HOUSE RESOURCES

1977/78

TESTIMONY BEFORE JOINT HOUSE AND SENATE RESOURCES COMMITTEE 1977/78

SENATOR POLAND, REPRESENTATIVE OSTERBACK AND MEMBERS OF THE JOINT HOUSE AND SENATE RESOURCE COMMITTEES OF THE ALASKA STATE LEGISLATURE.

I WANT TO THANK YOU FOR THIS OPPORTUNITY TO SPEAK TO YOU TODAY ON WHAT I CONSIDER A TOP PRIORITY THIS YEAR - A COMPREHENSIVE REVISION OF THE STATE'S OIL AND GAS TAXING SYSTEM.

FOR SEVERAL MONTHS MEMBERS OF MY STAFF MADE A COMPREHENSIVE REVIEW OF ALASKA'S CURRENT OIL AND GAS TAX STRUCTURE. THAT REVIEW CULMINATED IN A REPORT ENTITLED "ALASKA'S OIL AND GAS TAX STRUCTURE: A STUDY WITH RECOMMENDATIONS FOR IMPROVEMENT." WITH THE PERMISSION OF THE CHAIRMAN, I WOULD LIKE THE DEPARTMENT'S STUDY TO BE MADE A PART OF THESE COMMITTEE'S RECORDS AND PROCEEDINGS.

BEFORE I GET TO THE SPECIFIC RECOMMENDATIONS AND BILLS INTRODUCED TO IMPLEMENT THOSE RECOMMENDATIONS, LET ME BRIEFLY SUMMARIZE THE DEPARTMENT'S REPORT. THE DEPARTMENT FIRST BY WAY OF BACKGROUND AND INFORMATION, SKETCHED OUT AN OVERVIEW

OF OIL AND GAS OPERATIONS IN ALASKA AS WELL AS DESCRIBED THE PRESENT ALASKA TAX SYSTEM. SECONDLY THE DEPARTMENT DISCUSSED PAST REVENUE EXPENDITURE PATTERNS AND MADE EXPENDITURE AND REVENUE PROJECTIONS OVER THE NEXT FEW YEARS. OUR PROJECTIONS OF OIL AND GAS REVENUES WERE BASED UPON THE ASSUMPTION THAT NORTH SLOPE OIL WOULD BE PRICED AS FREE MARKET OIL WITHOUT ENTITLEMENT PENALTIES. WE ALSO POINTED OUT, HOWEVER, THAT OUR REVENUES WOULD BE SUBSTANTIALLY SMALLER IF NORTH SLOPE OIL RECEIVED A DEPRESSED PRICING TREATMENT. AS YOU KNOW THE FEDERAL ENERGY ADMINISTRATION HELD HEARINGS IN WASHINGTON D.C., SAN FRANCISCO AND ANCHORAGE THIS WEEK ON THIS VERY QUESTION. AT THOSE HEARINGS WE HAVE TAKEN THE POSITION THAT NORTH SLOPE OIL SHOULD BE PRICED AS FREE MARKET OIL WITHOUT ENTITLEMENT PENALTY.

IN A THIRD PHASE OF THE REPORT, THE DEPARTMENT DISCUSSED SEVERAL PROBLEMS OR DEFICIENCIES WHICH WERE FOUND IN EACH OF THE STATE'S MAJOR OIL AND GAS TAXES. IN THE FOURTH SECTION OF THE REPORT, THE DEPARTMENT MADE ITS RECOMMENDATIONS TO

CURE THE DEFECTS, AND THEN ESTIMATED THE REVENUE EFFECTS OF THE VARIOUS RECOMMENDATIONS.

WITH THAT SUMMARY OF THE DEPARTMENT'S REPORT LET ME DISCUSS IN TURN EACH OF OUR RECOMMENDATIONS AS EMBODIED IN BILL FORM AND CONTRAST OUR PROPOSALS WITH OTHER BILLS WHICH ARE NOW PENDING BEFORE YOUR RESPECTIVE COMMITTEES.

LET ME START WITH WHAT I CONSIDER AS THE FIRST PRIORITY - A REVISION OF THE STATE'S SEVERANCE TAX. THESE REVISIONS ARE CONTAINED IN HB 321 AND SB 238. ALTHOUGH OUR SEVERANCE TAX PROPOSAL HAS SEVERAL PARTS, IT ESSENTIALLY ACCOMPLISHED TWO MAJOR GOALS. FIRST, IT PROTECTS THE STATE'S SEVERANCE TAX REVENUES IN THE EVENT OF ARTIFICIALLY DEPRESSED FEDERAL PRICING. SECONDLY IT PROVIDES TAX RELIEF TO PRODUCTION AT OR NEAR A PROPERTY'S LIMIT. EACH OF THESE GOALS ARE EXTREMELY IMPORTANT. AS YOU KNOW, THE FEDERAL GOVERNMENT WILL

SOON BE ESTABLISHING THE PRICING TREATMENT TO BE AFFORDED NORTH SLOPE OIL. BOTH THE STATE'S ROYALTY SHARE AND SEVERANCE TAX ARE DEPENDENT UPON THE "WELL HEAD" PRICE OF OIL PRODUCED. IF NORTH SLOPE OIL IS ALLOWED TO FIND ITS PLACE IN THE FREE MARKET OUR ROYALTY AND SEVERANCE TAX REVENUES ARE PROTECTED. IF, HOWEVER, THE PRICE IS SET ARTIFICIALLY BELOW THE FREE MARKET PRICE A PORTION OF THE STATE'S REVENUES WILL BE LOST UNLESS CORRECTIVE ACTION IS TAKEN. THE CORRECTIVE ACTION WHICH WE PROPOSE TO GUARD AGAINST THIS DEPRESSED PRICING IS TO RAISE THE CENTS-PER-BARREL FLOOR IN THE SEVERANCE TAX TO WHAT WE PROJECT TO BE A MID POINT FREE MARKET PRICE OF OIL ON THE NORTH SLOPE ($7.50 PER BARREL) AND TO ESCALATE THAT FLOOR THROUGH TIME WITH A PRICE ESCALATOR. THUS IF AN ARTIFICIAL PRICE IS SET AT $7.00, $6.50 , $6.00 OR EVEN LESS, THE STATE WOULD STILL COLLECT SEVERANCE TAX ON THE BASIS OF THE FREE MARKET VALUE OF THE OIL. ACCORDINGLY WE MUST PROTECT OURSELVES FROM THE POTENTIAL DANGER OF DEPRESSED PRICING BY RAISING THE CENTS-PER-BARREL FLOOR THIS YEAR. IF WE WAIT AND THE PRICING DECISION GOES AGAINST US, WE MAY LOSE SUBSTANTIAL AMOUNTS OF

REVENUES DURING AN INTERIM PERIOD UNTIL CORRECTIVE ACTION CAN BE TAKEN. TO DELAY IN THE FACE OF THIS DANGER MIGHT RESULT IN A LARGE BUDGET DEFICIT FOR THIS NEXT FISCAL YEAR.

THE SAME DANGER TO THE STATE CAN ARISE THROUGH THE ACTIONS OF THE OIL CORPORATIONS THEMSELVES EVEN WITH A FAVORABLE PRICING DECISION BY THE FEDERAL GOVERNMENT. FOR EXAMPLE INTEGRATED OIL CORPORATIONS - OIL CORPORATIONS WHICH NOT ONLY PRODUCE BUT TRANSPORT, REFINE AND MARKET THEIR OWN OIL CAN ESSENTIALLY EFFECT THE WELL HEAD VALUE BY THE TARIFFS WHICH ARE SET FOR TRANSPORTATION OF ITS OIL AND BY THE CHOICE OF THE PLACE WHERE THE OIL IS REFINED. SINCE THE ALASKA WELL HEAD PRICE IS DETERMINED BY TAKING THE REFINERY PRICE AND NETTING BACK ALL THE TRANSPORTATION CHARGES TO THE FIELD, THE WELL HEAD VALUE WILL BE REDUCED AS TRANSPORTATION CHARGES ARE INCREASED. IF THE PIPELINE TARIFF OR TANKER TARIFF ARE INFLATED IT MAY SUBSTANTIALLY REDUCE THE WELL HEAD VALUE. BY INFLATING THE TRANSPORTATION CHARGES, THE INTEGRATED COMPANY CAN SHIFT THE

PROFITS FROM ITS PRODUCTION OPERATION TO OTHER PHASES OF ITS BUSINESS AND REDUCE ITS ROYALTY AND SEVERANCE TAX LIABILITIES. THESE POTENTIAL ACTIONS MUCH AS FEDERAL PRICING WOULD EFFECTIVELY REDUCE THE WELL HEAD PRICE BELOW WHAT WOULD OTHERWISE BE THE MARKET VALUE OF THE OIL. BY RAISING THE CENTS-PER-BARREL TAX FLOOR YOU PROTECT THE STATE AGAINST THESE POSSIBILITIES.

THE SECOND MAJOR GOAL OF OUR SEVERANCE TAX BILL AFTER ASSURING THAT OUR SEVERANCE TAX REVENUES ARE PROTECTED FROM THE VAGARIES OF FEDERAL PRICING ACTIONS AND CORPORATE MANIPULATION, IS TO PROVIDE TAX RELIEF FOR PRODUCTION WHICH IS APPROACHING, OR IS AT, ITS ECONOMIC LIMIT. AS MENTIONED IN OUR REPORT THE SEVERANCE TAX CAN ACT AS A DISINCENTIVE TO CONTINUED PRODUCTION AS PRODUCTION FROM A PROPERTY REACHES ITS ECONOMIC LIMIT. A PARTICULAR PROPERTY'S ECONOMIC LIMIT IS NOT SOLELY A FUNCTION OF THE VOLUME OF PRODUCTION BECAUSE THE COSTS OF PRODUCING OIL MAY VARY SUBSTANTIALLY IN DIFFERENT REGIONS OF THE STATE. FOR EXAMPLE A WELL PRODUCING 1,000 BARRELS A DAY IN COOK INLET

MAY BE NOWHERE NEAR ITS ECONOMIC LIMIT BUT A WELL PRODUCING AT THE SAME RATE ON THE NORTH SLOPE OR IN INTERIOR ALASKA MAY ACTUALLY HAVE REACHED ITS ECONOMIC LIMIT BECAUSE OF THE HIGHER COSTS OF PRODUCTION AND TRANSPORTATION IN THOSE AREAS. ACCORDINGLY A STAIR STEP APPROACH BASED UPON PRODUCTION LEVELS MAY WORK WELL FOR ONE PART OF THE STATE BUT NOT ANOTHER. THEREFORE HB 32L AND SB 238 PROVIDE A MECHANISM WHEREBY THE TAX RATE IS SCALED DOWN OR REDUCED AS A PARTICULAR PROPERTY REACHES ITS TRUE ECONOMIC LIMIT. THIS FEATURE ESSENTIALLY TAILORS THE TAX RATE SCHEDULE TO THE ECONOMICS OF EACH PRODUCING PROPERTY. INSTEAD OF STAIR-STEPS IT PROVIDES A CONTINUOUS SERIES TAX RATES FROM 10 PERCENT TO ZERO AND WHICH DECLINE AS PRODUCTION APPROACHES THE PRODUCTION LEVEL AT THE PROPERTY'S ECONOMIC LIMIT.

THERE WAS SOME SUGGESTION EARLIER IN THE WEEK BY MR. KILGORE, THAT THE ECONOMIC LIMIT FACTOR WAS DEFICIENT IN PRACTIVE SINCE IT SEEMED TO RESULT IN HIGHER EFFECTIVE TAX RATES FOR SOME

PRODUCTION IN COOK INLET. THIS PRESUMED DEFICIENCY IS SIMPLY NOT TRUE. I BELIEVE THAT THE EFFECTS WHICH MR. KILGORE SPOKE TO WERE NOT BECAUSE OF ANY DEFICIENCY IN THE ECONOMIC LIMIT FACTOR BUT RESULTED FROM THE EFFECTIVENESS OF THE CENTS-PER-BARREL FLOOR IN PROTECTING THE STATE AGAINST THE ARTIFICIAL PRICING ACTIONS OF THE FEDERAL GOVERNMENT. IN THIS REGARD IT SHOULD BE NOTED THAT AS PRODUCTION BECOMES INECONOMIC IN COOK INLET THE PRODUCERS MAY APPLY AND RECEIVE PRICING RELIEF FROM THE FEDERAL GOVERNMENT. NO SUCH LUXURY IS GIVEN TO THE ROYALTY OWNER, - THE STATE - AS PRICING RELIEF WILL BE GIVEN ONLY TO THE WORKING INTEREST AND NOT ROYALTY INTEREST. THE FEDERAL RATIONALE FOR THIS POLICY IS THAT THERE WILL BE NO ADDITIONAL PRODUCTION AS A RESULT OF PRICING RELIEF TO THE ROYALTY OWNER. THUS PRICING RELIEF IS GIVEN TO THE WORKING INTEREST. CERTAINLY IF YOU COMPARE THE TAX RATES TO THE ARTIFICIALLY ADMINISTERED PRICE IN COOK INLET YOU WILL GET HIGHER EFFECTIVE TAX RATES. BUT AS STATED BEFORE, THE STATE SHOULD NOT BE CONTENT TO SIMPLY ACCEPT TAXES BASED ON THE

ARTIFICIAL PRICE SET BY THE FEDERAL GOVERNMENT BUT SHOULD INSIST ON A PERCENTAGE OF THE TRUE MARKET VALUE OF THE RESOURCES PRODUCED. IF THE TAX RATES ARE COMPARED TO THE TRUE MARKET VALUE OF OIL IN COOK INLET THESE HIGHER EFFECTIVE TAX RATES DISAPPEAR. THE ECONOMIC LIMIT FACTOR DOES WORK AS PLANNED TO SCALE DOWN THE TAX RATE AS THE PROPERTY REACHES ITS "TRUE ECONOMIC LIMIT". BY THIS I MEAN THE ECONOMIC LIMIT AS GAUGED BY THE MARKET VALUE OF THE OIL NOT THE ARTIFICIALLY SET PRICE. THUS USING THE TRUE MARKET VALUE OF OIL AS THE STANDARD IF THE ECONOMIC LIMIT FOR THE PROPERTY IS 100 BARRELS A DAY AND THE CURRENT PRODUCTION HAS DECLINED TO 200 BARRELS A DAY THE TAX RATE WILL BE SCALED DOWN BY 50 PERCENT. WHEN PRODUCTION REACHES 100 BARRELS A DAY OR WHEN IT IS AT ITS ACTUAL ECONOMIC LIMIT, THE TAX RATE IS ZERO.

LET ME ALSO POINT OUT SOME OF THE OTHER FEATURES OF HB 321 AND SB 238.

THE BILL WOULD PLACE THE TAX ON GAS PRODUCTION ON AN EQUIVALENT BASIS AS OIL AND IT WOULD ESTABLISH A CENTS-PER-MCF FLOOR AT 6.4 CENTS PER MCF. THIS IS BASED UPON THE HIGHEST PRICE PAID FOR GAS IN COOK INLET. THIS FLOOR, AS THE CENTS-PER-BARREL FLOOR, WOULD PROTECT GAS SEVERANCE TAX REVENUES FROM DEPRESSED PRICING BELOW MARKET VALUE.

BOTH THE CENTS-PER-BARREL AND CENTS-PER-MCF FLOORS WOULD BE ADJUSTED BY AN INFLATION FACTOR SET OUT IN THE BILL.

IN ADDITION THE BILL WOULD PROVIDE FOR TAX ON FLARED GAS WHICH IS PRESENTLY UNTAXED. THE TAX RATE FOR THIS FLARED GAS WOULD BE TWICE THE CENTS-PER-MCF RATE. THIS WILL PROVIDE ADDITIONAL INCENTIVE TO THE PRODUCER TO CONSERVE OUR NATURAL RESOURCES.

WITH THAT DISCUSSION OF THE SEVERANCE TAX PROPOSAL, I WOULD LIKE TO CONTRAST OUR SEVERANCE TAX PROPOSAL WITH OTHER SEVERANCE TAX PROPOSALS WHICH HAVE BEEN INTRODUCED. THE OTHER SEVERANCE TAX PROPOSALS ARE SB 103 AND HB 144.

FIRST, SB 105 AND HB 144 IN CONTRAST TO OUR BILLS DO NOT FULLY PROTECT THE STATE AGAINST UNFAVORABLE FEDERAL PRICING DECISIONS. THIS IS BECAUSE THE OTHER BILLS LEAVE THE CENTS-PER-BARREL FLOOR AT ITS PRESENT LEVEL OF $6.10 PER BARREL. THUS THE CENTS-PER-BARREL FLOOR WOULD NOT KICK IN TO PROTECT THE STATE UNTIL THE WELL HEAD PRICE OF OIL WAS REDUCED BELOW $6.10. THIS IS $1.40 BELOW THE PROJECTED FREE MARKET PRICE OF NORTH SLOPE OIL. JUST THIS DIFFERENCE OF $1.40 A BARREL IN THE SEVERANCE TAX FLOOR COULD COST THE STATE FROM $100 TO $200 MILLION DOLLARS A YEAR. TO PROTECT THE STATE AGAINST UNFAVORABLE FEDERAL PRICING AND CORPORATE MANIPULATIONS, IT IS NOT ENOUGH SIMPLY TO RAISE THE PERCENTAGE RATES SINCE ANY PERCENT OF AN ARTIFICIAL PRICE ONLY RETURNS THAT PERCENTAGE AMOUNT OF THAT ARTIFICIAL PRICE. TO PROTECT THE STATE, THE CENTS-PER-BARREL FLOOR HAS TO BE RAISED TO THE FREE MARKET LEVEL.

SECONDLY SB 103 AND HB 144 DO NOT ADEQUATELY PROVIDE TAX RELIEF TO PRODUCTION APPROACHING ITS ECONOMIC LIMIT. THESE BILLS ATTEMPT TO PROVIDE RELIEF FOR MARGINAL WELLS BY EXPANDING THE NUMBER OF STAIR-STEP TAX RATES AND BY APPLYING A ZERO TAX RATE IF PRODUCTION DECLINES TO 100 BARRELS A DAY. AS STATED EARLIER, THE STAIR-STEP APPROACH WILL WORK AT BEST ONLY FOR A PARTICULAR PART OF THE STATE. THUS THE STAIR-STEP SCHEDULE SET OUT IN THESE BILLS WILL PROVIDE RELIEF FOR COOK INLET PRODUCTION BUT WILL NOT PROVIDE RELIEF FOR OTHER AREAS IN THE STATE IN WHICH THE ECONOMIC LIMIT IS WELL ABOVE 100 BARRELS A DAY. FOR PRODUCTION ON THE NORTH SLOPE AND IN INTERIOR ALASKA WHICH HAVE HIGHER COSTS OF PRODUCTION AND TRANSPORTATION, THERE WILL NOT BE TAX RELIEF SINCE THE ECONOMIC LIMIT FOR THIS PRODUCTION MAY IN FACT REACH AS HIGH AS 1,000 BARRELS A DAY. THUS IN CONTRAST TO OUR SEVERANCE TAX PROPOSAL, SB 103 AND HB 144 DO NOT PROVIDE TAX RELIEF FOR MARGINAL PRODUCTION EXCEPT FOR COOK INLET PRODUCTION.

IN ADDITION SB 103 AND HB 144 DO NOT ADDRESS THE SEVERANCE TAX ON GAS PRODUCTION. THESE BILLS SIMPLY LEAVE THE TAX AT THE CURRENT 4 PERCENT OF VALUE WITHOUT PROVIDING A SEVERANCE TAX FLOOR TO PROTECT AGAINST DEPRESSED GAS PRICING. ALSO THE GAS FLARING TAX IN THESE BILLS MAY BE TOTALLY DEFICIENT SINCE IT IS NOT BASED ON A CENTS-PER-MCF BASIS BUT ON A PERCENTAGE OF VALUE BASIS. FOR EXAMPLE IT MIGHT BE ARGUED THAT GAS WHICH IS FLARED HAS ZERO VALUE OR PRICE SO ANY PERCENTAGE OF ZERO WOULD GIVE YOU ZERO REVENUE. ACCORDINGLY THE GAS FLARING TAX SHOULD BE BASED ON A CENTS-PER-MCF BASIS AS IN OUR BILLS TO CLOSE THIS POTENTIAL LOOPHOLE.

THUS WE BELIEVE THAT OUR SEVERANCE TAX PROPOSAL IS SUPERIOR IN THAT IT PROTECTS THE STATE AGAINST DEPRESSED FEDERAL PRICING; PROVIDES TAX RELIEF TO MARGINAL PRODUCTION IN ALL PARTS OF THE STATE; AND ASSURES A FAIR SEVERANCE TAX RETURN ON GAS PRODUCTION.

I WOULD LIKE TO NOW TURN TO OUR INCOME TAX PROPOSAL.

AS EXPLAINED EARLIER IN THE WEEK BY PROFESSORS ZEIFMAN AND AINSWORTH, THERE ARE TWO MAJOR PROBLEM AREAS WITH THE CURRENT CORPORATE INCOME TAX. THE FIRST PROBLEM IS THE ERODED FEDERAL CORPORATE INCOME TAX BASE WHICH ALASKA HAS INCORPORATED AS ITS OWN. OVER THE YEARS, CONGRESS HAS CONTINUALLY ERODED THE FEDERAL TAX BASE BY SPECIAL EXEMPTIONS, DEDUCTIONS, AND CREDITS WHICH DO NOT REFLECT NORMAL FINANCIAL ACCOUNTING. THE EROSION HAS BECOME SO GREAT THAT FEDERAL TAXABLE INCOME IS SUBSTANTIALLY BELOW THE NET INCOME WHICH IS CERTIFIED AND REPORTED TO SHAREHOLDERS. FOR EXAMPLE AS INDICATED ON PAGE 7 OF CHAPTER 5 OF OUR REPORT, A CONGRESSIONAL REPORT SHOWS THAT 5 MULTINATIONAL OIL COMPANIES PAID $107 MILLION DOLLARS IN CORPORATE INCOME TAXES TO THE FEDERAL GOVERNMENT ON PRE TAX PROFITS OF MORE THAN 2.2 BILLION FOR AN EFFECTIVE AVERAGE TAX RATE OF 4.8 PERCENT. THE REPORT ALSO SHOWS THE FINDINGS OF THE CONGRESSIONAL STUDY, IN WHICH THE EFFECTIVE FEDERAL TAX RATE ON THEIR WORLDWIDE INCOME IS

SHOWN FOR SEVERAL OF THE MAJOR OIL CORPORATIONS. NEEDLESS TO SAY THESE EFFECTIVE TAX RATES ARE SUBSTANTIALLY BELOW THE FEDERAL STATUTORY TAX RATE OF 48 PERCENT.

THE SECOND MAJOR PROBLEM FOUND WAS THE MANNER IN WHICH THE CORPORATION'S TOTAL NET INCOME IS APPORTIONED TO ALASKA. CURRENTLY THE TOTAL FEDERAL TAXABLE INCOME OF AN ALASKAN CORPORATION PLUS THE TAXABLE INCOME OF ALL OF ITS UNITARY AFFILIATES AND SUBSIDIARIES ARE COMBINED INTO A TOTAL WORLD-WIDE TAXABLE INCOME FIGURE AND THEN THAT AMOUNT IS MULTIPLIED BY A 3 FACTOR FORMULA OF PROPERTY, PAYROLL AND SALES. THE PRODUCT OF THAT CALCULATION BECOMES ALASKA TAXABLE INCOME FOR THE ALASKAN CORPORATION AND IT IS TAXED AT THE 9.4 PERCENT NOMINAL RAX RATE.

THE PRESENT APPORTIONMENT FORMULA OF PROPERTY, PAYROLL AND SALES IS DESIGNED TO MEASURE THE ACTIVITY OF GENERAL MERCHANTILE BUSINESSES. IT DOES NOT ACCURATELY MEASURE THE ACTIVITIES OF NATURAL RESOURCE COMPANIES AND IT DOES NOT TAKE INTO

ACCOUNT THE UNIUQE CONTRIBUTION MADE BY NATURAL RESOURCES THEMSELVES. THE PRESENT DESTINATION-ORIENTED FORMULA DOES NOT GIVE ANY WEIGHT TO THE SCARCITY VALUE OF THE NON-RENEWABLE RESOURCE WHICH IS REALLY WHAT DETERMINES THE INCOME OR PROFIT FOR A NATURAL RESOURCE COMPANY.

THE TAX WOULD BE LEVIED ON AND WOULD BE MEASURED BY THE TOTAL WORLD-WIDE NET INCOME OF THE CORPORATION AND ALL OF ITS UNITARY AFFILIATES AND SUBSIDIARIES AS REPORTED AND CERTIFIED TO ITS SHAREHOLDERS AND THEN APPORTIONED TO ALASKA BY A 3 FACTOR FORMULA. IN ONE CLEAN SWEEP IT WOULD ELIMINATE ALL OF THE SPECIAL SUBSIDIES AND ACCOUNTING DEVICES WHICH ARE EMBODIED IN THE PROVISIONS OF THE INTERNAL REVENUE CODE. THUS THE INCOME WOULD BE BASED ON NORMAL FINANCIAL NET INCOME UNERODED BY ALL THE SPECIAL FEDERAL EXEMPTIONS, CREDITS AND DEDUCTIONS.

ADMITTEDLY THERE IS SOME FLEXIBILITY UNDER NORMAL ACCOUNTING PRINCIPLES FOR THE DETERMINATION OF NET INCOME THAT IS REPORTED

TO STOCKHOLDERS. WE BELIEVE, HOWEVER, THAT THERE ARE REAL DETERRENTS AGAINST MANIPULATING "BOOK INCOME" FOR STATE TAX PURPOSES. FIRST OF ALL, BOOK INCOME IS SUBJECT TO CERTIFICATION UNDER RULES PROMULGATED BY THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AND IS SUBJECT TO REVIEW BY THE SECURITIES AND EXCHANGE COMMISSION. IN ORDER TO MANIPULATE "BOOK INCOME" TO LOWER ALASKA TAX LIABILITY, IT WOULD HAVE TO BE DONE AT THE EXPENSE OF THE CORPORATION'S STOCKHOLDERS.

THE EFFECTIVENESS OF ELIMINATING THE FEDERAL EROSIONS THROUGH THE ADOPTION OF BOOK INCOME WAS DEMONSTRATED BY PROFESSORS ZEIFMAN AND AINSWORTH. THEY FOUND IN THE SAMPLE OF LARGE OIL CORPORATIONS DOING BUSINESS IN ALASKA THAT BOOK INCOMES EXCEEDED FEDERAL TAXABLE INCOME BY 1.6 TO 3 BILLION DOLLARS A YEAR OVER THE LAST THREE YEARS.

THE SECOND MAJOR REVISION IS A MODIFICATION OF THE UNIFORM APPORTIONMENT FORMULA OF PROPERTY, PAYROLL AND SALES. THE

BILL SUBSTITUTES AN ORIGIN ORIENTED EXTRACTION FACTOR FOR THE DESTINATION ORIENTED SALES FACTOR. THUS A NEW FACTOR WOULD BE ADDED TO THE APPORTIONMENT FORMULA AND WOULD BE MEASURED BY THE NET PRODUCTION OF OIL AND GAS IN ALASKA VERSUS THE NET PRODUCTION OF OIL AND GAS EVERYWHERE. THIS WILL MEAN THAT FOR THE FIRST TIME, THE AMOUNT OF INCOME ATTRIBUTED TO ALASKA WILL BE BASED UPON, IN PART, THE AMOUNT OF OIL AND GAS PRODUCED IN ALASKA.

ACCORDINGLY THE BILL PROVIDES A METHOD IN WHICH WORLD-WIDE "BOOK INCOME" OF THE TOTAL UNITARY BUSINESS OPERATIONS WILL BE MULTIPLIED BY A FORMULA OF PROPERTY, PAYROLL AND EXTRACTION. IN ADDITION, TO SPECIFICALLY MEASURING PRODUCTION ACTIVITY IN THE STATE, THE SUBSTITUTION OF THE EXTRACTION FACTOR FOR THE SALES FACTOR WILL RETURN A LARGER PORTION OF A CORPORATION'S INCOME TO THE STATE. AND WELL THAT IT SHOULD SINCE THE TAX SHOULD BE MEASURED BY THE SCARCITY VALUE OF OUR NATURAL RESOURCES.

THERE WAS SOME SUGGESTION EARLIER IN THE WEEK THAT THERE MIGHT BE A PROBLEM WITH THE DETERMINATION OF NET EXTRACTION FROM FOREIGN JURISDICTIONS IN WHICH THE CORPORATIONS WOULD BE ACTING AS ESSENTIALLY A CONTRACTOR AND HAVE NO INTEREST IN THE OIL ITSELF. THE REASON FOR THE CONCERN SEEMED TO STEM FROM THE FACT THAT A BREAK DOWN OF PRODUCTION MIGHT NOT BE REPORTED IN PUBLISHED FINANCIAL STATEMENTS. IN OUR EARLY CONSIDERATION OF THE EXTRACTION FACTOR, WE ANTICIPATED THIS POTENTIAL DIFFICULTY BECAUSE OF THE ABSENCE OF CONSISTENT FIGURES ON PUBLISHED FINANCIAL STATEMENTS. FOR THAT REASON WE HAVE HAD OUR MULTI-STATE TAX COMMISSION AUDITORS DETERMINE IF ADEQUATE RECORDS ARE AVAILABLE TO AUDIT WORLD WIDE NET PRODUCTION. IN CONNECTION WITH CURRENT AUDITS WHICH THEY ARE DOING IN OUR BEHALF OF SOME MULTINATIONAL OIL CORPORATIONS, THEY FOUND THAT ADEQUATE RECORDS AND DOCUMENTATION EXIST TO AUDIT THE PRODUCTION FIGURES WHICH WOULD BE REPORTED BY THE CORPORATIONS SUBJECT TO THE TAX. IN ADDITION WE NOW UNDERSTAND THAT INDEPENDENT PRODUCTION STATISTICS ARE REPORTED BY THE UNITED NATIONS AND THE OPEC COUNTRIES THEMSELVES.

ANOTHER EXTREMELY IMPORTANT FEATURE OF THE FRANCHISE TAX IS ITS ABILITY TO INCLUDE IN THE MEASURE OF THE TAX THE ACTIVITIES LOCATED ON THE OUTER CONTINENTAL SHELF. BY THIS FEATURE WE ARE TAKING THE POSITION THAT IF ELEMENTS OF PROPERTY, PAYROLL AND SALES ARE NOT ASSIGNED TO ANY OTHER JURISDICTION, THEN THEY SHOULD BE ASSIGNED TO THE STATE WHICH HAS RECEIVED THE MOST DIRECT IMPACT. IN ADDITION TO COMPENSATING THE STATE FOR THE ECONOMIC IMPACT FELT BY THIS ACTIVITY IT PREVENTS THE CORPORATION FROM ASSIGNING INCOME TO THE STATE OF NO WHERE. ALSO THE PROPERTY AND PAYROLL FACTOR OF MARINE TRANSPORTATION SUBSIDIARIES WOULD BE ASSIGNED ON THE BASIS OF THE NUMBER OF DAYS IN PORT.

LET ME NOW COMPARE BRIEFLY SB 236 AND HB 322 WITH THE OTHER INCOME TAX BILLS WHICH HAVE BEEN INTRODUCED. SB 105 AND HB 145 ADOPT AN APPROACH ENTIRELY DIFFERENT THAN THE APPROACH WHICH WE HAVE TAKEN AND IS CALLED SEPARATE ACCOUNTING.

INSTEAD OF COMBINING THE ENTIRE NET INCOME OF THE UNITARY GROUP OF BUSINESSES AND APPORTIONING THAT TOTAL INCOME TO THE STATE BY AN APPORTIONMENT FORMULA, THE SEPARATE ACCOUNTING

BILL LOOKS ONLY AT THE SEPARATE INCOME AND EXPENSE OF A CORPORATE ENTITY DOING BUSINESS IN THE STATE. SEPARATE ACCOUNTING ESSENTIALLY SEPARATES THE NET INCOME OF THE BUSINESS INTO GEOGRAPHICAL UNITS. IN EFFECT, THE BUSINESS ACTIVITIES IN ONE STATE ARE TREATED AS IF THEY WERE CARRIED ON BY A TOTALLY SEPARATE BUSINESS.

THEORETICALLY, SEPARATE ACCOUNTING MEASURES THE NET INCOME OF THE BUSINESS EARNED WITHIN THE STATE. IN PRACTICE IT DOES NOT. THE REASON IT DOES NOT STEMS FROM THE WAY THAT LARGE MODERN BUSINESSES, ESPECIALLY LARGE INTEGRATED MULTINATIONAL CORPORATIONS, OPERATE.

THE ENTIRE ENTERPRISE IS OPERATED AS A UNIT WITH THE PROFIT BEING EARNED ONLY BY THE ENTIRE OPERATION AS A WHOLE. THUS THE WHOLE ENTERPRISE IS ACTUALLY MORE THAN THE SUM OF THE PARTS SINCE EACH PART IS ESTABLISHED ONLY TO CONTRIBUTE TO THE ENTIRE UNITARY BUSINESS. THE NET PROFIT IS ACTUALLY THE FINAL RESULT OF THE CONTINUOUS SERIES OF INCOME AND EXPENSE TRANSACTIONS AMONG THE VARIOUS COMPONENT PARTS OF THE BUSINESS.

WITH REGARD TO AN INTEGRATED MULTINATIONAL OIL CORPORATION, THE NET INCOME IS NOT EARNED BY ANY PARTICULAR PHASE OF THE OPERATION SUCH AS PRODUCTION, TRANSPORTATION, REFINING OR MARKETING. EACH SEGMENT CONTRIBUTES TO THE WHOLE, AND THE NET INCOME IS ONLY REFLECTED AFTER THE FINAL SALE AND THE CONTRIBUTION OF EACH PART OF THE BUSINESS.

BECAUSE OF THE REALITIES OF MODERN BUSINESS OPERATIONS, A SEPARATE ACCOUNTING METHOD OPENS THE DOORS TO WIDESPREAD TAX AVOIDANCE. WITH A MULTIFACETED BUSINESS ACTING THROUGH DIFFERENT DIVISIONS, AFFILIATES AND SUBSIDIARIES, IT DOESN'T MATTER TO THE OVERALL ENTERPRISE WHETHER A PARTICULAR DIVISION IS SHOWN TO MAKE A PROFIT OR LOSS AS LONG AS IN THE END A PROFIT IS MADE FOR THE COMPANY AS A WHOLE. IN A REAL SENSE THE PROFIT OR LOSS OF A PARTICULAR DIVISION CAN BE MADE TO APPEAR ANY WAY THAT THE ENTERPRISE WANTS IT TO APPEAR.

FOR EXAMPLE, WHEN GOODS ARE TRANSFERRED FROM ONE DIVISION TO ANOTHER, THE AMOUNT CHARGED TO EACH SEGMENT OF THE BUSINESS

CAN BE ANYTHING THAT THE ENTERPRISE FINDS IN ITS BEST INTEREST TO CHARGE. LIKEWISE AS THE PARENT CORPORATION OR ANOTHER DIVISION PROVIDES MANAGEMENT, ACCOUNTING, LEGAL OR OTHER RELATED SERVICES FOR ANOTHER DIVISION OR AFFILIATE, THE SAME FLEXIBILITY EXISTS FOR DETERMINING THE AMOUNT OF FEES TO BE CHARGED. INCOME AND EXPENSE CAN BE EFFECTIVELY SHIFTED FROM ONE PART OF THE BUSINESS TO ANOTHER. THIS SHIFTING OF INCOME AND EXPENSE DOES NOT TAKE PLACE THROUGH A HANDFUL OF EASILY RECOGNIZABLE TRANSACTIONS, BUT THROUGH A SERIES OF THOUSANDS OF TRANSACTIONS A DAY WHICH AMOUNT TO MILLIONS FOR AN ENTIRE YEAR. ALSO, THESE TRANSACTIONS ARE MADE NOT JUST BETWEEN A HANDFUL OF CORPORATE ENTITIES, BUT THROUGH LITERALLY HUNDREDS OF DIVISIONS, AFFILIATES, AND SUBSIDIARIES. WITH SUCH A MYRIAD OF CORPORATE ENTITIES AND TRANSACTIONS, IT IS EXTREMELY DIFFICULT, TO SAY THE LEAST, TO DETERMINE WHAT IS THE "TRUE" NET PROFIT EARNED BY ONE ENTITY OR GEOGRAPHIC PART OF AN ENTITY.

AS APPLIED TO THESE SEPARATE ACCOUNTING BILLS, THE SAME PROBLEM OCCURS. THAT IS, THESE BILLS COULD OPEN THE DOOR TO WIDESPREAD TAX AVOIDANCE BECAUSE OF THE MANIPULATIONS OF INCOME AND EXPENSE WHICH ARE POSSIBLE.

AS WITH THE OTHER SEVERANCE TAX PROPOSALS THE SEPARATE ACCOUNTING BILL WOULD LEAVE OPEN THE POTENTIAL OF EROSION BY FEDERAL PRICING DECISIONS. FOR EXAMPLE UNDER THESE BILLS GROSS REVENUE FOR PRODUCTION OPERATIONS IS DEFINED TO MEAN THE WELL HEAD VALUE. IF FEDERAL PRICING DECISIONS SET A DEPRESSED WELL HEAD PRICE THEN THE GROSS REVENUES UNDER THE BILL WILL BE SUBSTANTIALLY REDUCED. LIKEWISE MANIPULATIONS BY TAXPAYERS OF WELL HEAD OR GROSS REVENUES ARE ALSO POSSIBLE BY THE TRANSPORTATION CHARGES WHICH ARE MADE FROM ONE AFFILIATE TO ANOTHER.

JUST AS THE GROSS REVENUE OR WELL HEAD VALUE CAN BE MANIPULATED UNDER THE SEPARATE ACCOUNTING METHOD, SO CAN THE EXPENSES AND DEDUCTIONS. THAT IS, THE CHARGES FOR SERVICES AND PROPERTY

FROM ONE AFFILIATE TO ANOTHER CAN BE MADE SO AS TO SHIFT PROFIT FROM ONE CORPORATE ENTITY TO ANOTHER. THROUGH SUCH SHIFTING OF INCOME AND EXPENSE BETWEEN THE ALASKA CORPORATION AND OTHER AFFILIATED CORPORATIONS, THE INCOME AND EXPENSE CAN IN A REAL SENSE BE MADE TO BE WHAT THE OVERALL CORPORATE ENTERPRISE WANTS IT TO BE.

THIS DEFICIENCY CANNOT BE CURED SIMPLY BY HIRING AN ARMY OF STATE AUDITORS. TO THE EXTENT OF REDUCED GROSS INCOME BY REASON OF DEPRESSED FEDERAL PRICING, THE STATE IS SIMPLY STUCK UNDER A SEPARATE ACCOUNTING APPROACH. IN ADDITION, TO FERRET OUT THE MULTITUDE OF INTERCOMPANY CHARGES AND OVERTURN THEM AS EITHER FRAUDULENT OR UNREASONABLE IS SIMPLY IMPOSSIBLE. WITH LARGE MULTINATIONAL CORPORATIONS THERE ARE VIRTUALLY HUNDREDS OF TRANSACTIONS A DAY BETWEEN DOZENS OF CORPORATE AFFILIATES. YOU SIMPLY CANNOT UNSCRAMBLE THESE TRANSACTIONS TO DETERMINE THE "TRUE" PROFIT EARNED IN ALASKA.

IN CONTRAST THE FRANCHISE TAX AVOIDS THESE EROSIONS AND MANIPULATIONS BETWEEN DIFFERENT SEGMENTS OF THE OIL INDUSTRY

AND BETWEEN AFFILIATED COMPANIES. IT AVOIDS THESE PROBLEMS BY COMBINING THE INCOME OF THE TOTAL GROUP OF RELATED CORPORATIONS. THUS THE GAME OF SHIFTING PROFIT FROM ONE CORPORATION TO ANOTHER IS AVOIDED SINCE THE ENTIRE NET IS COMPUTATED AND NOT JUST FOR ONE CORPORATION IN ISOLATION. IT ALSO AVOIDS THE UNCERTAINTIES OF PRICE REGULATION OF THE PRODUCTION SEGMENT OF THE INDUSTRY, SINCE ALL SEGMENTS OF AN INTEGRATED COMPANY WOULD BE COMBINED AND THE OVERALL PROFIT OF UNITARY BUSINESS TAXED. THESE OTHER SEGMENTS OF THE INDUSTRY SUCH AS TRANSPORATION, REFINING AND MARKETING MAY NOT HAVE PRICE REGULATIONS AND SO THE PROFIT MAY BE TRANSFERRED TO THESE UNREGULATED SEGMENTS. THE SEPARATE ACCOUNTING APPROACH WOULD NOT MEASURE THIS SHIFTED PROFIT. THE FRANCHISE TAX BILL WOULD.

THE SEPARATE ACCOUNTING BILLS ALSO WOULD NOT INCLUDE IN THE MEASURE OF THE TAX, THE OIL AND GAS ACTIVITIES OCCURRING ON THE OUTER CONTINENTAL SHELF. IT WOULD SIMPLY ATTEMPT TO SEGREGATE THE INCOME GENERATED IN THE STATE. IN CONTRAST THE FRANCHISE TAX WOULD INCLUDE IN THE MEASURE OF THE TAX

PROPERTY, PAYROLL AND EXTRACTION LOCATED ON THE OUTER CONTINENTAL SHELF. I BELIEVE THAT IT IS IMPORTANT THAT THE STATE SEEK COMPENSATION FOR THE IMPACT FROM THIS ACTIVITY. THE FRANCHISE TAX WOULD COMPENSATE THE STATE AS A RESULT OF THESE ACTIVITIES TAKING PLACE OFF OUR SHORES. THE SEPARATE ACCOUNTING BILL WOULD ALSO NOT INCLUDE THE INCOME OF MARINE TRANSPORTATION SUBSIDIARIES TRANSPORTING OIL FROM OUR STATE.

CONTINUING ON, I WOULD NOW LIKE TO MAKE SOME COMMENTS ABOUT OUR PROPERTY TAX PROPOSAL. THIS IS CONTAINED IN SB 237 AND HB 323. OUR PROPERTY TAX PROPOSAL CORRECTS SEVERAL DEFICIENCIES IN OUR 20 MIL AD-VALOREM TAX.

ONE PORTION OF THE BILL WOULD STRENGTHEN THE VALUATION METHOD PRESCRIBED FOR PIPELINES AND ASSURE THAT THE TRANS-ALASKA PIPELINE WILL BE VALUED UNDER A FULL AND TRUE VALUE. UNDER THE PRESENT WORDING OF THE STATUTE, IT IS POSSIBLE THAT THE TRANS-ALASKA PIPELINE WILL BE VALUED ONLY AT ITS ACTUAL COST AND DEPRECIATED ON A STRAIGHT LINE BASIS OVER THE ECONOMIC

LIFE OF THE FIELD. WE FEEL THIS POTENTIAL OUTCOME WOULD BE DISASTROUS SINCE THIS ACTUAL COST-DEPRECIATED METHOD WOULD YIELD A VALUE SUBSTANTIALLY BELOW THE PIPELINE'S FULL AND TRUE MARKET VALUE. THE ARGUMENT FOR THIS DEPRESSED VALUATION HAS ALREADY BEEN MADE BY OTHER PIPELINE COMPANIES IN THE STATE AND THE DETERMINATION OF THE PROPER PIPELINE VALUATION METHOD IS NOW UNDER REVIEW BY THE SUPERIOR COURT.

OUR BILL WOULD ELIMINATE THIS POTENTIAL HAZARD BY AMENDING THE STATUTE TO INSURE A FULL AND TRUE VALUE OF PIPELINES WITH DUE REGARD TO THEIR ECONOMIC VALUE. THUS INSTEAD OF A VALUATION BASED SOLELY ON ACTUAL COST, THE VALUATION WOULD BE BASED UPON MORE REALISTIC VALUATION METHODS SUCH AS REPLACEMENT COST APPROACH AND THE CAPITALIZED NET INCOME APPROACH. IT SHOULD BE NOTED THAT THE COMPANIES WILL BE ALLOWED A RATE OF RETURN ON THE BASIS OF REPLACEMENT COST. IT IS ONLY FAIR THAT OUR TAX SHOULD BE BASED ON THE SAME BASIS.

SECONDLY THE BILL WOULD INCLUDE IN THE COVERAGE OF THE TAX SEVERAL IMPORTANT CATEGORIES OF OIL AND GAS PROPERTIES WHICH

ARE PRESENTLY EXEMPT FROM THE STATE TAX. THESE INCLUDE TANKERS, GAS PROCESSING PLANTS AND REFINERIES. GAS PROCESSING PLANTS AND REFINERIES WOULD BE VALUED AND TAXED AT THEIR REPLACEMENT COST. TANKERS WOULD ALSO BE VALUED AT THEIR REPLACEMENT COST EXCEPT THAT VALUATION WOULD BE APPORTIONED TO THE STATE UNDER A FORMULA OF DAYS IN PORT IN ALASKA VERSUS DAYS IN PORT EVERYWHERE. WE BELIEVE THAT A PORTION OF THE REVENUES FROM THESE IMPORTANT PROPERTIES SHOULD BE SHARED BY ALL ALASKANS. TANKERS, GAS PROCESSING PLANTS AND REFINERIES ARE SIMPLY EXTENSIONS OF THE PRODUCTION AND PIPELINE TRANSPORTATION PROPERTIES.

THE BILL ALSO AMENDS THE PROPERTY TAX STATUTE TO MAKE ABSOLUTELY CLEAR THAT TAXES PAID TO MUNICIPALITIES WHICH EXCEED THE MUNICIPAL LIMITATIONS ARE NOT CREDITABLE AGAINST THE STATE PROPERTY TAX.

I WOULD LIKE TO ADD A FEW COMMENTS ON OUR RESERVES TAX PROPOSAL. BECAUSE OF RECENT TAX CHANGES AND UNFORESEEN EVENTS, WE HAVE

DEVELOPED A SURPLUS IN FISCAL YEAR 1977. THIS SURPLUS IS SOMEWHAT ILLUSORY, HOWEVER, SINCE MOST OF IT REPRESENTS RESERVE TAX PAYMENTS WHICH WILL BE RECOUPED IN SUBSEQUENT YEARS BY OIL AND GAS COMPANIES THROUGH CREDITS AGAINST THEIR SEVERANCE TAXES. THE DEPARTMENT BELIEVES THAT IT MAKES SENSE TO REDUCE THIS YEAR'S TEMPORARY SURPLUS AND FREE UP ADDITIONAL REVENUES IN FUTURE YEARS. THE BILL WOULD DO THIS BY REDUCING THIS YEAR'S RESERVES TAX MILLAGE RATE FROM 20 MILLS TO 12 MILLS. AT THE SAME TIME, HOWEVER, I AM PROPOSING THAT IF THERE IS A DELAY IN THE START-UP OF THE TRANS-ALASKA PIPELINE, THEN AN ADDITIONAL RESERVES TAX PAYMENT WILL BE DUE.

THUS IF ON OCTOBER 1, 1977 THE TRANS-ALASKA PIPELINE IS NOT TRANSPORTING AT LEAST 600,000 BARRELS A DAY THEN AN ADDITIONAL 8 MILLS WOULD BE IMPOSED. ALSO IF ON DECEMBER 25, 2977 THE TRANS-ALASKA PIPELINE IS NOT TRANSPORTING AT LEAST 1.2 MILLIONS BARRELS A DAY THEN A RESERVES TAX WOULD BE IMPOSED FOR 1978 AT A RATE TO BE SET BY THE NEXT LEGISLATURE. WE

THINK THIS BILL IS IMPORTANT TO PRESERVING THE STATE'S FINANCIAL FLEXIBILITY DURING THE NEXT FISCAL YEAR.

IN ADDITION TO TAX CHANGES WHICH I AM PROPOSING FOR THE OIL AND GAS INDUSTRY, I AM ALSO PROPOSING A TAX MEASURE WHICH WILL PROVIDE SOME RELIEF TO INDIVIDUAL TAXPAYERS WHO ARE IMPACTED BY THE INCREASING COST OF ENERGY. AS A PART OF OUR TAX PACKAGE WE ARE PROPOSING A FUEL CREDIT FOR INDIVIDUALS TO TAKE ON THEIR INCOME TAX RETURNS TO ACCOUNT FOR THE HIGH COST OF ENERGY. THE CREDIT WILL BE EQUAL TO TWO PERCENT OF A PERSON'S HOME FUEL EXPENSES OR A MINIMUM CREDIT OF $10.

ALL OF THESE BILLS TOGETHER REPRESENT A COMPREHENSIVE REVISION OF OUR OIL AND GAS TAX STRUCTURE. THEY CLOSE CURRENT LOOP-HOLES AND PROTECT THE STATE FROM THE FUTURE UNCERTAINTIES OF FEDERAL OIL PRICING AND CORPORATE MANIPULATIONS. I URGE THAT YOUR COMMITTEES REPORT FAVORABLY ON THESE BILLS.

IN JUDGING THE TAX MEASURES BEFORE YOU I BELIEVE THAT WE MUST NOT ONLY PROTECT OUR REVENUES IN THE SHORT TERM BUT ALSO INSURE SUFFICIENT RETURN FROM THESE NON-RENEWABLE NATURAL RESOURCES FOR FUTURE ALASKANS AS WELL. WE SHOULD NOT BE SWAYED BY THE ARGUMENTS OF THOSE WHO WOULD HAVE US RECOVER FROM OUR NON-RENEWABLE NATURAL RESOURCES ONLY AMOUNTS SUFFICIENT TO COVER TODAY'S OPERATING EXPENDITURES. WE SHOULD NOT BE THAT SHORTSIGHTED THAT WE FORGET THAT THE REVENUES FROM THESE RESOURCES BELONG TO SUCCESSIVE GENERATIONS OF ALASKANS. ACCORDINGLY, IN DECIDING THE CORRECT LEVEL OF TAXATION LET US NOT FORGET FUTURE ALASKANS WHO WILL INHERIT THE STATE WHEN THE OIL AND GAS RESOURCES ARE DEPLETED. WE SHOULD WORK TO ELIMINATE THE LOOPHOLES AND POTENTIAL EROSIONS FROM OUR TAX SYSTEM AND SET A LEVEL OF TAXATION WHICH WILL RETURN REVENUES TO THE STATE FROM THOSE NATURAL RESOURCES FOR OURSELVES AND FUTURE GENERATIONS.

TESTIMONY BEFORE THE JOINT HEARING
OF THE
SENATE RESOURCES COMMITTEE
AND THE
HOUSE RESOURCES COMMITTEE
OF THE

ALASKA STATE LEGISLATURE

BY

RICHARD M. DONALDSON

VICE PRESIDENT FOR GOVERNMENT AND PUBLIC AFFAIRS

THE STANDARD OIL COMPANY (OHIO)

AT JUNEAU, ALASKA

ON MARCH 24, 1977

CONCERNING PENDING OIL TAX PROPOSALS

Testimony Before The Joint Hearing
Of The
Senate Resources Committee
And The
House Resources Committee
Of The
Alaska State Legislature
By
Richard M. Donaldson
Vice President For Government And Public Affairs
The Standard Oil Company (Ohio)
At Juneau, Alaska
On March 24, 1977
Concerning Pending Oil Tax Proposals

Senator Poland, Representative Osterback and Members of the Resources Committees:

I am Dick Donaldson, Vice President for Government and Public Affairs of Sohio, The Standard Oil Company of Ohio. Most of us are acquainted and I expect that all of you know of Sohio's and BP's interests in Prudhoe Bay and the Trans Alaska Pipeline, so I won't waste any words of introduction summarizing them. I would underscore, however, our continuing and long term interests in the future of Alaska as companies engaged here and as people working for them, many of whom now live here.

With respect to the subject of this hearing and all of the tax proposals you may consider, I hardly know where to begin. I guess that my first response is one of "disappointment". Let me explain, because my disappointment is probably not what you might be assuming.

About a year ago I appeared before a joint hearing of your Committees here in Juneau. Other tax legislation was being considered then. At the end of our discussion that day, I urged

the State to take whatever time was necessary to assess and balance three things: the future revenues of the State, the future expenditures of the State, and the State as a place to do business since a substantial majority of the people of Alaska are engaged in or work for businesses of all kinds. I not only urged the State to consider these three things but also to determine a longer term taxing and leasing policy for the State that would serve all three needs. I stated that my company would be responsive to such policy studies and would participate in them if invited. I felt that such a policy assessment was long needed by all of us, and that since the State no longer had its back to the wall financially, it could and should take some time to do the job right.

I can tell you that I was pretty excited when I read the Governor's statement on March 31, 1976, to your Committees. He said that the State's taxing policy must accomplish the following objectives:

1. It must generate sufficient revenues not only to compensate the State for additional service costs attending such development but also to provide a reasonable additional "dividend" to Alaskans.

2. It must leave profits to investors sufficient to encourage their continued interest in Alaskan resource development, especially where high risks, such as those in the area of oil and gas development, are involved.

3. It must be reasonably responsive to national and world economic trends of the time.

4. It should not discriminate on the basis of ownership.

5. It must reduce uncertainty and encourage stable expectations about future resource tax and management policies.

I felt further encouraged when I read Senate Concurrent Resolution No. 101 which spoke of the "revenue needs of the state", "revenue from oil and gas leases and production from oil and gas", and the "effect of increased taxation *** on future oil and gas development in the state".

The thought that both the Administration and the Legislature were going to take a thoroughgoing look at State revenues, State expenditures and their impact on the private sector in Alaska was good news. On July 1, 1976 I wrote Gregg Erickson, Director of Research Services, Legislative Affairs Agency, identifying some of the subject areas these studies might examine, and sent information copies to Commissioner Gallagher and Commissioner Martin who were heading up the Administration's studies. A copy of that letter is attached to my testimony today as Attachment A, if you are interested in it.

During the summer and fall which followed not much appeared to be happening with these studies, or at least not very much was visable to us. Various consultants were hired and the word

that filtered out seemed to indicate that some of them were looking at additional revenue possibilities, but not much else. In October, I tried to stir up some interest again on the need for a longer term taxing and leasing policy for the State, its people and our industry. I spoke to the Fairbanks Industrial Development Corporation, the Anchorage Chamber of Commerce, the Anchorage Rotary, the Kenai Chamber of Commerce, and to the Bar Association here in Juneau. Again, the responses seemed affirmative.

Since the first of the year there has been a lot of new tax bills introduced for consideration by the Legislature, and I suppose that's to be expected in the first session of every new Legislature. My disappointment, however, was that there still had been no in depth study of the policy implications, of how such revenue measures might impact the longer term economy of the State that will depend a lot on continued, reasonable resource development.

Today, I'd like to summarize and give you copies of some of the work Sohio undertook in anticipation of responding to the State's policy studies. I will tell you about some other work we undertook which is still in progress and which I hope will be finished before too long. All of this bears on both the policy questions to be considered and the bills before your Committees.

First, let's take up the subject of new revenues to the State. Many times over the last few years we have been asked to project what our company and the State might receive from Prudhoe Bay and the Trans Alaska Pipeline. We knew that if we furnished the State projections of our own future earnings expectancies, the rules of the Securities and Exchange Commission would then require us to disclose such projections to the general public and to publicly and perpetually update those projections any time our internal estimates of the future changed. The burden of disclosing such projections on a perpetual basis and the potential liabilities to investors if such projections turned out to be wrong have led substantially all U.S. companies to decline publication of any earnings projections. Our counsel has advised against this too. Instead, and in order to be of some help to the State, we developed a hypothetical projection of tax payments to Alaska which would result from an assumed one-third ownership of Prudhoe Bay and the Trans Alaska Pipeline by each of three typical companies. None of these companies is intended to represent a company actually involved in the development of the field or the pipeline. Rather, the projections are intended to demonstrate the level of tax obligations which would result from the project being owned by companies varying in size and scope of overall operations.

This particular work was included in a paper entitled Sohio Submission One which was submitted informally to the Alaskan Administration and Legislature on October 28, 1976, and which I offer now formally as Attachment B to my testimony today. To summarize, this paper examined the Alaska state income tax under the allocation method of the Multistate Tax Compact and made illustrative projections of the substantial revenue that Alaska would receive as a result of the first ten years of operation of Prudhoe Bay and the Trans Alaska Pipeline. No oil or gas production from any other fields in Alaska, either existing or likely, were included in these projections. The projections of revenue included estimates of the State's royalty income and the tax receipts resulting from Alaska's present severance tax, reserves tax, ad valorem tax and state income tax. The projections showed that under present Alaska laws, and assuming a $13.00 per barrel selling price in California, Alaska would receive from Prudhoe Bay and the Trans Alaska Pipeline average annual revenues on the order of $1 billion without consideration of any factor for future inflation. If the selling price in California were $10.00 per barrel, or $16.00 per barrel, Alaska would receive annual revenues on the order of $800 million or $1.6 billion, respectively.

While that's a lot of money, even without the numbers being escalated for any inflation, we also wanted to know from a "fair

share" standpoint what part of the total revenues attributable to this Alaskan oil the State could expect to receive as compared to all other states in the U.S. which will buy, refine, transport and use it. Let me give you a few interesting statistics based on the Sohio Submission One example. Since the Prudhoe Bay field is located on state lands, Alaska would receive 100 percent of the royalty payments. Similarly, Alaska would receive 100 percent of the severance tax payments and 100 percent of the ad valorem tax payments. The reserves tax payments and the severance tax credits resulting from those payments are also strictly an Alaskan transaction. Since the field and pipeline are located in Alaska, though most of the sales of the oil will probably not be, the State will also receive state income tax payments amounting to 22 percent of the total income tax paid to all states in the U.S. Finally and at all three of the oil price levels assumed in Sohio Submission One which were intended to range over the probably market price, Alaska, as one state, would receive 75 percent of all revenues to be received by all fifty states from oil production at Prudhoe Bay.

Though Sohio Submission One looked at only one field and one pipeline, it does provide a lot of assurance that Alaska's revenue needs will be well covered in the years ahead.

This was confirmed directionally by the Report of the Department of Revenue to the Governor on Alaska's Oil and Gas Tax

Structure, dated February 11, 1977. Chapter IV of this Report states that the Department of Revenue has calculated a combined general fund and permanent fund balance at the end of fiscal year 1985 ranging from $8.5 billion to $8.7 billion, depending on which gas pipeline project is ultimately built to take gas from Prudhoe Bay. In any event, the State is looking forward to very substantial revenue surpluses. That has another implication for the legislation you are considering now. Any additional tax legislation will only add to the surplus.

The second piece of work Sohio undertook in anticipation of State studies on longer term tax and leasing policies was a comparison of the total tax burdens under the present laws in Alaska and other leading oil producing states. This work proved further the testimony I presented to you a year ago and was developed on the same factual base as we used in Sohio Submission One. We called it Sohio Submission Two and submitted it informally to the Administration and Legislature on January 21, 1977. May I offer it formally now as Attachment C to my testimony today.

Sohio Submission Two compares the projected total taxes that Alaska will receive as a result of the first ten years of operation of Prudhoe Bay and the Trans Alaska Pipeline with the total taxes which the State would receive if it had the tax structure of the other three leading oil producing states of Texas, Louisiana or

California. Since this was a comparison of the taxes of these states, Alaska's royalty payments were not considered in Sohio Submission Two. For comparison purposes, only the $13.00 per barrel California selling price was used. This comparison, again under present law, confirmed that Alaska's tax burden on a project like Prudhoe Bay and the Trans Alaska Pipeline already equals or exceeds that of other oil producing states. Specifically, Alaska's present tax burden is 176 percent of the Texas tax burden, 99 percent of the Louisiana tax burden, and 111 percent of the California tax burden. Since state tax burdens represent a cost to companies engaged in oil exploration and production, the overall tax burden in one state compared to another is one of the factors considered by companies in deciding where additional oil exploration should be done.

Other comparisons in depth with the same import have been done by the Alaska Legal Committee of the Alaska Oil and Gas Association, and I think you will find them to be of interest.

There are, of course, other factors which influence decisions on where resource development will be carried on. Among these factors are the basic costs of finding, producing and transporting oil in various states or regions of the U.S. The third subject Sohio has been examining with respect to the State's long term taxing and leasing policy considerations is how the costs of

carrying on oil and gas development in Alaska and other areas of the country compare. We know from our general experience that there is a premium to be paid for working in the arctic and offshore, but we hoped to be able to document this and do so on a comparative basis. Good current data is difficult to come by. We are making progress, but not as fast as I had hoped, so I do not have finished work on that to offer you today.

The work so far confirms the premium cost factor of oil and gas development in the arctic and offshore. Let me give you a few examples. It costs two or three times as much to drill a well in Alaska as it would to drill the same well most places in the Lower 48. It sometimes costs more to ship a piece of casing to northern Alaska than the casing itself costs. Hourly rates for construction labor are substantially higher in the arctic, and the productivity is in many instances less than one-third or one-half of what you expect in other areas of the country due to the extreme weather conditions.

Last August, the Federal Energy Administration published a study that had been made of potential future developments of NPR 4.[1/] While this report was written in terms that were somewhat difficult for us to understand, at least two points seemed clear. The first one was that the costs are so high and risks are so great in the

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1/ "The Exploration, Development and Production of Naval Petroleum Reserve No. 4." published by the Federal Energy Administration August, 1976.

arctic that with present prices of oil in California, it would be uneconomic to develop oil in Naval Petroleum Reserve 4 unless a field or a cluster of closely located fields were found with a total reserve of one-half billion barrels of oil. The significance of this is startling when you consider that a one-half billion barrel field in the Lower 48 would be a real bonanza. The second point in that report that struck us was the indication that at present oil prices, a 3-billion barrel field would earn a private investor an 8 percent rate of return. If the figures of this study are right, it is doubtful that anyone would undertake a venture like that for that level of economic return.

The three areas of our studies which I have summarized tells you about where we were when this session of the Legislature began. Since then, a number of proposals for additional Alaska taxes on future oil and gas operations have been introduced for consideration. We have tried to study all of these proposals, and have made a start on two aspects: their economic impact on our industry here and their legality. Because there are so many bills, I would like to comment on those that have been submitted by members of the Legislature as a group and on those that have been submitted by the Administration as a group. Specifically, the bills that I will be referring to as Legislative bills are those pertaining to severance tax, income tax, and the net proceeds tax. In connection

with those submitted by the Administration, I will be including the franchise tax, the property tax, and the severance tax.

The economic impact analysis produced some startling numbers. You will recall that in our Sohio Submission One and Sohio Submission Two we calculated what the tax income to the State will be from Prudhoe Bay and the Trans Alaska Pipeline under present severance tax, ad valorem tax and income tax during calendar years 1977 through 1986. We then made the same calculations assuming the taxes proposed by the Legislature were enacted, and also made them assuming the taxes proposed by the Administration were enacted. In each case we compared the results with the same leading oil producing states, Texas, Louisiana and California. The results of all this are set forth in Sohio Submission Three which is Attachment D to my testimony today and which I formally offer now as a part of your Committees' record.

You may want to examine Sohio Submission Three in detail, but let me highlight a few things for our discussion today. The hypothetical companies assumed to own all of Prudhoe Bay and the Trans Alaska Pipeline in Sohio Submissions One and Two were projected to pay the State $5.5 billion from 1976 to 1986 under present Alaskan laws. You will recall that the $5.5 billion figure represented revenues from the field and pipeline only, and did not include likely revenues from any other present or

future oil and gas development in Alaska. You will also recall that these figures have no factor in them for any inflation which will probably occur. The results are summarized in the following table, and show that Alaska would collect from the three companies about the same total amount it would if it had the tax structure of Louisiana on Alaska's books, 176% of the amount it would if it had the tax structure of Texas' laws, and 111% of the amount it would if it had the tax structure of California.

		If Alaska had the taxes of:		
	Alaska	Texas	Louisiana	California
Severance Tax	$2,688	$1,649	$4,466	$ 0
Ad Valorem Tax	2,038	1,459	684	4,202
Income Tax	753	0	382	728
Total	$5,479	$3,108	$5,532	$4,930
Alaska as a percent of the other states		176%	99%	111%

In Sohio Submission Three, we first calculated the results if the Administration's tax proposals are enacted and found that the State's tax income just from Prudhoe Bay and the Trans Alaska Pipeline is non-inflated dollars would increase by about $2 billion through 1986 over what it would be under Alaska's present tax laws. This would bring the total payments by the three companies in our analysis to $7.5 billion. Comparing these results with the results under the tax structures of Texas, Louisiana and California

showed that Alaska's tax income would be 240% of the revenues produced by the Texas laws, 135% of the revenues produced by the Louisiana laws, and 151% of the revenues produced by the California laws. As Sohio Submission Three shows, that even the passage of one of the Administration's proposals significantly lengthens Alaska's lead over the other oil producing states.

		If Alaska had the taxes of:		
	Alaska	Texas	Louisiana	California
Severance Tax	$3,283	$1,649	$4,466	$ 0
Ad Valorem Tax	2,582	1,459	684	4,202
Income Tax	1,591	0	382	728
Total	$7,456	$3,108	$5,532	$4,930
Alaska as a percent of the other states		240%	135%	151%

The next thing we did in Sohio Submission Three was to calculate the results if the Legislature's tax proposals are enacted and found that the State's tax income just from Prudhoe Bay and the Trans Alaska Pipeline in non-inflated dollars would increase by $3.6 billion through 1986 over what it would be under Alaska's present tax laws. This would bring the total payments by the three companies in our analysis to $9 billion. Again, comparing these results with the results under the tax structures of Texas, Louisiana and California showed that Alaska's tax income would be 291% of the revenues produced by the Texas laws, 163% of the

revenues produced by the Louisiana laws, and 183% of the revenues produced by the California laws. And again, Sohio Submission Three shows that the passage of just one of the Legislature's proposals will significantly lengthen Alaska's lead over the other oil producing states.

		If Alaska had the taxes of:		
	Alaska	Texas	Louisiana	California
Severance Tax	$4,219	$1,649	$4,466	$ 0
Ad Valorem Tax	2,038	1,459	684	4,202
Income Tax	2,774	0	382	728
Total	$9,031	$3,108	$5,532	$4,930
Alaska as a percent of the other states		291%	163%	183%

In making the calculations in Sohio Submission Three we assumed a price of $13.00 for oil in California, and included no factor for inflation. I realize that our treatment of price and inflation is conservative and that it is different from the way the Department of Revenue has done its work. The surpluses in 1985 for the General Fund and for the Permanent Fund which have been projected by the Department of Revenue and which I referred to above reflect some assumed increases in the price of oil and a factor for inflation. In any event, it seems likely that any increases in tax income which the State will realize if it enacts part or all of

the Legislative package or the Administration package will simply increase the surpluses. I don't know what the total surplus would then be, but it could be several times $8.5 billion now projected by the Department of Revenue under the present laws of Alaska.

Most of you know that I have always been reluctant to argue legalities of proposed legislation. It sometimes produces more misunderstanding than help. It is, however, a subject of concern from time to time on the part of the Legislature itself, the Administration and our industry. As you know, we routinely review significant legislative proposals for legality. With the number of bills before this Legislature and the diversity of their concepts, we have only had time to make a preliminary review. For what it's worth and not to be argumentative, let me give you some first observations. They suggest that further legal analysis may be appropriate for both the State and ourselves.

In addition to the numerical facts of the matter, there are some circumstances in the overall setting which bear on the legality of further tax proposals. For about seven years or perhaps a little longer, the State has made persistent efforts to increase its tax revenues from oil and gas activities in Alaska, and particularly its expected revenues from Prudhoe Bay and the Trans Alaska Pipeline. The focus has been rather narrow and the principal burden has been

directed to a few larger companies who have come to the State to engage in oil and gas exploration, development and transportation. Most all of such taxes impact upon interstate commerce by reason of the fact that over 99 percent of the markets for this Alaskan industry are located outside the State. The results are the tax laws presently on the books here. It is generally recognized that these laws as now constituted will produce revenues far in excess of the State's revenue needs over the next decade and beyond. No revenue need justification has even been attempted for the new tax proposals now before this Legislature. The cumulative effect of all this raises questions whether further substantial taxes become a confiscation of an equity interest or a modification of royalty contracts after the leases have been sold. The cumulative effect raises the question of a demonstrable bias against interstate commerce that would lead a court to conclude that this package of taxes discriminates against and unduly burdens interstate commerce. Again, let me say that I am outlining these questions to point up some legal areas I believe we all should examine, and not to be argumentative.

You may also be interested in some specific comments on the new income tax proposals before your Committees. My comments in this regard relate essentially to two legal concepts: fairness

and uniformity. Fairness to the taxpayer is of course something that should characterize all taxes that a government imposes. It takes on an added dimension, however, in the context of a federal system where, in addition to the exactions of the national government, a company can be obliged to contribute to the fiscal needs of as many as fifty state governments. If such businesses are not to bear a disproportionate share of the total tax burden, it is essential that the taxes imposed by each jurisdiction reflect a high sense of equity, of fairness, in determining the portion of the company's activities to be included in that state's tax base.

This concern for fairness is embodied in the federal constitution in the Commerce Clause and the Due Process Clause, and is at the core of the approach which the Supreme Court has charted in construing those provisions as they relate to state taxing statutes. A similar sentiment emanates from the Equal Protection Clause. Thus, for example, the U.S. Supreme Court has said that a multi-state enterprise should not be made to "bear more than its fair share" of the costs of state government, "that taxes imposed on income from interstate commerce (should) be fairly apportioned" between the States in order to avoid the risk of multiple taxation, and that the tax should be "a constitutionally fair demand by the State for that aspect of the interstate commerce to which the State bears a special relation." It is interesting

and somewhat refreshing that a matter so fundamental to our federal system should be governed in the final analysis by a simple, penetrating, common-sense inquiry: Is it fair?

Although, as one might expect, the precise dimensions of this "fairness" standard have not been fully spelled out, there are a number of decisions which shed some light along the way. For example, we know that it is not fair in terms of the Commerce Clause for a state taxing statute directly or indirectly to prefer local activity at the expense of interstate activity. The cases also tell us that it is unfair for a State to apply an imprecise apportionment formula which inflates the portion of the multi-state enterprise included in its tax base. We know that it is unfair for a State to adopt an apportionment formula so plainly inconsistent with that prevailing in other States that the logical and inevitable consequence will be that interstate income is subjected to multiple taxation.

In the light of these indications, it would seem appropriate for your Committees to give consideration to the provisions of each new proposal to ascertain how fairly each one treats the multi-state companies which are actively engaged in Alaska. With reference first to the proposed Oil and Gas Corporate Franchise Tax, there are several general lines of inquiry which I would recommend and which in turn will likely lead to further, more specific questions.

The proposed substitution of an "extraction factor" for the widely used "sales factor," would apportion the entire enterprise of a multi-state taxpayer according to a factor which measures only the taxpayer's oil and gas extraction activity. The essential problem with the extraction factor is that, unlike the standard three factors which measure activity common to virtually all profit-making endeavors and thus will generally result in a fair estimate of the portion of the taxpayer's entire enterprise related to the taxing state, the extraction factor is very narrowly based and thus seems wholly inappropriate to the task of apportioning the fruits of a multi-faceted interstate enterprise. As a result, this factor, in the case of Sohio, would apportion to Alaska income derived from a wide variety of our activities wholly unrelated either to Alaska or to oil and gas extraction, such as chemical sales, patent licensing, coal and uranium extraction, sales of plastic products and toothbrushes, and fertilizer sales, even though none of these activities will be reflected in either the numerator or the denominator of the fraction. I submit that this overreaches all bounds of fairness.

Moreover, as a result of the patent inconsistency of the extraction factor with the sales factor applied in the overwhelming majority of other states, the extraction factor will inevitably lead to multiple taxation of income derived from the sale or exchange of Alaskan oil out-of-state. Between Alaska and the

state of sale, for example, as much as 133% of this income could be taxed. This would well be the impact on Sohio and I ask you to consider whether this represents fair treatment of interstate commerce.

You may also want to refer to Tables A, B and C of Sohio Submission Three and particularly the line on each of those tables entitled, "Effective Composite State Income Tax Rate on Total Taxable Earnings". The jump in the percentages from those shown on Table A to those shown on Tables B and C are a pretty clear demonstration of the duplicative tax impact that raises the Constitutional questions.

A final point in reference to the franchise tax proposal which I think the Committees ought to consider is whether the effect of the $250 million floor is to exempt local producers while concentrating the impact of the tax on the multi-state producers. I understand the interests which this provision is designed to protect and am sympathetic to them. But the legal question is can the actual effect of this be reconciled with the notion of fairness underlying the Commerce Clause.

In the same vein, both the net proceeds tax proposal and the separate accounting proposal should be subjected to the same careful analysis. In general, I hope the Committees will consider whether it is appropriate and fair to single out the oil industry from all other corporations in Alaska for such extraordinary tax

treatment. In particular, the deductions allowed under these proposals should be analyzed to see whether they discriminate between in-state and out-state expenditures, which I submit may constitute unfair treatment of interstate commerce.

Finally, I would like to refer briefly to the legal concept of uniformity which Alaska has endorsed by its adoption of the Uniform Division of Income for Tax Purposes Act and of the Multi-state Tax Compact. I submit that the proposals I have just been discussing amount to a major retreat from the principle of uniformity, especially in light of the unavoidable duplicative taxation which the extraction factor would generate. Moreover, the separate accounting and net proceeds proposals are difficult to reconcile with the Multi-state Tax Commission's view that the three-factor formula should, in the interests of uniformity, enjoy clear predominance over any alternative approaches. As the Commission has said in its proposed regulations under the Compact, separate accounting "may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment and allocation provisions contained in Article IV." Even under the Compact, departure from the three-factor formula is to happen, if at all, only on a case-by-case basis within the reasonable discretion of the Tax Commissioner. In this light, the Committees should ask

to what extent, if any, Alaska's statutory departure from the Compact in the case of the State's largest industry would be consistent with Alaska's continued membership in the Multi-state Tax Compact.

Well, where are we? I realize that I've given you a lot to think about. I don't mean to overwhelm you, but the subjects you are considering are pretty substantial in and of themselves. Let me try to tie it all together with five principal perspectives.

First, the State's needs for revenues are more than covered for the forseeable future, and the past concerns about running out of money to meet current needs are no longer with you.

Second, the State's present tax laws concerning oil and gas exploration, production and transportation equal or exceed those in the other leading oil producing states. Any further oil and gas taxes will simply add to the State's projected revenue surpluses.

Third, the other costs businesses must pay for carrying on exploration, production and transportation in Alaska reflect the premium that must be paid in pursuing the potential of energy resources in the arctic. It is a penalty that Alaska itself must recognize in considering major new tax legislation, notwithstanding the high potential it has in energy resources. This is particularly true now when construction of the Trans Alaska Pipeline is winding down. Alaska is moving into what Robert R. Richards of the Alaska

Pacific Bank has recently called the "post pipeline plateau".[2/] He forecasts a "modest downturn" but not a "bust". He points out that the construction industry will experience somewhat of a setback in 1977, that retail and wholesale trade will level off in Anchorage and will drop significantly in Fairbanks, and that the State's economy in general will decelerate this year. A bright spot in the State's economy will be the Kenai region which will grow as a petroleum service and supply base for both Cook Inlet production and Gulf of Alaska exploration. He notes that Alaska's future remains bright because of its resource and other potentials.

Underlying this future, however, is the assumption of continued, reasonable resource development, and the positive incentives needed to assure its continuation. This subject was addressed in depth in Washington, D.C. last Monday, in San Francisco on Tuesday, and in Anchorage yesterday in hearings before the Federal Energy Administration on the appropriate pricing of Prudhoe Bay oil. I attended the hearings in Washington and Anchorage and would like to give you a report on the testimony of three witnesses. Their remarks recognized the high costs and risks of oil and gas development in the arctic, the need for positive economic incentives to encourage this work, and the important role Alaska will play in meeting the United States' needs for energy in the future.

2/ "Economic Outlook for the Year 1977", Alaska Business Trends, Alaska Pacific Bank.

Commissioner Sterling Gallagher represented the State in the Washington hearing and made a fine presentation. In at least four places in his testimony he urged the FEA to provide "positive price incentives" at the wellhead in Alaska that would encourage future development. He recognized that this applied to developments now underway like Prudhoe Bay and to all future resource development in Alaska. He expressed real concern that other possible courses of decision by the FEA would "virtually guarantee that no other North Slope resevoir is developed and (would) create a pronounced disincentive for the State of Alaska and the Alaska Native corporations to make any more lands available for oil and gas leasing." He stated that "The North Slope is a frontier area, still largely unexplored and untested despite past and present exploratory work. Likely discoveries and development will be much closer to the threshold of economic visability than is the main pool of Prudhoe Bay." With respect to Prudhoe Bay he noted that at the low wellhead prices possible under one FEA alternative, "the economic justification for developing even the main Prudhoe Bay oil pool would, if discovered today, be an 'iffy' proposition. And I can assure you that the likelihood would be nil for any further North Slope development other than that to which the companies are already deeply committed." I sat there and quietly cheered when the Commissioner concluded his testimony

saying, "Oil production decisions generally entail middle to long-term investments, and stability is more important in the decision than making ephemeral benefits that may be offered by FEA." I'm sure that you recognize that the interests of the State and those of our industry are identical in this, both before the FEA and generally speaking.

Senator Ted Stevens also spoke eloquently for Alaska in the FEA hearing urging the maximum incentives possible under present federal law.

The third witness before the FEA hearings in Washington that I want to report on was David P. Goodman, Managing Director of Morgan Stanley & Co. Incorporated, investment bankers in New York City. Mr. Goodman is also a member of the Energy Financial Advisory Committee to the FEA. His firm arranged over $5.5 billion of the financing for Prudhoe Bay and the Trans Alaska Pipeline, and he personally had the responsibility for over $5 billion of that amount. In the course of his work he has had in depth discussions with more than seventy major institutional investors regarding the financing of these and other large energy projects. His testimony before the FEA last Monday is Attachment E to my testimony here today, and I urge you to read the full account. There are several parts of his testimony to the FEA which bear directly on the business climate here in Alaska and which I would like to highlight for you.

With respect to the central issue on the pricing of Alaskan oil, Mr. Goodman made the following statement which he characterized as a strong one. He said that as a result of all the financing work he had been engaged in and all the discussions with institutional investors he had had,

> "I have concluded that if the Administration establishes price control or entitlements treatment for (Alaska North Slope) crude which does other than allow it to compete in price with world oil in the United States market, this action will have a serious detrimental impact on investor's willingness to provide financing for the development of future energy projects, both for petroleum and other energy sources."

He noted that there were four areas of risk that lenders sought assurance on: that the oil was there, that the pipeline and terminal would work, that there would be a ready market for the oil, and that the overall project evidenced continued financial viability. He said that his firm had been able to answer most of the questions most investors had, but

> "there was one risk which we were unable to eliminate in the minds of certain major, sophisticated investors, and they declined to participate in the financing partly because of it. That risk was that government would not permit (Alaska North Slope) crude oil to compete with world oil in the market place, but would place restriction on its price such as are currently under consideration."

A few moments later he said:

> "That is why my firm feels strongly that unfavorable treatment for (Alaska North Slope) crude will adversely affect the ability of industry to finance future energy projects."

Mr. Goodman then turned to the risk elements of Alaskan North Slope development and the appropriate rate of return for projects like Prudhoe Bay and the Trans Alaska Pipeline. He said:

"These hearings are also investigating the risk elements of North Slope development and the appropriate rate of return for this project. Both of these subjects were obviously matters of great interest to investors. This project is one of the riskiest ever undertaken by industry. The important risks aren't those cited in the Mortada study. The cost of exploration before the Prudhoe Bay discovery well is insignificant compared with the risk undertaken by the industry in going ahead with the project under the Pipeline Right of Way Act. The participants were committed to complete the project no matter what the cost in the face of absolute federal and state controls over construction. Remember that this project had been delayed over four years by court intervention and government redesign. Compliance with these actions had already more than doubled costs. Yet the industry was forced to accept a set of stipulations far more exacting than any ever applied to such construction before, stipulations that many in the industry were concerned about being physically able to comply with, and to proceed with absolute authority vested in one man to halt construction or require design changes that could cause costs to skyrocket with no accountability for cost effectiveness. The industry undertook these absolute obligations, and costs did rise to the point where, if ANS crude is allowed to compete against world oil, the Mortada study and industry figures indicate that the project will earn a discounted return in the area of 14% to 16%.

"Mortada states that a return of 12% should be equitable. There may be some analogy to the returns allowed to regulated industries in Mortada's thinking, although even higher returns are allowed in risky start-up ventures there. But regulated returns involve an exclusive franchise wherein subsequent rate regulation assures such a return. No one is assuring the price of Alaskan or world oil.

"If we had projected a 12% return from the outset, I'm not sure that the project could have been financed. It's our experience that oil companies will not undertake a project involving any significant risk for a projected return of under 15%. The industry will earn returns of approximately 22% in the British North Sea, where they have experienced retroactive majority participation by the British government. The financial institutions who invest in the equity of the leased tankers for the Valdez trade will earn a discounted after tax return in excess of 15% with the benefit of a hell or high water, all events charter from the oil companies. Based on these facts, I cannot accept that a 12% return is equitable for a project of the magnitude and riskiness of the North Slope project.

"The aggregate earnings from the North Slope will be very large. It is one of if not the largest oil field ever found outside of the Middle East. But the costs are high and the rate of return will be modest, particularly bearing in mind the risk. If you want industry to be able to finance the development of major energy discoveries this country so sorely needs, particularly the smaller companies you want to favor in your OCS leasing policies, do not make the wrong decision in pricing ANS crude oil. It is critical with regard to establishing an overall energy policy, of which the issue of pricing Alaskan North Slope crude oil can be looked on as an important first step to retain the willingness of the private sector to provide financing of future energy projects."

From all of the foregoing, you can see that the health of Alaska's economy has some sensitivities which the present pricing determination of the FEA materially impact. Similar impacts can also come from substantial new state taxes on oil and gas exploration, development and transportation. The point is I hope you will

take as much care on your consideration of the various tax proposals as we all want the FEA to take on the pricing of Alaskan oil. This is also important to all the Alaskans whose trade and business depends directly or indirectly on continued, reasonable resource development right here in Alaska.

The fourth of the five perspectives I mentioned concerns the FEA hearings specifically. It is most appropriate for the State to appear in these hearings and urge the maximum price permitted under federal law for Alaskan North Slope crude oil. That position is based on the need for positive economic incentives for present and future resource development here. On the other hand, it seems utterly inconsistent to me for the State to be urging the need for major economic incentives in Washington and at the same time be seriously considering substantial new taxes on oil and gas in Juneau which would wipe out a big part of whatever incentives there are. May I suggest that these tax measures be given a good deal of study, that whatever tax measures may be appropriate for serious consideration be taken up in the next session, and that the State, our industry and other Alaskan businesses concentrate on critical decisions that are now before the FEA. I understand, but don't know, that the FEA is trying to come to judgment by June 1st. There is a good deal of work to be done there and I hope we can all concentrate on that.

The fifth, and the last perspective, comes back to the point of beginning. The State and the industry still need to resolve a longer term policy for oil and gas taxation and leasing. If nothing else, the events of the last year and the present problems confirm this. It's not too late. Can't we begin again and take a look at the whole picture? At least for Sohio, we're still ready to be responsive.

Thank you.

Richard M. Donaldson
The Standard Oil Company (Ohio)
Guildhall Building
Cleveland, Ohio 44115
March 24, 1977

Attachments:

A - Letter to Gregg Erickson from Richard M. Donaldson, July 1, 1976.

B - Sohio Submission One, October 28, 1976

C - Sohio Submission Two, January 21, 1977

D - Sohio Submission Three, March 22, 1977

E - Statement of David P. Goodman, Morgan Stanley & Co. to FEA on Alaskan North Slope Crude Oil Pricing and Entitlements, March 21, 1977.

ATTACHMENT A

SOHIO THE STANDARD OIL COMPANY

MIDLAND BUILDING, CLEVELAND, OHIO 44115

RICHARD M. DONALDSON
VICE PRESIDENT
GOVERNMENT AND PUBLIC AFFAIRS

July 1, 1976

Mr. Gregg Erickson
Director, Research Services
Legislative Affairs Agency
State of Alaska
Pouch "Y", State Capitol
Juneau, Alaska 99811

Dear Gregg:

I have your letters of June 16 and 22, 1976, regarding the study you are preparing to undertake with respect to Alaska's longer term natural resource leasing and taxing policies.

These letters deal specifically with Alaska's income tax. While I recognize that the figures in these letters are hypothetical, the fact that "answers" have been calculated at the beginning of the study is somewhat disturbing. My experience has been that figuring out specific "answers" before the overall problem has been defined can preclude a study, unduly limit it or affect its objectivity. I certainly hope that none of these things happen as the proposed intersession studies hold out some promise of stability for both the State and our industry.

I am writing to give you some thoughts on three segments these studies could logically consider:

- Future revenues of the State
- Future expenditures of the State.
- Alaska as a place to do business from industry's perspective.

Set out below are some ideas that have occurred to me as starting points for things that could be considered in each of these subject areas.

Future Revenues

1. What are the ranges of revenues that the State government can expect to receive from all of its existing taxes--including those that impact on natural resources and their related facilities; and from other sources such as bonuses, royalties, and the Federal government?

2. To what extent will these revenues cover a reasonable estimate of the State government's future money needs?

3. What are the leasing alternatives available to the State with respect to its natural resources, and what would be the ranges of revenues from such alternatives?

4. What are the taxing alternatives available to the State with respect to its natural resources and other sources, and what would be the range of revenues for each such alternative?

5. How do other states compare with Alaska in tax revenues, in tax rates and in the leasing of their natural resources?

Future Expenditures

6. What is a reasonable estimate of the State government's future money needs for various purposes and in total under a range of prospects with respect to its future business and commercial development?

7. What will be the financial impact of the recommendations in the Governor's recent management and efficiency review?

8. Are management and efficiency reviews in other areas of the State government needed and what financial impacts are they likely to have?

Business Perspective

9. What factors does business use in determining what it considers a worthwhile investment? How does it choose the location for its investments where choices are available?

10. How do business conditions in Alaska compare with those in other states, in terms of availability of resources to be developed, financing, employment, construction and operating costs, regulation, taxes, government attitudes and so forth?

11. What can be learned of business' reaction to significant or continuing changes in the factors listed in the preceding question?

I don't mean to imply that these are the only questions that should be considered, but offer them as some indication of the scope that ought to be examined in a meaningful study of Alaska's longer term tax and leasing policies.

In my testimony on March 30, 1976 before the Joint Hearing of the Senate and House Resources Committees, I suggested such a study and indicated that we would be responsive to such a study. In addition to studying the attachments to your letters, we are thinking about ways in which all the questions noted can be studied and discussed in a manner which would be meaningful and understandable.

These questions are not only of interest to the State government and our industry, but concern everyone in Alaska I can think of--the native regional corporations, other business and commercial interests in the State, labor, the financial community, and people generally. I hope that this study will seek advice on that broader base.

I understand that a study similar to the one the Legislative Council will consider is being initiated by the Administration under the direction of Commissioner Gallagher and Commissioner Martin. Presumably these studies will be coordinated to some extent. It seems appropriate to send the Commissioners copies of this letter and I hope you won't mind my doing so.

Sincerely,

Richard M. Donaldson

cc: Sterling Gallagher, Commissioner
Department of Revenue

Guy Martin, Commissioner
Department of Natural Resources

October 28, 1976

SOHIO SUBMISSION ONE

This paper is submitted for consideration by the Alaskan Administration and Legislature in the intersession studies each is now conducting concerning the long term oil taxation and leasing policy for the State.

The first subject of inquiry by the staffs working for the Legislature and the Administration on these studies concerns the nature, revenue potential and appropriateness of Alaska's present tax laws as they will apply to the Prudhoe Bay field and the Trans Alaska Pipeline (TAPS). One point of interest to the staffs in this area of inquiry is Alaska's state income tax and how it will apply.

This submission examines the state income tax of Alaska and makes projections as to what the income tax payments will be utilizing certain assumptions for the future operations of Prudhoe Bay and TAPS. However, since state income tax is only one part of the substantial total revenue Alaska will receive as the result of Prudhoe Bay and TAPS, the non-income tax revenues have also been calculated. These revenues include projections of the State's royalty income and tax receipts resulting from Alaska's severance tax, rese es tax, and ad valorem tax. In addition, this submission points out certain relationships which exist within the present Alaskan tax structure.

Most of the larger companies in the United States are engaged in business activities in a number of states. Each of the states in which these companies do business expect to receive some state income tax

payments from them. Yet, if a company were to pay taxes to each state in which it operates calculated by applying that state's income tax rate to the total earnings of the company wherever earned, multiple taxation, or as the law states it, "duplicative taxation" would result leaving the firm with little, if any, after tax income. As companies became larger and did business in many states, there was a need for some method of equitably determining what each state's fair share of such income taxation should be.

The Multistate Tax Compact was set up by the states to ensure that effective and fair taxation of multistate businesses could be established among the various states. Today, most of the fifty states are members of the Multistate Compact, and Alaska has been a member since 1970 as a result of the Legislature's action.

States which are members of this Compact follow the Uniform Division of Income for Tax Purposes Act. Under this Act, the total taxable income of a company, wherever earned, is allocated to the various states in proportion to the amount of that company's business activity conducted in each state. This allocation is calculated by averaging three basic factors that take into account the extent of a company's business in a particular state: its physical property there, its actual sales there, and the number of its employees located in the state. The first factor is the percentage of the company's total physical property which is located in the state in question compared to all of its property wherever located. The second factor is the company's annual sales which occur within the specific state as a percent of the company's total annual sales. The third factor is the company's payroll costs incurred in the specific state divided by that company's total payroll for all of its operations.

The arithmetic average of these three factors for the state in question is multiplied times the company's total taxable earnings to arrive at the share of taxable earnings to be allocated to the state. This share is then taxed at that state's full tax rate. While any allocation of earnings among the states is probably not perfect, this particular system for doing so has been considered the fairest compromise approach that anyone has devised.

The Legislative Affairs Agency has asked us to provide it with a projection of what Sohio's state income tax payments to Alaska would be under the Multistate Tax Compact allocation method. Unfortunately, we are unable to provide this specific information because doing so would be equivalent to providing projections of Sohio's future earnings and create a number of other problems for us. The rules of the Securities and Exchange Commission would then require us to disclose such projections to the general public and to publicly and perpetually update those projections any time our internal estimates of the future changed. The burden of disclosing such projections on a perpetual basis and the potential liabilities to investors if such projections turned out to be wrong have led substantially all large U.S. companies to decline publication of any earnings projections. Our counsel has advised against this, and in view of the overall problems, we feel we cannot respond to the specific request and so advised the Legislative Affairs Agency.

However, in order to be of some help to the Legislative Affairs Agency and still follow our counsel's advice, we have developed hypothetical projections of tax payments to Alaska which would result from an assumed one-third ownership of Prudhoe Bay and TAPS by three typical companies.

None of these companies is intended to represent a company actually involved in the development of the Prudhoe Bay field or construction of TAPS. Rather, the projections are intended to demonstrate the level of tax obligations which would result from the project being owned by companies varying in size and scope of overall operations. Specifically, the three typical companies in our hypothetical example have the following assumed characteristics:

Company A - A California based marketing and refining company with no crude oil production.

Company B - A large integrated domestic company with significant petroleum production and transportation operations.

Company C - A major international company with substantial foreign operations.

The significant basic assumptions for each of these companies are summarized in the following table:

	Company A	Company B	Company C
Annual Sales (Millions)	$3,700	$8,200	$24,500
Gross Property (Millions)	$1,800	$8,200	$13,800
Total Employees	27,000	32,500	75,000
Taxable Income (Millions)	$ 210	$ 850	$ 1,700

For the purpose of these tax calculations, it was assumed that a ratio of employees in Alaska to total employees would be equivalent to the payroll ratio since detailed data on payroll costs is unavailable. It was also assumed that the only business activities any of these three companies had in Alaska was its one-third ownership of the field and the pipeline.

Since a great deal of uncertainty surrounds both the future price of North Slope oil and future rates of inflation, the tax payments of the three companies were calculated in terms of constant 1976 dollars assuming three different California market prices: $10.00/barrel, $13.00/barrel, and $16.00/barrel. (To put this range of prices in perspective, the price of foreign crude oil similar in quality to Prudhoe Bay oil is approximately $12.30/barrel delivered to California.)

The characteristics of the Prudhoe Bay field and TAPS project determine the nature of the allocation factors used in this analysis. First of all, crude oil production is a very capital intensive operation. This has been accentuated in the case of Prudhoe Bay due to the high cost of Arctic development.

Secondly, Alaska's industrial development has not as yet reached, and may never reach, the stage where significant volumes of Prudhoe Bay crude oil can be consumed within the State. That being the case, the $7.7 billion Trans Alaska Pipeline and Valdez terminal had to be constructed so that the crude oil could be shipped to other states where there is a demand for that oil. Without the demand in other states and the TAPS line, Prudhoe Bay oil would be of little value. These transportation facilities have contributed to the high capital costs of the project.

Finally, in most oil production and pipeline activities, the number of employees required for routine operations after the original construction has been completed is relatively small. This holds true for Prudhoe Bay and TAPS.

When these characteristics are translated into allocation factors, similar trends develop for each company. The Alaskan property factors of

all three companies are large relative to the overall scope of the basic companies' operations. The property factor for Company A, for example, is in the range of 65 to 70 percent and even for Company C, the major international, it is between 20 and 25 percent. On the other hand, the Alaskan payroll factor in all cases was assumed to be less than 2 percent of the companies' total employment. Finally, since Prudhoe Bay oil must be transported to other states for sale, an Alaskan sales factor of zero percent results.

The results of our analysis are summarized on the attached six tables. There are two tables, labeled A and B, for each of the assumed West Coast market prices, $10.00/barrel, $13.00/barrel, and $16.00/barrel.

Referring to Table 2-A which summarizes the results of the $13.00 per barrel market price caluclation as an example, the annual state income tax payable to Alaska by each of the hypothetical companies for each year from 1977 through 1986 is listed along the top of the Table. These tax payments in total range from $27.4 million in 1977 to almost $90 million in 1985.

It is very important to bear in mind that all these figures are expressed in 1976 dollars and that no adjustment has been made for any inflation in any year which would increase the dollar figures received by the State. These charts can be adapted, however, to whatever inflation factors one thinks appropriate to get a more accurate projection of actual revenue expectancies.

The other revenues that Alaska would receive in addition to income tax have also been calculated for each year for these companies and displayed in the second segment of the A Tables in order to provide an overall picture

of the revenues produced by the present Alaskan tax structure. The figures in this segment are totals for the three companies rather than individual amounts for each company, since each company's share would simply be one-third of the total figures shown. Included in this segment are royalty payments, severance tax payments, reserves tax payments, and ad valorem tax payments. Also shown are credits against severance tax for the reserves tax payable in 1976 and 1977 to the extent of 50 percent of the severance tax as provided by Alaskan law.

The sum of the Alaskan income tax payments by the three owner companies and the other revenues represents a projection of the total revenues Alaska would receive as a result of the field and pipeline project in our hypothetical case. These annual totals are also listed on the A Tables. Using Table 2-A as an example again, Alaska's total revenue as a consequence of the field and pipeline would range from over $600 million in 1977 to more than $1.1 billion annually from 1981 through 1985 if the market price of crude oil were to remain constant at $13.00/barrel. The comparable annual total revenues for a $10.00 market price and a $16.00 market price are displayed on Table 1-A and Table 3-A, respectively. The hypothetical case does not include any similar types of revenues from Cook Inlet development or future development in other parts of the State.

For comparison purposes, the total state income tax payments that the three companies would make to all the states in which they do business have also been calculated and displayed on the A Tables. These figures are based upon the total taxable earnings of the three companies, and they include the state income tax paid to Alaska listed along the top of the A Tables. As indicated on these Tables, the effective composite state

income tax rate on the total taxable earnings of the three companies, that is, all income taxes paid to all states, is around 6 percent. This is what one would expect, since income not allocated to Alaska is taxed by other states and the average state income tax rate of all the states in the United States is significantly below Alaska's 9.4 percent rate.

It is interesting to note that since the field and pipeline project is located in Alaska, Alaska's state income tax payments from the three companies will exceed 20 percent of the total income tax payments made to all states even though extensive activities are carried on by the three companies in other states. It is also interesting to note that this high percentage received by Alaska holds true for all three market prices of $10.00/barrel, $13.00/barrel, and $16.00/barrel. This percentage is shown at the bottom of each of the A Tables.

Tables 1-B, 2-B and 3-B show the total revenue that Alaska will receive from each of the companies over the 1977-1986 ten year period.

These B Tables also point out what percent of the total revenue paid to all states resulting either wholly or in part from the field and pipeline will go to Alaska. Since the Prudhoe Bay field is located on state lands, Alaska would receive 100 percent of the royalty payments. Similarly, Alaska would receive 100 percent of the severance tax payments and 100 percent of the ad valorem tax payments. The reserves tax payments and the severance tax credits resulting from those payments are also strictly an Alaskan transaction.

In addition, since the field and pipeline are located in Alaska, the State will also receive state income tax payments as indicated above. Alaska's state income tax payments are a result of that portion of the total

taxable income from all operations of the companies which would be allocated to the state under the Multistate Tax Compact. As such, it reflects the income distribution to Alaska based upon property, sales and payroll factors, regardless of how or where the taxable income originated.

Using Table 2-B as an example, at a $13.00/barrel California market price, Alaska will receive a total of $756 million in income tax revenues. This would be almost 22 percent of the total state income tax paid on all the operations of the three companies.

When those income tax receipts are added to the other revenues listed on Table 2-B, it can be seen that Alaska will receive almost $10.2 billion in revenues from 1977 through 1986. Those revenues will represent almost 75 percent of all the revenues going to all states, either wholly or partially as a result of the field and pipeline project. Again, as indicated by Tables 1-B, 2-B, and 3-B, this high 75 percent share holds true over the entire range of market prices from $10.00 to $16.00 per barrel.

In summary, the significant points that this three company hypothetical case confirms seem to be the following:

1. Under the existing Alaskan tax structure and royalty obligations, the State would receive substantial annual revenues from the three companies which in total are directionally representative of the actual ownership of the Prudhoe Bay field and the Trans Alaska Pipeline. In constant 1976 dollars, such revenues would average almost $800 million per year as a consequence of this project alone if the California market price for oil were $10.00 per barrel, and would exceed $1.3 billion if that price were $16.00 per barrel.

2. Such tax and royalty revenues to Alaska will represent approximately 75 percent of the total revenue paid to all states, including Alaska, resulting either wholly or in part from the Prudhoe Bay field and the Trans Alaska Pipeline.

3. Of the total revenues to be paid to Alaska attributable to this field and pipeline, the principal part of such revenues are due to State ad valorem taxes, State severance taxes, and State royalties which are 100 percent allocable to Alaska and to State income taxes, over 20 percent of which is allocable to Alaska under the Multistate Tax Compact.

4. With respect to the Alaskan State income tax, the State would receive payments at the full 9.4 percent rate of Alaskan income taxation on that portion of the three companies' total taxable income which is allocated to the State under the Multistate Tax Compact. This allocation would be based upon the extent of the business activity in Alaska measured by physical property in the State, actual sales within the State, and the number of employees located in the State.

The composite state tax rate on the total taxable earnings of the three companies will be approximately 6 percent. This is the portion of total taxable earnings the companies would pay as income tax to all the states in which they do business. This composite rate is lower than Alaska's income tax rate because the average state income tax in the United States is substantially below Alaska's 9.4 percent.

Alaska, however, would receive over 20 percent of the income tax payments which the three companies in our example would make to all states. That is a high percentage in light of the extensive business activities carried on by these companies in states other than Alaska.

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