

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1461 SCOMM 55: INT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987

1261

NUMBER 109

GORDON HARRISON asked, in reference to the Dept. of Revenue's analysis of incremental tax revenue from the various proposals, if they also did an assessment of the present value of foregone production to revenue received by the state.

VINCE WRIGHT said they had not, that it was strictly in nominal value terms.

REP. SUND recessed the meeting for a short break at 11:00 a.m.

NUMBER 127

REP. SUND called the meeting back to order at 11:10 a.m. He invited Deborah Vogt to join Charles Logsdon to assist in answering questions about the various alternatives. He discussed one option that had not been raised about the ELF, that being to continue the current situation but not apply it to Prudhoe Bay and asked what the impact might be.

CHARLES LOGSDON stated that the last alternative of eliminating the ELF was evaluated on a field by field basis. A rough idea of the effect on Prudhoe Bay appears in Tables 7 and 8.

REP. GRUSSENDORF asked, in reference to alternative three, how the figure of \$1.50 as a severance tax floor came about.

CHARLES LOGSDON replied that it was essentially derived from inflation which has occurred since the 80¢ floor was put in place. The number would vary depending on the price index series.

NUMBER 185

REP.-ELECT BROWN referred to the paper by Tom Williams submitted by George Nelson from a past meeting. On page 23, there is an analysis for a large field based on a company's perspective and considerations for drilling incremental wells. She asked to what extent the Dept. of Revenue's model accounts for the loss of tax savings with regard to a company's decision to drill additional wells. She said it is an important consideration in that the tax structure should not discourage appropriate development.

CHARLES LOGSDON said the model does take that into consideration. The model specifies a cost production relationship such as the costs associated with increasing the level of production in increments of about ten million to twenty million barrels. The marginal cost is compared with the incremental revenue that would be received from that increased production. The incremental costs include not only the out-of-pocket expenses for capital and labor, but also tax costs because severance tax and royalties are going to be directly affected by how much oil is produced; they are volume sensitive. The revenue received is going to be affected by the taxes also.

NUMBER 234

REP. GRUSSENDORF asked when the Dept. of Revenue estimates recoverable oil production and analyzes the estimated production costs in order to work out a tax formula, if they base it on the most current oil production technology available.

CHARLES LOGSDON said to the extent that they can, they use historical cost relationships. He was fairly certain that they don't introduce any technological trends.

REP. GRUSSENDORF stated that the technological trend gives the cost of producing recoverable oil. He recalled the Texas oil field example which was originally a twenty-year field and has now been producing for fifty-six years because of changing technology. He said technology is changing currently and asked if tax structures would change with the available technology, which might also reduce production costs and increase the amount of recoverable oil.

CHARLES LOGSDON said their estimates of enhanced recovery (recovery beyond primary and the water-flood which is in place now) are based on a certain percent of the estimated recoverable reserves under current technology. They are using the figure of 92% based on a very high price of oil, which may be somewhat unrealistic, but they have attempted to account for the fact that if the price of oil is high enough the industry will find a way to get the oil out of the ground.

NUMBER 282

GEORGE NELSON said the industry expects to recover about 44% of the original oil in place in Prudhoe Bay, roughly ten billion barrels. He asked if the department is saying the industry will get another 48% of the remaining oil.

NUMBER 314

CHARLES LOGSDON stated that he wanted to introduce a more realistic number than producing another ten billion out of Prudhoe Bay. He said for the last few forecasts, enhanced recovery has given an additional 500-700 million barrels out of currently producing fields. That includes Endicott and Lisburne, which aren't on line yet, but are used in evaluating the marginal cost - marginal revenue approach to incremental investments beyond those necessary to bring up primary production.

REP. MARTIN said it was mentioned at a previous meeting that past legislators had planned only on the potential of oil production decreases and increases, and that no one took into consideration a decline in oil prices. He said it seemed the Dept. of Revenue did give scenarios to the legislators so that they would think of the potential of decreased oil prices. He asked if the major factors could be re-evaluated to see if that was a consideration when the legislators looked at severance tax rates and separate accounting. He said it is important to know whether the legislators and the Dept. of Revenue based their conclusions on both aspects of production and oil prices.

NUMBER 346

CHARLES LOGSDON said a previous presentation indicated the severance tax currently in effect was targeted strictly toward productivity. There is the introduction of price sensitivity of the Production at the Economic Limit (PEL). Since the price was very stable at the time the tax was considered, it was not perceived as being an important issue. The idea that was advanced at the last meeting was as long as prices stay relatively stable, per-well productivity is a reasonable measure of profitability and that the more profitable fields should be expected to pay a higher tax burden than the less profitable if the state wanted to encourage the development of low-productivity fields. With the potential for very low prices, this may change the context in which the tax

should be viewed, and that is also why the Dept. of Revenue evaluated different alternatives such as de-coupling the floor to assure a minimum payment for the oil. The Dept. of Revenue continues to feel that it is not the most likely case that prices would be low enough that the cents-per-barrel floor and a falling ELF would be a problem. However, if the state is concerned that it wants to establish some minimum level of tax for oil produced in the state, it is a different issue than whether it is price sensitive. They are related, but not exactly the same issue.

REP. SUND referred to an issue raised by George Nelson. By changing the curve or exponent to allow greater incentive for marginal fields yet raising the rate on productive fields such as Prudhoe Bay, what would be the impact of Prudhoe Bay as a marginal field. He asked when does the state look at Prudhoe Bay as a marginal field and if it was after the first ten billion barrels are gone.

GEORGE NELSON said the enhanced oil recovery project which is currently in place was looked at as a way to obtain some additional oil. With the fall of oil prices, by the time the project was in there was no benefit. The industry is currently looking for other methods to produce through research and development. As the economics go down, the programs are squeezed back. In the third quarter of this year, Standard Oil made \$7 million. They paid state taxes far in excess of the amount they made. By virtue of the current price climate, some of the projects in enhanced oil recovery for future work have been cut back and more concentration has been placed on what is needed to sustain the current rate.

NUMBER 460

REP. SUND said there are two ways to look at it. He cited the Texas field example where so much oil is planned to be pumped out in twenty years and they have been pumping on it for an extra thirty-six. Referring to Prudhoe Bay, he asked if the industry looks at the time margin aspect, pumps the first ten billion barrels and then comes back in the next twenty years and works on the next twelve billion barrels, or do they work on the whole twenty billion barrel field all the time.

GEORGE NELSON responded that they try to work on the entire field the whole time because as new technology progresses they will try to recover the oil. He said the industry is conservative about what they believe can be recovered from the remaining twelve billion barrels. They are working on technology for the entire field, not just the first ten billion barrels, but more time and effort is being spent on producing the first ten billion than the remaining twelve billion. The effort and money spent on the latter will depend on incoming revenue. The priority is to get barrels-per-day right now.

REP. SUND said that if there is a scheduled life to the end of the field, instead of working on extending that scheduled life five or ten years longer, the industry is working on how to keep the curve from declining so fast. From a tax policy point of view, we should concentrate on recovering the state's share within the scheduled time of the field rather than working on tax policies that would try to extend the life of the field. If it is the industry's incentive to pump more oil within the twenty-five year life of the field rather than make a 35-year life, the state should take the same point of view.

GEORGE NELSON stated that the difference is a small percentage of the amount they know is there in Prudhoe Bay. If the industry is discouraged by a "get

while the gettin's good" attitude, they will be encouraged to look for other areas that will provide a better rate of return to invest money. They may even be able to come up with primary reserves rather than working on tertiary reserves. He said it would be a short-sighted approach.

NUMBER 550

DEBORAH VOGT commented on what the real definition of a marginal field is with reference to the ELF and PEL. Three different considerations which may define a marginal field are the cost of production related to low oil prices, increased production costs due to secondary and tertiary recovery expenditures, and a decrease in total production. As a policy question, marginal needs to be defined. In 1977, because of the long stability in oil prices, whether it was the intent or not to make the PEL sensitive to price, it wasn't considered. The idea was that the cost of production would go up relative to that stable value and that would make the field more marginal.

REP. SUND said that one of the original discussions was how to keep Cook Inlet out of the picture and that is where the 300 barrels per-day per-well originated. So, we would define marginal based on per-well production. Using that definition, he questioned how the extra twelve billion barrels at Prudhoe Bay can be considered marginal, when it is being pumped at the same time the first ten billion barrels is being pumped. It is not defined as marginal in any of the equations in the ELF.

GORDON HARRISON stated that the ELF in alternative two does behave like the conventional ELF, even on large fields, it just does it slower. When productivity on Prudhoe Bay is substantially less, there will be an ELF, it will just be higher. The preferential treatment of marginality is still in that alternative.

NUMBER 643

GEORGE NELSON said there are over 800 wells in Prudhoe Bay, approximately 600 of which are producing. Relative to his experience with similar fields, additional drilling will be required, possibly another 1,200 wells in a smaller spacing to maximize recovery in a particular area. If it is not economically attractive, they may leave some oil in the ground that may otherwise be produced.

REP. GRUSSENDORF stated that he has viewed the definition of a marginal field in terms of barrels of oil produced along with the potential of reserves rather than an economic or market aspect as others may. He stated that it is important to discuss the definition of a marginal field.

GEORGE NELSON said that the oil industry does not look at the barrels-per-day but rather the recoverable reserves. He discussed the variable elements that are used in determining production costs which then determines whether a field is marginal.

TAPE 6, SIDE 2

REP. GRUSSENDORF restated his definition of a marginal field in terms of potential reserves and asked about the industry's definition of marginal.

NUMBER 60

GEORGE NELSON said the TAPS helps define what a marginal field is because without it they would not have developed Kuparuk, Endicott, Lisburne, and Seal

Island. His personal definition of a marginal field in Alaska is different than what it would be for a lower 48 field, and it would be somewhere around 500 million barrels of recoverable oil or less. In a deeper water field, it must exceed one billion barrels or more to be economical.

REP. SUND recessed the meeting at 11:40 a.m.

REP. SUND called the meeting back to order at 1:40 p.m. He indicated that Deborah Vogt would present an overview of state corporate and individual income taxes.

NUMBER 93

DEBORAH VOGT discussed the three components of income regarding a tax liability. They are (1) a jurisdiction's definition of income, (2) how much of taxpayer's overall (worldwide) income is earned in the taxing state, and (3) what tax rate is applied. She referred to a paper before the committee (see Appendix B) which lists the tax rates Alaska, both as a state and territory, has used for corporate and personal income tax.

REP. SUND interrupted Ms. Vogt's presentation while committee members located the overview paper. For the record, he acknowledged receipt of a letter regarding the ELF addressed to Senator Ferguson from Harold Heinze of ARCO Alaska, dated December 2, 1986. Copies were made and given to committee members.

NUMBER 130.

DEBORAH VOGT continued with the overview of income taxes. The chart in the overview only shows changes in tax laws. The first four entries show a percentage of federal tax, meaning the tax was levied on federal tax liability rather than federal taxable income. By 1957, the corporate tax rate was 18% of federal tax, which translates into an effective rate of about 9% because the federal corporate tax rate is 50%. When the state changed to a direct tax in 1975 of 5.4% plus a 4% surtax on federal taxable income, it was a fairly revenue neutral change. The state really hasn't changed the corporate tax rate since 1957. With the personal income tax, when the state changed to taxing federal taxable income instead of federal tax, it had the effect of divorcing Alaska's system from the graduated system incorporated in federal tax liability, so that was when the state changed to a graduated personal income tax.

She discussed in more detail what constitutes taxable income. Starting from the proposition that a gross receipts tax is constitutional, from a legislative perspective, deductions against gross receipts are a matter of legislative grace. There are certain senses of what net income is. For example with a manufacturing enterprise, deductions allowed would include cost of labor and typical costs of doing business. It is worth noting that our sense of what net income is varies tremendously between corporations and individuals. Corporations are taxed generally on what's left over at the end of the year after all expenses are paid.

The major consideration in determining what is taxable income is whether and to what extent to incorporate the federal definition of taxable income. Other states and Alaska have taken a variety of approaches to that question. On one extreme, the simplest thing to do is incorporate all federal rules so anything they allow as a deduction or tax credit is automatically incorporated into our

tax structure. The other extreme is to develop the state's own definition of allowable deductions to reach net income. Alaska has walked a path in between by starting with federal taxable income and making adjustments to that income. For example, the state adds back in foreign taxes paid and treats intangible drilling costs differently.

The advantages of tracking the federal system are that it is easiest to administer. A tax return filed in Alaska includes a copy of the federal return which is subject to the enhanced auditing capacities of the United States. The point being that it is more difficult to cheat. The rules and regulations up until the tax reform are well understood and there are rulings on applications of the law in certain situations. The disadvantage of buying off on federal policy is that it may not be appropriate for the state. Corporate taxable income is often different from corporate book income. The new changes in federal tax law takes steps in narrowing the gap between book income and federal taxable income. Most of the differences are what taxpayers call "timing differences" such as early depreciation (a deduction taken in one year that cannot be taken in a later year). Some of the differences have been a complete loss in the tax base such as investment tax credits.

In the late seventies, when the income tax was under scrutiny, there was concern about the erosion of the federal tax base which is really the difference between book income and federal taxable income. This has largely been accounted for in Alaska's law. There are some provisions that at that time were industry wide such as early depreciation and some differences that were specific to the oil industry such as the expensing of intangible drilling costs rather than the capitalization and depreciation, and percentage depletion. Over the years, our tax law has adjusted those differences so that taxpayers under Alaska law must capitalize their intangible drilling costs. The state never incorporated the Accelerated Cost Recovery Act (ACRS) for oil and gas taxpayers. When it went to modified apportionment in 1981 the state required them to use depreciation as it stood before that time. Percentage depletion must be recalculated as cost depletion under Alaska's law. That is one major old policy consideration that has largely been eliminated.

On the whole, for most corporate taxpayers, the new federal law will show an increase in the federal definition of net income. The United States expect to gain revenue from corporations. They have lowered the corporate tax rate but will gain revenue by increasing the amount of taxable income. They have done that by means such as repealing the investment tax credit and tightening up depreciation rules. Intangible drilling costs are still deductible (up to 70% under the new law) but wouldn't be under Alaska's current law. As a general rule, corporate taxpayers will have higher federal taxable income as a result of the federal tax changes. The Dept. of Revenue is in the process of examining these changes as some length and will provide some information in the near future.

Dividing up the income of a taxpayer that does business in more than one jurisdiction is the most difficult category (of income tax liability). With individuals, there are two ways states have done it. One is taxing income earned within the state, the other is taxation based on citizenship (taxing income of their citizens regardless where it is earned). The United States does that with domestic corporations by taxing their worldwide income rather than just their United States income. The corollary of that approach is to permit

tax credits for taxes that are paid on that income in other jurisdictions. Multistate taxpayers have not generally been taxed by states based on citizenship, they have been taxed on the basis of identifying the amount of income that they earn within the state regardless of where the corporate domicile is.

NUMBER 270

For corporations there are traditionally two ways to divide net income. They are apportionment and separate accounting. Separate accounting attempts to treat the instate portion of a taxpayer's overall income as though it were a separate entity. Formula apportionment, on the other hand, looks at all the income earned everywhere and attributes a part of the income to the taxing state on the basis of certain indicators of business presence, most commonly they are payroll, property and sales. If 10% of all property, payroll and sales are in the taxing jurisdiction, apportionment will tax 10% of that corporation's income. She referred to the overview paper which contained a hypothetical illustration (1-A) of the ways the different approaches divide income. It is set up to illustrate two points. The first hypothesizes a horizontally integrated business like a hotel or department store chain where the taxpayer is doing a similar business in each of three jurisdictions. In the hypothesis, the business in State A and B are identical, and the business in State C is twice as big. The top of the page can be viewed as a simplified federal tax return. It shows overall gross income, total payroll costs, total other costs and total net income and would be the federal taxable income calculations that you would start with using the apportionment formula. The costs and income are divided up equally between States A and B and doubled for State C to point out that even though State C is twice as big the formula will attribute according to the relative magnitude of the business done. State A and B will each end up with a quarter of the income and State C will have half.

The next page (1-B) showed how separate accounting might treat that same taxpayer. As the starting point in States A, B and C, the first example shows the same gross income that appeared as sales in the apportionment example. The payroll costs are also from the formula and appear in the same proportions in States A, B and C. The other costs were divided up on the same basis. In this example, separate accounting and formula apportionment come to the identical result. The point being that there isn't any particular inherent bias in one system or the other. It is possible that a change from one method to another does not affect the actual taxes paid.

Example two shows separate accounting except that some of costs were moved out of State C and put into States A and B. Costs don't go into the formula apportionment calculation so in example one she hypothesized that the costs would follow the same fractions as the other elements that appear in the formula. In example two, \$1 million of the costs were moved over to States A and B, \$500,000 in each jurisdiction. By assigning more costs to States A and B, they are only making \$500,000 instead of \$1 million and State C's income has gone from \$2 million up to \$3 million.

This is one of the elements that gives tax authorities nightmares about separate accounting because these costs are not easily auditable. Tax authorities believe the taxpayers can shift costs and pile them up and assign none of the income to the jurisdiction in which the tax burden is heavier. They come up with reduced tax liability in heavy tax states and assigning all their income to states that have low or no taxes. They don't even have to do that because

states don't communicate one to another, so the tax authorities have nightmares that the tax return filed in State A added to the tax returns filed in all the other states will not amount to the total income on the federal tax return. That is what tax authorities call "nowhere income" and it makes them leery of the separate accounting approach.

Example three carries that idea a step further and attributes another \$500,000 worth of costs each to States A and B. This shows States A and B earned no income at all and the total income for the corporation is assigned to State C. Taxpayers have traditionally taken the position that separate accounting more accurately represents their income than does formula apportionment. It is more consistent with the way they keep their books. If you owned a hotel chain in eight different states, you would probably keep separate books for each hotel and have a sense of how profitable each was compared to the others. From the taxpayer's perspective, it is possible that example two might be the way that the income actually looked to the taxpayer, so that the operation in State C was, in fact, a fair amount more profitable than the operations in States A and B. The formula on page 1-A will attribute the income that is set out on that page irregardless of what the taxpayer's books show, no matter whether it is like examples one, two or three.

Much of the litigation about formula apportionment has been because the taxpayer said their books resembled those in example two or three and the tax authorities said they are going to tax on the basis of the first hypothetical with the apportionment formula. The taxpayer doesn't raise that argument in State C where his books show he made more money than the state is taxing, it is only in States A and B where the state shows him earning money that his books don't reflect.

The next hypotheticals (2-A) deal with a vertically integrated business. It is more complex. The hypothesis is of a manufacturing enterprise that manufactures a product in State A. For the purpose of the hypothetical, it is assumed that the manufacturer transfers all his products to State B where the taxpayer incurs marketing and sales costs and all of the sales occur in State B. Separate accounting applied to this kind of taxpayer has to establish transfer value for the value of the commodity when it leaves State A. For oil production that would be wellhead value. On the separate accounting books, the transfer value becomes gross income for the state in which the product is manufactured and a cost for goods in accounting in the state in which the goods are sold. The accounting goes thus: the transfer value times the number of products is gross income in State A, less the cost of production, leaving net income in State A. In State B, gross income is the actual third party retail sales price. The costs include the transfer value, which is the cost of goods, plus the sales costs. In this hypothesis it leaves an identical amount of income from each of those activities in each of the two states.

The bottom of the page shows how apportionment would treat that same taxpayer. For the purposes of the hypothesis, assume that half of the payroll is in each of the activities, half in manufacturing and half in sales, but that all of the property is in manufacturing and all of the sales are in State B. The average of the fractions on each is still one half. Although it is unlikely that this would happen in life, but it is theoretically possible that separate accounting and formula apportionment will reach the identical result.

On the next page (2-B), fiddle with the hypotheticals a little and see what happens when the transfer value is changed. On the previous page the transfer value was \$5.00 per unit. If it is lowered to \$4.00 per unit, and this is a private number that the manufacturing arm of the business establishes vis a vis the sales arm, the taxpayer can report that the transfer is \$4.00 per unit. The gross income in State A has gone from \$5 million down to \$4 million. That is the basis on which the gross income is calculated. Now there is zero income in State A and all income has been transferred to State B by altering that transfer value number. This is the other nightmare that tax administrators have, because artificially setting that transfer value too high or low moves income from one jurisdiction to another in separate accounting. The apportionment formula treatment of the same entity is exactly the same as it was in the previous page, and that is one of the main advantages of the apportionment formula is that the transfer value is taken out of the calculation. It doesn't matter where the taxpayer sets the transfer value for his own purposes, the formula doesn't take it into account.

NUMBER 461

She introduced another concept that has not been previously discussed which was worldwide combination and how it relates to separate accounting and formula apportionment. She referred back to the hypothetical on page 1-A which is a horizontally integrated business that does business in three states. It could be hypothesized that State C, instead of being a state is another country. By looking at the example, it is obvious that it doesn't matter whether there was a line drawn between States A and B on one side, and State C on the other side to separate the domestic income and apportion it by a formula. States A and B would then be under a formula attributing half the income between the two states. By adding into the formula the activities in the foreign country, it doesn't necessarily change the tax results in State A or B. Increments can be added indefinitely as long as profitability is relatively uniform throughout the corporate business as a whole.

Looking at variations on the next page (1-B) it is obvious that it would matter to the taxpayer if the income from the foreign jurisdiction were taxed by separate accounting in the foreign jurisdiction. Then there would be income attributed under one of the examples as being higher than would be attributed under the formula. When separate accounting is used by the foreign jurisdiction and formula apportionment is used by the instate jurisdiction, many taxpayers feel that they are being exposed to excessive taxation. The point is that there is nothing inherent in the formula that makes that result. The only time separate accounting and formula apportionment come to different results is if profitability is not uniform within the enterprise as a whole. If the foreign operations are vastly more profitable than the domestic operations, then using worldwide combination will increase the tax burden domestically. Taxpayers and administrators cannot agree on distortions like that. The taxpayer will always argue that more of their income was earned outside of the state's reach and the state will always take the other side, and there may never be an end to that sort of litigation.

The concept of worldwide combination has been in the forefront nationally the last several years subsequent to the decision in the Container Corporation versus Franchise Tax Board of California in which the taxpayer argued that because foreign jurisdictions used separate accounting and because income earned in foreign jurisdictions was taxed by separate accounting, the inclusion in

California's calculations of the foreign income overly attributed income to California. The United States Supreme Court held that the use of the method by California was not only constitutional but rationally related to the taxpayers contacts within the state. This gave the United States Supreme Court's approval to worldwide combination approach. It has resulted in a tremendous amount of political activity on the basis of foreign trading partners who have presented their position that the worldwide unitary approach is a disincentive to investment in the United States. There has been a nationwide, presidentially-appointed working group to try to work out some solutions. A point here is that Alaska has been a worldwide unitary combination state for some time. Now there are only two states that use the method and Alaska is the only state that has not had legislation proposed to repeal worldwide combination. She was uncertain of the revenue impact of using or not using the method, but expected that the impact would probably favor the state otherwise taxpayers would have been raising it as a concern. It is a subject the committee may consider investigating.

NUMBER 589

There are two elements to the worldwide combination theory. The first is the worldwide aspect of it, the second is the combination. Worldwide means that you don't stop at the edge of the United States when you look at a taxpayer's income. The combination part means that you look not only at the corporation which is doing business in your jurisdiction, but also at affiliated corporations, so you tax the parent and the subsidiary that does business in Alaska as well as subsidiaries that have no contact with Alaska. They are treated as one corporate family and a chunk of that income is apportioned to the state under the formula factors that occur in the state. She raised the point because it is related to separate accounting and modified apportionment and it may be worth some investigation by the committee.

The reasons that tax administrators like formula apportionment is because they are easy to administer and there is flexibility of the taxpayers to shift profitability around by shifting costs or entering transfer values. In 1978, this was thrown out and the state adopted separate accounting for oil and gas taxpayers. As early as 1971, the legislature began to hear testimony that the three factor (payroll, property and sales) formula was not well designed for the oil industry. She referred to the Affidavit of Edward Deakin, an accounting professor at the University of Texas, which walks through separate accounting and formula apportionment for oil and gas taxpayers in great detail. The affidavit was in the committee packets and provides additional information.

NUMBER 600

The legislature learned that none of the three factors were particularly well designed to measure oil production activities. The property factor is probably the worst design because it does not measure the value of the oil in the ground. Oil and gas corporations are unique in that their most valuable asset, reserves, does not appear on their books of account. Property owned by an oil company includes wells, pipelines, hardware, but not the value of the oil. Estimates before the legislature in the late seventies indicated that Prudhoe Bay would appear in the property factor at approximately two percent of its actual value. The property factor is further distorted because of the federal rules for the deduction of intangible drilling costs rather than the capitalization. The intangible drilling costs enter into the property factor because property that

would otherwise be capitalized is expensed and as a result doesn't appear in the property factor.

The payroll factor does not work well because oil production compared to refining and marketing is not labor intensive in the first place. Secondly, because the intangible drilling cost rules encourage the oil companies to do business through subcontractors who don't appear in their payroll factor, whereas in the other activities against which production activities are measured, the work that is done in refining and marketing is more likely to be done by oil company employees.

The sales factor obviously was not going to be very helpful to Alaska because very little of the oil was predicted to be sold in the state. It is most defective because it doesn't measure the magnitude of production.

END OF TAPE 6

TAPE 7, SIDE 1

DEBORAH VOGT continued her discussion about the three-factor formula saying that it would only attribute to Alaska a small percentage of the income that was actually earned here. The pie chart (Chart 3) in the overview paper shows some of the estimates that were before the legislature were. The UDIPTA is the Uniform Division of Income for Tax Purposes Act or the three-factor formula. The charts show various estimates of Prudhoe Bay income, one from Exxon, one from Arthur Anderson, and one from W. J. Levy and Associates. The comparison is between the various estimates of overall income to that which would have been attributed by the formula.

Chart 4 is a company by company analysis for the life of the field from the Arthur Anderson study. It shows the three major taxpayers, Sohio, Exxon, and Arco. A major focus of the legislature was not only the difference between apportionment income compared with the estimates of actual income, but also the difference in tax treatment between similarly or not similarly situated taxpayers. Exxon and Arco at that time were identical. They owned all their assets jointly. That fact is reflected in the estimates of their actual incomes which are very close. Arco is a little shorter due to greater interest payments because it had to borrow more money to get into Prudhoe Bay than did Exxon. The formula income that was attributed to the states was vastly different. Exxon would have paid much higher taxes than Arco under the formula. Comparing Sohio and Exxon on the other side, they would have had the same tax burden under formula apportionment, but Sohio owned approximately twice as much as Exxon, as actual income would have been approximately doubled Exxon's. This was one of the major factors that the legislature focused on in turning to separate accounting.

She returned to the subject of general taxpayers briefly to illustrate how the formula reacts to taxpayer business. The formula is designed for mercantile and retail operations. If you had a chain of stores in three different states and one of the stores was greatly more profitable than the others, that additional profitability would result pretty quickly in additional payroll in the state, immediately in additional sales in the state, and probably additional inventory, and maybe even an addition on the building itself so that the property factor would go up. The formula more or less presumes that business owners will adjust their affairs to even out profitability so that eventually over time the formula

will fairly accurately reflect business activity. In that example, it is obvious that the formula factors are all sensitive to business decisions. For oil income, if one hypothesizes that the value of oil goes from \$10 to \$26, think about the three factors. It doesn't take more people to pump the oil, so the payroll factor stays the same. No additional wells are built, the pipeline size doesn't need to be increased, so the property factor stays the same. The sales factor is just about unchanged because none of the sales are in the state in the first place. So all the additional income from the increase in crude oil value goes into the big pot that is divided up, but the state's share of the pot doesn't increase. This was one of the reasons that the legislature adopted separate accounting in 1978.

Ms. Vogt referred to the last graph in the overview paper. It was made from numbers that appeared in the oil companies' briefs in the AS 43.21 litigation. It shows their allegations of the comparison between separate accounting income and formula apportionment income. To the extent that the early charts were predictions, these can be viewed as what actually happened. They are very similar to the predictions that were made in the late seventies that formula income ranged between 12% and 36% of the income that was attributed to the state under separate accounting.

NUMBER 76

She discussed the 1981 repeal of separate accounting and the return to modified apportionment (which is not the same as the three-factor formula previously discussed). The current system has three different formulas, depending on the type of taxpayer. An oil producer that doesn't transport oil by pipeline has a two-factor apportionment formula which is extraction and property. The extraction factor is the number of barrels produced in Alaska as a function of the number of barrels produced everywhere else. The property factor is the same as usual. A transporter by pipeline who is not a producer is subject to a two-factor formula that is composed of sales or tariffs, and property. If a taxpayer is both a producer and transporter, the income is attributed to the state on the basis of all three factors.

She was unsure how much of an improvement modified apportionment is over the original three-factor formula which was the subject of the legislative inquiry. With the current system, questions to be addressed would be whether it is appropriate to use a sales factor for production income, which is what happens when a producer is also a pipeline transporter, and whether it is appropriate to use an extraction factor for pipeline income when the two are lumped together. The formula doesn't appear to address the question of the reserves not being in the property factor. The value of the reserves is still not accounted for in the formula. It is possible for an oil company that is just a producer, with income attributed on the basis of a two-factor formula, to buy a small interest in the pipeline so that they could get the advantage of having the sales factor used to apportion their formula income.

NUMBER 135

GEORGE NELSON asked for clarification of Ms. Vogt's statement about it not making a difference whether the price of oil was \$10 or \$26 with regards to payroll.

DEBORAH VOGT said that the payroll factor would not necessarily increase if the only thing that changed was the value of oil.

GEORGE NELSON said that may be correct, but when oil is \$26 per barrel, there will be more projects implemented which would require additional people on the payroll. The number of people on the North Slope now compared to when production started up in 1977, when oil was about \$10, has changed extremely. Standard Oil had 95 people then and there are now 680, so payroll has increased. He felt it was incorrect to imply that because the oil industry makes a million and a half barrels per day out of Prudhoe Bay that they could do it with the people they started with irrespective of price.

NUMBER 146

REP. MARTIN stated that the unitary tax makes a major difference in how the pie is divided depending on whether something is being imported or exported. Alaska has been successful so far because of the export of natural resources. The real consideration should be, as California has learned, will the market bear what the state thinks it is entitled to.

DEBORAH VOGT agreed. She said when the United States Supreme Court announced the constitutionality of worldwide combination, there were eleven to fifteen states that used that method and there are now three. It wasn't that the decision opened the floodgates for the other states to use the method. It created a focus on the problem and the problem has been resolved through political means and economic arguments rather than legal means. Oregon made a presentation to the Multistate Tax Committee about a year ago in which they claimed that their repeal of worldwide combination earned them money because it encouraged new business to settle in the state. It created more revenue because of the businesses even though they lost tax revenues. Alaska is the only state that has not investigated whether it ought to be using worldwide combination or not.

NUMBER 198

REP. SUND said his assumption is that Alaska is getting about \$110 million from corporate oil and gas income taxes. The expected revenue projections from severance tax goes from \$1.1 billion to \$459 million, about a \$600 million drop, and the corporate income tax drops \$20 million in the same projection. He asked why the severance tax drop is so much higher.

VINCE WRIGHT explained that the reason was because of the structure of separate accounting versus modified apportionment. Separate accounting is such that whenever there is a drop in the price of oil there is a direct effect, whereas if that is applied to the modified apportionment approach, the effect is somewhat mitigated. If production drops ten percent, the separate accounting effect is roughly ten percent. It won't work that way with modified apportionment because of the three factors. To a certain extent, that ten percent drop in production is diluted in the apportionment formula.

REP. SUND said, referring to the projections, all he could see that happened from FY 86 to FY 87 and FY 88 is the price. The volume is the same, the corporate income tax is about the same, yet severance tax drops sharply. That infers to him that the income is not price sensitive and severance tax is.

VINCE WRIGHT said the income tax is price sensitive, but not to the degree the severance tax is.

DEBORAH VOGT said the apportionment formula will lump the income from production in Alaska plus everywhere else, plus all the refining and gas station sales prices. If that income didn't go down as much as Prudhoe Bay income went down, then modified apportionment isn't going to go down as rapidly. If the state was just looking at Prudhoe Bay activities under separate accounting, it would have gone down more proportionately.

REP. MARTIN asked about a report by the Dept. of Revenue last July which compared figures of lost revenue between separate accounting versus apportionment formula.

REP. SUND said a question that should be addressed is whether it is worth trying to change the present tax formula and what the impact would be.

REP. MARTIN said with the current price of oil, the state is making out with apportionment. It would have lost quite a lot this year under separate accounting. When prices are up again, the state may lose under apportionment, whereas it would make it with separate accounting.

GORDON HARRISON, asked if Ms. Vogt had an opinion about the comparison of modified apportionment versus the three-factor formula.

NUMBER 250

DEBORAH VOGT replied that the use of an extraction factor instead of a payroll factor would help by being more related to oil production activity than the old three-factor formula. A property and extraction formula, which is what is paid if an oil company is just producing and not transporting, would be a step in the right direction toward a formula that was tied more to production activities than the old formula. The major flaw in apportionment is that the value of the reserves are not reflected in the formula, making the property factor undervalued. She did not know how that could be put into the formula because you would have to know the value of the taxpayer's worldwide reserves.

GEORGE NELSON asked if Ms. Vogt thought it was better to have a reserves tax.

DEBORAH VOGT said the property factor of the formula values the refinery at full cost. The value of North Slope holdings includes only what was paid for the leases, it does not include the value of what is owned there, which is the right to produce a tremendous amount of oil. She said she was not proposing a reserves tax.

REP. SUND said there is a difference between putting the value of the oil in the property factor in the formula and actually adding a property tax on the reserves.

GEORGE NELSON said the bottom line remains the same.

DEBORAH VOGT said the compounded difficulty for a formula to work is that you have to compare the value of Alaska reserves to the value of worldwide reserves.

REP. SUND asked if the timber industry carries the value of forest holdings on their books.

DEBORAH VOGT said she did not know. From the Deakin affidavit, she knows the fact that an oil industry does not book the value of their reserves is unique in the accounting world. There was an intensive effort years ago to require the oil industry to use "reserve recognition accounting" to post the value of its reserves in its books. She thought the effort failed.

NUMBER 362

REP. GRUSSENDORF said that the reserves are a financial asset that could be used for getting loans, so it does have value.

DEBORAH VOGT agreed that it is the most important asset an oil company has. If you buy an oil company, you buy the reserves.

NUMBER 370

REP. MARTIN asked if we did that, would the laws have to change to treat all types of corporations equally. For instance, timber has value, fish has value, coal has value, so shouldn't a reserves tax apply equally.

DEBORAH VOGT said it is not a reserves tax. For example, the state taxes Nordstrom's on the basis of including the full value of the property they own in their property factor. Alaska already treats Nordstrom's the way it would be treating the oil industry if it posted the value in the property factor. Most businesses already have the full value of their property in the property factor.

GEORGE NELSON commented on the value of reserves in the fishing industry as a parallel to the oil industry. He agreed that oil in the ground has a value, but fish in the sea also have a value. He asked how a value could be attached when the fish swim around to different places. Oil migrates as well. Standard knows better than anyone because they drilled Mukluk.

REP. GRUSSENDORF asked which formula encourages an oil business to maintain a high payroll profile in that tax structure as opposed to moving people to different regional out-of-state offices.

NUMBER 470

DEBORAH VOGT said that under separate accounting, the payroll related to production activities in Alaska is deductible as a cost regardless of whether that payroll is incurred in California or Alaska or elsewhere. The modified apportionment formula doesn't include a payroll factor right now. Most states use the three-factor formula. If a multistate business thought about locating an employee in California or Alaska and they put the employee in California, the payroll would go into California's payroll, property and sales factors and would attribute some income to California. By putting the employee in Alaska, a state which doesn't use the payroll factor, there might be bad incentive. Because Alaska's modified apportionment does not include a payroll factor and because the apportionment formulas of most other states do include payroll factors, the payroll factor attributes income to the state for every additional dollar spent in paying the employee. There might be an incentive, because of California's law, to put payroll in Alaska because if payroll is in California it will affect the tax liability, if it is in Alaska, it won't.

NUMBER 515

GEORGE NELSON commented that Standard Oil closed down an office in San Francisco and relocated people in Alaska and there were some distinct monetary advantages in doing so.

REP. GRUSSENDORF referred to employee relocation and subcontracting and said he wanted to see how Alaska's tax structure could encourage more activity related to oil and gas.

DEBORAH VOGT stated that it was a federal tax rule on intangible drilling costs that provides an incentive to employ through subcontracting.

GEORGE NELSON said that with subcontracting the oil industry doesn't have the capital investment in the rigs and it is done worldwide. The industry quit having their own drilling rigs and personnel in 1950 and that includes overseas. But it doesn't take away from the state because the drilling contractors have their companies and equipment here and pay taxes on their payroll.

REP. MARTIN said the discussion of separate accounting and enticing new industry, which is what other states are doing, is exciting because it could be a new era for Alaska. The state could give special privileges on corporate and property taxes, compete against other states for business and bring more jobs to Alaska. Then separate accounting could be better for the corporations whether they are national or international because they would get special consideration for the number of people they employ by decreasing corporate and property taxes.

NUMBER 580

REP. SUND asked if it would be sensible in terms of generating more revenue to return to separate accounting at this time.

DEBORAH VOGT said that it depends on what happens to the price of oil. By sticking with modified apportionment, the state will have a smoother, less risky route. Going back to separate accounting, the state takes a chance that the price will go up and result in a tremendous benefit. If the price stays low, modified apportionment would be better.

REP. SUND referred to Ms. Vogt's examples where it didn't make a net change by going from one method to the other. He asked if Alaska was at that point now.

DEBORAH VOGT said she did not know, but the Dept. of Revenue is preparing a report with new numbers that might address the question.

VINCE WRIGHT said the department is looking at an array of wellhead values and what the crossover point is. Based on the preliminary information they have run at today's prices, the state would lose under separate accounting. With a higher price scenario, the state would make more under separate accounting.

NUMBER 635

REP. MARTIN said the best evaluation he had seen was a House Research Agency report for Rep. Clocksin. It gave various options of what prices would be and when separate accounting and apportionment accounting would be of value to the state.

REP.-ELECT BROWN asked about Ms. Vogt's reference to a movement at the national level to get people off of apportionment in California.

NUMBER 660

DEBORAH VOGT said it's not exactly to get people off of apportionment formulas, it is to stop the functioning of the apportionment formula at the water's edge or the edge of the United States. One way of doing that is to not combine affiliated corporations anymore because most overseas activity is carried on by different corporations. It would have the effect of excluding foreign affiliates. The water's edge methodology implies that an apportionment formula will be used within the United States but it will turn to separate accounting when the water's edge is met.

TAPE 7, SIDE 2

DEBORAH VOGT said when the Container Corporation decision came out, there was a serious question that Congress might act to prohibit worldwide combination by states. If the decision had had the effect of other states jumping on the bandwagon and going that way, then Congress may have acted, but the opposite effect has happened. Most states have repealed their worldwide approach, so it is doubtful that Congress will take any action in the near future.

REP. SUND recessed the committee for a break at 3:05 p.m.

NUMBER 9

REP. SUND called the meeting back to order at 3:15 p.m. He indicated that Ms. Vogt will finish up with the income tax overview and then the Dept. of Revenue could go through other non oil and gas tax issues.

REP.-ELECT BROWN said it was not clear to her why the other states left the unitary method. She asked if Ms. Vogt would discuss the factors and considerations involved in the change and why Alaska should look into this as a policy issue.

DEBORAH VOGT said her sense of what happened has come from attending multistate tax conference meetings and reading the materials they put out. Her impression was that after the Container Corporation decision, the foreign trading partners began to put a great deal of pressure on the United States arguing that they were being penalized by setting foot in states that used worldwide combination because a business presence in a state that used that system had the result of bringing their worldwide income into the computations and sometimes with tremendous tax liabilities. So there was political pressure to repeal the systems and most of the states have responded. It was not necessarily that people feel it is a better method of taxation, or that there are any legal problems with it. It is more a matter of simple economics. As an example, Oregon claims that by giving up the income associated with worldwide unitary combinations, it gained income from additional businesses locating within their borders.

NUMBER 45

MARTIN RICHARD said Ms. Vogt made a valid point and added that with the United Kingdom, in working out a treaty with the United States, the main pressure was to get the individual states away from the worldwide unitary concept. There was a worldwide working group put together at the federal level with members of industry and Congress to work out some of the details. They came out with some recommendations, but nothing ever became of it. A bill was introduced in Congress to force the states off the worldwide method and no action was taken on it because California, which was the major consideration, went to a type of water's edge. They did not come to a water's edge like some of the other states

have, they have a complicated hybrid method that involves a contractual arrangement between the taxpayer and the state. If they want to report on a water's edge basis they have to pay a fee, and if they want to return to worldwide, they have to notify the state ten years in advance. The main point is that when California backed off of its worldwide stance, the federal legislation died. Alaska and Montana, two resource states, are the ones left with worldwide. For Alaska to move to water's edge, it depends what it does and does not include. He said he did not see any reason to move to water's edge at this point. Worldwide is easier to administer, there is no concern about transfer prices and things of that nature. For a resource base state as large as Alaska, the taxpayers are really not concerned about it either.

GEORGE NELSON stated that when the pressure was put on, it was put on California, Florida, and Oregon. The unofficial statements, especially by the Japanese, was that there was not a problem with Alaska's tax program. Alaska's current system was readily acceptable to them and they were putting the pressure someplace else.

REP. SUND asked if it made a difference under modified apportionment or separate accounting to individual companies and if it treated them differently or equally.

NUMBER 89

DEBORAH VOGT said it generally would not treat them equally. A previous chart showed the difference in treatment between Exxon and Arco prior to the enactment of AS 43.21. Because the apportionment formula looks at all activities everywhere and separate accounting looks at Alaska activities, the activities of the taxpayers are not uniform outside the state and would affect the apportionment formula. She said she would be surprised if two identical producers in Alaska were taxed to the same extent under any apportionment formula, whereas they would be taxed very similarly under separate accounting. It also depends on what is meant by being treated similarly. If it means they have a tax burden related to their overall income, then the apportionment formula will treat them more similarly because the tax is a portion of their overall income. If it means they are taxed similarly on the basis of their Alaska activities, then separate accounting will treat them more similarly.

GEORGE NELSON said each company is affected differently due to the activities it has outside of Alaska and they all have considerably different activities in different areas of both the United States and elsewhere.

REP. SUND asked what the tax rate is that produces the \$110 million a year in income.

DEBORAH VOGT said it is 9.4% on income above a fairly low floor of \$50,000.

REP. SUND said if there were some willingness to increase the rate of taxation you could just modify the number.

DEBORAH VOGT agreed and said it was modified in 1981 so that it had more graduations that went up to 11%. The 11% rate applied only on income above \$4 million. It was part of the 1981 package because of the repeal of separate accounting and the adoption of severance tax provisions. There was a revenue

gap that was filled by a one year only increase in the rate of corporate income tax. It was enacted with a repealer.

REP. SUND asked what an 11% rate would produce.

NUMBER 120

GREGG ERICKSON said an earlier calculation of an increase to 12% from the 9.4% would increase FY 88 revenue by \$30 million. They also calculated that if wellhead prices in FY 88 are below \$8.50 per barrel, there might not be a gain going to separate accounting, but if wellhead prices are above that price, their calculations indicate separate accounting will produce more revenue in FY 88 than the modified apportionment.

REP. SUND asked if it would be a fair summary to say that if people are relatively happy with the present method of taxation, then the legislature's option is just to look at the rate.

GEORGE NELSON said that Alaska has the highest severance tax in the United States. The 12% referred to by Mr. Erickson is Minnesota, which has the highest corporate tax. If Alaska moves to 11% or 12%, it will have the highest corporate tax as well as the highest severance tax with respect to the oil industry. And it doesn't pick up that much money in corporate taxes.

REP. SUND said that he wanted to bring the points out, pro and con, so that the committee's preliminary report to the legislature will show that these issues and their impacts were addressed.

NUMBER 160

REP.-ELECT BROWN asked what proportion of corporate tax is paid by the oil industry versus other corporations. She said it would at least give the advantage of not singling out the oil industry.

GEORGE NELSON said that a corporate tax rate would affect everyone, whereas a severance tax would not.

GREGG ERICKSON said the general corporate tax is expected to raise \$16 million in FY 88, corporate tax on insurance companies raises another \$20 million, and there are some other taxes that might be considered in lieu of corporate taxation. It is a relative magnitude where you are talking about \$36 million as opposed to \$110 million.

NUMBER 179

REP. MARTIN said a good example with regard to severance taxes is what happened between Wyoming and Montana when they got into severance tax on coal. It was Montana that began to pull their horns back and allowed incentives to get employment in the state. In Wyoming, development did not occur and they had a high rate of unemployment, but Montana is doing great. There is a direct relationship from two other states across the border from each other that we can see. Legislators should consider a long range plan for the betterment of the state and whether the state should charge greatly for its resources even though people are unemployed or be reasonable and get a good tax on profits and employ people to develop the state.

REP. GRUSSENDORF asked if the \$36 million figure referred to by Mr. Erickson is a projection and how much of that is expected to be contested or not collected.

NUMBER 210

VINCE WRIGHT said that the Dept. of Revenue projects what they expect to collect or what they think they should get. There will be additions to the projections as audits are completed over the years. It is a conservative approach.

REP. GRUSSENDORF asked if the \$36 million was a conservative figure or a figure the Dept. of Revenue thinks ought to be collected.

VINCE WRIGHT said it is the figure they think they will collect immediately. In reality, they think they will collect more than that.

REP. SUND asked if it would be a fair summary to say that about \$110 million of an approximate total of \$174 million comes from the petroleum industry. There were no objections. He asked if Mr. Wright would address some questions on individual income tax and state sales tax and bring the committee up to date on some of the numbers that have been looked at.

NUMBER 242

VINCE WRIGHT said in a January 1986 report they discussed the individual income tax and sales tax and in conjunction with those discussions the equitability issue. They also went into elasticity of tax rates and administrative efficiency of different tax structures. Currently, with regard to individual income tax, they are looking at three basic scenarios with a report expected to be completed by the end of the month. One is a progressive tax structure that is piggybacked with the federal system, similar to what existed a few years ago. The second is a progressive tax system that is independent from the federal system. The third is a flat tax structure. Associated with each of the three scenarios are sub-scenarios which must be looked at. They have to evaluate what will happen to the state's economy within the next year or two which is difficult to predict and is partially dependent on the actions of government. They are asserting in one sub-scenario that state government does nothing, the worst case scenario. Then they worked up the ladder and looked at what happens if the state taps \$350 million on up to \$500 million of its savings account. This is important because as this money is fed into the economy it generates a certain amount of employment and a certain income in revenue. They have to look at a whole array of economic situations.

He said when they developed estimates on individual income tax last January, they came up with a range between \$300 million to \$350 million based on the level of population and income at that time. He did not know what the range is at this point, but suspected that it may be from \$150 million to \$400 million depending on what is done. Also, they are currently setting up models such that if the legislature or the governor requests a certain scenario at one rate versus another rate, they will be able to run the information. In conjunction with the revenue impacts, they will discuss how various income groups are affected, the elasticity factor, and what it will take to administer each of the programs.

He said there are many arguments for and against the individual income tax. The argument against the tax is people don't want additional taxes. The arguments for the individual income tax are as follows:

(1) it is expansionary to the economy, you can deduct state individual income tax from federal income tax, which results in a direct infusion of money from the federal government's pocket to the state's pocket, so more money is pumped into the economy, it is new money;

(2) there is what economists call the budget multiplier effect where the government initiates a tax structure, funds come in and are recycled through the economy, and there is a multiplier effect in terms of jobs and income generated;

(3) people do receive services from the state and perhaps they should pay for those services;

(4) perhaps most important is what he called "tax diversification", and the state has learned over the last year that it should not be dependent on one revenue resource from one industry, plus by diversifying the tax base, peaks and valleys in the economy can be mitigated;

(5) the state is running short of money.

NUMBER 329

He said there are also several arguments as to when this tax should be implemented. He asserted that the tax should be implemented this year and not next year because there is a possibility that oil prices will collapse this spring. There are good reasons for that scenario and the state should not be in the position where it is open to that possibility and not have other tax measures in place. Early in the summer, we were within twenty to thirty cents of zero wellhead value at one point and it could happen again. Even if prices do not collapse this spring, the state should be prepared for any eventuality. The state is extremely vulnerable and he was unsure if the public really understands that. Another reason why a tax should be implemented right away is because it takes six to nine months to implement a tax structure, hire auditors, set up computer programs, establish data banks, establish arrangements for the Internal Revenue Service and so on.

With regard to a state sales tax, he said last January they figured for every 1% sales tax, the state would generate between \$50 to \$75 million, depending on what is exempted. They are looking at several important issues relative to the sales tax. One is the regressivity of it where it tends to be a greater impact on lower income groups than higher income groups. Another factor is whether or not a community has a sales tax and if it does, should the state grant that community a credit if a statewide sales tax were initiated. The third factor deals with the nature of the Alaska economy. The state has a population that is oriented toward mail order sales and that money can escape taxation. An argument against a state sales tax is that it cannot be deducted under the new federal individual income tax law.

REP. MARTIN asked if Dept. of Revenue has considered the suspension of permanent fund dividends for a time. The state is giving away between \$300 million to \$400 million each year and it will continuously increase. He said it should be looked at objectively as a temporary period. The original intent of the permanent fund revenues was to be the lifeline of the state operating budget. He disagreed that the worst scenario was to do nothing. The worst scenario may be to impose a state income or sales tax and not stop the giveaway programs.

NUMBER 483

VINCE WRIGHT said when tying individual income tax in with the dividend program, there are different effects on different income groups.

REP. SUND asked if the ELF were changed so that \$100 million were added to the state coffers what impact it would have in terms of jobs and state economy. If it is a straight trade-off and the state had the \$100 million, what would it do with it and what would the economic impact be, versus if the oil industry had the \$100 million and they invested it all on the North Slope. He said if \$100 million were taken out of individual's pockets, it has an impact on their personal income, but then it is put in the state coffers and rolled back into the economy, and it is a trade-off question that will come up. He asked if the state should do something with the oil companies and change the ELF, go to separate accounting, raise the corporate income tax rate, or should it go to individuals and if there is a way to measure or quantify the impact on the economy.

VINCE WRIGHT said it could be measured and that the Dept. of Revenue and the University of Alaska have employment and income models.

REP. SUND said there was a study with the permanent fund dividend monies and its impact on the economy, but that it was new money coming in, it wasn't taken out of someone else's pocket and reinvested. He agreed with Mr. Nelson that if an increase in the ELF went through, it would not totally be new money to the state's economy because they would be spending it in the economy anyway and their expenditure would be a different utilization of the money than the state would make of it. He said it would be interesting to see what the differences are.

GEORGE NELSON said that if they run a scenario along Rep. Martin's suggestion, and depending on how much the permanent fund dividend check is, one thing to look at is not to eliminate it completely, but like a corporation which sometimes continues to pay the same dividend for a short while when they have a loss, it could be reduced and make additional monies available for the state. He was unsure of the legislative implications, but like a dividend in a corporation, it can be changed when things get better and the revenue comes back.

REP. SUND said he would not mind setting a cap on the permanent fund dividend at a reasonable rate, but that it should not be eliminated because people need to receive a dividend to maintain interest in how the fund is operated. By eliminating the dividend, philosophically, the fund has been given over as an annuity to fund government. People need to keep touch with it.

NUMBER 597

BART GARBER said he had a concern with fairness because when you shift to dividends in lieu of income as a source of state revenue it is shifted disproportionately like the sales tax over to lower income groups. They would gain disproportionately more from the dividend than they would lose under an income tax. He was curious if there were any figures about the administrative costs of an income tax and if they were significant. He asked what percentage of the return does administration take and how much bigger government has to get to collect and enforce an individual income tax.

VINCE WRIGHT said it is an area the department is looking at. He was unsure of the percentage, but it was an insignificant figure in terms of rate of return.

MARTIN RICHARD said a lot depends on what type of law exists, such as a flat tax, our own tax system or a piggyback with the feds.

REP. SUND said a piggyback tax seems to be the easiest.

MARTIN RICHARD said a flat tax would be the easiest to administer.

BART GARBER referred to a previous statement that the downside of an income tax is that people don't want to pay it, but on the federal level they argue that under the current economic system no taxes gains the state income through economic development. He asked if there would be disincentive to develop under that system and what effect an income tax has on economic development.

VINCE WRIGHT said he could make an argument that income tax would enhance it by putting more money into the economy.

BART GARBER said he had doubts about the Reaganomics view of income tax, but he would like to see if the state has its own independent argument on that side.

REP. SUND said it would be interesting to see how many businesses relocated to Alaska in the last six years because there was no individual income tax. He said he didn't know of any.

BART GARBER said Oregon was different than Alaska in that they have larger populations and ports and different things which attract people. He referred to the analogy of why Oregon dropped the worldwide unitary tax and said there was certainly political pressure, but they gained in other categories that Alaska won't gain from for eons, such as large populations that facilitate factory locations.

REP. SUND asked with regard to a federal piggyback income tax, if they are looking at adjusted gross income or the actual federal tax itself. There are two levels in the tax return you can attach to. If you take the adjusted gross income side, you don't have to automatically adopt any deductions that the feds may or may not want to add on in the future.

END OF TAPE 7

TAPE 8, SIDE ONE

REP. SUND said he would like to incorporate this information into a report to the legislature around the beginning of session.

NUMBER 3

DAVE RASLEY asked what part of income earned by people who are from out of state would be captured with a state income tax.

VINCE WRIGHT said he was unsure, but they had done a previous study that broke out part-time residents that he could refer back to, but there was some leakage.

REP. SUND said he thought the number was over \$100 million out of \$300 million.

REP. MARTIN said two scenarios were done, one was 17% and the other 23%. He asked for clarification about when you pay state taxes if it is directly taken off of the federal taxes or the gross income. There is not a direct dollar

transfer from the federal government to the state, it is under federal gross income.

VINCE WRIGHT said it is a direct transfer.

DAVE RASLEY asked if the new federal tax treats state sales and income tax basically the same as itemized deductions.

VINCE WRIGHT said sales tax is not deductible under the new federal tax law.

DAVE RASLEY said if the state has an income tax, there is a transfer of money to the state, but there wouldn't be with a sales tax.

VINCE WRIGHT confirmed that statement.

NUMBER 38

REP. SUND discussed the agenda for the next day and what he would like the committee to do regarding a preliminary report for the legislature.

GEORGE NELSON asked if the committee will try to put together different options in the report rather than make precise recommendations.

REP. SUND said that without the Senate members of the committee present, they would narrow down the options for the various issues and address some of the concepts brought up in committee. He said he would like the committee to meet in Juneau in January and will consult with the Senate members about meeting before submitting the report. He adjourned the meeting until 9:00 a.m. the next day.

NUMBER 106

REP. SUND called the meeting to order on December 5, 1986 at 9:25 a.m. Committee members present were Rep. Sund, Rep. Grussendorf, Rep. Martin, Rep.-Elect Brown, George Nelson, Bart Garber, Dave Rasley, Gordon Harrison, and Martin Richard. Members absent were Sen. Ferguson, Sen. Eliason, and Sen. Abood. He discussed the direction of the committee with regard to the report to be presented to the legislature. He would like staff to prepare a draft report which could be circulated and reviewed by the committee at a meeting during the first or second week of session. A good place to proceed would be to go back to each of the issues and discuss each option. He had requested draft legislation for seven ELF options. He referred to an October 14, 1986 memo in committee packets addressed to Rep. Grussendorf from Mary Halloran which lays out the seven options. He asked Ms. Vogt to go through the options for the committee.

DEBORAH VOGT said she drafted legislation based on the options listed in the October 14th memo so they are not in the same order as the options presented by Mr. Logsdon's paper. Option one established the 80¢ floor to which the existing ELF does not apply. It involves changing the language so that the ELF applies only to the percentage-of-value calculation and not to the 80¢ floor and is the same as Mr. Logsdon's alternative one. Option two does the same thing as one except that it changes the formula so that the PEL is set without discretion at 300 barrels, eliminating the exponent. There has not been any discussion on it, nor was it an option analyzed by the Dept. of Revenue.

REP. SUND asked Mr. Erickson if he had discussed the option in his presentation to the committee in September.

GREGG ERICKSON said he did not. It was discussed in a general way by Dick Monkman, but there were no cost estimates made.

DEBORAH VOGT said there are two different concepts that are in addition to the changes made in option one. The first is to establish the presumption of 300 barrels per day as law rather than a rebuttable option and that would remove from statutes the opportunity for a taxpayer to prove that his actual PEL is a number other than 300 barrels per day. The second change is to delete the exponent, and she deferred explanation to Mr. Erickson.

NUMBER 182

GREGG ERICKSON said eliminating the exponent changes the shape of the curve that relates tax rates by pushing the curve down in the middle. The purpose of the exponent was to get the rates higher in the middle.

REP. SUND said the impact of option two would be that the ELF factor would become smaller on wells between 300 to 2,000 barrels per day.

DEBORAH VOGT said it would also take the element of price sensitivity out of the ELF calculation.

NUMBER 228

GORDON HARRISON said option two has three elements. One is removing the "trap door," another is eliminating the rebuttable presumption of 300 barrels, and changing the exponent. It is the only option that deals with the rebuttable presumption of 300 barrels and it is an important issue the committee may want to discuss.

REP. MARTIN asked if Dept. of Revenue will bring up gains and losses as the committee discusses each option.

DEBORAH VOGT said it could be done for options one, three, four and five because those have been analyzed by Dept. of Revenue.

GREGG ERICKSON said he has a brief analysis of option one, and since some of the elements of option one are the same as in other options, it may cover those also. Option one is simple in the sense that it just says the ELF doesn't apply to the floor price. Every oil producer would have to pay at least 80¢ per barrel. If oil prices got real low, the severance tax revenue would be arrested in the area of \$400 million to \$500 million per year. Under current revenue projections, the floor isn't in effect for the largest, most productive fields, as a consequence, the revenue effects projected in the September forecast are minor. For the North Slope fields, there would be \$19 million in FY 88 in additional revenue from option one and most of it comes from Kuparuk and Endicott, none of it comes from Prudhoe Bay since their price is above the floor price of 80¢. Another important effect is that under current conditions establishing an 80¢ floor would mean that Cook Inlet oil fields would pay about \$8 million in severance tax. As projected for FY 88, Cook Inlet oil fields are only expected to pay about \$50,000 in severance tax because the field productivity is very small, or in some cases zero or negative. Additionally,

establishing a severance tax floor such as option one would mean that some smaller fields may shut down sooner than they would otherwise.

NUMBER 296

GEORGE NELSON pointed out that with option one, there will be premature field shut-in at lower prices. Considering Prudhoe Bay, if they hypothetically had a \$1.50 pump station wellhead net back and even if lifting costs are in the area of \$1.00, when you add the property taxes and a severance tax of 80¢ there would be a total cost of \$2.10 to achieve a \$1.50 wellhead price. They would be in a negative position, and he asked what incentive would there be to continue to produce oil. He said the industry feels the world oil price will remain at \$12 to \$15 which means \$10 to \$12 at the West Coast price. As far as the industry is concerned, the only feasible option at this time is no increase to any of the taxes.

NUMBER 366

REP. MARTIN expressed concern about what point jobs and local economy become sacrificed. If the state went with option one because of the overriding factor that it will bring more money to the state, it may have to sacrifice Cook Inlet and the jobs that go with it. He asked which is more important to the state. With regard to getting some value out of the state's oil, he asked if it meant the state should immediately establish a minimum cap of 80¢ of \$1.50 per barrel, or consider the value of jobs and economy to the state. He felt that Endicott, Kuparuk, and Cook Inlet are extremely vulnerable to option one.

GREGG ERICKSON said there is no question that Cook Inlet oil production is an important element of the Kenai Peninsula economy. Although he had not made a careful analysis of it, he has been in the business for about twenty years and his guess is that the additional 80¢ per barrel tax that the Cook Inlet fields would have to pay under this proposal would be a significant element in the decision of whether they could continue operating or not. Those fields are very close to their shut-down economics. His guess is that there would be a loss of jobs in the Kenai peninsula as a consequence of adopting option one as it stands. It also seems somewhat counterproductive, if additional revenue is the driving force of these decisions, to choose an option which under Dr. Logsdon's analysis indicates is the most inefficient in terms of additional revenue for barrels foregone. Of the options that Dr. Logsdon analyzed, this is the least efficient under that criteria. It collects revenue from Kuparuk and Endicott under current price situations and doesn't collect any additional revenue under the September projections from Prudhoe Bay. We all know Prudhoe Bay is more profitable than Endicott, so it doesn't seem to make much sense.

NUMBER 435

REP. SUND commented that some of the discussion has focused on who gets the last dollar out of the state's resources, or who gets the first dollar. If you look at it from the point of view of owning a farm which has oil on it, and someone wants to drill for oil on your farm and they say they can afford to drill it and transport it and hire people to work on the farm, but cannot afford to pay anything for the inconvenience, it is unlikely that you will say come and do it, why put up with the hassle. If they can afford to pay something, you might want to get into it. The state does own the resource and at some point we have to decide if we are going to go to that break-even point, or are we even going to pull money out of some other part of the economy so that we can afford to let this activity take place, such as the agricultural industry in the state.

GORDON HARRISON - He felt that is the real issue with option one as well as the possibility of eliminating the rebuttable presumption on the 300 barrels, which would have the effect of eliminating the price sensitivity of the ELF. The question is: what is the state's best economic interest when you have basically a zero wellhead value, or you are collecting no severance tax on some production on the North Slope. It is a question that is subject to economic analysis and he didn't think there has been any. He asked if the state is indifferent about whether production continues or not. One aspect brought up by Rep. Martin is employment. There would also be presumably some royalty under certain scenarios. The state would be in the situation of gaining very little revenue for the production of its resources still at almost peak level. He asked if the state would want to see production halted until prices improved and the state got something for its oil. If we were looking at a zero wellhead value and virtually no severance tax from Prudhoe Bay when they were still producing a million and a half barrels per day, it would probably be in the state's interest to call a halt to production. It is also a question of whether the benefits of employment are significant enough to allow that kind of severance of our resources to take place.

GEORGE NELSON pointed out that without the 80¢ floor and additional taxes, Conoco is shutting in Milne Point for the time being, which has been running between 12,000 to 17,000 barrels per day. He said the 80¢ floor option figures are based on state models, but it is only one position and the industry feels the figures for lost production are substantially low. Another point is that with the way the current ELF law is, the industry has to request a review. The presumption has been that in July 1987 they will automatically receive something, and anytime the formula is changed, they have to come in as Conoco did with the facts and have them approved. It is not a matter that the industry will automatically say the 300 barrels should be 3,000, and they will start paying the state only so much. They have to present that before the state and get approval, plus it is very restrictive on some of the allowable costs to change to formula.

NUMBER 600

REP. SUND discussed the three factors in option two. One was to establish the floor, another sets the 300 barrels in statute rather than as a presumption, and it eliminates the exponent which has its own impacts. He confirmed with Mr. Erickson that there has not been an analysis of the impact of eliminating the exponent.

GREGG ERICKSON said that one of the difficulties that arises in analyzing the freezing of the PEL assumption at 300 barrels is that in the September forecast all the calculations of expected revenue were made on the basis that the 300 barrels was not rebutted. Therefore, using the forecast, it would show no effect of the PEL element in option two, and yet it is clearly very important.

REP. SUND asked if there are any scenarios in the Monte Carlo simulation that assume that the 300 barrels is challenged or changed.

VINCE WRIGHT said there is but he was unsure how far he could go into it, because of the confidentiality matter.

GREGG ERICKSON said it is difficult to analyze the change because if they are talking about a particular situation with a particular field, going back and

analyzing its effects shows some data that the department considers proprietary. It is difficult to show the fiscal effect because we do not know how many operators are currently requesting changes in their PEL, nor the likelihood of those changes being granted.

TAPE 8, SIDE TWO

GORDON HARRISON said there is the theoretical possibility that there could be full tilt production and no severance tax to the state and option one closes off that eventuality.

REP. MARTIN wondered when the PEL was adopted if there was a motivating factor for minimum production or an incentive in marginal cases that would encourage employment and production because of the other spin-off taxes we have. He asked if the state would be eliminating a motivating force by changing the PEL.

GREGG ERICKSON said he could not answer that definitively because there were sixty legislators that voted on it, but he believed the ELF as a whole is designed to encourage continued production when production levels are low.

NUMBER 18

DEBORAH VOGT commented that the 300 barrels would be sensitive to reducing production because as the number of barrels falls off the fraction changes, but the change to solidify the 300 barrels would make that factor only sensitive to production changes, and not sensitive to price changes. The apparent legislative history of the ELF didn't contemplate lowering prices.

REP. SUND said it is a policy call of how much the state wants to produce its resources at no return to the state. Once the policy is established, a formula can be written to reflect it.

REP. MARTIN said with no return, the state won't get direct money off the front, but in return it will get revenue from the other three levels of taxation as well as employment. The state invests money in the fishing industry in many ways, and it is a good investment which provides employment. We don't invest anything in oil and it has probably increased the cost of development more than in other states. We haven't taken in to consideration how we treat one resource to pay for another resource. He said he didn't mind that the state invests in timber, and in zinc and copper with the Red Dog Mine. But in the case where we only have the oil companies investing in our resource and we receive a profit, there is a major difference in the way the state treats its different resources.

NUMBER 58

GEORGE NELSON asked if the committee was familiar with what the industry can and cannot deduct when they apply for a reduction. He said there are many things they cannot deduct even to sustain a certain rate. When they are producing less oil on a per-barrel basis per well, they are not allowed by statute to include well workovers, replacement or repairs, property or severance taxes, insurance, any kind of overhead, any type of abandonment costs, or any other costs not directly related to the operation such as a special study to try to find different ways to continue production at an economic rate as a field gets older. They are allowed operating costs, royalty, production supplies, purchased fuel, routine maintenance, and employee wages and benefits that apply to that particular aspect of the operation. They can get additional deductions that are not listed, but it is only allowed by Dept. of Revenue regulations. It is not a

simple process to change the ELF and when requesting a change, there are many costs that are not deductible.

REP. SUND asked if it was correct that, to date, no one has received a change in the ELF.

GEORGE NELSON said that Conoco tried and there were many costs that were disallowed in their case, and there were other factors involved such as royalty. They were not successful with their application.

NUMBER 98

DEBORAH VOGT continued discussion of the options by explaining option three. It establishes a \$1.50 floor to which the ELF does not apply and adds an inflation index that would raise the \$1.50. She gave a sectional analysis of the proposed legislation for option three. She pointed out that the committee has not focused on gas production, so the proposed legislation does not apply to gas production.

REP. SUND said that if the 80¢ floor causes problems, the \$1.50 floor causes bigger problems.

GORDON HARRISON read Dr. Logsdon's comments regarding option three, "It has a devastating impact on average expected production which is reduced by nearly 170 million barrels. This impact on production is a direct result of the increased likelihood that such a tax would cause a premature shut-down in the already producing fields or it would make additional investment uneconomic...as we'll be seeing, eliminating the ELF entirely results in a much greater expected revenue without as severe an effect on production."

REP. SUND asked if there was any objection to discarding option three from consideration by the committee.

NUMBER 127

REP.-ELECT BROWN moved that the committee should not consider option three. There was no objection.

DEBORAH VOGT discussed option four which eliminates the ELF on all fields.

REP. SUND said there is a strong theoretical argument for option four. He referred to a paper from Jon Tillinghast that makes the argument that severing the value of products from the fields should not have any economic aspects to it all, there is a just a pay-per-unit taken off. He said Dick Monkman made that same presentation to the committee. The issue was discussed thoroughly years back and the reason the ELF came in to being was to get around the implications of straight cost severance.

GORDON HARRISON suggested the committee discard option four.

GEORGE NELSON said that option four would take substantial funds away from the industry that could and would be used for exploration, research and development.

NUMBER 157

REP. SUND asked if there were any positive aspects to option four.

GREGG ERICKSON said it raises a lot of money, but he concurs with Dr. Harrison.

REP. SUND discarded option four from consideration by the committee.

DEBORAH VOGT discussed option five which makes a change in the formula that measures field productivity rather than per-well productivity. She said this option is the same as alternative two in Dr. Logsdon's paper.

REP.-ELECT BROWN said the committee should give consideration to option five. It retains the positive features of the current severance tax and it would also give a break to the smaller fields. As a policy matter, the committee should think about the long term effects and look at the size and distribution of the oil fields that have been discovered on the North Slope. There are a number of fields in the range, especially if you take the figure of 80,000 to 100,000, that will fall within that and get some positive benefit from it. It seems to have a minor amount of production lost as a result, although the revenue to be gained from it is modest. This option would raise \$12 million in 1987, \$64 million in 1988, \$86 million in 1989, and on up. She was unsure to what extent the specific proposal that Mr. Logsdon referred to the day before had been costed out and asked for clarification from Mr. Erickson.

GREGG ERICKSON said Dr. Logsdon did do revenue analysis and although he did not have his updated paper, he thought the figures were unchanged and were about \$123 million additional gain with the Monte Carlo model. There is a significant difference from the numbers that Dr. Chester had calculated earlier. Given the uncertainty surrounding this, it would be best to assume that the alternative ELF would raise roughly \$100 million in FY 88.

NUMBER 222

GEORGE NELSON said option five on the surface may look good, but it is detrimental to the development of larger fields and to the state's overall picture because of the fact that as a comparison if they were doing a marginal project such as enhanced oil recovery in Prudhoe Bay it could involve a lot more barrels than a smaller field. The additional oil they can recover out of the twelve billion barrels will probably be larger amounts than any of the fields currently in production on the North Slope, including Endicott and Kuparuk.

REP.-ELECT BROWN asked how tax laws treat separate reservoirs that are on top of each other such as at the Prudhoe Bay unit, there is the Sadlerochit reservoir and Lisburne, which is coming on production soon. Lisburne has been referred to in the press as a marginal field, yet it is quite large and it does underlie Prudhoe Bay and it benefits from use of the Prudhoe Bay production facilities. She asked what the term "field" means, if it means separate reservoir or unitization of the individual leases that is operated as a single entity.

GEORGE NELSON said West Sak, which underlies Kuparuk, is an example of an underlying field, where there are large reserves, but they are spread out, and that it will be a very difficult project. The reserves range from 10 billion to 25 billion barrels, so it is a large project, but it would have small per-well production in the range of 250 to 500 barrels per day.

REP.-ELECT BROWN said it brings up a point that may discourage the state from wanting to go to per-field productivity. Using the example of West Sak, which would cover at least four units, she asked how one would calculate what a field

is. The term is imprecise in its legal meaning. She said the issue was brought up with Conoco when they applied to have their royalty reduced at Milne Point. The question arose because the production from Milne Point unit comes from the Kuparuk reservoir and it is separated by a fault from the Kuparuk reservoir which is part of the Kuparuk unit. Because the royalty reduction statute references the term "field", there was a long running discussion over several years about the legal interpretation. The Dept. of Natural Resources chose to interpret field in that case as a unit and they did not grant a royalty reduction on the basis that there had already been two years production from that field. She said she could foresee that it could bring up difficulties with regard to the definition of what a field was if they go with option five. REP. SUND said it brings up a point for consideration regarding per well or per field. If there is a potential in West Sak for large recovery, but low per well productivity, it is a factor that the committee should think about.

NUMBER 309

GREGG ERICKSON said in their calculations West Sak was treated separately from Sadlerochit and the other fields, and the ELF is zero. It was his understanding that West Sak is now being treated differently than Prudhoe Bay in terms of those calculations. It is also his understanding that every well that is producing from the Prudhoe Bay field has the same ELF applied to it and every well producing from West Sak is at zero because the productivity is very low.

GEORGE NELSON said West Sak is a pilot project and that is why production is low. He concurred with Rep.-Elect Brown that additional language regarding total field productivity is needed to account for the definition.

GREGG ERICKSON noted that the language is what is currently being used in current law. The result of that element in current law is that all wells producing from the Prudhoe Bay fields have the same ELF applied to them, so whatever the arrangements are in terms of definitions of what a field is, they exist in today's law and if they are a problem, they presumably could be a problem in calculating current ELFs and severance tax.

GORDON HARRISON questioned the projected ELF on West Sak under a full production scenario and thought it would still be very low or zero.

GREGG ERICKSON said the presumed ELF is zero through 1995. Production levels are low, but they are positive, about 21,000 barrels per day. He said is clear that if production proceeds from West Sak, it is not going to be gushing out.

GEORGE NELSON said there is reluctance to proceed with West Sak under current law.

NUMBER 392

REP.-ELECT BROWN said if the committee were to pursue the field approach as opposed to per well, it would want to define field as a separate reservoir and perhaps go beyond that and define it as a separate reservoir being operated as a single unit for purposes of production. If they went the other way and tried to make the same one apply to everything within a unit, it would eliminate the positive incentive to develop marginal reservoirs that overlie and underlie a main formation like Prudhoe Bay. She pointed out that there are technical engineering difficulties when you try to precisely define the field because of faulting, reservoirs that start, stop, and continue, and little groups of owners

that could get together and say, "Well, we'll put up the money to develop this little piece of a bigger field.", and that is what exists with the Milne Point unit.

REP. SUND asked if the committee wants to consider option five.

GORDON HARRISON felt it is a viable option and the discussion about the definition of a field is not relevant because the factors in the formula are all known and they are in existing law.

GREGG ERICKSON reiterated that if the definition is a problem under the proposal, it would be a problem under current law and it is his understanding that it has not been a problem to date.

NUMBER 392

REP.-ELECT BROWN said part of the reason it is not a problem yet is because the overlapping and underlapping phenomena are just now being seen. Until now, there has only been one reservoir producing at Prudhoe Bay, so a problem may arise that hasn't come up before.

REP. SUND said an example that was related to him was that a producer could pump Lisburne and Prudhoe Bay out of the same well, coming up in two different pipes, and treeing off at the top, with Lisburne oil going one direction and Prudhoe oil going the other direction, and there would be two different ELF's applied.

GREGG ERICKSON said there would not be two different ELF's if they are both working in the same unit. If they were separate units there would be.

BARBARA HERMAN said the way Dept. of Revenue has approached it to date, there would be two separate units, but because it has not gone into production, the department has not approached that problem.

GEORGE NELSON said there is a 350 million barrel recoverable reserve in Lisburne. It is a marginal field whether it lies under Prudhoe Bay, or over by Endicott, and should not be handled in the same fashion as Sadlerochit. There are many reservoirs in the same area that can be produced out of the same well bore and one of the reasons that Lisburne is economical is because they are utilizing a sharing basis of facilities within Prudhoe Bay so that they don't have to make additional capital investment in equipment to produce that reservoir. The industry is doing all they can to make it economical.

NUMBER 465

GORDON HARRISON said of the options, this is the most attractive, but any change in the ELF that the legislature contemplates should take into consideration the warnings of Mr. Nelson.

DEBORAH VOGT said if a problem exists currently with the interpretation of field, it could be dealt with in departmental regulations.

REP. MARTIN said the Dept. of Revenue last year felt it necessary to come to the legislature, and they have done so in the past to deal with changes in the formulas. He was unsure if it was more prudent to go through regulations which the legislature has no control over. He felt it would better to address some of the terminology through the legislature.

REP. SUND said some of the criteria that has come up in considering the options are if it raises revenue to the state, if it impacts exploration, if it employs people, if it encourages development of small fields, how it impacts development of large fields, and if it causes premature shut-down. There are means and methods of affecting those, such as raising the severance tax, doing something with the 300 barrel presumption, eliminating the exponent, and defining per field or per well. Those are factors which have come up and he felt it was the responsibility of the committee to present to the legislature the policy calls and the means and methods of getting there. Some of the options were so devastating on those policies, that they have unilaterally discarded them, others they may want to hang on to. He inquired of the committee if option five is one of those.

NUMBER 539

GEORGE NELSON said he could not agree that option five is one of the best alternatives because it doesn't take into account the larger fields and he would like to see it discarded.

GREGG ERICKSON brought up a technical point. This option has been referred to as the field productivity instead of the individual well productivity option. In the description it says field productivity rather than individual well productivity. It should be in addition to individual well productivity, both factors are considered in this option.

REP. MARTIN said his major concern is this option has the most direct impact in loss of jobs.

REP. SUND said that the committee is just putting together a report that puts sideboards on the issues, it is not making specific recommendations, but pointing out policy options and effects.

REP.-ELECT BROWN commented on Rep. Martin's concern about loss of jobs and that she felt that it was not necessarily the case that adoption of option five would reduce overall drilling. One of the points in pursuing it would be to get more drilling and more development of smaller areas. She said she would like to see an analysis of what affect it would have on a large field.

NUMBER 607

DEBORAH VOGT discussed option six, which is a combination of option one and five. It would establish an alternative ELF with field-based applicability and establish a severance tax floor to which the alternative ELF would not apply.

REP. SUND asked if there was any way to write the cents-per-barrel floor so that it doesn't apply to every field.

GORDON HARRISON said that there may be a way to deal with it. The objective is to eliminate the price sensitivity of the current ELF factor and he would approach it by not eliminating the rebuttable presumption for fields with a low ELF. For example, fields with an ELF of .5 or .4 could apply for a revision of the PEL. It would have the effect of leaving Cook Inlet fields alone as well as the smaller marginal fields, but it would prevent in the near future Prudhoe Bay or Kuparuk from getting access to the current statutory provisions for revision of the PEL.

REP.-ELECT BROWN suggested eliminating option six because of the devastating effect of a floor on Cook Inlet and marginal fields.

END OF TAPE 8

TAPE 9, SIDE 1

REP. SUND discarded option six with unanimous approval of the committee.

NUMBER 3

DEBORAH VOGT discussed option seven which postpones the scheduled application of the existing ELF to Prudhoe Bay. With current law, if the ELF is greater than .7 for a field in the first ten years of production, then ELF is 1, which is the provision that prevents the ELF from being currently applicable to Prudhoe Bay and expires next July. Option seven changes the ten years to fifteen years. The proposal presumes that a PEL adjustment is not made because if it is, there could be an applicable ELF even with a fifteen year postponement. In discussions with the Dept. of Revenue, their current projections don't show that a PEL hearing would benefit Prudhoe Bay. If there was a price disaster, the proposal would not accomplish what it says it does because a PEL hearing would be held.

GEORGE NELSON said this whittles away at the goose that lays the golden egg. The whole industry is not doing that well. Any option other than retaining the current statute, which is what he recommends, will take money away from the industry for capital projects and exploration. Option seven is estimated to cost Standard alone in 1988 tax payments, based on OMB projections, about \$50 million. He said he was the most optimistic in the industry about being able to sustain rate out of Prudhoe Bay, but he didn't believe anyone would say that they will still be producing 1.5 million barrels per day in 1992, unless they were to do extreme infield drilling as the Chinese did in Manchuria, where they drill about 700 wells a year infield just to sustain their million barrel per day rate, and it is unlikely they will do that because it is not proper reservoir management. He pointed out that with an additional five year period where they won't get any relief from the ELF, they will definitely be on the decline and it will have an effect. The effect in 1988 will not be as great as it will be by 1992. He felt the price of oil over the next two years will remain around \$15, so it's not a robust picture, and it is somewhat punitive to single out Prudhoe Bay, although he understands the reason. He suggested that if option seven is to be considered, the period should be reduced from fifteen years to twelve years because it would be easier to extend it in the future rather than reduce it from fifteen.

NUMBER 73

DAVE RASLEY said option seven should be discarded because it does not go far enough. It should cover Kuparuk also. He suggested it could also be changed to include Kuparuk.

GEORGE NELSON said option seven would pose a severe penalty for Kuparuk if left at five years.

REP. SUND pointed out the impact of eliminating the ELF. Referring to Table 8 of Dr. Logsdon's paper, Prudhoe Bay starts at about \$100 million in FY88 and goes to \$134 million in 1992, so under this proposal it is about \$600 million,

and on Kuparuk it runs from \$38 million to about \$60 million per year. He asked Dr. Logsdon to address this.

CHARLES LOGSDON said he thought the question was not about eliminating the ELF, but the timeframe in which the applicable test of whether the ELF was greater than .7 was used. The ELF for Kuparuk has been below .7 for quite a while. The Kuparuk field has been paying a tax based on something less than the currently applicable 12.25%. With their projections, option seven would have no effect on Kuparuk unless the wells became much more productive.

NUMBER 125

REP. SUND said the issue brought up by Mr. Rasley to include Kuparuk in option seven would entail dealing with the .7 factor, and that would also affect other fields. To accomplish this, it would require additional drafting.

REP.-ELECT BROWN said the committee should leave option seven on the table. She agreed with many of Mr. Nelson's points about the difficulties any kind of tax increase presents. She felt the committee needs to question how this proposal fits into the overall revenue needs and spending plan. Of the various proposals, this is one of the least onerous. It has the advantage of being simple to explain and understand. She proposed keeping this option and discussing the drawbacks of any type of change or tax increase in the context of the overall need for revenue, which obviously has other associated factors and can't be looked at in a vacuum.

NUMBER 147

REP. SUND said it has been agreed to leave option five and seven in. Option eight is to do nothing and it is a viable discussion that should be included in the report. Discussion of option one brought up the question of if there is a way to establish a floor that doesn't apply to all fields and Mr. Harrison said there was a way to do it.

GORDON HARRISON said that if the PEL could be revised so that the ELF essentially went to zero at Prudhoe Bay and the ELF applied to the cents-per-barrel floor, there would be no severance tax on Prudhoe Bay via the price sensitivity problem. If option five were adopted, there would be an ELF that was defined in part on the basis of field productivity, so there would be classes of fields. If the ELF were low, that would mean you would have a field with fairly low productivity in which case you would want them to have access to the ability to revise the PEL and escape a floor. But, if there is concern with the potential problem of a large field with high production, and you didn't want to eliminate the floor, you could cut off access to revision of the 300 barrels, so the ELF threshold could be set at .4 or .5.

REP. SUND said what they would effectively be doing with a policy statement is saying they want to cause a shut-in of the field at an earlier date by putting a severance floor in. If the severance tax went to zero, they would produce a field down to that point, and then if it became uneconomic for other reasons, they would shut it in. This raises the shut-in threshold a little higher. He asked if it would be in the state's interest to cause shut-in for a highly productive field.

REP. SUND asked if the committee wanted to look at the additional option of making a floor applicable to selected fields.

REP.-ELECT BROWN said the main point in favor of doing that is for protection against keeping the bottom from falling out of revenues should prices fall very low. She didn't see it as a policy reason to encourage premature shut-down of Prudhoe Bay, but rather to provide a safety net in the event the price collapses.

NUMBER 226

GORDON HARRISON concurred with Mr. Nelson in that it could have the result of premature shut-in, depending on internal calculations of the company. If they chose to continue at a loss to minimize their overall losses, it would have the effect of raising more money, but if they were to shut-in when their marginal revenue was less than their marginal costs, then it would cause the shut-in.

REP.-ELECT BROWN said the committee should keep in mind the timing of how that would occur. It's not going to be a repetitious start up, shut down, as was seen with Milne Point. Even though Milne Point was clearly on the edge before the price drop, they continued because the break point was farther down the road. She was unsure if it would have the effect of causing an immediate shut-down.

REP. SUND asked for a general consensus from the committee of what should and should not go into the report. He suggested that the committee finish the discussion on the ELF then take a short break and work through the lunch hour to finish up the discussion.

REP.-ELECT BROWN said the committee should include in the report the option of putting in a floor that affected large fields only as a protection against price collapse and the bottom falling out of revenue.

GORDON HARRISON agreed for the reason that it would allow for more analysis and further discussion.

DAVE RASLEY also agreed for the reason that it needs additional input on how to separate out marginal fields. It gets back to an earlier point that state resources can flee the state without some compensation.

NUMBER 278

REP. SUND summarized the options to consider for the report. The last option discussed would be a variation of option one. In option two, Mr. Harrison wanted further study only of the middle element of the impact of setting the 300 barrel limit. Option five was field productivity in addition to individual well productivity. Option seven was a continuation of current law for a certain number of years to be discussed. Option eight was to do nothing. He asked for consensus of the committee that these were the options they agreed on. He recessed the committee for a break at 11:15 a.m.

REP. SUND called the meeting back to order at 11:30 a.m. He discussed how the report should appear and said notes on policy issues will be put together as well as some of the means of accomplishing the policies, but will exclude draft legislation. A draft report will be circulated among committee members before any final action is taken.

BART GARBER asked if the draft report will also be circulated among the senate members of the committee who are not present.

REP. SUND confirmed that it would and there would be another committee meeting for discussion of the draft before it is finalized.

BART GARBER said the committee should make certain that the report notes the negative items so it reflects the total field of options they considered.

GORDON HARRISON said there had been previous discussion about the possibility of consultant studies from outsiders and asked if that was still a possibility in regard to committee funds.

NUMBER 350

REP. GRUSSENDORF said the likelihood of consultant studies would probably not be available. In looking at the options, the legislative body or the administration may contract out. He felt interested parties would come forward with their experts and the state would have to do the same.

NUMBER 364

REP. MARTIN said the report should include other aspects besides the ELF. One of his concerns was what could be done that would be least disruptive to the current economy. He also brought up the concept of putting a cap on permanent fund dividends in consideration of the original intent of the permanent fund which was for the future operation of the state. The Dept. of Revenue indicated that the state may give out \$362 million because of the decrease and inflation costs. If there were a \$300 cap per person, there would be only about \$160 million going out next year, saving the state about \$200 million which could be used for state operations. Over the years, everyone has shared in the wealth in the state and in this way, they are sharing the loss of revenues to the state. It could be less disruptive and more acceptable by the people of the state.

REP. SUND asked to hold off on that issue and continue with the remainder of the oil and gas issues first, such as corporate tax, separate accounting and property tax. One element that came up was raising the corporate income tax rate. It is now 9.4% and it raises about \$120 million. He noted Mr. Nelson's comment that if it were raised to 12%, Alaska would have the highest corporate income tax in the nation. He asked what the pleasure of the committee would be regarding the separate accounting issue.

REP. MARTIN said separate accounting is too volatile to constructively make a decision on.

REP. SUND asked Rep. Martin if he thought the committee should include in their comments on separate accounting the fact that there is a threshold issue. He asked Mr. Erickson if there was a threshold number.

NUMBER 438

GREGG ERICKSON said there are many thresholds regarding separate accounting. One is what happens outside the state with the enterprises that oil companies active in this state own elsewhere. If their mining operations lose money, it doesn't matter what the price of oil is, the companies doing business here will show worldwide or nationwide losses. It doesn't matter what our apportionment factor is, a high percentage of zero is still zero. It would be a mistake to look at the threshold as simply being a function of oil prices. His analysis concludes that, under the current circumstances and those foreseeable within the next five years, there is no question that separate accounting will raise more money for the state than modified apportionment. Nor is there any doubt that

the oil industry strongly opposes it for that reason. The technical issue of whether it will raise more money or not is resolved for the near future.

MARTIN RICHARD clarified that when the current apportionment accounting is used, the oil and gas operations are considered separately from other operations. If there is a loss going on in a mining company, it may not directly affect the oil and gas profits. There are two income pies as opposed to one.

REP. MARTIN referred to the Dept. of Revenue's July report showing the state would have lost about \$60 million this year had they been using separate accounting and related it to the drop in oil prices. He asked Mr. Erickson where his optimism lies regarding his conclusion that separate accounting is better than modified apportionment and if there was a level of oil prices to consider.

GREGG ERICKSON said he is neither optimistic nor pessimistic, but that he was stating a fact as he understood it. A change to some form of separate accounting would clearly raise more money for the state. The analysis that showed a loss of income under separate accounting assumed that the modified apportionment tax would bring in over \$200 million. When prices go down, modified apportionment has in the recent past shown that it declines as well. The reason he felt confident that separate accounting would bring in more money is that if all corporate income taxes on oil industry operations were eliminated except the pipeline, the state would be collecting about \$191 million in income tax instead of \$110 million. The pipeline alone earns more profit than we are taxing under modified apportionment.

REP. MARTIN asked if the state can treat corporations differently within the same state, such as one at 9% and one at 12%.

NUMBER 523

DEBORAH VOGT said the equal protection standard for taxation is a fairly minimal standard. If some rational basis can be found for distinguishing amongst types of taxpayers, then the courts will uphold that distinction. A caveat is that interstate commerce cannot be treated differently from instate commerce. There are cases, for example, in treating shore-based processors differently than floating processors. There could be an equal protection attack if one industry is treated differently than another, but courts have generally been fairly deferential to the legislatures' determination of what is appropriate in that area.

GEORGE NELSON said he takes exception to the statement that the state should turn to separate accounting to gain revenue from pipeline tax. The pipeline cost almost \$9 billion and the investment was made with an expected rate of return. To go to separate accounting in order to increase taxes solely from the pipeline does not seem to be a valid reason. It is short-sighted and the committee should look at the long term picture with regard to future investment within the state.

GREGG ERICKSON said his statement was not recommending what the state should do, but merely an observation of the fact that if the state were to levy a separate accounting tax on the pipeline alone, the revenue gained from that tax would be greater than the revenue currently being collected under modified apportionment. He would make no judgment on whether it would be an appropriate policy or not.

GEORGE NELSON asked for clarification if Mr. Erickson's statement was just an answer to which method would provide more revenue. That being the case, he stood corrected.

NUMBER 590

REP.-ELECT BROWN said in deciding whether or not to put an option to make a change to separate account in the report, the committee should question what the purpose is behind the report. She asked if it is to identify for the legislature various ways to attain more revenue it would be appropriate to include this option with a summary of the revenue effects along with other possible revenue sources such as Rep. Martin's suggestion regarding the permanent fund dividends.

REP. SUND said there is the option doing nothing and leaving modified apportionment alone. If there was a discussion in the report to go to separate accounting, it would be further divided by Mr. Erickson's analysis of separate accounting on the entire oil industry or separate accounting on a portion of it such as the pipeline, if it could even be done.

GORDON HARRISON said in the previous day's discussion an intriguing alternative came up regarding the options of modified apportionment and separate accounting, which was further examination of apportioned factors that are used in the modified apportionment now. He referred to Ms. Vogt's discussion of the problem of including production reserves as a factor in the formula and was curious to know if it could be a productive avenue for study by tax experts.

NUMBER 672

DAVE RASLEY said all the options should be made plain in the report. The legislature will make the decision about which one will be enacted.

TAPE 9, SIDE 2

NUMBER 005

REP.-ELECT BROWN concurred with Mr. Rasley. With regard to whether the committee should also look further at the value of reserves and including that in modifying the formula, she said it will probably not be productive because of the difficulty of determining value not only in Alaska, but worldwide.

REP. GRUSSENDORF said there were excellent points made about why separate accounting should be included. The committee should look at how the state got into the modified approach in the first place. It was not to stimulate industry, but rather because the state was faced with a legal suit in relation to separate accounting. So it is not a matter of changing the rules of the game, the state had a game plan and an umpire was called in, and the state made a call without really looking at what was happening. He felt the committee's function is to present the alternatives.

REP. MARTIN agreed that a full discussion of the alternatives will be helpful to the legislature, no matter how controversial. The committee should evaluate the downside of the issues. People look at Alaska as an investment state and consideration should be given to whether it will discourage investors if taxes are increased.

NUMBER 44

REP. SUND said a point many people discuss is whether tax policy should encourage or attract industry. Some states have used that as an element and some have not. Alaska is unique in that the gas, coal and minerals aren't really options to find elsewhere. It is not like looking at where to locate an automobile plant where there is a choice. The consensus is to include separate accounting in the report. He asked if a legal opinion was needed to determine if separate accounting could only be applied to the pipeline.

DAVE RASLEY said the state should not single out an industry with regard to separate accounting, but that it should be applied across the board to all industries.

REP. SUND said that perhaps the analysis of separate accounting should point out the argument about the pipeline.

GREGG ERICKSON said the Dept. of Revenue has a study underway that is looking at these issues and will presumably provide more definitive answers to some of the questions that have come up.

DEBORAH VOGT referred to Mr. Rasley's comment about not singling out industries and said that was not a consideration between 1978 and 1981 when separate accounting only applied to the oil industry, although it was a major element in the litigation. The state's arguments were that the apportionment formula wasn't shown to be defective for other industries and it was shown to be defective for oil and gas. Separate accounting is much more difficult to administer because of the difficulty of establishing such things as transfer values and cost allocations.

NUMBER 81

GEORGE NELSON reiterated that the oil industry would take exception to being singled out. Separate accounting is not viewed as being consistent with encouraging exploration and development within Alaska.

REP.-ELECT BROWN asked if a decision had been made to include an option for increasing the corporate income tax rate and would an increase apply to other industries.

REP. SUND said the option would be included in the report and a rate increase would be applicable across the board.

REP.-ELECT BROWN said to clarify that there would be one option of raising the rate and applying it to all industries and another option would be to leave it alone, or raise it in conjunction with going to separate accounting on oil and gas only.

DEBORAH VOGT said the only time since 1957 the state has had a rate higher than 9.4% was in 1981. The current structure is graduated in the sense that the first \$90,000 of income are treated differently from income above that point. Another option is to look at graduating scales so that more marginally economic activities are taxed at a lower rate, which was done in 1981.

REP. SUND asked if the committee wanted to address the issue of oil and gas property tax.

NUMBER 117

MARTIN RICHARD pointed out that of the total amount of property tax currently collected, the state only receives 29%, the rest goes to local municipalities.

GREGG ERICKSON said it would be likely that 100% of an increase in the property tax would accrue to the state. At the current time, none of the communities' mill levies is equal to twenty mills which is the current rate. So, a one mill tax increase would raise \$18 million according to OMB calculations, but there is a slight offset because part of it results in increased pipeline tariffs which would result in net revenues of about \$16 million annually.

GEORGE NELSON said the discussion throughout the meeting has revolved around increasing various taxes to the oil industry. He asked how the industry could be expected to have any encouragement for future expenditure of money in the state. He said the state needs to be careful about what message it is giving to the oil industry.

REP. MARTIN said it was clear to him over the summer that the population is opposed to increased taxation on the oil industry because they recognize the disparity. Regarding property taxes, there is a need for evaluation of which local communities are getting the most out of that. There was discussion in the past about how much the North Slope Borough and Valdez gets and how much of a drain it is to state revenue as a whole. An evaluation should be made of the fairness to the various local government recipients compared to the state rather than an evaluation of an increase of property tax.

NUMBER 170

REP.-ELECT BROWN made the point that in terms of the message given to the oil industry, her hope was that they would take into consideration the fact that the state has had a period of stability. The last change was made in 1981 and that was favorable to the industry. The primary driving force of a review at this time is circumstances beyond everyone's control. She would like to see long term stability come out of such a discussion and review. Although it may be true that the rules of the game are changed, an individual who says, "I made a mortgage commitment, I did all these other things on the assumption that I would never have a personal income tax" is in a similar situation. She was not in favor of taxation unless there is a specific purpose for it which is why it is important to look at the spending side as well as the revenue raising side. She said former Rep. Freeman was quoted yesterday as saying they were presenting a "shock" budget to Governor Cowper so that the public would begin to get the message that there is going to be drastically reduced services under the present situation unless people are willing to have more taxes. While it is true that people are generally not in favor of taxation, when the severe effect of the revenue decline begins to filter through the economy, there may be a change in their attitude. In the discussion of increasing taxes, the committee should not single out the oil industry. She would favor an option of raising corporate tax for all industries and coupling that with some personal contribution, whether it be an elimination of the dividends which would have the same effect as a tax, although it would be regressive in that the dividends tend to benefit lower income groups. People will have to collectively decide whether they are willing to have a change in order to support services and she felt that should be the primary criteria in approaching these questions.

GEORGE NELSON said to remember that the industry suffers like the state when there are recessions and both are in the game together.

GORDON HARRISON said he would be content to leave the property tax out of the list of options. There haven't been any issues about it that the committee has discussed other than the allocation problem.

REP. SUND noted unanimous agreement that property taxes will be left out of the report.

NUMBER 229

REP. MARTIN said he was optimistic with the governor's approach in encouraging development and diversifying the economy within the state. He expressed concern with continuation of the cash giveaway programs such as longevity bonuses, student loans, and dividends. He asked if the state could do better with that cash flow in shoring up the basic needs of government services, education, university, and similar things rather than any new taxation.

BART GARBER referred to an important point made by Sen. Abood at a previous meeting which questioned what the total scope of the committee should be. There may be a point in which this committee would infringe upon another committee's work. It is difficult to look at taxes in isolation, but he was unsure if the committee should make recommendations in terms of taxes versus other kinds of uses of revenue.

GORDON HARRISON concurred that the question of scope is pertinent. His understanding of the assignment of the committee was to discuss taxation and taxation policies to be one element of the broader discussion, when it came, of all fiscal issues of the state. He agreed with Rep. Martin's comments, but felt the scope of the committee is narrower.

NUMBER 270

REP. SUND agreed and said the committee's job is to bring some expertise in and show the impacts of various options discussed such as individual income tax and sales tax.

REP. MARTIN said an overlying question is if any new taxation of any nature is necessary for the next two years. If the state forgets all the other cash flows and existing giveaway programs and says it has to tax to raise more revenue, it is only answering half the problem.

REP. SUND directed focus of the committee on individual income tax. He said the report they really want to look at by the Dept. of Revenue will be out by the end of the month and maybe many of the comments and analysis should wait until then, or it could be incorporated by him and his staff into the report. He asked what issues the committee would be concerned with regarding whether individual income tax should be imposed or not.

REP. MARTIN said his major concern was that it does reduce individual's personal take home pay, therefore it will have a dramatic impact on their commitments, especially state and university employees and teachers, because they look at it as another way of significantly reducing their salary levels.

REP.-ELECT BROWN said she thought people would view losing the dividends as a similar direct loss to their personal income. An option she would like considered would be a scenario where the tax were brought back and the dividends were kept. For the average earning person, the dividend is a credit against the tax and would be a wash, the wealthy person would pay the tax, and the person at

the lower end of the scale would get a positive check in the form of the dividend. This could possibly be done on one form and fairly simply. It would keep the positive benefits of the permanent fund dividends as well as incorporating the progressive features of an income tax.

NUMBER 329

DAVE RASLEY said he didn't think that the people of Alaska minded paying for services they want. It may be very hard politically for the legislature to pass at this time. There probably will be a personal income tax again and he supports that, but from a political point of view, if the state needs revenue within the next two years, it is not a viable way to raise taxes.

REP. SUND said it seemed many of the policy issues are similar to those raised in looking at the impact of raising the ELF, such as if it discourages development and exploration and takes money out of the state. He asked Mr. Wright how much income could be raised. VINCE WRIGHT said in discussing the economic impacts the department may have to contract outside because they do not have the inhouse models necessary to do that additional analysis. Also, staff is being reduced so they are short of labor. It would involve a lot of analysis and the university may have that capability as well as private consultants. The department has the capability, but they would require additional people.

NUMBER 373

GREGG ERICKSON said on a nationwide average, state income taxes raise about 2.5% of the personal income collected in the state. He was unsure what personal income would be for Alaska, but knowing what it was and projecting ahead, OMB estimates an average tax applied to Alaska would raise \$235 million in FY88. If Alaska were to establish a high personal income tax, such as 4% of personal income, and there are a few states such as Delaware, New York and Oregon that have historically had high tax rates, it would collect an estimated \$380 million.

REP. SUND said the next question would be what the impact of doing that would be on society.

GORDON HARRISON said it is a very difficult analysis to do. There is a model at the university that might shed some light on that. He expressed hope that the upcoming Dept. of Revenue report will describe in theoretical terms the economic impact issues. For example, if you take \$100 away from an individual's personal income, and the state spends all of that, probably the state will spend the full \$100 whereas if it were left in an individual's account, some of it might go into savings or to pay taxes. It may be the best analysis that one can do and individuals can arrive at their own conclusions about the economic effects. In general, there could be a comparison of economic effects of personal income tax with money that comes in from outside the economic system such as oil taxes or permanent fund dividends. But, the committee may have to satisfy itself with those kinds of general theoretical analyses rather than quantitative analyses.

GEORGE NELSON said the committee should include the available estimates from the Dept. of Revenue and the effect on the economy should be looked at. He did not understand why the department could forecast economic impact on the oil industry if taxes were increased but they could not do the same regarding individual income tax.

REP. MARTIN said when discussing individual income tax, the committee is getting into the most historical mission of the governing body, which is the redistribution of the wealth of the working class. It would be ironic to give more money out to those who are not working and punishing those who are working. It would give incentive to people to stay out of the work force. It would cost working persons \$1,700 just to equal what the state gave away in dividend checks. ISER came out with a report two years ago showing that income tax would be a better distribution of individuals' income, because obviously we don't know how to use it, but if the tax department got it and redistributed it, somehow more money stays in the state and is beneficial, but he did not conceive that. At the same time, they said that dividend checks are also better because it distributes more money throughout the population. His pointed out that what should be considered is the matter of who you are taking it from and who owns it.

NUMBER 477

REP.-ELECT BROWN said when considering the source of the permanent fund dividends, the dividend mechanism is the only way to directly benefit citizens from this collective, publicly owned wealth. She did not view that as earned by anyone.

REP. MARTIN said the original intent of the permanent fund was to use the interest for the operation of state government.

REP. GRUSSENDORF said for the purposes of the preliminary report the committee could simply state that personal income tax is an option and mention the discussion in relation to the flat rate, the rate tied in with the federal income tax return, and a separate form by the state.

REP. MARTIN asked if a conclusion could be included that the income tax option may not be logical at this time.

REP. SUND said they could write up the facts and impacts and work from the upcoming Dept. of Revenue report and lay out the options without drawing conclusions. To draw conclusions, the committee should take a vote after the draft report is distributed at the next meeting. He requested that the committee move on in its discussion to sales tax and asked if there was a range of revenue estimates.

VINCE WRIGHT said it was between \$40 million to \$75 million, depending on what is exempted.

NUMBER 547

GREGG ERICKSON said it was an accurate estimate at the time it was made, but it was based on sales, and everyone familiar with the economy knows that the volume of sales in Alaska next year is probably not going to be as great as it was last year, so the estimates may need downward revision.

GORDON HARRISON said something that was not discussed regarding the sales tax was the fact that it is a tax that local governments rely on. He was unsure if there were statutes that would prevent the state from doing it, but there is the political assumption that the property and sales tax are taxing resources of local governments. The state, if it were to venture into a sales tax, would

have to deal with that problem of pre-empting a revenue source from local governments.

REP. SUND said that is an issue he sees in Ketchikan where they just went to a 5% sales tax, with funds from the 1% increase dedicated to the police department. If a statewide income tax were added to that which drove it to 6% or 7%, he was unsure what impact it would have on purchases and the economy. There is also the threshold level where they exempt anything over \$1,000 from the sales tax. It is important to point out that various municipalities have different rules.

NUMBER 596

REP. GRUSSENDORF said that the committee may want to do something similar to the individual income tax and make no specific recommendations, but present it as an option and list some of the concerns in relation to the political subdivisions and the federal tax implication that it is not deductible as well as revenue which would be generated. REP. MARTIN asked if the Dept. of Revenue could work with the Dept. of Labor to get the latest statistics of population of the work force to pinpoint where the bulk of the income tax would come from in terms of area of the state and political representation. It is important from a political point of view. Alaska is the only state that has a simple majority of twenty-one in the house and eleven in the senate, every other state has at least two-thirds of each body. Because of malapportionment, the majority of legislators do not represent the majority of the people, nor would they represent the majority of the taxpayers.

REP. GRUSSENDORF said Rep. Martin's arguments are well taken, but at the same time, looking at the separation of powers in Alaska, the governor has veto power and everyone has an option, if they are a voter in the state, to make a decision on that.

NUMBER 654

BART GARBER said there were a couple of previous information requests related to this. One was about dedicated taxes, and the other was a request he made which was similar to Rep. Martin's concern about distribution of the labor force and income.

GORDON HARRISON said they were diligently working on that when their staff person, Tom Chester, took another job in Washington, D.C. So, there has been a delay, but they are still working on it. They are trying to get an income distribution model of the state to be able to say what the liability would be for various income levels under various tax proposals.

END OF TAPE 9

TAPE 10, SIDE 1

VINCE WRIGHT said that if the committee asks what happens to the population if \$100 million is left with the oil companies versus taking it away through taxation, the department is not prepared at this point to answer those types of questions.

REP. SUND asked if any work was being done on the fisheries tax that the committee needs to be aware of or should be included in the report.

NUMBER 15

VINCE WRIGHT said they are doing work in terms of rates. Fisheries taxes were streamlined a few years ago and lately overhauled. It doesn't result in a great increase in revenue, it is virtually insignificant, but they are discussing what the impact would be in terms of revenue as well as elasticity factor, efficiency, and so forth.

REP. MARTIN said a good evaluation on the fish tax is what the state puts into fishing enhancement, protecting the rights of local fishermen. He was unsure what portion of those taxes goes back into the industry, but he felt more than that goes back into it. It does give a positive aspect of what the state can do to keep people employed.

REP. SUND said one way to gain more revenue to the state from fisheries is called economic rent. A large number of fishermen who are limited entry permit holders are non-residents and the only way the state can get more revenue out of them is through an individual income tax. When models are put together, they might show what amount of revenue would come out of that.

NUMBER 60

REP. SUND asked what the committee's pleasure was regarding miscellaneous taxes such as motor fuel, cigarettes, licenses, and liquor taxes. There has been a bill to raise liquor taxes every year since he has been a legislator and there has been a proposal to raise gas taxes from eight to sixteen cents. He proposed that staff can research the issue and provide a summary in the preliminary report and the committee could make a decision on it then.

GORDON HARRISON said a very useful memorandum was one prepared by Dept. of Revenue last December which showed how much could be raised with various taxes and perhaps an update would be useful and put the options in perspective.

REP.-ELECT BROWN said another area to consider is the mining license tax. Several years ago, the Dept. of Natural Resources did an analysis that showed the mining industry was paying very low taxes. The argument there is that there is not much room to capture revenue because those operations are very close to the margin. She was unsure if any work had been done on that recently in respect to new mining developments.

NUMBER 86

REP. SUND asked if there were any other issues to bring before the committee. There being none, he concluded the agenda. He said he would work with John Hartle of his staff to coordinate the report and work with others present at the meeting to get the issues into the report. He indicated that they would try to get the draft report to the committee by the first of the year. He said he would consult with the senate committee members about scheduling the next meeting which would be around the first or second week of session. At the next meeting, they will review the report and discuss what action the committee wants to take during the session. He recommended that, although bills cannot be referred to the committee, it may be appropriate to reconvene and review all tax bills introduced and make general recommendations. He adjourned the meeting at 12:45 p.m.

MEMORANDUM

State of Alaska

APPENDIX A

TO: Vincent Wright, *VW*
Chief of Research

DATE: December 3, 1986

FILE NO.:

THRU:

TELEPHONE NO.:

SUBJECT:

ELF presentation
for the Tax
Committee

FROM: Charles Logsdon, *CL*
Petroleum Economist

Per your request, enclosed is the latest draft of my presentation on the ELF for the joint Tax Committee meeting December 4, 1986. We have essentially updated the analysis prepared for the cancelled October 15, 1986 meeting using the assumptions underlying the December petroleum production revenue forecast. Unfortunately, due to the severe time constraint in preparing this updated analysis, "minor" revisions in the numbers may be necessary. As you will notice, the new input assumptions do not materially change the original analysis.

ANALYSIS OF ELF ALTERNATIVES

State of Alaska
Department of Revenue
December 4, 1986

The Effect of Four Possible Changes in the ELF on State of Alaska Severance Tax Revenues

The purpose of this brief note is to examine the effect of changing the relationship of the Economic Limit Factor (ELF) to State of Alaska Severance taxes. The ELF is a number with a value of between zero and one which is multiplied by the nominal severance tax rate or the cents per barrel tax floor to reduce the severance taxes paid as an oil or gas producing lease approaches its economic breakeven point. This analysis will specifically examine how changes in the application of the ELF and in the ELF itself impact oil revenues and production. The focus will be on the North Slope. Cook Inlet production will be considered separately since the economics of these producing fields are dominated by costs associated with the shutdown and abandonment of older low productivity oil wells located on expensive offshore production facilities.

Specifically the following four possible changes are investigated.

1. Eliminate application of the ELF to the current \$.80 per barrel tax floor.
2. Change the ELF formula to one similar to that proposed in HB545 and modified by OMB in which the exponent is modified to raise the tax rate on fields with total field productivity in excess of roughly 100,000 barrels per day and lower the tax rate on fields with production less than this amount.
3. Establish a new severance tax floor at \$1.50 not subject to the ELF and index it for inflation.
4. Eliminate the ELF entirely.

These hypothetical changes in the severance tax law are analysed using the Department of Revenue Petroleum Revenue Forecasting Simulation Model. All assumptions concerning oil prices, transportation costs, and market deliveries are the same as were used in preparing the Department's December 1986 forecast of petroleum production revenues.

The simulation model is used because it can show the changes in average expected revenues and oil production due to a change in the tax law over a wide range of price and transportation cost assumptions. Further, since it is the model used to make the official State forecast of severance tax revenues it conveniently illustrates how the current forecast would change if the severance tax law were changed.

As a general principle, any of the changes in the severance tax mentioned above will increase the average expected taxes levied on the oil producers in the State. Since higher taxes make producing oil a more costly enterprise it is likely that in some instances this higher cost will make production unprofitable. In a broad sense then, it would be nice to know the tradeoff between the increased tax revenue to the State and the reduced investment in oil production and consequently reduced tax base due to the increased cost of producing oil.

Such an investigation is possible but since so many assumptions have to be made, the results will always be subject to dispute. As a practical matter oil producing companies are not a homogenous group with respect to risk preference or financial capacity. One has only to look at the companies producing on Alaska's North Slope to appreciate this distinction i.e. Amerada Hess as compared to Exxon. It is also important to stress that the companies are the one's who make the decisions affecting production and any financial model such as the one used in this analysis can only make reasonable assumptions about the parameter values the companies themselves would choose (price, discount rate, or capital outlay). Further this analysis can only examine the relative merits of oil production in the State of Alaska, since we do not have accurate data on oil production prospects globally. Finally this analysis is done without examining the issue of budget constraints which obviously all in the oil business are facing given the current depressed price situation.

There too many unknowns for this analysis to delve in depth into the relative regional economic impact of public expenditure vs.

private expenditure in the State of Alaska so the discussion will be limited to the effect of changes in ELF on State petroleum revenues and barrels of oil and not on whether those changes make sense for the Alaskan economy.

Eliminate the application of the ELF to the cents per barrel tax floor

This would essentially guarantee the State a minimum severance tax payment for every barrel of oil produced in the State (currently \$. 80 per barrel). Tables 1 and 2 show the change in average expected revenues and production for each of the North Slope oil fields assumed to be in production between the present and 2005. Fixing the severance tax floor would increase average expected revenues between 1987 and 2005 by \$135.42 million in nominal dollar terms or \$95.98 million discounted at 8%. The disincentive to produce created by the fixed floor results in a decrease in average expected production of over 19 million barrels of oil. One way of looking at it is that the State gains an average of roughly \$7.00 for every barrel of oil production foregone.

Prudhoe Bay production is effected the most by this change in the severance tax. This is primarily because after primary recovery Prudhoe will still have a tremendous amount of oil in the ground which may be recoverable with additional investment. On the other hand Kuparuk and some of the other more marginal fields can be seen to provide the lion's share of the average expected revenue increase. This is because these fields currently have calculated ELF's which are much lower than Prudhoe so that at prices which trigger the cents per barrel tax these fields will experience a relatively larger increase in their tax bill.

Modify the ELF Exponent to Reflect Total Field Production

This proposed change in the ELF is contained in a bill submitted in the Alaska House of Representatives in the Spring of 1986. In

Table 1

Production Impact of Fixed Severance Tax Floor = \$.80/bbl
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.04	0	0	0	-.04
1988	-.77	-1.01	-.08	-.08	-.08	0	0	0	-2.02
1989	-.68	-.12	-.11	-.26	-.10	0	0	0	-1.27
1990	-.60	-.12	-.16	-.29	-.13	0	0	0	-1.30
1991	-.56	-.12	-.11	-.31	-.20	0	0	0	-1.30
1992	-.52	-.09	-.11	-.27	-.20	0	0	0	-1.19
1993	-.48	-.09	-.12	-.26	-.24	0	0	0	-1.19
1994	-.45	2.22	-.21	-.19	-.24	0	0	0	1.13
1995	-.40	1.42	-.22	-.11	-.23	0	0	0	.46
1996	-.50	1.18	-.17	-.04	-.26	0	0	0	.21
1997	-.34	-.73	-.11	-.01	-.31	0	0	2.99	-4.49
1998	-.64	-.72	-.05	.02	-.44	0	0	1.50	-3.33
1999	-.59	-.49	-.03	.05	-.25	0	0	-.03	-1.34
2000	-.42	-.38	0	.05	-.16	0	0	.20	-1.11
2001	-.40	-.31	0	.06	-.06	0	0	-.15	-.86
2002	-.02	-.32	0	.05	-.04	-.02	0	-.03	-.38
2003	-.02	-.25	0	.03	-.03	0	0	-.09	-.36
2004	-.01	-.23	0	.03	-.02	-.03	0	.57	.83
2005	-.01	-.20	0	.01	-.01	-.02	0	-.02	.25
Total	-7.41	-.36	-1.48	-1.52	-3.04	-.07	0	5.58	-19.16

Table 2

Revenue Impact of Fixed Severance Tax Floor - \$.80/bbl
(Millions \$)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	.10	29.66	1.70	0	.50	0	0	0	31.96
1988	9.50	8.92	.11	1.38	.27	0	0	0	20.18
1989	5.16	5.37	0	2.66	.64	0	0	0	13.83
1990	2.74	3.83	-.03	1.51	.30	0	0	0	8.35
1991	3.35	4.37	-.02	1.45	.58	0	0	0	9.73
1992	2.21	4.14	-.03	.84	.38	0	.01	0	7.55
1993	2.71	3.53	-.03	-.01	.66	0	.02	0	6.88
1994	3.12	19.80	.13	-.05	.96	0	.07	0	24.03
1995	2.70	17.43	.10	-.02	1.02	.09	.03	0	21.35
1996	1.75	15.58	.05	.04	.87	.09	.02	0	18.10
1997	1.34	-1.42	.03	.07	.66	-.01	0	0	.67
1998	.30	-2.50	.03	.09	.34	-.02	-.01	0	1.77
1999	-.53	-3.17	.05	.14	.22	-.02	0	0	-3.31
2000	-.13	-3.51	.07	.13	.13	-.03	-.01	0	-3.35
2001	.13	-3.76	.06	.13	.13	-.06	-.01	0	-3.38
2002	.05	-3.95	.05	.10	.07	-.13	-.01	0	-3.82
2003	.01	-4.09	.05	.08	.05	-.10	0	0	-4.00
2004	-.07	-3.97	.04	.05	.04	-.14	.01	0	-4.06
2005	-.08	-3.68	.04	.03	.03	-.16	0	0	-3.82
Total Revenue									
Nominal	34.36	82.58	2.40	8.62	7.85	-.49	.10	0	135.42
10% disc	20.07	57.69	1.63	5.21	3.64	-.06	.05	0	88.24
8% disc	22.15	62.23	1.73	5.71	4.18	-.09	.06	0	95.98

this example the formula specification is the one used in the presentation by Dr. Tom Chester at the Tax Committee's September meeting. The formula used in HB545 raises the tax rate on fields with production in excess of roughly 80,000 barrels per day and lowers the rate for lower production rates. The modification presented by Dr. Chester changes the trigger to roughly 100,000 barrels. The purpose of this change is to increase the effective tax rate over current law for "large oil fields" while at the same time keeping severance taxes from discouraging investment in smaller oil fields. Practically speaking it effectively increases revenues to the State through the impact on the prolific Prudhoe Bay field.

Tables 3 and 4 illustrate the field by field impact on revenue and production of this change in the severance tax law. Average expected revenues through the year 2005 increase \$2270.52 million in nominal dollar terms (\$1073.67 million discounted at 8%). As might be expected because of the upside potential of the higher effective tax rate on large fields, should oil prices grow over time the large reserves of Prudhoe contribute the most to this revenue increase. Average expected production would decrease by 28.41 million barrels under this tax regime. Once again the disincentive to produce additional barrels from the large Prudhoe Bay field accounts for the largest share of estimated production decrease. However because the tax burden is lowered for some fields, West Sak and Seal Island actually show greater average expected production. This ELF alternative increases State revenues by roughly \$80 for every barrel of oil production foregone.

Establish a New Severance Tax Floor at \$1.50 Not Subject to the ELF and Index it for Inflation.

Tables 5 and 6 show the field by field effect of this alternative on average expected production and average expected revenues. Indexing the severance tax floor from a \$1.50 base results in an increase of revenues of \$1797.17 million through 2005 in nominal dollar terms (\$1195.04 discounted at 8 percent). This alternative has a devastating impact on average expected

Table 3

Production Impact of OMB Altered Exponent
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pl. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.01	-.01	0	0	.02
1988	-.71	-.05	0	-.02	-.01	0	0	0	.79
1989	-.63	-.12	0	-.04	-.01	0	0	0	.8
1990	-.57	-.12	-.01	-.04	-.01	0	0	0	.75
1991	-.55	-.11	-.01	-.05	-.02	0	0	0	.74
1992	-.47	-.09	-.01	-.07	-.02	0	.13	0	.79
1993	-.45	.09	-.02	-.07	-.03	0	-.23	0	.71
1994	-.2	.23	-.43	-.06	-1.31	0	-.24	0	3.81
1995	-1.73	.17	-.35	-.06	-1.09	.79	-.3	0	2.57
1996	-2.37	.15	-.28	-.05	-.9	.72	-.31	0	3.04
1997	-3.05	-.33	.05	-.05	-.86	.77	-.29	2.99	.77
1998	-3.19	-.2	.04	-.04	-.68	.7	-.24	1.4	2.21
1999	-2.72	-.21	.05	-.04	-.57	.62	-.32	-.09	3.28
2000	-2.18	-.16	.05	-.03	-.49	.61	-.26	.01	2.45
2001	-2.04	-.13	.06	-.02	-.39	.61	-.2	.05	2.06
2002	-1.62	-.09	.05	-.02	-.28	.77	-.17	-.07	1.43
2003	-1.32	-.07	.03	-.01	-.22	.81	-.09	-.03	.9
2004	-1.06	-.09	.03	-.02	-.2	.73	-.06	.45	.22
2005	-1.17	-.08	.02	-.01	-.15	.48	-.03	-.13	1.07
Total	-27.83	-1.21	-.73	-.7	-7.25	7.6	-2.87	4.58	28.41

Table 4

Revenue Impact of OMB Altered Exponent
(Millions \$)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	5.94	29.29	-.35	0	-3.35	0	0	0	31.53
1988	93.85	38.51	-.7	-2.18	-5.84	0	0	0	123.61
1989	106.32	49.2	-1.92	1.06	-4.8	0	0	0	149.86
1990	114.56	55.31	-2.31	1.08	-5.18	0	0	0	163.46
1991	117.43	40.61	-2.38	1.14	-1.45	0	0	0	155.35
1992	121.4	21.83	-3.43	1.26	-1.61	0	-2.76	0	136.69
1993	124.53	17.32	-4.07	1.71	2.49	0	-3.42	0	138.56
1994	124.27	14.59	-7.22	-3.66	8.69	0	-3.35	0	133.32
1995	122.99	11.42	-7.32	-2.74	6	2.56	-3.53	0	129.38
1996	121.97	5.22	-7.15	-5.63	.76	5.32	-3.83	0	116.66
1997	121.16	2.47	-4.86	-6.91	1.21	15.03	-5.19	0	122.91
1998	123.22	-2.01	-4.39	-6.67	-6.63	17.42	-5.89	-2.87	112.18
1999	123.31	-5.48	-3.66	-5.19	-13.47	20.38	-6.2	-1.7	107.99
2000	123.55	-8.42	-2.85	-3.65	-17.84	27.9	-8.1	-1.26	109.33
2001	118.02	-9.7	-1.81	-2.21	-18.53	31.67	-8.17	-2.3	106.97
2002	112.28	-7.83	-1.49	-1.19	-16.1	41.71	-8.97	-2.37	116.04
2003	106.24	-5.79	-.61	-.45	-12.2	46.2	-10.48	-3.11	119.80
2004	99.26	-4.25	-.2	-.02	-7.99	34.3	-10.51	-4.04	106.55
2005	91.89	-3.1	.17	.06	-5.27	17.56	-9.72	-1.29	90.30
Total Revenue									
Nominal	2072.19	239.19	-56.55	-34.19	-101.11	260.05	-90.12	-18.94	2270.52
10% disc	781.96	166.60	-22.23	-9.90	-28.72	56.40	-22.67	-3.96	917.48
8% disc	927.72	179.68	-26.39	-12.54	-35.58	75.37	-29.26	-5.33	1073.67

Table 5

Production Impact of Indexed Fixed Floor
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.21	0	0	0	-.21
1988	-15.79	-2.93	-.32	-.69	-.44	0	0	0	-20.17
1989	-14.15	-2.4	-.45	-2.18	-.61	0	0	0	-19.79
1990	-12.48	-2.4	-.49	-1.97	-.79	0	0	0	-18.13
1991	-11.77	-2.17	-.44	-1.87	-1.18	0	0	0	-17.43
1992	-10.74	-1.9	-.44	-1.84	-1.18	0	.25	0	-15.85
1993	-9.35	1.68	-.45	-1.86	-1.42	0	.43	0	-10.97
1994	-8.24	.77	-.47	-1.34	-1.44	0	.42	0	-11.84
1995	-7.15	.04	-.51	1.09	-1.43	.06	.46	0	-7.44
1996	-7.23	.1	-.45	.82	-1.45	.03	.49	0	-7.69
1997	-6.87	-1.95	-.29	.63	-1.64	0	.5	2.99	-6.63
1998	-5.93	-1.65	-.27	.47	-1.28	-.01	.52	1.5	-6.65
1999	-5.46	-1.02	-.31	.37	-.79	-.04	.54	.03	-6.68
2000	-4.12	-.93	-.21	.36	-.57	-.04	.43	.2	-4.88
2001	-3.43	-.91	-.18	.35	-.37	-.06	.36	.15	-4.09
2002	-1.93	.79	-.08	.08	-.23	.02	.32	.03	-2.58
2003	-1.84	-.91	-.04	-.02	-.25	.03	.27	.09	-2.67
2004	-2.12	-.94	0	-.02	-.32	.06	.2	.57	-2.57
2005	-1.88	-.67	0	-.01	-.36	.06	.16	.02	-2.68
Total	-130.48	-20.52	-5.4	-7.63	-15.96	.11	5.35	5.58	-168.95

Table 6

Revenue Impact of Fixed Indexed Floor
(Millions \$)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	223.91	80.84	5.87	0	2.27	0	0	0	312.89
1988	180.5	58.65	2.21	8.56	7.33	0	0	0	257.25
1989	109.65	44.29	6.21	32.07	14.94	0	0	0	207.16
1990	77.65	37.84	7.34	32.63	16.36	0	0	0	171.82
1991	76.29	36.51	7.13	34.7	26.88	0	0	0	181.51
1992	55.19	30.8	5.4	33.15	25.8	0	4.68	0	155.02
1993	43.17	24.46	5.27	23.42	29.17	0	5.72	0	131.21
1994	34.04	36.88	4.44	17.49	27.57	0	4.36	0	124.78
1995	24.57	30.63	3.56	13.49	25.57	5.28	3.4	0	106.50
1996	15.6	25.97	2.67	9.99	22.87	5.05	2.43	0	84.58
1997	10.22	6.09	2.04	7.53	20.46	5.51	0	0	51.85
1998	4.43	2.25	1.39	5.39	14.16	3.78	-.71	.07	27.76
1999	-2.09	.32	.8	3.76	10.22	2.46	-1.18	.04	14.33
2000	-1.79	-1.03	.42	2.2	7.62	.98	-.92	.04	7.52
2001	-1.61	-2.26	.02	-.1	5.84	.86	-.87	.02	1.90
2002	-2.19	-3.08	-.05	-.15	4.29	.39	-.98	.01	-1.76
2003	-5.34	-4.78	-.07	.1	2.71	.2	-.95	0	-8.13
2004	-8.9	-5.29	.03	.07	.61	.01	-.76	-.01	-14.24
2005	-8.95	-4.84	.05	.04	-.33	-.12	-.63	0	-14.78
Total Revenue									
Nominal	821.35	394.25	54.73	224.34	264.34	24.4	13.59	.17	1797.17
10% disc	562.83	247.88	30.11	117.70	117.13	7.82	7.57	.05	1091.10
8% disc	604.33	270.22	33.57	132.65	135.90	9.72	8.60	.06	1195.04

production which is reduced by, nearly 170 million barrels. This impact on production is a direct result of the increased likelihood that such a tax would cause a premature shutdown in the already producing oil fields or would make additional investment uneconomic. This alternative has a most dramatic effect on Prudhoe Bay production because it significantly increases the probability that Prudhoe Bay shuts down prematurely. As will be seen, eliminating the ELF entirely results in much greater expected revenue without as severe an effect on production. This is because with the percent of value tax the State shares in the high oil price value cases and also shares the loss in the low oil price case (down to the current \$.80/bbl floor). The fixed indexed floor fails to reflect the relative change in profitability of falling oil prices. The indexed floor increases State revenue by roughly \$10 for every barrel of production foregone.

Eliminate the ELF Entirely

This alternative would remove entirely the severance tax relief given to low productive oil wells.

Tables 7 and 8 show the revenue and production effect on a field by field basis. Total average expected revenues through the year 2005 increase by \$5082.43 million, \$2111.87 million discounted at 8 percent, while average expected production falls by 84.67 million barrels. Prudhoe Bay because it dominates North Slope production over the next ten years accounts for over half of the increased revenue. Kuparuk one of North America's largest fields because its current ELF is roughly .6 accounts for the largest relative increase.

Prudhoe Bay with its large reserves accounts for a 23 million barrels of the production loss, while the West Sak field with its relatively low productive high cost wells accounts for another 21 million barrels of the average expected decline in production. Eliminating the ELF increases State revenue by roughly \$19 for every barrel of oil production foregone.

Table 7

Production Impact of Eliminating the ELF
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.05	0	0	0	-.05
1988	1.1	-1.01	-.08	-.15	-.09	0	0	0	-2.43
1989	-.96	-.18	-.11	-.51	-.12	0	0	0	-1.88
1990	.85	-.18	-.16	-.55	-.15	0	0	0	-1.89
1991	-.8	-.17	-.12	-.58	-.22	0	0	0	-1.89
1992	.72	-.14	-.12	-.6	-.22	0	-.3	0	-2.1
1993	-.67	-.13	-.13	-.62	-.27	0	-.5	0	-2.32
1994	-1.19	-.52	-.67	-.49	-4.76	0	-.5	0	-8.13
1995	-.99	-.87	-.61	-2.49	-3.9	-1.41	-.55	0	-10.82
1996	-3.2	-.73	-.5	-1.98	-3.23	-1.71	-.57	0	-11.92
1997	-2.97	-.8	-.14	-1.56	-.48	-2.13	-.58	-2.99	-11.65
1998	-2.65	-.7	-.08	-.19	-.44	-1.97	-.6	-1.92	-8.55
1999	-1.63	-.47	-.09	-.07	-.2	-1.69	-1.75	-.64	-6.54
2000	-.79	-.39	-.08	-.16	-.09	-1.55	-1.45	-.74	-5.25
2001	-1.01	-.37	-.1	-.21	.06	-1.3	-1.23	-.69	-4.85
2002	-1.75	-.39	-.08	-.1	.19	-2.93	-.34	-.55	-5.95
2003	2.61	-.5	-.06	-.02	.17	-2.63	-.27	-.62	-6.54
2004	2.15	.64	-.03	.01	.05	-2.49	-.2	-1.06	-6.51
2005	-2.04	-.58	-.05	-.08	-.06	-1.15	-.14	-.8	-4.9
Total	28.08	-8.77	-3.21	-10.35	-13.81	-20.96	-8.98	-10.01	-104.17

Table 8
Revenue Impact of Eliminating the ELF
(Millions \$)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	5.76	30.42	2.03	0	.58	0	0	0	38.79
1988	100.45	38.53	1.17	3.19	.57	0	0	0	143.91
1989	114.81	49.32	3.08	13.28	7.21	0	0	0	187.7
1990	125.23	55.31	3.9	14.88	13.53	0	0	0	212.85
1991	129.21	56.02	4.01	15.87	21.39	0	0	0	226.5
1992	134.94	59.97	5.59	17.84	23.66	0	3.2	0	245.2
1993	140.42	59.92	6.48	24.57	33.16	0	4.07	0	268.62
1994	148.74	62.93	3.18	24.04	3.76	0	3.93	0	246.58
1995	148.9	59.93	2.92	9.4	13.16	10.7	4.29	0	249.3
1996	152.12	63.71	2.91	11.01	21.54	14.22	4.86	0	270.37
1997	162.67	60.9	5.07	11.81	46.78	28.35	6.7	0	322.28
1998	167.04	60.34	4.95	22.4	47.85	33.54	7.66	-2.04	341.74
1999	169.48	58.82	4.63	22.23	47.02	39.63	-6.57	3.12	338.36
2000	171.87	57.33	4.11	20.46	46.3	55.66	-2.08	4.45	358.1
2001	167.58	54.07	3.56	15.26	45.39	64.29	2.72	5.41	358.28
2002	163.87	50.23	3.11	11.19	44.26	48.56	14.08	6.66	341.96
2003	159.23	30.89	2.54	10.03	41.89	60.19	13.48	9.99	328.24
2004	154.36	19.41	1.87	7.3	37.3	72.01	13.56	11.64	317.45
2005	147.21	12.71	.32	4.91	33.15	67.92	13.51	6.47	286.2
Total Revenue									
Nominal	2663.89	940.76	65.43	259.67	528.5	495.07	83.41	45.7	5082.43
10% disc.	948.54	383.01	26.18	98.23	157.56	107.91	20.72	8.45	1750.61
8% disc	1137.24	448.57	30.79	116.89	196.10	143.89	26.70	11.68	2111.87

Summary and Analysis

All four of the proposed changes in the severance tax result on average in increased State revenues. Average expected oil production, however, is lower due to the negative impact of potentially higher taxes on expected profitability.

The effect of each of these proposed changes is analysed using the Monte Carlo simulation model. This type of model evaluates many possible combinations of variables effecting oil production revenues including high prices where taxes are not so important in determining development feasibility and low prices where taxes may be an important consideration in deciding whether or not a project is viable. The output of the model is determined not only by the scenarios of the prices and costs and quantities entered as input into the model but also by the probability assigned to each scenario. The model results, in this case State petroleum production revenue by year to the year 2005, are depicted as the probability distribution of possible outcome. Another way of looking at the output is to say many possible outcomes are evaluated and this is what to expect on average will occur. The analysis of these changes in severance tax law is of course only as good as the input into this model. Department of Revenue analysts have weighted the inputs into the model which may or may not correspond to the way in which the different producing oil companies would weight them. Further the feasibility part of the model uses a hurdle rate 8% real and assumes no budget constraints and no competing global investment alternatives. Those caveats aside the results of this analysis are summarized as follows.

1. Fixing the severance tax floor at \$0.80 per barrel has the least impact on expected State revenues and has the least negative impact on expected North Slope production.

2. Eliminating the ELF entirely, generates the largest average expected increase in State revenue.
3. Increasing the fixed floor to \$1.50 and indexing it to account for inflation has the greatest negative effect on average expected production.
4. Because the real upside potential for State revenue continues to depend on the share of the value of Prudhoe Bay production taken by the State, modifying the ELF to reflect total field productivity is the most efficient alternative in terms of dollars gained for every barrel foregone (\$80 per barrel as opposed to \$7 per barrel for the fixed \$.80 per barrel ELF alternative). This is because this tax increases revenues while at the same time mitigating the negative effect on average expected production. The ranking of ELF alternatives using this type of revenue maximizing criteria is as follows.

1) Modified Exponent ELF	\$80/bbl
2) Eliminate ELF	\$49/bbl
3) Indexed Floor	\$10/bbl
4) Fixed \$.80/bbl Floor	\$7/bbl
5. The production disincentives are generally associated with development of the so called marginal fields, and enhanced recovery investment in Prudhoe Bay and Kuparuk although in some very low price cases no doubt potentially higher taxes cause even these already producing fields to be shut-in.

The above analysis says nothing about the impact of any of these hypothetical tax changes on Cook Inlet. Currently Cook Inlet production is roughly 50 thousand barrels per day. Because much of current production is from a large number of wells with average daily production less 300 barrels, the ELF under current law is zero or nearly zero for most oil producing leases. As a result FY 1986 oil severance collections are estimated to be less than \$2 million or roughly \$.12 per barrel. If a minimum tax of \$.80 per barrel were levied, assuming no fields were abandoned,

severance taxes would increase to \$12.78 million. Although there is a considerable difference in terms of well productivity and profitability among the Cook Inlet fields, given the economics of field abandonment it is likely that the bulk of production would continue even with higher taxes burden. On the other hand additional investment in further production would no doubt be much much lower than it would be under the current tax regime. It may be important to note that Cook Inlet oil production is an integral part of the regional economic base on the Kenai Peninsula. Eliminating the ELF would probably shut in Cook Inlet production. The modified exponent ELF would have no negative impact on Cook Inlet because all these fields produce much less than 100,000 bbls/day.

INCOME TAX IN ALASKA AN OVERVIEW

Joint Special Committee on State's Tax Policy

Deborah Vogt
Assistant Attorney
General

- I. Introduction: three components to income tax liability
 - A. What is income?
 - B. How much income was earned in Alaska?
 - C. What is the tax rate?
- II. The tax rate.
 - A. Historical overview, individual and corporate.
 - B. Rate applied to federal tax liability vs. federal taxable income.
- III. What is income?
 - A. Legal parameters.
 - B. Corporate vs. individual
 - C. Federal piggybacking.
 - 1. Advantages
 - 2. Disadvantages
 - a. Federal "tax subsidies"
 - b. Book income vs. federal taxable income
 - 3. What Alaska has done; current law
 - 4. The new federal tax bill.
- IV. How much income was earned in Alaska?
 - A. Description of the two major methods: separate accounting and formula apportionment.
 - 1. Examples and hypotheticals.
 - B. Historical development of formulas - unitary theory.
 - 1. Combination
 - 2. Worldwide vs. water's edge.
 - C. What Alaska has done.
 - 1. UDITPA
 - 2. MTC
 - 3. Separate accounting for oil and gas.
 - D. AS 43.21
 - 1. Why the legislature adopted AS 43.21
 - 2. How it worked
 - 3. The litigation
 - a. The 1981 legislation
 - 1. Repeal of separate accounting
 - 2. Modified apportionment

INCOME TAX RATES IN ALASKA
State and Territory

<u>Year</u>	<u>Individuals</u>	<u>Corporations</u>
1949	10% of Fed. tax	10% of Fed. tax
1955	12½% of Fed. tax	12½% of Fed. tax
1957	14% of Fed. tax	18% of Fed. tax
1961	16% of Fed. tax	18% of Fed. tax
1964	3.2% - 14.56% of income (graduated) (retroactively repealed)	5.4% & 3.96% surtax of income (surtax on income over \$25,000)
1965	16% of Fed. tax	18% of Fed. tax
1975	3% - 14.5% of income (graduated)	5.4% & 4% surtax (surtax on income over \$25,000)
1980 (June)	3% - 14.5% of income (graduated) (1/3 of income exempt for each prior year of filing)	5.4% & 4% surtax (surtax on income over \$50,000)
1980 (Sept.)	repealed	
1981		2% - 11% (graduated to \$4,000,000)
1982		1% - 9.4% (graduated to \$90,000)

HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)

Total Gross Income (Sales): \$16,000
Total Payroll Cost: \$4,000
Total Other Costs: \$8,000

Total Net Income from Three Stores: \$4,000

STATE A	STATE B	STATE C	TOTAL
Payroll: \$1,000	Payroll: \$1,000	Payroll: \$2,000	Payroll: \$4,000
Property: \$10,000	Property: \$10,000	Property: \$20,000	Property: \$40,000
Sales: \$4,000	Sales: \$4,000	Sales: \$8,000	Sales: \$16,000

STATE A TAX LIABILITY

<u>State A Payroll = \$1,000</u>	+	<u>State A Property = \$10,000</u>	+	<u>State A Sales = \$4,000</u>
<u>Total Payroll = \$4,000</u>		<u>Total Property = \$40,000</u>		<u>Total Sales = \$16,000</u>
		3		

$$\frac{1/4 \text{ \& } 1/4 \text{ \& } 1/4}{3} = \frac{3/4}{3} = \frac{1}{4} \times \$4,000 = \$1,000$$

STATE C TAX LIABILITY

<u>State C Payroll = \$2,000</u>	+	<u>State C Property = \$20,000</u>	+	<u>State C Sales = \$8,000</u>
<u>Total Payroll = \$4,000</u>		<u>Total Property = \$40,000</u>		<u>Total Sales = \$16,000</u>
		3		

$$\frac{2/4 \text{ \& } 2/4 \text{ \& } 2/4}{3} = \frac{6/4}{3} = \frac{1}{2} \times \$4,000 = \$2,000$$

SEPARATE ACCOUNTING FOR
HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)
Example 1

	STATE A	STATE B	STATE C	TOTAL
Gross income:	\$4,000	\$4,000	\$8,000	\$16,000
<u>Costs</u>				
Payroll	\$1,000	\$1,000	\$2,000	\$4,000
Other	\$2,000	\$2,000	\$4,000	\$8,000
Net income:	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$2,000</u>	<u>\$4,000</u>

Example 2

	STATE A	STATE B	STATE C	TOTAL
Gross income:	\$4,000	\$4,000	\$8,000	\$16,000
<u>Costs</u>				
Payroll	\$1,000	\$1,000	\$2,000	\$4,000
Other	\$2,500	\$2,500	\$3,000	\$8,000
Net income:	<u>\$ 500</u>	<u>\$ 500</u>	<u>\$3,000</u>	<u>\$4,000</u>

Example 3

	STATE A	STATE B	STATE C	TOTAL
Gross income:	\$4,000	\$4,000	\$8,000	\$16,000
<u>Costs</u>				
Payroll	\$1,000	\$1,000	\$2,000	\$4,000
Other	\$3,000	\$3,000	\$2,000	\$8,000
Net income:	<u>\$ 00</u>	<u>\$ 00</u>	<u>\$4,000</u>	<u>\$4,000</u>

**APPORTIONMENT FOR HYPOTHETICAL
VERTICALLY INTEGRATED TAXPAYER
(Example 1)**

This taxpayer manufactures a product in State A. The product is then transferred to State B for marketing and sale. There are no sales of the product in State A; all of the product is transferred to the marketing operation in State B. The product costs \$4.00 per unit to produce, and an additional \$4.00 of distribution and marketing costs are incurred. The product sells retail for \$10.00 per unit. 1000 units are produced. In this example, the manufacturing operation "sells" the product to the marketing operation at a "transfer value" of \$5.00 per unit. This transfer value is reflected as income to the manufacturing operation, and a cost to the marketing unit.

SEPARATE ACCOUNTING

STATE A		STATE B		TOTAL	
Gross income (transfer value X 1000):	\$5,000	Gross income (retail sales X 1000):	\$10,000	Gross income (retail sales X 1000):	\$10,000
Cost of production:	\$4,000	Cost of goods:	\$ 5,000	Cost of production:	\$ 4,000
		Sales costs:	\$ 4,000	Sales costs:	\$ 4,000
NET INCOME:	<u>\$1,000</u>		<u>\$ 1,000</u>		<u>\$ 2,000</u>

APPORTIONMENT BY THREE FACTOR FORMULA

For simplicity, assume that all of the corporation's property is in State A (the manufacturing plant), all of the sales are in State B, and that one half the payroll is in each state.

	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	1/2 X \$2,000 = \$1,000	1/2 X \$2,000 = \$1,000

**APPORTIONMENT FOR HYPOTHETICAL
VERTICALLY INTEGRATED TAXPAYER
(Example 2)**

In this example, the only change from the previous example is that the taxpayer books the "sale" of the product from the manufacturing operation to the marketing operation at \$4.00 instead of \$5.00.

SEPARATE ACCOUNTING

STATE A	STATE B	TOTAL
Gross income (transfer value X 1000): \$4,000	Gross income (retail sales X 1000): \$10,000	Gross income (retail sales X 1000): \$10,000
Cost of production: \$4,000	Cost of goods: \$ 4,000	Cost of production: \$ 4,000
	Sales costs: \$ 4,000	Sales costs: \$ 4,000
NET INCOME: \$ 00	\$ 2,000	\$ 2,000

APPORTIONMENT BY THREE FACTOR FORMULA

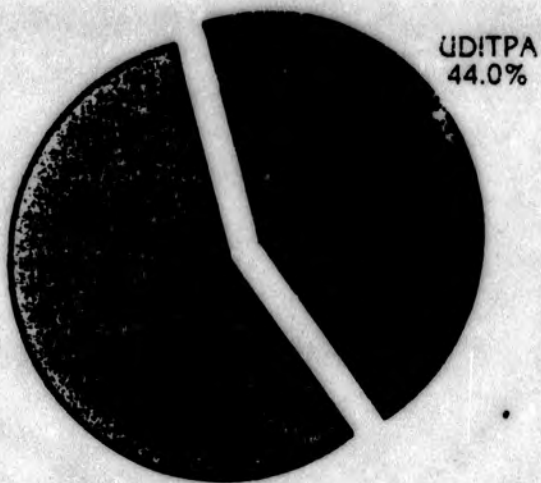
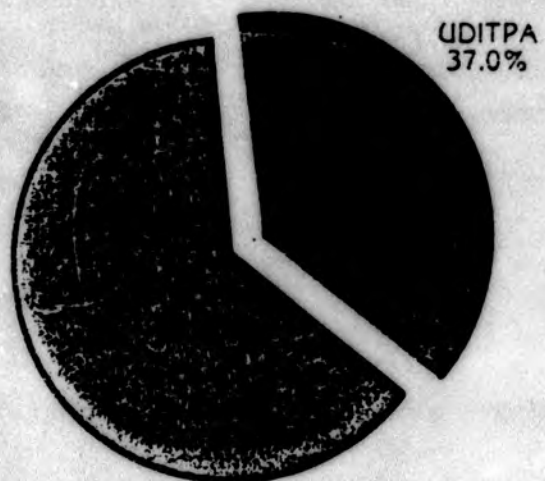
Since the bookkeeping change of the transfer value did not change the formula factors, the formula calculation remains unchanged:

	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	$1/2 \times \$2,000 = \$1,000$	$1/2 \times \$2,000 = \$1,000$

UDITPA Tax Base As A Percentage of Prudhoe Bay Net Income

From Exxon Estimates (1976—1990)

L.H. Doc. 7-036, File 26 at 13(R. 4348)
L.H. Doc. 7-037, File 26 at 18, 21(R. 4367, 4370)
See R. 16955

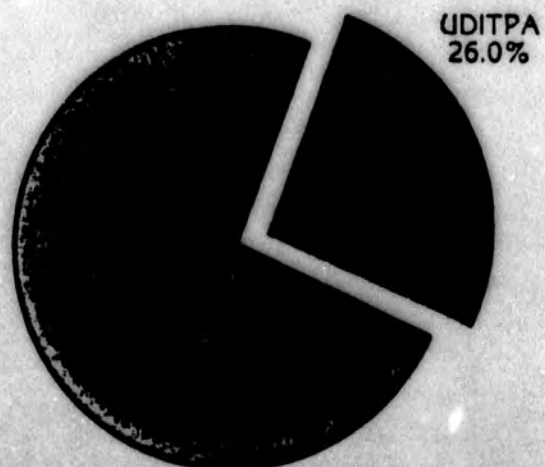


As Estimated By Arthur Anderson (Life of Field)

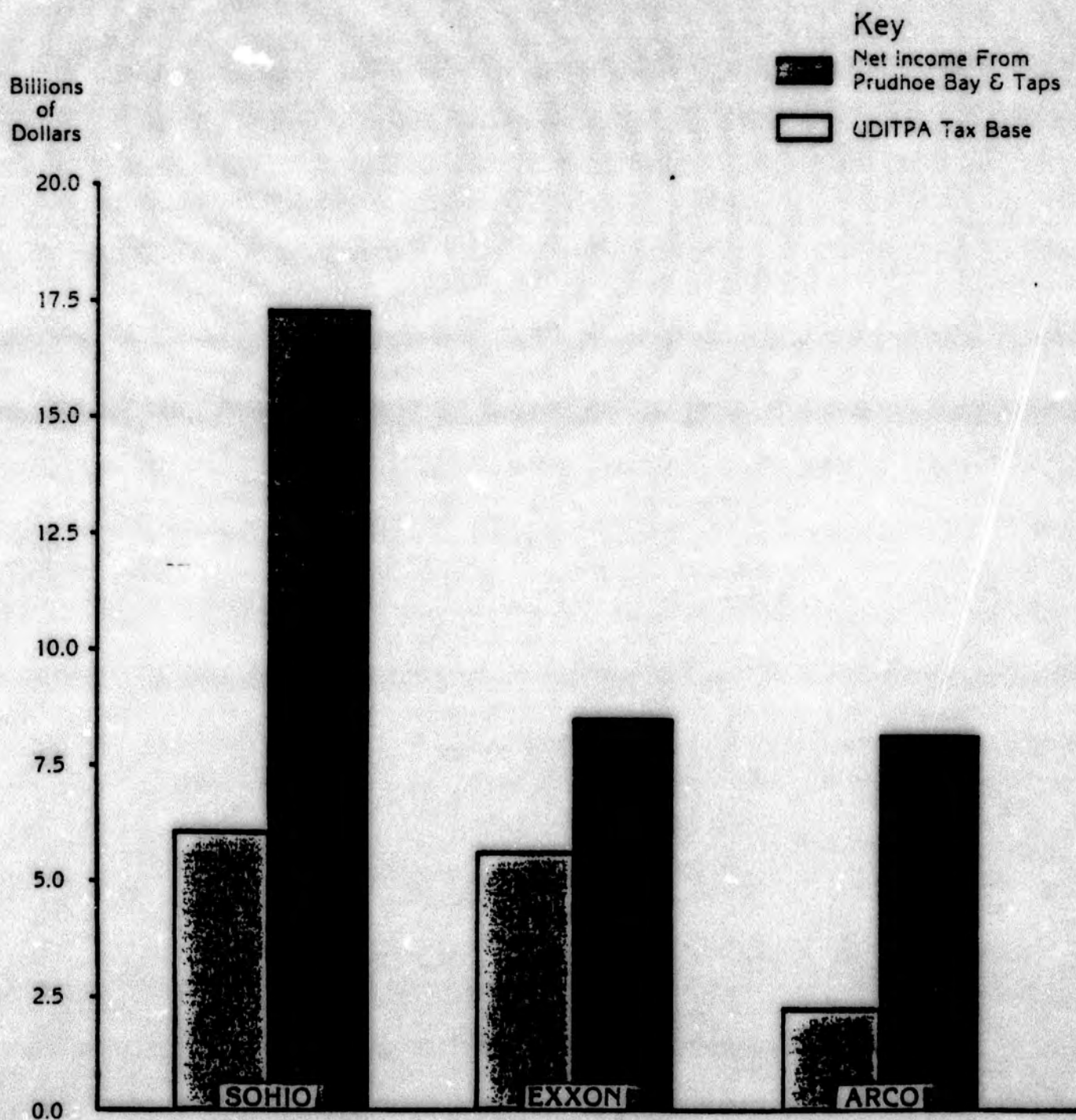
L.H. Doc. 8-080, File 13 at Exhibit VIII(a) (R. 2899)
See R. 16955—16956

As Estimated By W.J. Levy & Assoc. From Sohio Submission One (1978)

L.H. Doc. 6-124, File 50 at 1-4(R. 8527-8530)
See R. 16954-16955

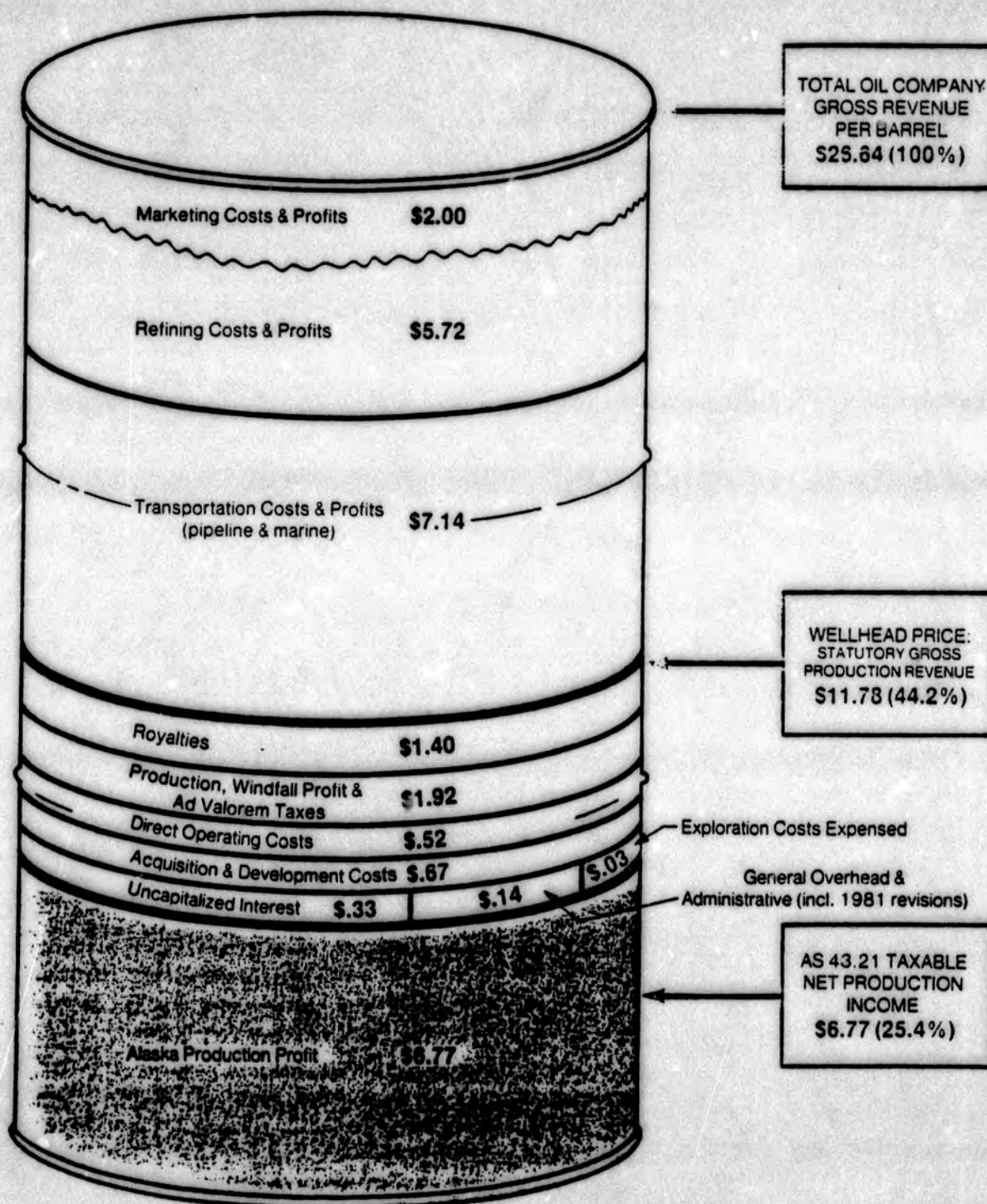


Net Income From Prudhoe Bay and Taps Compared With UDITPA Tax Base (Life of Field)



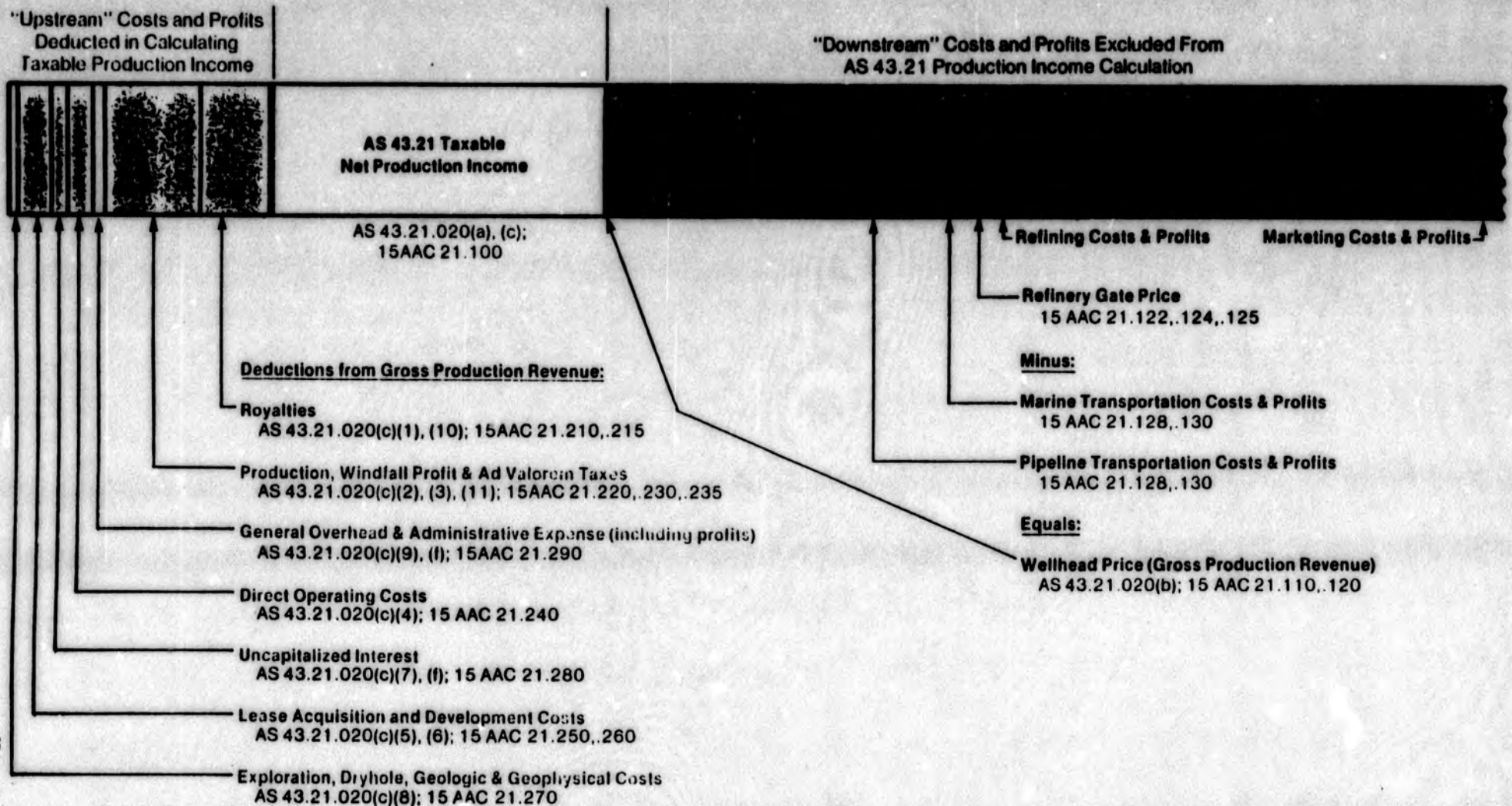
Source: Arthur Anderson Study, Exhibit VIII(a)(R. 2899)

**ESTIMATED REVENUES AND COSTS
PER BARREL OF ALASKAN CRUDE OIL
1978 - 1980**



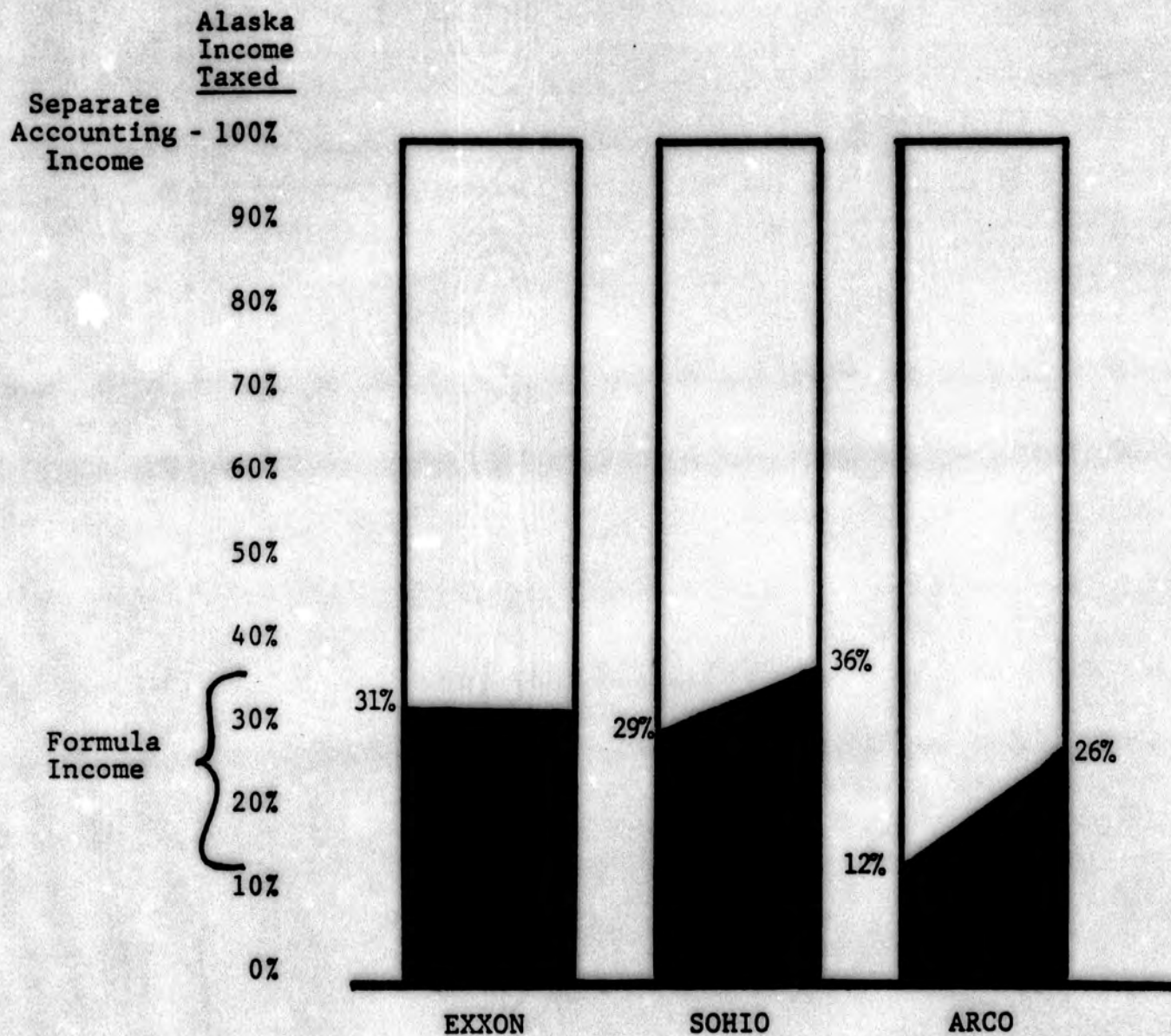
SOURCE: Deakin 2d Supplemental Affidavit * 15, R. 16917, 16929.

AS 43.21 TAXABLE NET PRODUCTION INCOME CALCULATION
EXCLUDES ALL COSTS AND PROFITS OF UPSTREAM AND DOWNSTREAM ACTIVITIES



NOTE: Segments of bar are proportioned by approximate values for these taxpayers for 1978 - 1980. SEE Deakin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

TAXPAYERS' CALCULATIONS OF
FORMULA INCOME AS A PERCENTAGE OF
SEPARATE ACCOUNTING INCOME
1978 - 1981



JOINT SPECIAL COMMITTEE ON TAX POLICY
February 3, 1987
3:30 p.m.

MEMBERS PRESENT

Representative John Sund, Co-chair
Representative Kay Brown
Representative Terry Martin
Senator Jack Coghill
Senator Jim Duncan
Mary Halloran, OMB
Bart Garber, Public Member
George Nelson, Public Member
Dave Rasley, Public Member

MEMBERS ABSENT

Senator Don Bennett, Co-chair
Commissioner Hugh Malone, Dept. of Revenue

OTHERS PRESENT

Senator Bettye Fahrenkamp
Senator Paul Fischer
Senator Jay Kerttula

COMMITTEE CALENDAR

Review of draft committee preliminary report.

WITNESS REGISTER

Vince Wright
Director of Research
Department of Revenue
P.O. Box SA
Juneau, Alaska 99811

Gregg Erickson
Office of Management and Budget
P.O. Box AM
Juneau, Alaska 99811
Phone: 465-3568

John Hartle
Aide to Chairman Sund
P.O. Box V
Juneau, Alaska 99811
Phone: 465-4990

PREVIOUS ACTION

ACTION NARRATIVE

TAPE 11 SIDE 1
Number 000

Chairman Sund called the meeting to order at 3:43 p.m. He noted changes in the committee membership. The newly appointed Senate members are Senator Bennett, Co-chair, Senator Coghill, and Senator Duncan who replaced Senator Ferguson, Senator Eliason, and Senator Abood. The newly appointed Administration members are Mary Halloran and Commissioner Malone who replaced Gordon Harrison and Martin Richard. He welcomed the new members as well as Senator Fahrenkamp and Senator Fischer of the Oil and Gas Committee and Senator Kerttula.

Number 48

Chairman Sund asked for approval of the minutes of the December 4-5, 1986 meeting. Representative Martin asked to postpone approval of the minutes until the next meeting as he has not had an opportunity to read them. Chairman Sund said he would postpone approval until the end of today's meeting. He then discussed work the committee has done over the interim which resulted in the draft report. He invited Vince Wright to give overviews of the income tax, sales tax, and miscellaneous taxes reports by the Dept. of Revenue, dated December 1986, which had been requested by the committee.

Number 105

Vince Wright announced he would first discuss the income tax report and what the department and OMB have been doing regarding income tax legislation. He discussed three approaches or alternatives taken with regard to income tax, focusing on exclusions, deductions and equitability. He said two economic scenarios were developed and used in the report. One was based on a \$13 per barrel price of oil and the other was based on a \$22 per barrel price.

He discussed the issues which were looked at for a tax structure. The first was progressivity or equitability. He said alternative one was the most progressive and alternative three was the least progressive. Second was elasticity. The more elastic a tax structure is, the more stability it provides in an economic structure. Each of the three alternatives had some elasticity, with alternative one the most elastic and alternative three the least elastic. Third was inflation indexing. Alternative one without indexing would raise \$400 million, with indexing it would raise \$300 million. He then discussed leakages such as itemized deduction of state income tax from federal income tax. Leakages to the state could occur with property tax deductions which would transfer money from the state to local governments. Next, with regard to the Permanent Fund dividend, Mr. Wright said an option would be to allow it as a deduction. He pointed out that the more complex the tax structure, the more administrative costs are incurred.

Number 284

Mr. Wright indicated the governor's office was putting together an income tax bill which would be ready by the end of the month and that currently OMB and the department are evaluating issues for the governor.

Number 293

Senator Kerttula pointed out that in making comparisons to states with sales and income taxes, some other states don't have local property taxes and that should be considered in the statistics.

Number 310

Representative Martin asked if the Department of Revenue has worked with the Department of Labor to come up with breakdowns of representative distribution of income groups. Mr. Wright said it had not been done and that it would require considerable personnel time. Representative Martin noted that past local hire reports have good statistics on regions. He said it is important to legislators to know what districts are getting returns for their money.

Number 347

Chairman Sund asked Mr. Wright to elaborate on why the price of oil scenarios have an impact on income tax. Mr. Wright said that revenues received from severance tax, property tax, and such are generated back into the state economy. As oil prices decline, so do jobs and the economy, and it ultimately has an effect on personal income.

Number 427

Mr. Wright next discussed the sales tax report. He said for every one percent of sales tax between \$31 million and \$57 million would be raised, depending on exemptions. He noted that exemptions were usually for equitability reasons, for instance exempting food and drug items results in a more equitable tax for lower income groups.

He discussed the issues which were considered in relation to a sales tax. Regressivity occurs because lower income groups pay a higher percent of their income than upper income groups. The unique geographical position of Alaska makes for higher mail order usage, so some tax escapement could occur with catalogue sales. There are intergovernmental effects which could occur such as double taxation by the state and local governments, although local sales tax could be credited against state sales tax. Sales taxes are no longer deductible under the new federal tax code. There is the question of whether to tax nonresidents or provide them with tax exempt cards such as Washington does. The advantages to a sales tax include its elasticity, stability, and it is easy to

administer. He noted that forty-five states have a sales tax and it accounts for 49% of all state tax collections.

Number 496

Representative Martin noted that Alaska does have a selective sales tax for cigarettes, gas, liquor, and excise taxes. Chairman Sund asked what the difference was between an excise tax and a sales tax. Mr. Wright said there was really no difference except the point of payment. Representative Martin stated that contrary to myth, higher income groups truly pay a higher percentage of sales taxes and if food were exempted, the higher income group would be hit disproportionately to the lower income group. Mr. Wright agreed that those arguments have been made. Representative Martin said an evaluation should be made of the impact of a state sales tax with respect to communities with a local sales tax, and especially with consideration to communities that have user fees which usually earn enough to pay for extra services without a sales tax.

Number 547

Chairman Sund stated he saw a municipal exemption option as a ploy to make municipalities enact sales taxes. He said communities would be encouraged to have a sales tax in order to keep some of the money and in terms of net revenue to the state, it would not be very much.

Number 559

Senator Kerttula reminded the committee that historically, sales tax has been reserved as a basis for local governments.

Number 563

Senator Coghill referred to page 12 of the sales tax report, and asked if the estimated receipts for gasoline service stations excludes the current 8% or 9% tax, and if the projected revenue is in addition to those taxes, to discern whether there was double taxation. Mr. Wright said it is not uncommon to double tax on certain things. Chairman Sund noted the \$2.15 million estimated revenue reflects a 1% tax on the sale of gasoline services on top of everything else that is being taxed. Senator Coghill stressed caution concerning a sales tax because it is the only revenue base 2nd class cities have. Chairman Sund pointed out that the purpose of the reports being presented is to provide raw data, not to establish policy at this time.

Number 589

Chairman Sund noted the next section in the report is analysis of the ELF alternatives, but unless there were specific questions, he would skip over that section because much time has been spent on it in past meetings. He pointed out there was a summary of the

options the committee considered in the draft report. He asked Mr. Wright to go over the last section of the report concerning alternative means of increasing revenues with miscellaneous taxes.

Number 597

Mr. Wright discussed the most recent report dated January 7, 1987 which lists excise taxes, fisheries taxes, licenses and permits. He stated they were not very elastic, but the yield is stable and they are already on the books. An increase would be easy and inexpensive to administer and also would not result in reduced consumption. He said if cigarette taxes were doubled it would generate \$10.7 million and if alcohol taxes were equalized on a per ounce basis it would raise an additional \$4 million. With regard to fuel taxes, he noted if the refund and credit system were eliminated and the tax equalized on a cents-per-gallon basis, they would have to charge 2.2¢ per gallon to generate the same amount of money. He noted that the motor fuel tax is about 8¢, with a 6¢ rebate factor. The highest rate in the nation occurs in Washington and is 18¢ per gallon. He explained that the motor fuel tax rebate applies to off-highway use and rebates are taken out of the highway fund.

Number 662

Senator Coghill noted there were several rebate taxes besides motor fuel taxes, such as liquor tax and tobacco tax. Mr. Wright agreed and mentioned that tobacco tax is split between the general fund and the school fund.

Number 667

Representative Brown asked for an explanation about the administration's proposal to increase the motor fuel tax and return some of the money back to local governments. Ms. Halloran responded that the administration is looking at the rebate structure and trying to figure out the simplest method. She said there are different options, one could be a complicated formula that attached rebates by region so that the funds could be returned to that municipality, another simpler method would deposit funds from an increase in motor tax into the general fund to form part of the base for municipal assistance revenue sharing.

Number 682

Senator Kerttula stated that increased gas taxes should accrue to the state coffers to continue the road maintenance program. The alternative would cost more and perform less service than the present system, although it needs to be beefed up. Ms. Halloran noted there would be a significant increase in revenue with Mr. Wright's suggestion to eliminate rebates.

Number 695

Senator Coghill said the aviation tax rebate should not be touched because that is the only way some communities run their airports and it would destroy that funding base.

TAPE 11 SIDE 2
Number 000

Mr. Wright discussed fisheries taxes. He said there were several ideas to consider. He noted the tax credit granted last year for certain capital expenditures presented a problem in that the credit only benefits healthy firms, and not those with financial difficulties. He suggested the legislature reconsider the intent of the law. He said another problem is that the law does not specifically orient the credit toward processors of developing species. He stated that if the language were amended to aid processors of developing species only, the state could save about \$1.5 million. Mr. Wright pointed out another area they looked at was leakage in the fishery business tax. He noted in past auditing procedures that a lot of evasion exists which adds up to about \$1.5 million. A third area relates to ASMI marketing assessment which is currently 2/10's of 1% of value and provided one-half of ASMI's budget this year, the other half being subsidized from the state's general fund. He pointed out that if the subsidy were eliminated, the state would save \$1.4 million and ASMI could increase their assessment to make up the difference. All three items taken together (tax credits, tax leakage, the subsidy factor) could generate an additional \$4.5 million per year if suggested action were taken.

Number 100

Chairman Sund asked if there was anything else Mr. Wright wanted to bring before the committee.

Number 115

Mr. Wright replied that Commissioner Malone wanted him to mention, with regard to the ELF, an approach based on HB 545 of last year, which would tax the more prolific fields heavier, and lessen the tax on marginal fields. He said it would stimulate production on the marginal fields and noted a key issue would be investment ability with the larger fields. He stated the administration's policy was to suspend the ELF for at least five years, and the commissioner felt it should be done in such a way as to limit the amount of production that would be cut back. By taxing the more prolific fields heavier and the less prolific fields lighter, there would be more equitability.

Number 144

Chairman Sund noted the committee went through eight different options concerning the ELF, a few of which were rejected, and the options were summarized in the proposed draft report. He asked if

the modification of the exponent in option five correlated with the commissioner's recommendation. Mr. Wright concurred.

Number 172

Representative Martin suggested the committee look at the potential of the export of oil with respect to the Jones Act. He said it should be looked at as a major source of revenue.

Number 190

Representative Brown asked about the revenue estimates of suspending the ELF for five years. Mr. Wright replied that it would raise \$150 million in FY 89 and \$163 million in FY 90.

Number 214

Senator Fischer commended the committee's draft report asked if the governor planned to introduce separate bills for an income tax, sales tax and the ELF. Mr. Wright replied that there would be separate bills, but sales tax would not be introduced. Ms. Halloran confirmed that statement.

Number 226

Chairman Sund stated the next item on the agenda was to approve the draft tax policy report. He briefly discussed the contents of the report and suggested going through it page by page for suggestion. He noted that proposed changes were submitted by Mr. Nelson and himself, copies of which were before the members. The first change was to the fourth paragraph on page 3.

Number 258

Mr. Nelson stated that it would be more comprehensive to use the language in SCR 42, which established the committee. Senator Duncan agreed. Representative Martin suggested adding a reference to SCR 42 along with the language. There was additional discussion about the language.

Number 321

Chairman Sund asked if there was any objection to adopting the language in SCR 42 as suggested by Mr. Nelson and Representative Martin. There being none, the language was adopted. Chairman Sund noted the next change was on page 6.

Number 327

Mr. Nelson discussed his proposal to insert language stating that testimony was limited to representatives from the Department of Revenue, the Office of Management and Budget, and the Department of Law, and the primary focus was on revenue raised by various proposals balanced with the various negative effects on exploration

and production, and that time did not permit testimony comparing Alaskan production taxes with those of other states, although a comparison was noted as useful information.

Number 355

Senator Kerttula asked if any comparisons had been made of production taxes in other nations or comparable areas. Chairman Sund replied that it had not been done yet and there were many information fields brought up subject to the committee's discretion to study. He noted the committee is in existence until January 1988 and such a study would be useful.

Number 370

Senator Coghill asked if this was going to be a preliminary report. Chairman Sund replied that it was preliminary and covers the work of the committee up to this point. Senator Coghill suggested adding to Mr. Nelson's proposed language the fact that a comparison study of production taxes would be forthcoming.

Number 380

Mr. Nelson discussed the next proposal to the page 6 regarding the purpose of the ELF. He suggested replacing the language with the following statement from a paper by Tom Williams, "The ELF operates to reduce the effective rate of the production tax as an oil and gas property nears its economic limit, ie. the point where the income gross value from producing a barrel or mcf of production from that property is just enough to cover the costs of producing that barrel or mcf." He said the idea is that the ELF is not only for marginal oil fields, but has to do with the effective rate of production and costs of production.

Number 410

Representative Brown suggested changing it to include the existing statement in addition to Mr. Nelson's suggestion.

Number 415

Chairman Sund asked if there was any objection to Representative Brown's suggestion. There being none, it was adopted. Chairman Sund asked if there was any objection to Mr. Nelson's previous suggestion about comparison to other production taxes. There being none, it was also adopted.

Number 424

Mr. Nelson proposed another change to page 6 to read "The oil industry is expected to oppose any change to the ELF formulas..." rather than simply stating that they oppose any change, as he could only speak for himself and not others in the industry.

Number 440

Chairman Sund asked if there was any objection to the proposal. There being none, it was adopted.

Number 447

Mr. Nelson's next proposal on page 7 was to delete the words "in Cook Inlet" from option three. He noted that option three would negatively impact North Slope production and other areas as well.

Number 460

Chairman Sund asked if there was any objection to the proposal. There being none, it was adopted.

Number 465

Mr. Nelson discussed his next proposal to replace the following sentence in option four: "This option was rejected as the committee supported the policy of giving marginal oil fields a tax break as with the ELF." Mr. Nelson's proposed language read: "This option was rejected as the committee supported the basic policy of the ELF." The meaning was that it was not just marginal fields that caused concern.

Number 492

Chairman Sund noted that previous discussion on option four centered on what constitutes a marginal field with regard to secondary and tertiary recovery. He stated he had no problem with removing the word marginal, but felt it was an issue that needed further discussion. Mr. Garber and Representative Brown concurred with those comments. Representative Martin said it was crucial to recall what was decided and suggested reviewing the minutes from the previous meeting.

Number 525

Chairman Sund asked if there was any objection to Mr. Nelson's proposal. There being none, it was adopted.

Number 530

Ms. Halloran suggested with regard to option five, that the first sentence read "...per field in addition to per well..." as the present language was incorrect.

Number 538

Chairman Sund asked if there was any objection, there being none, Ms. Halloran's proposal was adopted.

Number 540

Mr. Nelson suggested another proposal to the second sentence in option five, which would insert the sentence, "However, the modification would discourage full development within large fields." Ms. Halloran stated that since the committee had not yet taken full testimony on option five, she would prefer changing Mr. Nelson's suggestion by changing "would discourage" to "may discourage."

Number 562

Chairman Sund asked if there was any objection to Ms. Halloran's proposal. There being none, it was adopted.

Number 565

Ms. Halloran noted that in option five the 50% case was used and that since all other revenue projections deal with the 30% case, it should be changed to be consistent with Department of Revenue and OMB figures. She said a footnote should also be added to identify which OMB alternative is being noted, as two different alternatives were run. Chairman Sund pointed out that it would also apply to option one.

Number 580

Chairman Sund asked if there was any objection, there being none, Ms. Halloran's proposal was adopted.

Number 585

Representative Brown proposed inserting the revenue estimates under option seven.

Number 590

Chairman Sund asked if there was any objection, there being none, Representative Brown's proposal was adopted.

Number 593

Representative Martin suggested listing the exact beginning and ending dates with regard to option seven. Chairman Sund directed staff to clarify when the exemption starts and expires.

Number 600

Mr. Nelson pointed out, with regard to option seven, that he had asked the committee's consideration to make it a two-year extension, rather than five years, and asked if the consensus was still at five years.

Number 630