \$7 million increase - that's the \$7 million that I showed
10 you earlier on the low price case.

11 MR. RAY:

12 Wait a minute. What was that first figure you just said?
13 No, the bottom, the total figure. The next one up.

14 COMMISSIONER WILLIAMS:

15 This one is the new cash flow. That's the 787 plus the 601
16 minus 83 minus 156 - adds up to 1149. This is the
17 revenue that we would see as the cash coming in under the
18 low price case with this bill in this fiscal year. In
19 this year, in 1983, this is the income stream you would
20 see. There would be no more retroactivity because that
21 has all been taken care of in the first year. So all you
22 have now is the ongoing effects of the reserves tax and
23 the ongoing effects of the amended version of Chapter 21.
24 So here you have a total of \$1.289 billion being collected.
25 That's short of the \$1.356 billion that would be collected

1 under the present tax, and is short by \$67 million. Same
2 thing here - it comes up short by \$49 million. And over
3 here it comes up short by \$55 million. It does not
4 necessarily, though, have to come up short. And I'd like
5 to show you one graph here illustrating that point.
6 Thank you. This is break even millage rates. One of
7 the provisions is that the legislature may adjust the
8 millage each year. If it fails to do it, it's 25 mills.
9 But if it does do it, it can fine tune this tax so that
10 the revenue effect is zero. In 1982 these are the
11 assessed values that come up from the low price case for
12 the reserves at Prudhoe Bay. These are all in millions
13 of dollars. So this is \$60.1 billion - would be the
14 approximate assessed value based on the research and analysis
15 we did. If you apply the millage, 29.65 mills, that's
16 2.965% of this assessed value - the gross reserves tax is
17 \$1.782 billion. The credit for income tax payments, for
18 past income tax payments and for current income tax
19 payments, comes to \$1.188 billion - that's the sum of
20 those two. So you subtract that from this, and you have
21 the net reserves tax payment of \$594 million. At present,
22 Chapter 21 produces \$1.142 billion. Taking the warts
23 off would reduce that by 33. Taking the windfall profit
24 tax deduction off, we would reduce it by another 308.
25 And deduction for this reserves tax, since this will now