

2-3-87

JOINT SPECIAL
COMMITTEE
ON TAX
POLICY

STATE OF ALASKA



POUCH V
JUNEAU, ALASKA 99811
(907) 485-4941

SENATE SPECIAL COMMITTEE ON OIL AND GAS

MEMORANDUM

TO: Members, Senate Special Committee on Oil and Gas

FROM: Committee Staff

RE: Joint Special Committee on Tax Policy Meeting,
February 3, 1987

DATE: February 2, 1987

On Tuesday, February 3, the regularly scheduled meeting of the Senate Special Committee on Oil and Gas has been cancelled so that members will be able to attend the Joint Special Committee on Tax Policy Meeting. The meeting will be held at 3:30 pm in House Finance. Attached please find a draft of the first report of the Tax Policy Committee. Discussion of oil and gas taxes, including options for changes to the Economic Limit Factor and the oil and gas income tax, should be of particular interest to committee members.

Also attached for your review is a letter from the Commissioner of the Department of Natural Resources regarding a determination to take royalty oil in money (in- value).



Official Business

Alaska State Legislature

Pouch V
State Capitol
Juneau, Alaska 99811

JOINT SPECIAL COMMITTEE ON TAX POLICY

AGENDA for February 3, 1987

1. Overview of Department of Revenue Tax Reports
Vince Wright, Chief of Research
2. Review Draft of Tax Policy Committee Report



Official Business

Alaska State Legislature

JOINT SPECIAL COMMITTEE ON TAX POLICY

Pouch V
State Capitol
Juneau, Alaska 99811

January 27, 1987

MEMORANDUM

TO: Members, Joint Special Committee on Tax Policy

FROM: Rep. John Sund, House Co-Chair

RE: Draft Committee Report

Attached please find a draft of the first report of the Joint Special Committee on Tax Policy. The report is limited in scope for three reasons: The committee took no votes and made no recommendations, the Senate Chairman resigned from the Legislature, and the House Chairmanship changed hands (from Rep. Grussendorf to Rep. Sund) at the final meeting, in December.

Please review the report and Table of Contents of materials to be attached to the final report and let me know any changes you might recommend.

DRAFT TAX POLICY COMMITTEE REPORT

Table of Contents:

1. Memo from the Chairman
2. Committee Report Draft
3. SCR 42
4. Membership list
5. Bibliography
6. Income Tax Report
7. Minutes
8. ELF Reports
9. Revenue Projections by tax type
10. Misc. Revenues report

A. Introduction

The purpose of this report is to outline briefly issues of Alaska tax policy considered by the Joint Special Committee on Tax Policy.

The Committee was created by the passage of Senate Concurrent Resolution 42, in May 1986. It is scheduled to dissolve on the 11th day of the second session of the Fifteenth Alaska Legislature, in January 1988.

Membership on the Committee includes three members from the House, three from the Senate, two from the Administration, and three public members.

The Committee has a comprehensive charge of examining all issues relating to tax policy in Alaska.

The Committee has met three times, in Anchorage (see minutes, attached).

B. Issues explored by the Tax Policy Committee

Before evaluating any specific taxes, it is important to establish criteria for evaluation. The Department of Revenue, in a memo given to the Committee on alternative means for increasing revenues, listed five criteria for evaluating tax policies.

The five are:

Economic Efficiency: What effect does the proposed tax law change have on incentives and economic decision-making which may alter consumption, production or resource allocation decisions?

Equity: Who bears the burden of the tax and how does that burden compare with ability to pay or benefits received? Is the tax progressive or regressive with respect to income and/or wealth?

Elasticity: What is the sensitivity of the tax revenue yield to changes in economic or demographic conditions? As income or population increase and decrease does tax revenue increase or decrease in greater, lesser or equal proportion?

Administrative Efficiency: How costly is the tax to administer in terms of resources devoted to administration and compliance relative to the revenue yield of the tax? Who bears the burden of administrative cost, the taxpayer, the State, or the tax collector if different from the state?

Political Feasibility: How acceptable is a proposed tax law change to the legislature and/or the electorate given the existing social, political, and economic conditions? Who benefits, who loses, and who has the most political power?

In addition to these, the Committee considered several other tax evaluation criteria:

Revenue raised for the state: How much revenue does the tax change raise for the State?

Employment Impact: What will be the impact on employment in the public and private sector?

Capital Impact: What will be the impact on investment capital availability in Alaska?

New Federal Tax Code: How does the proposed tax law change relate to the new Federal Tax Code?

For oil and gas taxes, the Committee looked at several additional evaluation criteria:

Impact on exploration, development and production.

Relative impacts on small and large fields.

Impact on secondary and tertiary recovery and recoverable reserves.

Possibility of premature shutdown of producing fields, and future oil and gas production loss.

Impact on Cook Inlet fields.

Impact on royalty income.

Impact on severance income.

Alaska Tax Policy

ELF

Much of the Committee's time has been spent on questions relating to the Alaska Severance Tax, in particular, the Economic Limit Factor (ELF). The purpose of the ELF is to provide severance tax relief to marginal oil fields in order to keep them in production, retaining economic benefits for the state. The ELF is calculated to be a number between zero and one and can be thought of as representing a percentage of the nominal severance tax rate (e.g. a field with an ELF of 0.6 means 60% of the nominal severance tax rate is applied to that field). The ELF is an issue at this time largely because an ELF provision that sets the ELF at 1.0 if the calculated ELF is greater than 0.7, expires after a field has been in production for ten years, and Prudhoe Bay will have been in production for ten years as of July 1987. When the ten-year exemption for Prudhoe Bay expires, and no changes are made to the law, the ELF for Prudhoe Bay will go to an estimated .82, reducing severance taxes by over \$100 million per year. The oil industry opposes any change to the ELF formula, saying that it will reduce producer revenues available for reinvestment in Alaska, reduce research and development in Alaska and may cause premature shutdown of producing fields.

Eight options were considered for the ELF:

1) Fix the per-barrel severance tax floor at \$.80 to which ELF does not apply.

	FY 88	FY 89	FY 88-2005
Revenue from this option:	30 M	20 M	210 M (50% case)

[Source: Dept. of Revenue]

2) Same as #1, plus set 300 bbl/day PEL (Production Economic Limit) in statute (now a rebuttable presumption), and repeal the ELF exponent.

3) Set the per-barrel floor at \$1.50 and index it with inflation. The \$1.50 figure was selected based on applying a CPI inflator to the original \$.80 floor. This option was rejected by the Committee based mainly on the fact that it would have a severe negative impact on oil production in Cook Inlet.

4) Repeal the ELF entirely on all fields. This option was rejected as the Committee supported the policy of giving marginal oil fields a tax break as with the ELF.

5) Modify the exponent of the ELF formula and base the PEL on field production rather than per-well production. The modification of the ELF exponent would have the effect of giving additional tax relief to marginal fields while increasing the tax receipts from very large fields. The net result would be an increase in severance tax income over present law.

	FY 88	FY 89	FY 88-2005
Revenue from this option:	140 M	140 M	1,670 M (50% case)

[Source: Dept. of Revenue]

6) Include the provisions of option 5 with the addition of a floor which is not affected by the ELF. This option was rejected by the Committee based on the negative effects on Cook Inlet oil fields stemming from the floor change.

7) Extend the ten-year Prudhoe Bay exemption to fifteen years.

8) No change in the law, i.e. allow the scheduled application of ELF to Prudhoe Bay.

Oil and Gas Income Tax

The major issues considered regarding the Oil and Gas Income Tax revolve around the question of separate accounting of oil and gas income in Alaska versus that of apportioning Alaska income by formula. Present law uses the 'modified apportionment' approach. Separate accounting was used in Alaska for the years 1978-1981, but was repealed because the State was exposed to the possibility of large tax refunds if the courts had ruled for the oil companies who brought suit. The State Supreme Court and the U.S. Supreme Court ruled in favor of the state, holding that separate accounting is within the prerogative of the legislature as a method of determining Alaska income for taxation.

Separate accounting is generally considered to more accurately reflect oil and gas income earned in Alaska. Separate accounting has the disadvantage of being more volatile, that is state income closely follows the rise and fall of oil prices on the world

market. The oil and gas industry vigorously opposes the imposition of separate accounting in Alaska as they feel that it can expose them to taxation on more than 100% of their earnings. House Bill 353, which would have reinstated separate accounting was introduced in the Fourteenth Legislature, but did not pass either body. According to the most recent (January, 1987) report of the Alaska Department of Revenue, at current oil prices separate accounting would result in lower revenues for the state. They show a crossover point where separate accounting would result in more revenue for the state at \$14-16/barrel wellhead value.

Individual Income Tax

The State of Alaska is one of seven states without an individual income tax. The Committee requested a report from the Department of Revenue on the revenue potential and economic impacts of a personal income tax. The report was completed at the end of December, 1986, and is attached. The report examines three types of state income taxes and examines revenue potentials of each against two possible economic scenarios for the state's future. It is interesting to note that were the State to reimpose the individual income tax with the same rate structure as was in effect before it was repealed, the tax would yield between \$399 million (low economic scenario) and \$436 million (moderate economic scenario) for tax year 1988. These amounts exceed previous estimates by approximately \$100 million.

State Sales Tax

The State of Alaska is one of five states without a statewide sales tax. The Department of Revenue recently completed a study of the revenue potential of a statewide sales tax. The report concludes that in calendar year 1988, if sales of food are not exempted, a retail sales tax would yield \$38,355,000 per one percent tax. In addition, the service sector of the economy, could yield approximately \$14 million per one percent tax.

Issues to be explored by Committee

There are a great many tax issues which could be productively explored by the Joint Special Committee on Tax Policy. An outline of some of these issues is provided below.

1. Corporate Income Tax
 - a) Rates
 - b) Worldwide Combination
 - c) Separate entity
 - d) Waters' edge
 - e) Changes to Apportionment formula
2. Severance Tax
 - a) Definition of a marginal field?
 - b) Definition of Field, Unit
3. Motor Fuel taxes
4. Special tax incentives and credits
 - a) Exploration Incentive
 - b) Mining License 3.5-year moratorium

- c) Special Industrial Tax Credit
- d) Credits included in adoption of IRS code
- e) Investment Tax Credit
- f) Non-Highway Use refund
- g) Oil Gravity Adjustment
- 5. Oil and Gas Property Tax (ad valorem)
 - a) Municipal uniformity
- 6. Disputed taxes
 - a) DOR need for auditors, etc.
 - b) Taxpayer Confidentiality
 - c) Outlook for settlements
- 7. Lottery
- 8. Oil & Gas Reserves Tax
- 9. Tobacco Tax
- 10. Alcohol Tax
- 11. Gross Receipts Tax
- 12. School Tax
- 13. Fisheries Taxes

Conclusion The Joint Special Committee on Tax Policy has attempted to establish policy guidelines to examine Alaska's tax structure. The Committee has developed information regarding impacts of some proposed tax schemes. Other than rejecting certain proposals relating to the ELF, the Committee has reached no conclusions or recommendations regarding any specific tax proposal.

* PLEASE NOTE: Circled reports are those which will be included in Table of Contents.

BIBLIOGRAPHY OF MATERIALS

JOINT SPECIAL COMMITTEE ON TAX POLICY

January, 1987

The following is a bibliography of research papers collected by the Joint Special Committee on Tax Policy as of January, 1987. A set of the materials is on file in the Office of Rep. John Sund, House Chair. (Rm 118, Capitol. 465-4919).

A. Individual Income Tax

- ① Individual Income Tax Report, Mary Ellen Frank, Economist, et. al. State of Alaska, Department of Revenue, memo to Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986
2. Commuter Taxes as They Relate to Resident Hire, Memo to Rep. Mike Davis from Mary Jennings, Legislative Analyst, State of Alaska, House Research Agency, April 1986

B. State Sales Tax

- ① Revenue Potential of a General Sales Tax, Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986

C. Oil Taxes - General

1. The Taxation of the Petroleum Industry Under Alaska's Corporate Income Tax: A Report Prepared for the Alaska Legislature and the Alaska Department of Revenue, Jerome Zeifman and Kenneth Ainsworth, January 1977
2. Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement. Alaska Department of Revenue, February 1977
3. Impact of Increased Taxation on Oil Exploration and Development in Alaska: A Report to the Alaska State Legislature, Tanzer Economic Associates, March, 1977
4. Recommended Changes in Alaska's Oil and Gas Production Tax Rates, A Report to Governor Jay Hammond, By the Alaska Department of Revenue, 1978
5. The History of Oil and Gas Taxation in Alaska, Thomas K. Williams, Commissioner of the Alaska Department of Revenue, 1978
6. Prudhoe Bay Field and Trans-Alaska Pipeline System: Comparative State Tax Burden Study, Arthur Anderson & Co. for the Alaska Oil and Gas Association, February, 1979
7. Historical Review of Alaska Petroleum Taxes, 1955-1978, Mike Bradner for the Alaska State Legislature, April 1979
8. Alaska Oil and Gas Income Taxation, John Messinger, Gregg Erickson, and Lawrence Eppenbach for the Alaska State Legislature Joint Gas Pipeline Committee, April 1981
9. A Sound Strategy for Protecting Alaska's Oil and Gas Revenues: an Analysis of the Backstop Tax Legislation, Preston Thorgrimson, Ellis & Holman (John Messenger) for the

Alaska State Legislature Joint Gas Pipeline Committee

10. Legislative History Materials, 1981 Corporate Income Tax Amendments, Volumes I & II
11. Alaska Petroleum Revenues: The Influence of Federal Policy, University of Alaska, Institute of Social and Economic Research, for the State of Alaska, Office of the Governor October 1984
12. Impact of Tax Simplification Proposals on Oil and Gas Production and the Economy - Alaska, Interstate Oil Compact Commission, February 1985
13. State, Federal and Industry Shares of Alaska Resource Income, Fiscal Years 1982-1985, State of Alaska, Office of the Governor, Office of Management and Budget, Tom Chester, April 1986

D. Severance Tax

1. Policy Considerations Behind the Severance Tax, Jon Tillinghast, Assistant Attorney General, State of Alaska, Attached to Memo to the Joint Special Committee on Tax Policy from Richard Monkman, Deputy Commissioner, Taxation, Department of Revenue, September 1986
2. History of Oil and Gas Tax Law, State of Alaska, Department of Revenue, September 1986

E. ELF

1. Transcript of Presentation on ELF given by Gregg Erickson State of Alaska, Office of the Governor, Office of Management and Budget, for the Tax Policy Committee Meeting, September 1986
- ② Memorandum on Proposed Changes to the Severance Tax ELF, Memo from G.J. Abraham to George Nelson, Standard Alaska Production, October 1986
- ③ Analysis of ELF Alternatives, Charles Logsdon, Petroleum Economist, State of Alaska, Department of Revenue, December 1986
4. Alternative ELF, Thomas Chester, State of Alaska, Office of the Governor, Office of Management and Budget, 1986
5. Low (Oil) Prices and the ELF, Memo from Charles Logsdon, Petroleum Economist, State of Alaska, Department of Revenue to Vincent Wright, Chief of Research, April 1986
- ⑥ Letter from John R. Kemp, Division Manager, Conoco, Inc. to Senator Frank Ferguson, Senate Chair, Joint Special Committee on Tax Policy, September 1986
- ⑦ The Economic Limit Factor in Alaska's Oil and Gas Properties Production Tax, Thomas K. Williams for Standard Alaska Production Company, September 1986

F. Separate Accounting

1. Affidavit of Edward B. Deakin, CPA, Ph.D. In the Superior Court, State of Alaska, in ARCO v. State of Alaska, November 1981
2. Interim Report of the House Finance Subcommittee on Oil and Gas, Louann Cutler and Sharman Piper, Alaska State Legislature, January 1986
3. Analysis of HB 353, Alaska Department of Revenue, Memo from Vince Wright, Director of Research to Commissioner Mary Nordale, October 1985
4. Sensitivity Analysis of House Bill 353, Memo from John Larson, Economist, et. al. State of Alaska, Department of Revenue, to Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986
5. Overview of Issues Involved in Consideration of HB 353, Memo from Louann Cutler, Special Assistant to Rep. Al Adams, Chair, House Finance Committee, State of Alaska, Alaska State Legislature, October 1985
6. White Paper Report to the Alaska State Legislature on Alaska Oil and Gas Resources, Alaska State AFL-CIO and Alaska Teamsters, Local 959, January 1986
7. The Effects of State Income Tax Policy on the Development of Marginal Oil Fields: An Analysis of the Impact of House Bill 353, House Research Agency, Alaska State Legislature, January 1986
8. Revenue from Separate Accounting, Memo to Mary Halloran, Office of the Speaker, State of Alaska, Alaska State Legislature, Gregg Erickson, Senior Economist, State of Alaska, Office of the Governor, Office of Management and Budget, December 1986
9. Overview and Sectional Analysis of House Bill 353, Deborah Vogt, Assistant Attorney General, State of Alaska,

G. Oil and Gas Conservation Tax

1. Memo to Governor Bill Sheffield and attached Proposed Legislation on the Oil and Gas Conservation Tax, Harold M. Brown, Attorney General, State of Alaska, November 1986

H. Corporate Income Tax

1. Sujong v. State of Alaska, Department of Revenue Court Decision, Alaska, 622 P.2d 967
2. Income Tax in Alaska, Deborah Vogt, Assistant Attorney General, State of Alaska, July 1986
3. Research Regarding Other States' Corporate Income Taxes Memo to Deborah Vogt, Assistant Attorney General, State of Alaska, from Michael D. Lowe and Jeffrey Blattner, Rogovin, Huge & Lenzer, November 1985

4. Container Corporation of America v. Francise Tax Board, U. S. Supreme Court Decision, June 1983

I. Tax Credits, Exemptions, and Deductions

1. "Special" Tax Credits, Exemptions, Deductions, Refunds provided by (Alaska) State Statutes, State of Alaska, Department of Revenue, September 1986

J. Misc. Taxes

1. Alternative Means of Increasing Revenues, Alaska Department of Revenue, Memo from Mary Ellen Frank, et. al. to Vince Wright, Director of Research, January 1986
- ② Revenue Alternatives - Excise Taxes, Fisheries Taxes, Licenses and Permits, Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986
3. Alaska Mineral Taxation Compared to Taxes on Mines in Eleven States, Whitney & Whitney, Inc. for State of Alaska, Department of Commerce and Economic Development, Office of Mineral Development, January 1982

K. Disputed Taxes

1. Expedited Collections of Disputed Taxes, Memo to Rep. Al Adams, Chairman, House Finance Committee, State of Alaska, Department of Revenue, January 1986
2. Prepayment of Disputed Taxes, Memo to Rep. Al Adams, Chairman, House Finance Committee, State of Alaska, Department of Law, January 1986
3. Department of Revenue Accounts Receivable, Richard Monkman, Deputy Commissioner, Taxation, State of Alaska, Department of Revenue, July 1986
4. The Appeals Process and Disputed Tax Dollars, Memo to the JSPTP, Division of Audit, State of Alaska, Department of Revenue, September 1986
5. Memo to Rep. Ben Grussendorf on Cases in Appeal Status, Martin Richard, Division of Audit, State of Alaska, Department of Revenue, October 1986



Official Business

Alaska State Legislature

Senate

Office of the Secretary

Pouch V
State Capitol
Juneau, Alaska 99811

January 30, 1987

M E M O R A N D U M

TO: Senator Bettye Fahrenkamp, Co-Chairman
Senate Special Committee on Oil & Gas

FROM: Peggy Mulligan *PM*
Secretary of the Senate

SUBJECT: Letter from Judith M. Brady, Commissioner,
Department of Natural Resources regarding
"Determination to Take Royalty in Money
(In Value)"

The President has referred the attached letter to your committee for review.

*Special oil and gas
Resources*

RECEIVED JAN 28 1987

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

POUCH M
JUNEAU, ALASKA 99811
PHONE: (907) 465-2400

January 26, 1987

The Honorable Jan Faiks
President of the Senate
Alaska State Legislature
P.O. Box V
Juneau, Alaska 99811

Reference: Determination to Take Royalty in Money (In Value)

Dear Senator Faiks:

Under the provisions of AS 38.05.182(b), I am writing to inform you of my determinations to accept royalty in value for certain royalties from production in the Prudhoe Bay, Kuparuk River and Milne Point Units on the North Slope, as well as from the Granite Point and Middle Ground Shoal fields and the McArthur River and Trading Bay Units in Cook Inlet. The rationale for these decisions is summarized below.

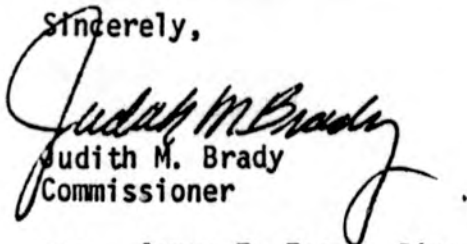
As you are aware, a fairly large percentage of royalty production from the North Slope Units remains committed to long-term negotiated contracts with Chevron, Mapco, Tesoro, Golden Valley Electric Association, and Petro Star, Inc. In addition, a percentage of the remaining production continues to be taken in value to ensure that the department has ample royalty production to offset the lessees' costs of cleaning, dehydrating and handling the state's share of the oil, and to ensure that the state has continued access to the producers' royalty sales reports. The remainder of the royalty production from the Prudhoe Bay Unit and approximately 80 percent from the Kuparuk River Unit, and all production from the Milne Point Unit remain in value. Following the department's February 4, 1986 competitive sale of royalty oil from Prudhoe Bay Unit, at which no bids were received, former Commissioner Wunnicke decided that additional competitive sales of state royalty oil should be deferred until world crude oil markets stabilized.

Jan Faiks, President of the Senate
January 26, 1987
Page 2

Currently, and until July 1987, all Cook Inlet royalty production is taken in value. The department has entered into a one year contract for the sale of 97 percent of west side Cook Inlet royalty oil with Chinese Petroleum Corporation with deliveries to commence July 10, 1987. This volume will comprise approximately 80 percent of available Cook Inlet royalty oil. Oil which is produced from the Middle Ground Shoal field on the east side of Cook Inlet and the remaining 3 percent of the west side royalty oil will be left in value. For logistical reasons--primarily resulting from insufficient storage capacity, rapidly declining volumes, and commingling of federal production--it was impractical to offer the east side volume with the rest of the Cook Inlet royalty oil. Consequently, because of its relatively small volume this oil will likely remain in value.

If you have any questions regarding these determinations, or would like to discuss the department's policies in more detail, please feel free to contact me.

Sincerely,


Judith M. Brady
Commissioner

cc: James E. Eason, Director, Division of Oil and Gas
Donna Wood Johnson, Royalty Manager, Division of Oil and Gas
Steve Porter, Assistant Attorney General, DOL

0583E

(h) Regulations adopted by the commissioner to implement this section shall be adopted in accordance with the Administrative Procedure Act (AS 44.62.010 — 44.62.650). (§ 1 ch 71 SLA 1971; am § 6 ch 104 SLA 1971; am §§ 34 — 36 ch 71 SLA 1972; am §§ 40, 41 ch 127 SLA 1974; am § 4 ch 175 SLA 1980)

Cross references. — For geothermal resources generally, see AS 41.06. For legislative policy with respect to geothermal resources, see § 1, ch. 175, SLA 1980 in the Temporary and Special Acts.

Effect of amendments. — The 1980 amendment rewrote the section.

Collateral references. — Construction and application of Geothermal Steam Act of 1970 (30 USCS § 1001 et seq.), pertaining to leases of government lands for development of geothermal steam resources, 40 ALR Fed 814.

Sec. 38.05.182. Royalty on natural resources. (a) Any royalty provided for in AS 38.05.135 — 38.05.181 may be taken in kind rather than in money if the commissioner determines that the taking in kind would be in the best interest of the state. However, royalties on oil and gas shall be taken in kind unless the commissioner determines that the taking in money would be in the best interest of the state.

(b) The commissioner shall submit a determination to take royalty in money to the legislature at the first opportunity during a current session or, if the legislature is not in session, at the next regular session. The legislature, within 60 days or by the adjournment of the session, whichever comes sooner, may revoke the determination by concurrent resolution. (§ 1 ch 56 SLA 1970; am § 7 ch 71 SLA 1971; am § 1 ch 9 SSSLA 1974; am § 5 ch 218 SLA 1976; am § 1 ch 146 SLA 1977; am § 8 ch 112 SLA 1980)

Revisor's notes. — Enacted as AS 38.05.362. Renumbered in 1970.

Effect of amendments. — The 1980 amendment deleted "(1)" following "in kind unless," and deleted "and (2) the Alaska Royalty Oil and Gas Development

Advisory Board approves the taking in money" following "best interest of the state," and in subsection (b), deleted "approved under (a) of this section" following "to take royalty in money."

NOTES TO DECISIONS

Quoted in *McKinnon v. Alpetco Co.*, Sup. Ct. Op. No. 2413 (File No. 5546), 633 P.2d 281 (1981).

Collateral references. — 38 Am. Jur. 2d, Gas and Oil, §§ 189-198.

58 C.J.S., Mines and Minerals, §§ 185 to 192, 213 to 219.

Acceptance of rents or royalties under oil and gas lease as waiver of forfeiture for

breach of covenant or condition regarding drilling of wells, 80 ALR 461.

Lessor's acceptance of royalty under gas and oil lease after lease has expired as precluding him from insisting upon expiration, 113 ALR 396.

What constitutes "royalty" on oil or gas production within language of conveyance, exception or reservation, 4 ALR2d 492.

Construction and effect of provision in mineral lease excusing payment of minimum rent or royalty, 28 ALR2d 1013.

Solid mineral royalty as real or personal property, 68 ALR2d 728.

Solid mineral royalty under mining lease as real or personal property for purpose of payment of damages in condemnation proceedings, 68 ALR2d 735.

Payment of shut-in royalties or annual rental lease as precluded forfeiture or abandonment, 1076.

"Shut-in royalty" in oil and gas leases, 96.

Rights of parties to royalty deed after expiration where production ten, ALR2d 885.

Sec. 38.05.183. Sale of royalty. (a) The sale, exchange or other disposal of a mineral obtained by the state as a result of AS 38.05.182, or the sale, exchange or other disposal in kind of a right to receive future mineral production under this chapter, shall be by competitive bid and tender or other disposal made to the highest responsible bidder. Competitive bidding is not required when the commissioner, after giving written notice to the Alaska Royalty Oil and Gas Development Board under AS 38.06.050, determines that the sale of the state does not require it or that no competitive bidding is required.

(b) When competitive bids are required, the commissioner, after giving prior written notice to the Alaska Royalty Oil and Gas Development Board, may reject all bids on a determination that the amount of the bids, the lack of responsibility of bidders, or for reasons consistent with the criteria in AS 38.06.070, the acceptance of the bids would not be in the best interest of the state.

(c) If the commissioner determines that a sale, exchange or other disposal of a mineral obtained by the state as a result of AS 38.05.182 or of a right to receive future mineral production under this chapter shall be made otherwise than by competitive bid, and the Alaska Royalty Oil and Gas Development Board has been notified in writing of that determination, the commissioner shall make public in writing the specific findings upon which that determination is based.

(d) Oil or gas taken in kind by the state as its royalty shall be sold or otherwise disposed of for export from the state if the commissioner determines that the royalty-in-kind oil or gas to the present and projected intrastate domestic and foreign markets. The commissioner shall make public, in writing, the findings and reasons on which the determination is based and the date of the convening of a regular session of the legislature showing the immediate and long-range domestic and foreign needs of the state for oil and gas and an analysis of how the needs are to be met.

2/3/87
3:40

BF	Brown	Tax Policy Committee
P. Fischer	Snod	
Mary Hallam	Kerthala	Bartender
Terence Martin	Coghill	Dave Rasch
<u>Murell Wright</u>	Dunne	George Nelson

Income tax — 3 structures

- 1) benchmark.
- 2) pigggy back to feds
tax tables, deductions, etc
- 3) flat tax —
some progressiveness. for equity.

1) Progressivity — equitable —
high income pay more.
#1 most progressive

2) Elasticity. —
more elastic, more unstable.
enhances peaks in income
#1 is most elastic

3) Inflation
= 400 million w/o index
300 w/indexing

4) Leakages.

- 1) deduct state taxes
transfer from fed → state
- 2) deduct property tax
leak from state → municipality

5) Link to other states

6) DEN — for or not?

- ④ administrative compliance cost.
most complicated, more cost

Gov. introducing bill by end of month.

SALES TAX

1% = 35 million

exemptions - for food, drugs -
for lower income -

2% - does not double revenue =
reduced consumption.

- 1) regressivity -
lower pay higher percentage of income
- 2) isolated -
catalogue sales not taxed
- 3) double taxation -
municipality tax too.
could credit community tax
- 4) not deductible from fed tax.
- 5) non-residents -
tax engine cards

advantages

- 1) elastic
- 2) easy to administer.
- 3) 45 states have it

49% of all tax collected.

Alternative —

①

excise —

alcohol
tobacco
fuel

1) not elastic → stable

2) administrative cost —
already are here

Cigarette.

16¢ = 10-11 million

Maine = 18¢ = 18 million = 7 million
extra

Alcohol —

equalize = 4.5 million more

Motor fuel —

refund + credits —

delete = would have to tax ^{addl.} 2.2¢/gal
8¢/gal tax off highway, construction, 6¢/gal

②

fishery

① credits used to aid processors only anti

② tax linkage

③

45M

assessment.

eliminate state subsidy

4.5 million

ELF — Malone units approach
based on HB 545 — tax punitive field
heavier, marginal higher —
stimulate production in marginal fields
suspend for 5 years —
in such way to limit output
production to be cut back.

Cumbe — 9 options
rejected 3 or 4.

* ① modify export
field rather than well production

Malin

Jones Act / Export of Ok oil
major source of revenue.

Bran

ELF
estimated from 10-15 years?

might = \$150 billion / year
\$4/87
90 143

JOHN SUND, REPRESENTATIVE

2505 2nd Avenue
Ketchikan, Alaska 99901
(907) 225-5552

While in Juneau
P. O. Box V
Juneau, Alaska 99811
(907) 465-4919

MEMORANDUM

2/3/87

TO: Members, Joint Special Committee on Tax Policy

FROM: Rep. John Sund, House Co-Chair
Joint Special Committee on Tax Policy

RE: Suggested changes to tax report

We have circulated the draft of the preliminary report of the Joint Special Committee on Tax Policy and are starting to get back comments and suggested changes.

The report, of course, should be viewed as attempting to briefly outline issues the Committee has considered. The actual Committee Report is due next year.

Based on comments received to date, I am suggesting the following changes:

- 1) Page 7, numbered paragraph 5: substitute "in addition to" for "rather than." This indicates that in an ELF proposal studied by OMB, field productivity would be used in addition to well productivity in calculating the ELF.
- 2) Page 7, where revenue estimates are used, use the 30% case instead of the 50% case.
- 3) On page 9 of the draft, first paragraph, delete the last two sentences and replace with:

"According to a January 1987 report from the Department of Revenue, substituting separate accounting for modified apportionment would increase FY 1988 revenues by almost \$100 million, assuming current oil prices [Graph II-9-1, page 95]. Little or no additional revenue would be gained, however, if the change to separate accounting were accompanied by the severance tax reduction called for under HB 353, again assuming no change in oil prices [Graph II-9-3, page 95].

The DOR study suggests that the crossover point, above which separate accounting by itself would produce more FY 1988 revenue for the state, is between \$5/barrel and \$7/barrel wellhead value. The current wellhead value is about \$8.75/barrel. The crossover point tends to increase in later years, as does the DOR forecast of wellhead value."

DRAFT TAX POLICY COMMITTEE REPORT
Volume I

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Official Business

Alaska State Legislature

JOINT SPECIAL COMMITTEE ON TAX POLICY

Pouch V
State Capitol
Juneau, Alaska 99811

January 27, 1987

MEMORANDUM

TO: Members, Joint Special Committee on Tax Policy
FROM: Rep. John Sund, House Co-Chair
RE: Draft Committee Report

Attached please find a draft of the first report of the Joint Special Committee on Tax Policy. The report is limited in scope for three reasons: The committee took no votes and made no recommendations, the Senate Chairman resigned from the Legislature, and the House Chairmanship changed hands (from Rep. Grussendorf to Rep. Sund) at the final meeting, in December.

Please review the report and Table of Contents of materials to be attached to the final report and let me know any changes you might recommend.

A. Introduction

The purpose of this report is to outline briefly issues of Alaska tax policy considered by the Joint Special Committee on Tax Policy.

The Committee was created by the passage of Senate Concurrent Resolution 42, in May 1986. It is scheduled to dissolve on the 11th day of the second session of the Fifteenth Alaska Legislature, in January 1988.

Membership on the Committee includes three members from the House, three from the Senate, two from the Administration, and three public members.

The Committee has a comprehensive charge of examining all issues relating to tax policy in Alaska.

The Committee has met three times, in Anchorage (see minutes, attached).

B. Issues explored by the Tax Policy Committee

Before evaluating any specific taxes, it is important to establish criteria for evaluation. The Department of Revenue, in a memo given to the Committee on alternative means for increasing revenues, listed five criteria for evaluating tax policies.

The five are:

Economic Efficiency: What effect does the proposed tax law change have on incentives and economic decision-making which may alter consumption, production or resource allocation decisions?

Equity: Who bears the burden of the tax and how does that burden compare with ability to pay or benefits received? Is the tax progressive or regressive with respect to income and/or wealth?

Elasticity: What is the sensitivity of the tax revenue yield to changes in economic or demographic conditions? As income or population increase and decrease does tax revenue increase or decrease in greater, lesser or equal proportion?

Administrative Efficiency: How costly is the tax to administer in terms of resources devoted to administration and compliance relative to the revenue yield of the tax? Who bears the burden of administrative cost, the taxpayer, the State, or the tax collector if different from the state?

Political Feasibility: How acceptable is a proposed tax law change to the legislature and/or the electorate given the existing social, political, and economic conditions? Who benefits, who loses, and who has the most political power?

In addition to these, the Committee considered several other tax evaluation criteria:

Revenue raised for the state: How much revenue does the tax change raise for the State?

Employment Impact: What will be the impact on employment in the public and private sector?

Capital Impact: What will be the impact on investment capital availability in Alaska?

New Federal Tax Code: How does the proposed tax law change relate to the new Federal Tax Code?

For oil and gas taxes, the Committee looked at several additional evaluation criteria:

Impact on exploration, development and production.

Relative impacts on small and large fields.

Impact on secondary and tertiary recovery and recoverable reserves.

Possibility of premature shutdown of producing fields, and future oil and gas production loss.

Impact on Cook Inlet fields.

Impact on royalty income.

Impact on severance income.

Alaska Tax Policy

ELF

Much of the Committee's time has been spent on questions relating to the Alaska Severance Tax, in particular, the Economic Limit Factor (ELF). The purpose of the ELF is to provide severance tax relief to marginal oil fields in order to keep them in production, retaining economic benefits for the state. The ELF is calculated to be a number between zero and one and can be thought of as representing a percentage of the nominal severance tax rate (e.g. a field with an ELF of 0.6 means 60% of the nominal severance tax rate is applied to that field). The ELF is an issue at this time largely because an ELF provision that sets the ELF at 1.0 if the calculated ELF is greater than 0.7, expires after a field has been in production for ten years, and Prudhoe Bay will have been in production for ten years as of July 1987. When the ten-year exemption for Prudhoe Bay expires, and no changes are made to the law, the ELF for Prudhoe Bay will go to an estimated .82, reducing severance taxes by over \$100 million per year. The oil industry opposes any change to the ELF formula, saying that it will reduce producer revenues available for reinvestment in Alaska, reduce research and development in Alaska and may cause premature shutdown of producing fields.

Eight options were considered for the ELF:

1) Fix the per-barrel severance tax floor at \$.80 to which ELF does not apply.

	FY 88	FY 89	FY 88-2005
Revenue from this option:	30 M	20 M	210 M (50% case)

303

[Source: Dept. of Revenue]

2) Same as #1, plus set 300 bbl/day PEL (Production Economic Limit) in statute (now a rebuttable presumption), and repeal the ELF exponent.

3) Set the per-barrel floor at \$1.50 and index it with inflation. The \$1.50 figure was selected based on applying a CPI inflator to the original \$.80 floor. This option was rejected by the Committee based mainly on the fact that it would have a severe negative impact on oil production, [in Cook Inlet.]

4) Repeal the ELF entirely on all fields. This option was rejected as the Committee supported the policy of giving marginal oil fields a tax break as with the ELF.

5) Modify the exponent of the ELF formula and base the PEL on field production ^{in addition to} [rather than] per-well production. The modification of the ELF exponent would have the effect of giving additional tax relief to marginal fields while increasing the tax receipts from very large fields. The net result would be an increase in severance tax income over present law.

	FY 88	FY 89	FY 88-2005
Revenue from this option:	140 M	140 M	1,670 M (50% case)

306

[Source: Dept. of Revenue]

DRAFT

6) Include the provisions of option 5 with the addition of a floor which is not affected by the ELF. This option was rejected by the Committee based on the negative effects on Cook Inlet oil fields stemming from the floor change.

7) Extend the ten-year Prudhoe Bay exemption to fifteen years.

8) No change in the law, i.e. allow the scheduled application of ELF to Prudhoe Bay.

Oil and Gas Income Tax

The major issues considered regarding the Oil and Gas Income Tax revolve around the question of separate accounting of oil and gas income in Alaska versus that of apportioning Alaska income by formula. Present law uses the 'modified apportionment' approach. Separate accounting was used in Alaska for the years 1978-1981, but was repealed because the State was exposed to the possibility of large tax refunds if the courts had ruled for the oil companies who brought suit. The State Supreme Court and the U.S. Supreme Court ruled in favor of the state, holding that separate accounting is within the prerogative of the legislature as a method of determining Alaska income for taxation.

Separate accounting is generally considered to more accurately reflect oil and gas income earned in Alaska. Separate accounting has the disadvantage of being more volatile, that is state income closely follows the rise and fall of oil prices on the world

market. The oil and gas industry vigorously opposes the imposition of separate accounting in Alaska as they feel that it can expose them to taxation on more than 100% of their earnings. House Bill 353, which would have reinstated separate accounting was introduced in the Fourteenth Legislature, but did not pass either body. According to the most recent (January, 1987) report of the Alaska Department of Revenue, at current oil prices separate accounting would result in lower revenues for the state. They show a crossover point where separate accounting would result in more revenue for the state at \$14-16/barrel wellhead value.

Incorrect

Individual Income Tax

The State of Alaska is one of seven states without an individual income tax. The Committee requested a report from the Department of Revenue on the revenue potential and economic impacts of a personal income tax. The report was completed at the end of December, 1986, and is attached. The report examines three types of state income taxes and examines revenue potentials of each against two possible economic scenarios for the state's future. It is interesting to note that were the State to reimpose the individual income tax with the same rate structure as was in effect before it was repealed, the tax would yield between \$399 million (low economic scenario) and \$436 million (moderate economic scenario) for tax year 1988. These amounts exceed previous estimates by approximately \$100 million.

State Sales Tax

The State of Alaska is one of five states without a statewide sales tax. The Department of Revenue recently completed a study of the revenue potential of a statewide sales tax. The report concludes that in calendar year 1988, if sales of food are not exempted, a retail sales tax would yield \$38,355,000 per one percent tax. In addition, the service sector of the economy, could yield approximately \$14 million per one percent tax.

Issues to be explored by Committee

There are a great many tax issues which could be productively explored by the Joint Special Committee on Tax Policy. An outline of some of these issues is provided below.

1. Corporate Income Tax
 - a) Rates
 - b) Worldwide Combination
 - c) Separate entity
 - d) Waters' edge
 - e) Changes to Apportionment formula
2. Severance Tax
 - a) Definition of a marginal field?
 - b) Definition of Field, Unit
3. Motor Fuel taxes
4. Special tax incentives and credits
 - a) Exploration Incentive
 - b) Mining License 3.5-year moratorium

- c) Special Industrial Tax Credit
- d) Credits included in adoption of IRS code
- e) Investment Tax Credit
- f) Non-Highway Use refund
- g) Oil Gravity Adjustment
- 5. Oil and Gas Property Tax (ad valorem)
 - a) Municipal uniformity
- 6. Disputed taxes
 - a) DOR need for auditors, etc.
 - b) Taxpayer Confidentiality
 - c) Outlook for settlements
- 7. Lottery
- 8. Oil & Gas Reserves Tax
- 9. Tobacco Tax
- 10. Alcohol Tax
- 11. Gross Receipts Tax
- 12. School Tax
- 13. Fisheries Taxes

Conclusion The Joint Special Committee on Tax Policy has attempted to establish policy guidelines to examine Alaska's tax structure. The Committee has developed information regarding impacts of some proposed tax schemes. Other than rejecting certain proposals relating to the ELF, the Committee has reached no conclusions or recommendations regarding any specific tax proposal.

Introduced: 4/23/86
Referred: State Affairs

1 IN THE SENATE

BY THE STATE AFFAIRS COMMITTEE

2 SENATE CONCURRENT RESOLUTION NO. 42

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - SECOND SESSION

5 Relating to a legislative committee to
6 study the state's tax policy.

7 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

8 WHEREAS the State of Alaska has a tax structure that has not been
9 comprehensively reviewed for fairness and equity; and

10 WHEREAS it is in the state's best interest to have a long-term tax
11 policy that is broad, stable, and accountable; and

12 WHEREAS the State of Alaska lacks the necessary information to develop
13 a comprehensive approach to existing state taxes, tax credits, licenses and
14 user fees; and

15 WHEREAS an examination of the relationship between minimizing taxes
16 and fostering economic growth is critical to the understanding of the
17 state's tax structure;

18 BE IT RESOLVED by the Alaska State Legislature that under Uniform Rule
19 21 a joint special committee on tax policy is established consisting of
20 three members of the senate appointed by the president of the senate, three
21 members of the house of representatives appointed by the speaker of the
22 house, three ex-officio members from the private sector appointed by the
23 governor and one ex-officio representative each from the Office of Manage-
24 ment of Budget and the Department of Revenue to conduct research, hold
25 public hearings and take testimony and collect data on the state's tax
26 policy; and be it

27 FURTHER RESOLVED that before the committee dissolves on the 11th day
28 of the Second Session of the Fifteenth Legislature, it submit a written
29 report to the legislature that addresses the merits of and makes

- 1 recommendations concerning a long-term, broad-based and stable tax policy
- 2 to minimize taxes and foster economic growth.

JOINT SPECIAL COMMITTEE ON TAX POLICY

List of Members

Appointed

Abood

d Eliason

John Sund, Co-Chair

Kay Brown

Terry Martin

cio

Programs
Alaska

Operating Engineers, Local 302

Production Company

Ex-Officio

gh Malone
Revenue

ement and Budget

BIBLIOGRAPHY OF MATERIALS
JOINT SPECIAL COMMITTEE ON TAX POLICY
January, 1987

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A. Individual Income Tax

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2. Commuter Taxes as They Relate to Resident Hire, Memo to Rep. Mike Davis from Mary Jennings, Legislative Analyst, State of Alaska, House Research Agency, April 1986

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1. Revenue Potential of a General Sales Tax, Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986

C. Oil Taxes - General

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2. Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement. Alaska Department of Revenue, February 1977
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2. Memorandum on Proposed Changes to the Severance Tax ELF, Memo from G.J. Abraham to George Nelson, Standard Alaska Production, October 1986
3. Analysis of ELF Alternatives, Charles Logsdon, Petroleum Economist, State of Alaska, Department of Revenue, December 1986
4. Alternative ELF, Thomas Chester, State of Alaska, Office of the Governor, Office of Management and Budget, 1986
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F. Separate Accounting

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2. Interim Report of the House Finance Subcommittee on Oil and Gas, Louann Cutler and Sharman Piper, Alaska State Legislature, January 1986
3. Analysis of HB 353, Alaska Department of Revenue, Memo from Vince Wright, Director of Research to Commissioner Mary Nordale, October 1985
4. Sensitivity Analysis of House Bill 353, Memo from John Larson, Economist, et. al. State of Alaska, Department of Revenue, to Vince Wright, Chief of Research, State of Alaska, Department of Revenue, December 1986
5. Overview of Issues Involved in Consideration of HB 353, Memo from Louann Cutler, Special Assistant to Rep. Al Adams, Chair, House Finance Committee, State of Alaska, Alaska State Legislature, October 1985
6. White Paper Report to the Alaska State Legislature on Alaska Oil and Gas Resources, Alaska State AFL-CIO and Alaska Teamsters, Local 959, January 1986
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MEMORANDUM

2/2/87

TO: Senator Bettye Fahrenkamp, Chair,
Senate Special Committee on Oil and Gas

FROM: Rep. John Sund, House Co-Chair,
Joint Special Committee on Tax Policy

RE: Invitation to Meeting

Thanks very much for cancelling your committee meeting. I apologize for the conflict in scheduling.

As you know, the Joint Special Committee on Tax Policy has spent considerable time looking into issues relating to the oil industry in Alaska, for example the ELF issue. We would appreciate it very much if you could attend the Tax Policy Committee meeting Tuesday, at 3:30 in the House Finance Committee Room. We will be getting a presentation from the Department of Revenue and considering the Tax Policy Committee preliminary report.