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this is really what you intend to do if we have companies operating in Alaska at losses because they haven't found any oil, haven't generated any income, do you really want to apportion income to them in Alaska and tax them on it? Should they pay income taxes when in fact they have no income in Alaska?

CHAIRMAN POLAND - Mr. Kilgore, I'm afraid we're going to have to break now. Our schedule this afternoon is 1:30 PM at the Supreme Court Room again, and we only have one individual scheduled to speak this afternoon, and that's the gentleman from British Petroleum, so possibly when he's through, we can resume the rest of this discussion with you. Thank you very much.

TESTIMONY OF RICHARD KILGORE
DIRECTOR OF RESEARCH FOR
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RICHARD KILGORE - I am trying hard not to take it as a reflection of my testimony that every time I testify fewer people seem to show up, but this is a Saturday morning and its not quite like the middle of the week. My opening remarks, if you recall, were, try to present some overview of the various types of taxation on the issues and principals of oil and gas taxation. My second testimony before Senate Resources, and in the afternoon before the two committees, tried to elaborate and sharpen the pros and cons in approaches to income taxation, that is the apportionment verses seperate and direct accounting. Now today, I would like to provide you with our comments on the specifics on the bills before you, and also take the opportunity to address some of the issues raised by other testimony you have heard. And I would like to start again with the income tax. Before I get to the specifics there, I would like to discuss very briefly, some of the broad questions raised by industry spokesmen, in which they say that any deviation from the present three factor proportionate formula raises the potential for double or multiple taxation. I think this point was realised by every one of the oil company spokesmen. I want to make it clear that if all states used the three factor proportionate formula only, then the total income of the companies is apportioned to all the states and the sum of the tax basis in the individual states will add up to the corporations total income, and the deviations,

either by different factors such as the (Eathen, Ainsworth approach?) as substituting abstraction or going to book income or going to some sort of separate accounting approach does tend to work in the direction of raising the tax basis of states that do that and has the tendency of each of the states in their own approach to taxation identifying a tax base which when added up on total would be somewhat more than the total income of the corporation. I think there can be no denying this, taking either of these two approaches, does raise the potential for double taxation. This is clear, but against this Alaska has to be concerned with how the apportionment works for the State itself, and how, not simply how the system works in broad for the companies and equity for the companies, but how it works for the State of Alaska and what sort of income is thrown up for the State of Alaska, it can't ignore this either. The State, looking at its own situation, I think in many respects does have a unique situation to look at, in many respects Alaska is unique and the taxation of oil and gas in Alaska in itself is unique. As I don't really have to tell you, oil and gas is far in the way, the largest industry and will be the largest income producing industry in Alaska. Alaska also does not have other industry, much in the way of other industry other than oil and gas it does not have major, it does not have agriculture on any kind of major scale as do other states, so many other states with a broader economic base can afford to have apportionment formulas

which they work well for some industries, not so well though for others and so forth, they tend to more average out than certainly they would for the State of Alaska. Another unique feature of Alaska's situation is its oil and gas industry is largely extractive and transportation ends of the business, Alaska does not have major refineries as do other states such as California, Louisiana, and Texas. It does not have major marketing because it has limited markets on it because of its limited population, so it does not have major investments in marketing and alike as other states do. So without refining, without marketing, head offices are not located here and so on, it does not have many of these factors which in other states have helped the apportionment formula work for the states. That is where you have all of these other activities, one tends to have larger payrolls, there are larger numbers employed in these other functions tends to apportion income to those states. It does not have major sales within the state and so on. So this also makes Alaska's situation unique and as we have said many times, it tends to make the three factor apportionment formula not particularly effective for Alaska. So on the one hand, the industry's argument is certainly a legitimate one and they have every right to be concerned about potential for double taxation and I think, beyond that, the potential that if you adopt this sort of a system that other states may somehow follow you and if this happens to them they more and more run the risk that the sum of the tax basis in all the states exceed their own income and this is a very legitimate concern of theirs. On the other hand, you do have these unique features of the oil and gas industry in Alaska that I have just mentioned. This means that Alaska really has to weigh its own unique

circumstances against the violence done to the principal of uniformity and the potential for double taxation, if you alter your income tax, you must appreciate what you are doing and what you are doing to the companies, you have got to attempt to assess, at least broadly what it really does mean to the company it violates the principal clearly, but what does it mean in terms or dollars and cents of the potential for double taxation in those terms and I think in that respect, some of the questioning of Senator Croft yesterday was along those lines and I think you probably also should pursue this somewhat more. You have to admit what you are doing, it would work in this direction but you have to get some appreciation of exactly what that does to oil companies. And I think in that respect if you are looking at that, I think, it is relevant that the oil industry is not taxed in all states, there are some states that do not have a corporate income tax and I think it is, also relevant that the tax rate in other states is often lower than it is in Alaska. So if you are looking at the double taxation issue, I think this is relevant because it bears on how much are they really hurt by this kind of double taxation sort of thing which other approaches imply. And I think you have also been concerned, to some extent, that what you do would set a precedent for other states and, this is a legitimate concern of the industry, I don't know any other situation, at least I can't think of any other situations which what you are doing would immediately trigger something by some other state, but still the potential for that happening is there. So I think its very important for you to appreciate that what is being said is correct, you have your own interest, and if you are going to go this approach, that you appreciate what you are doing and try to get some feel for what it really means to the

companies. Now I would like to move on to some specifics on the bills before you, the income tax bills, and I would like to start with Senate Bill 236, and House Bill 322. This is the so-called corporate franchise tax and it is a modified apportionment formula. Now, here we really don't have comments on the bill itself and the way its drafted, it is, as far as we can see, a well drafted bill, does what it is intended to do, and I think in the respect of this bill the questions we have on the bill really have to do with the effectiveness of the approach and not really the specifics in the bill. It seems to do what it intends to do and the question in mind is, how effective is the approach this bill is attempting to use, so I really won't have any line-by-line comments on that, but I will on H.B. 105, excuse me, S.B. 105, H.B. 145, somehow I seem to have misplaced that one. Yes, Senate Bill 105. I would first like to call attention to, on page 1, line 18, to the intent of this bill, the intent of the bill seems to be, have to do with the determination for tax liability on production and pipeline activities, it addresses itself to these activities and in fact, uses the work "activities", it is not a tax on an entity, its tax on activities, now this approach would presumably differ from a net proceeds approach which taxes income from well or field or this kind of thing. This is presumably looking at these particular activities, that is oil and gas production activities and oil and gas transportation activities. And this is what the intent states, but when I am going to come to later sections and discuss those, I think it looks to us as when you go into the sections of the bill, which involve the calculation of the tax it doesn't really seem to be consistent with the intent to tax activities which is stated in the beginning, and I will ella-

borate on that when I come to it. I would also point out on page 1, line 28, that when it comes to taxing oil and gas transportation, like pipeline, this bill refers only to crude oil or natural gas by pipeline, the wording of the bill very specifically excludes products pipelines in the state and you have a products pipeline coming on soon I believe, I don't know whether this was the intent of the bill, I just want to point it out to you but this particular piece of legislation specifically excludes products pipelines and I question whether this was deliberate or not, I think you ought to consider that. Moving on to page 2, line 24, these are the costs that could be deducted under this bill. It has costs, including the cost of gathering, gathering is used there. Now, the point I want to make on the use of the words "cost of Gathering" is that these costs of gathering may very well be beyond the well head. This is a bill which takes well head value as the income and starts deducting cost, gathering cost may be beyond the well head in which they don't, in this case if they are beyond the well head they do not go to build up the well head value, but in fact, rather serve to reduce the well head value, so in effect if you take this treatment of using gathering costs as a deduction and these gathering costs are beyond the well head, in fact what you are doing seems to be allowing a double deduction, double deduction.

QUESTION- Thinking that the tax is placed at well head, and these are beyond the well head so its a bouble deduction.

KILGORE - It is a double deduction, right, it could be a double deduction, in fact I don't know how it is going to work on Prudhoe Bay, but the gathering could in many areas trump lines that also are the gatherers, it could be in this case that Alyeska pipeline would be the gatherer and you would be taxing them under this bill then you would also be allowing against oil and gas production a gathering

charge or a gathering cost so I think you ought to, this is something that needs to be cleared up, if it is gathering, maybe it should very specifically say, "gathering before the well head" or something of this sort. Your wording should establish some kind of consillience between the value in the producing function and the value of the activities in the transportation function beyond that. My next comments are on page 3, line 1, again we are talking about expences that can be deducted when it talks about lease acquisitions payments on the well head, lease acquisition payments, property taxes paid before the production on the lease holds, so what we are talking about are lease acpquisition payment on the lease holds, now we are going to underscore on the lease hold. Now its not clear to us with this kind of wording whether this is ment to be restrictive so that the deduction for these kinds of costs are restricted to producing lease holds, or is this generally an applicable feature of the law, that is when we use a word on the lease hold does that mean we are confining deduction of those costs specifically to income from that lease hold or is it more generally deductible. This sort of problem I think runs all the way through here and this particular section looks to us as if it might be intended to be restricted, that is restrict the income against which these acquisition costs could be written. Especially if you look at this in the content of section 7, a little further below it appears to us that this may be the intent. And that same problem comes up on the same page 3, on line 9, where we have associated with a lease hold, another case we have "field" in this particular wording here and, I t .ink in another section there's the use of the word "property". Now, if these different words are used in here, I think that it ought to be made clear that there

is a intended distinction amongst these various things, I am going to come later, to a more general approach to this, where one really wouldn't really need these kinds of words and this seems to imply to us that there is some distinction between these and therefore, there is some restriction against, restriction on what income various kinds of categories acrossed here can be written off. In general, the wording of this whole section here on deductions really seems to be closer to us to a net proceeds tax than it is what we would call a separate accounting approach. The wording here would seem to imply that to us if it doesn't mean that I think the wording ought to be changed, it ought to be very clear against which income you can deduct, your various expenses. For example, it is not clear to us in the wording of this bill how a producer who has income, say in Prudhoe Bay, has made another oil discovery and he is in the process of developing that discovery, putting in producing wells and the like, it is not clear under this bill, to us, how he could handle those development costs, would be able to, if he had to capitalize it, could he start writing them off immediately against his Prudhoe Bay income or his other income, or would he have to capitalize those and wait to deduct some sort of, that capitalized cost until he had production from this other new field that he has, so its not clear to us what is really intended in this bill, is it really a separate accounting approach or is it something closer to a net proceeds. This raises the question of what should be your basic approach. Now if what is intended here is really separate accounting, under an income tax and not a separate kind of tax as a net proceeds was, we would think a more appropriate way would be really, to consolidate all the exploration, development and production

revenues and costs anywhere in the State. That is one would take revenues where ever they were from oil production or production of oil and gas in the State, and then be allowed to deduct all expences having to do with the activity of exploring, development, producing oil and gas, and this ould mean allowing the expencing of dry wholes here agains income there or development costs, amortization of development costs as against your income elsewhere, and we think if this is really an income tax approach, this makes more since really than an attempt to narrowly link expenditures with producing income from specific fields, even if you then allow some sort of write-off for losses and so on. We think it makes more since to go a more consolidated approach and it does not appear to us that the working nearly does that. Moving on to page 3, down on line 24, this is where we get into the determination of pipeling transportation income, the first section of this has to do with pipelines that, operating solely in interstate commerce and in this case subject to ICC regulations. Now what the bill sets as taxable income under those situations is 8% comes from, ICC said that one can set tariffs no higher than that level which would result in a 8% return on valuation of the pipeline, thats where this comes from, and seems to be an attempt to get that income. Well, first of all there would appear to be a technical flaw if this is the intention of the bill, to tax from the basis of ICC income. If you may recall, the ICC 8% allowable return on pipeline valuation is 8% after tax, that is after income taxes, after the deduction of all income taxes, including federal income tax, therefore, if this tax were operative and you were taxing at 8% of the valuation of the pipeline, you would be taxing 8% of after tax income, not before tax, and I don't

think that was the intent of this bill. All your other sorts of taxes are always on before tax income, your present tax law starts with taxable income, federal taxable income, well, this is before the deduction of federal income taxes and this is after the deduction of federal income taxes, a very much smaller tax base, and I don't think your intent ever was to tax after the federal income tax was already deducted. So I think this was probably just a technical problem here I don't believe it was really an intent to tax after tax income rather than before tax, and if the intent is to really do this, that is tax assentually on a ICC basis this is what you would obviously have to do I think. is to take 8% after tax, add back the federal income tax, gross it up to a pretax concept. Again I think this is just a technical matter, I don't think this was the intent.

SEN. HUBER - I think, I wish Chancy were here, I think it was their intent to tax it after, if that was their intent, would you have any comments that would apply to it?

KILGORE - Well, I don't really know what the prupose of it would be, your general principal of taxation in most cases for corporations taxes in states is to tax on a taxable income basis before deduction of federal income taxes. And it seems to me, you are kind of restricting yourself to roughly half what kind of tax base you normally would try to reach.

SEN. HUBER - If the intent was to tax after, would this have the effect of not allowing it to be put into the base in such a manner that it would decrease the value of the oil? In other words, the value of Alaska's oil would decrease by the transportation charges and the profits on the transportation. They may have been aiming at that particular item.

KILGORE - Senator Huber, I don't see how it would work that way because no matter, what ever state taxes you impose on the pipeline I don't care whether they are on a before tax, after tax, or property or whatever basis, they are going to be a liable deduction under ICC rule making. Going to a lower base and taxing loss will not, it will still be a deduction obviously, it will be a lower deduction, but if thats purely your aim, you can not tax them at all if you want to get the well haired by that, if thats what you really have in mind. I think this is, you can talk to the people who wrote this but I think this is an oversite. This is a technical matter, I want to point it out because I suspect it was not the intent, but we also feel that this method of taxation has problems anyway it is clearly tax on deemed income, it does not look at the actual revenue of the pipeline, it does not look at the individual costs incurred by the pipeline, its deed, and it may very well not accord with the income actually earned by the pipeline. That is even if the pipeline, a Alyeska pipeline is setting tariffs in line with ICC rule making trying to get the maximum 8% there is no assurance in any one year that they will in fact earn 8% on valuation obviously, you don't know exactly what your costs are you don't know what the values are going to be and so forth, so what you do is set a tariff which would appear on a projected basis we will try to get your 8% valuation, there is no assurance from year to year that you may in fact earn income greater than 8% of valuation or less than 8% on valuation, there is just no knowg exactly what sort of results you will get, and so certainly the ICC itself does not intend that exactly 8% is earned every quarter every year and so on, its just an impossible thing, it just can't happen, infact if youlook at the ICC records,

you will see that's clearly the case, not every pipeline is earning exactly 8% from year to year. So we think the real problem with taxing on a deed basis an approach which looks at the actual revenue and expenditures of the pipeline, one of the other witnesses yesterday asked if this was in fact legal to do it on a deed basis, we don't know the answer to that but it may very well be legal questions with this, there are also questions with equity, taxing in a deed basis rather than an actual basis. Sen. Huber- is it possible then that they just intended to use the lower base so it would be effectively about 4% instead of 8%, is that possible

Kilgore- that's possible, that would be . . .

Sen. Huber - cause I can see what they are trying to get to, if you have to tax these oil pipelines in accordance with percentage of interest, mobile oil pipelines all over the country are all worked into the company and you get that scrambled egg that you can't unscramble, and I think they were probably willing to take a smaller percentage right off of the interstate Alaska line at a point where they would get it rather than unscrambling that egg., I think that's the attempt.

KILGOR_- Senator Huber, it is my understanding that out of some underlegislation you passed in past session that the companies will be providing you with an accounting of Alaskan pipeline, unscrambled from the rest of their pipeline operations. That is my recollection, and the pipeline regulatory bill, this is one of the provision and one that was not taken out later that the companies will in fact provide you with revenues, costs for Alaskan pipeline

HUBER- again, this wasn't something that I helped draft, but I believe you to know information is to be provided the mechanisms

in our income tax law for unscrambling it and getting to the income of the pipeline just from Alaska are considered to be unyielding or don't exist. I think that's where the egg scramble is. I think that's what we've got here. It just may help in you telling us how to do it. I wish Chancy was here again, as I say. Is he coming back Madam Chairman?

CHAIRMAN POLAND - No.

SENATOR HUBER - He won't be back this morning. I had counted on him being here, he said he was going to.

CHAIRMAN POLAND - He's at a finance meeting.

SENATOR HUBER - The reason is because the bills that he's talking about now by the subcommittee, Chancy and Greg are the people that can really help us on them, and they should be here.

CHAIRMAN POLAND - Well, don't tell me Senator Huber, tell him.

SENATOR HUBER - Well, I can't tell another Senator what to do, but I'd really counted on him being here. It's too late now. We could have Greg and we'd be getting more information.

CHAIRMAN POLAND - I don't know why Greg isn't here. Let's go on anyway.

RICHARD KILGORE - Well, some of the intent of this section, I think, becomes clearer when you get to later sections about the Alaska Pipeline. I would like to point out though, that this taxing on this basis of inter-state pipeline at the 8% also really doesn't give them much of any incentive, no incentive really to lower their tariffs if they're really interested in doing it. What is being taxed at that full 8% and you go to a lower tariff, you don't even get any income tax benefit for doing that, so I'd like to point that out.

SENATOR HUBER - And even if you taxed it at half of that, it would be the same kind of incentive situation.

RICHARD KILGORE - Yeah, there just is no incentive to do that. You're going to pay on that regardless of what you do, unless you go to the other section of the bill that follows a little further on, which appears to be an attempt to strengthen the Alaska Pipeline Commission. That's a section just a little bit further on. Now, we basically wonder whether this is really necessary that one would try to force people through your income tax legislation to accept rules and regulations, and so on, of the Alaska Pipeline Commission through an income tax approach. I think we should also point out that under this

bill if a company, pipeline company, wishes to set tariffs, say, lower than what would give him 8% on valuation, in fact, he may very well want to set tariffs along the line established by the Alaska Pipeline Commission, but he may not want to go as far as the section here that says that he has to abide by all the rules and regulations of the Alaska Pipeline Commission. He may not want to go that far, but he may be willing to set tariffs along the lines that the Alaska Pipeline Commission feels are appropriate, and he'll still be taxed at the 8%. He has to go all the way in order to have his income calculated in another way along the lines of the Alaska Pipeline Commission, and we really question whether this is the proper vehicle for trying to strengthen the Commission. We think there's a question also on the bottom of Page 3, where there's no ICC valuation where companies engage at least partially in intra-state commerce, and then it talks about he can have his taxes assessed on the basis of the Alaska Pipeline Commission assessment of income, and it's not clear to us from the wording here whether, what this means. Does this mean the rules of the Alaska Pipeline Commission as applied to the total operations of this pipeline which is both an inter-state and intra-state commerce, or does it only mean that part of the business of the pipeline which is purely intra-state. I suspect the intent means all. The Alaska Pipeline Commission rules and assessments of income as applied to the total business of the pipeline, but it's not entirely clear to us that this section says that.

As I said before, when you come to Page 4, Line 14 where the election, there is an election, it may very well be that companies are willing to set tariffs more in line with what Alaskan's deem are appropriate, but still be reluctant to subject themselves to all regulations and so forth, provisions of the Commission. A minor technical problem on Page 4, Line 21, where we're talking about taxation of gas pipelines, this has to do with income along procedures established by the Federal Power Commission. I think it would work out very well to say Federal Power Commission or Assessor because as you may know there are, President Carter has proposed a reorganization of our energy, various energy agencies in the United States, including a Department of Energy which would include in it the Federal Power Commission, so it may very well be subsumed under something else, so I think it should say that. Now, our feeling is that if you're going to go the separate accounting route, I think you ought to consider carefully, rather than these sort of provisions that appear here, a more straightforward kind of separate accounting approach for oil pipelines. As I said before, it is our understanding that all the revenues and costs of the Alyeska Pipeline will be made available to the State, that is they will not be hidden in all the other pipeline operations of the companies in the lower '48, which would have been the case without your own provisions for them, but you will, it is our understanding, get the information, and it would seem to us a more straight-

forward approach to take these data and assess what the income is of the pipeline. One may want to take the information given and change depreciation rates or something of this sort. You may not want to use the same ones that the ICC does, as would be given to you by the companies, but you would have information to make a straight-forward accounting of the pipeline, if you desire to go the separate accounting route, and if you do, we would urge that you look carefully at that rather than these sorts of provisions here.

On Page 5 we have a section for the determination of income from other activities, that is from activities other than the oil and gas production and transportation, which you dealt with on the separate accounting basis, and what it amounts to is an apportionment formula for the rest of the income. Now, we think that the language here is really not clear either. There is talk about adjustment of factors to take out of the factors, say the payroll, etc., that are involved in the production and transportation section before which are separately accounted. One would take those out it says, but it doesn't really tell you whether they should be taken out of the numerator, or whether they would also be taken out of the denominator of the fractions used in the apportion system. We don't think it's clear. I think you could also raise a question as to what's intended here also, what you're going to do is exclude income that you tax otherwise in this bill before this on production and transportation,

but when you come to apportioning for other activities in Alaska, you appear to leave in the total income that gets apportioned, the total income of the company, you appear to leave in all their other production and transportation activities, so in attempting to get at, say, what refining income is here in the State, you're going to go through an apportionment formula which is also going to produce not only their refining activities elsewhere, but their production and transportation, and so on, and it's not entirely clear to us what exactly you really want to do under these circumstances. Presumably, if a company had no other activities in Alaska, that all their payrolls, properties, etc., were associated purely with the transportation and production functions, these fractions would be zero, and there would be no problem, but as long as there are other people involved in Alaska you would be apportioning, and I think you ought to consider carefully what it is that you want to, how you want to try to do that.

We have down in Section 15, some provisions that have to do with the Department of Revenue providing estimates of tax costs of various kinds of deductions, and I think our only question there is the way the wording is, it's a very raw statement about the tax costs of various deductions. It would seem to mean you would have to come up with a tax cost of all kinds of categories of costs. I think what is meant is the tax costs of various special kinds of tax accounting. I don't think it really means that they want the tax cost

of such things as just plain operating costs, wages and so forth. I don't think that's the intent of this that one would want the tax cost of deducting payrolls, I mean because noone questions the deduction of payrolls.

CHAIRMAN POLAND - I'm sorry, but we've had a slight emergency, and we're going to take a ten minute break. .

(MEETING RESUMED)

RICHARD KILGORE - I've been asked if I wouldn't state again what our problems were with the wording on the bottom of Page 5. This section calls for the Department of Revenue to provide a report, and in that report it asks for a report on itemized deductions by category, and the tax cost of these deductions. Now, I suspect what is not meant is all itemized deductions, that is, one would have the tax cost of allowing royalties as an expense, the tax cost of allowing payrolls as an expense. I don't think this is what they have in mind. Normally when you're talking about the tax costs of something, you're talking about what is the cost of treating various items in one way versus another way. That is in the case of intangible drilling costs, allowing them as a straight expense, or do you capitalize and advertise them over time, or if it's percentage depletion, what's the cost of this particular way of accounting, and normally one calculates tax cost for those things, not for

normal kinds of operating costs and so on that one has. I think that this should be defined a little bit more here, and the purpose of doing it too, also, I think should be defined, but I think what is meant is some special accounting procedures and so forth on tax cost of these, not all itemized deductions as is stated here.

Now, turning to Page 6, Line 3, talks about in this report for the Department of Revenue, a summary of each corporate tax return filed which shows income from the production of oil or natural gas, showing the total amount of oil and gas produced by or for each tax payer, the taxable income of the corporation from production as reported in accordance with and so on, and also the pipeline transportation. Now, we feel that this kind of a public report of income tax information could be especially threatening for the companies. We think it raises a lot of questions about laying out in the public record various kinds of information that would normally be considered confidential, and laying this out on the record, we think could have some impact on competitive situation of the industry. What it would do, it probably disclose the specifics of Prudhoe profitability. Everybody has an idea of what Prudhoe Bay profitability is, but this would probably lay it out on the line.

SENATOR HUBER - Is that bad, to have the profitability laid out on the line for all to see, so that we all know what we're

talking about?

RICHARD KILGORE - Well, I think from the standpoint of the companies, it is bad, and I think they have a legitimate complaint about this because once this information is out, it's not only available for you people to assess, but it also would effect competitive relationships. That is it would throw up information which say companies in the position of negotiating for the purchase of Prudhoe Bay Oil would know alot about what their competitors' costs and so forth were, and this is the kind of information which is normally not available in those kinds of buying and selling relationships, and I think for those who are in the selling position, this is.....

SENATOR HUBER - Did you say for oil or for lease _____ so that I can relate it.

RICHARD KILGORE - This calls for the whole corporation as such. This would presumably show for any individual company its total profitability on oil and gas production in Alaska, but it's basically EXXON's and Prudhoe Bay's position obviously.

SENATOR HUBER - Richard, I'm trying to be constructive, but I'm having trouble, I can see where more data base being out, if the companies we're talking about between themselves

selling their leases for their property, maybe somebody wants to sell somebody a pig in a poke or something, so the data being out would be detrimental, but I think you said that in selling oil, rather than oil properties, and I wonder about that being it's a completely controlled market, how there would be any legitimate interest there.

RICHARD KILGORE - Well, it may not very well be a completely controlled market, we don't know how FEA, what they're going to do on Prudhoe Bay pricing and so on, but what the FEA does is always set ceiling prices, and there's a question of whether one can realize the ceiling prices. There may very well be a situation where major refineries in California who are not Prudhoe Bay producers will be bargaining for North Slope Crude, and trying to strike a bargain with a North Slope producer, and this price is not fixed, there will be a bargain on some of these prices, and you do something when you introduce information in the public record that the buyer has access to. He knows then more about the economics of the seller.

SENATOR HUBER - The future danger it might cause than, rather than the present because they're so tightly sewed up now.

RICHARD KILGORE - In fact there's a general proposition putting this kind of thing on the record does put out confidential information which is normally not made available in public,

which is internal to companies, and I think it changes the bargaining kind of situation to some extent, it just has to.

SENATOR HUBER - I'm happy to hear, Madam Chairman, that somebody thinks that something may go more than the free market place, because from listening to the radio this morning, I was afraid that everything about energy was going to get further from the free market place until the President comes right into my house and tells me what I can do inside of my home.

RICHARD KILGORE - Anyway, we see problems with making this kind of information available by company. I think, if you want information it might very well be possible for the Department of Revenue to combine information in such a way that wouldn't disclose individual company positions. I don't know, aggregating data by producing areas or something of this sort. I don't know, but giving you information that would be helpful without raising these kinds of disclosure problems. That really concludes my specific comments on this piece of legislation. In sum, I guess, what we're really saying is if you feel you want to go the separate accounting route, that you might very well consider some alternative to this, or some alternative provisions, and in the oil and gas producing area really thinking seriously about consolidation, the consolidated kind of thing where you would consolidate all the revenues

and deduct all costs in the State of Alaska rather than the provisions here, which seem to be closer to a net proceeds, and on the pipeline that you consider again a more simple straight forward direct taxation on the basis of the information that will be coming to the State on the Alyeska Pipeline.

SENATOR HUBER - Madam Chairman, while Dick is still in this 015, this is the area where I questioned industry yesterday, if you remember. Dick on the secrecy of these reports, do you think that Line 28, Page 5, under the 015, one of the things I read into this is I thought that was all inclusive, and maybe it isn't.

RICHARD KILGORE - Would you repeat that again, Senator.

SENATOR HUBER - Page 5, Line 28, under 015. We're talking about public reporting, which you were just talking about a moment ago. I took it to mean itemized deduction by category, and that these returns by category must run all the way through this, so that you aren't disclosing actual returns, but only by category.

RICHARD KILGORE - Well, I did not read it that way Senator Huber. I read this particular part of the report has to do with itemized deductions by category and tax cost, and then

I read on the next page, Line 2 of the next page, also included in the report shall be the summary of each corporate tax return. I didn't read by categories as part of that. These seem to be two separate parts of this report to me.

SENATOR HUBER - Greg was that meant to be in there so that that is by category rather than divulging the summary of an actual individual tax report?

GREG ERICKSON - Mr. Haggert drafted that particular portion of it, and it is my understanding that, subject to correction by him, is that each individual tax report and the summary by category.

SENATOR HUBER - In other words, the way I'm reading category is what you determine it to be? But the category goes over to the next page too.

UNIDENTIFIED SPEAKER - No. There are two requirements. The intent when it was drafted, was that there be a general summary for all taxpayers under this piece of legislation by category. Then, in part B there would be for each taxpayer a summary of that taxpayer's tax due and paid, and so on, so that it would not be by category it would be by taxpayer in two parts of it.

RICHARD KILGORE - Okay, I would then like to turn to the severance tax. As I said in my general remarks, if you're interested in raising the severance tax, both of these bills that we're going to consider seem to in general follow our guidelines, and has to do with more the specifics of how each one of them works. We'll start with HB 144, SB 103. This bill does several things. One is it moves to lease averaging rather than wells in the calculation, and we think that makes an awful lot of sense from the administrative standpoint, and probably should be done even if you don't raise the severance tax, probably even amending your present severance tax would do that, and would make sense. Page 1, Line 11 of the bill moves the point of tax from the wellhead to a new point of production which is later defined.

SENATOR HUBER - How is this defined?

RICHARD KILGORE - It's defined back on Page 4, line 9, gross value at the point of production means for oil, the value of the oil at the point where it is metered or measured in a condition of pipeline quality on the premises of the lease or property from which it is recovered. So in some cases it would change the point of taxation from the wellhead to somewhere beyond up to a point where it was meter measured and made put in pipeline conditions, so it clearly, and this is pointed out by someone else, moves the point of taxation

and in a sense in certain situations it would tend to tax the transportation and upgrading of the crude oil. That's clearly the case.

SENATOR HUBER - I think it had another reason for being in there. I think it was on account of that Kenai deal to where if they transferred our royalty share portion that went into resale that they were subject to the APUC, and doing it this way, while they pushed their royalty share through our line, they were not subject to our APUC. There was quite a problem on that in Kenai, it happens to be in gas, but we're talking jointly here and I think this was done for the company's benefit.

RICHARD KILGORE - Well, I think also in Cook Inlet, as I understand it, there have been continuing disputes about questions of wellhead and where one taxes, and I think this is all intended to straighten this matter out by legislation. This is where it is, and we don't have to argue about backing out transportation or whatever, this is what they're talking about. This makes administration of it easier, clearly, I think that some of the testimony yesterday it was complained that there would be a cost to the companies in a sense that they wouldn't be taxed on transporting and upgrading. I think that if it's administratively easier and there is a cost, perhaps what you should do here is get a better idea of what you're really talking about in terms of cost and dollars and

cents. What is really the extra costs that companies would bear by doing this, or some idea. I think that's how you would have to assess that. Now lets look at the tax rates in this bill. I think you are all familiar with the fact that it adds higher well brackets and puts in these higher brackets at higher tax rates than exist in the present legislation, and it also lowers the tax rates, both the cents per barrel tax and the percentage tax for lower productivity wells. Now, just to give you a rough idea of what this does, and I'd like to just give you some numbers on how it would seem to us to effect, say, Prudhoe Bay, and then look at the Cook Inlet situation under this bill. All the numbers I'm going to use are ease of comperability for 27 gravity crude oil. Now, in Prudhoe Bay, and I'm assuming for purposes of this calculation that the wellhead value on Prudhoe Bay is say \$7.50 per barrel just as illustriative. Under the present tax for a 5,000 barrel a day well in Prudhoe Bay, and these figures are cents per barrel of gross production not of taxable production, but you still get an idea of the relative increase in the tax. The present tax for 5,000 barrel a day well at \$7.50 is 49 and 1/2 cents per barrel of gross production. This tax for the same well, a 5,000 barrel a day well would raise the tax to 68.9 cents. That's about a 37% increase in taxation of a 5,000 barrel a day well in Prudhoe Bay. If you went to a 10,000 barrel a day well, the percentage increase and the tax is greater. As against

about 51 cents at the present time, this tax would raise it to about 80 cents, so on a very productive 10,000 barrel a day well at Prudhoe Bay, the increase there would be about 58%, increased through this tax over what you have today. The effective rate on gross barrels produced would go from about 7.3% on a 10,000 barrel a day well to about 12.2% under the new tax, so this is what it does to Prudhoe Bay, very significant increases. And the percentage as I gave you were really the effective rate on taxable barrels going from 7.8 to 12.2. So you are ending up on the very productive well, you end up with an average effective rate on taxable barrels of just under 12 and 1/2 percent in Louisiana. I think that's what was intended. So that's the impact it has on Cook Inlet, I mean on Prudhoe Bay. Now, let's look at Cook Inlet, and particularly the old oil because we've always been worried about effective taxation of old oil. Now, this bill does retain the cents per barrel feature that exists in the present bill, and it retains the cents per barrel feature with basically the same floor price as you have today. It works out for 27 gravity crude to about \$6.10 today. So it retains that, but what it does at the same time is that it does lower the rates of taxation both percentage and the cents per barrel taxes in the lower well brackets, so despite the cents per barrel feature still being in there, it does lower taxes on low productivity wells below what they are today. I'll again give you some examples, and they'll

again be on the same basis as before. 27 gravity crude, and these are figures on a gross barrel basis. At the present time a 100 barrel a day well in Cook Inlet would be on the cents per barrel tax and it would pay 26.6 cents per barrel. This bill on a 100 barrel a day well would eliminate the tax. It would go to zero, and a very substantial gain for a 100 barrel per day well. For a 300 barrel a day well, would also pay under the present tax, 26.6 cents. Under this bill, under our calculations, it would drop that 26.6 to 14.2 cents per barrel. So you have about a 12 and 1/2 cent reduction for a 300 barrel a day well, and if you move up to a 500 barrel a day well, you still get a reduction. Under the present tax it would be 28.7 cents. Under SB 103 it would be 21.2. So even for a 500 barrel per day well, you're going down by about 7 and 1/2 cents per barrel, and in fact this new tax as compared with the present lowers the tax up to somewhere wells in the range of 1,000 to 2,000 barrels a day. Somewhere in that range, the new tax gets higher than the old tax, so it does provide very significant relief for low productivity wells.

SENATOR HUBER - Madam Chairman - the figures which we have in the committee they are open to him now, I think, I just wonder when he finishes there. If you have any dispute with those, I think that they confirmed his testimony.

RICHARD KILGORE - Yes Senator, we did do our own homework on this obviously, and we have had a chance to look at what legislative affairs has, and they coincide with what I'm testifying here.

SENATOR HUBER - I was wondering. It would help us a lot to know that they do or don't or if there are differences.

RICHARD KILGORE - No they don't they calculate the same way we do.

Now, so this bill does, I think, meet our objections really to the present taxation of old oil at Cook Inlet which has the high effective rates because of the cents per barrel feature. At least its present operation would reduce the tax substantially for low productivity wells, and we think that's a good feature of this bill. I should point out though, this bill does retain cents per barrel and it does retain escalation of that cents per barrel, so it is possible that under this bill we would again be back in the same problem that we have today. If the escalation manages to raise the cents per barrel tax high enough, we could be back in this problem again of taxing old oil in Cook Inlet at high prices, it's possible. The potential is still in this bill.

SENATOR HUBER - This evades it from present time, and we might have to look at it again in future years if we don't do something with cents per barrel.

RICHARD KILGORE - Yes, it may be back again.

SENATOR HUBER - Well, I'd sure look at it again, Madam Chairman, than I would to have Tom Fink for Governor.

RICHARD KILGORE - I think I was on record the first time I testified as saying that if you do retain a cents per barrel that perhaps what you do is at least consider no further escalation in cents per barrel, and perhaps that could be in this bill too. I don't know. I want to only point out that it could happen again. So that's basically what this tax does. It raises fairly significantly, the tax in Prudhoe Bay, but it does lower the tax considerably on low productivity old oil priced wells in Cook Inlet. It also has a severance tax for gas that is flaired, and a very substantial one, five times the rate. I think before you do this kind of thing and add such a tax, you ought to look very carefully at where gas is being flaired and why. There has been testimony yesterday about safety flairs and so on. I think you ought to look very carefully at what it is that you would be taxing and why the flairing is going on at the present time. Now, if what you're really trying to do is tell companies to find a use for this flaired

gas and find markets for it, I think that at the very least if there is gas being flaired now which you think you could find markets for, therefore you're going to try to compel people through this tax, somebody used the word incentive the other day, but you're compelling them through this tax that at least you ought to provide somebody with a grace period before they would pay this tax. That is, you wouldn't start right away. You would make it clear to them that they had certain time within which to find markets for this. You wouldn't penalize them in the meantime, but if you don't find gas for which it's logical to find markets, that you would say at some point in the future you're going to start paying a tax on this, so you had better get busy and look for markets. I don't think I.....

SENATOR HUBER - I think, Madam Chairman, that we should make sure in there. I think we should find out the required safety flair of no more than a certain amount except during an emergency blowout or something like that. The idea was, as long as it's economically unfeasible to take small amounts of gas and reinject them, the State loses its royalty share on it, and the nation loses the energy strictly because at a given space in time, using if you will excuse me, a cash discounting flow and everything else, that we determine its value and we say it's nothing, and what's nothing is moving down the pike another twenty or thirty years may be all we have, and Prudhoe Bay, in spite of an absolute no

flair restriction has been allowed to flair and everybody knows it. Somehow or other, it does have to be stopped, and if you make it so it isn't economically feasible to flair, then it becomes economically feasible to build a small compressor system for saving.

GEORGE SILIDES - Madam Chairman, I know that the flairing _____ as Huber pointed out, _____ that the flairing of course, and the word allowed is important, they get permission from the State, and we have to do something about the bill, that we don't have competition between the taxing department and the Department of Oil and Gas Conservation. They are the ones that give the permission, and you have to apply and you have to point out that it's being done with safety and so on. I don't think that the bill intended to penalize somebody for entering into a safety feature, and so am I correct Mr. Kilgore?

RICHARD KILGORE - I would assume that that's the intent. You'r not really interested in taxing gas.....

SENATOR HUBER - But that board still has the power and makes the exemptions and has been constantly making the exemptions, and it's a matter of record, both at Prudhoe Bay and elsewhere, they make the exemptions, they're legally made, but the product is gone, the resource is gone, it is flaired, and so at least putting in a fairly stiff recovery there, does at

least give us something off of our severance tax that went up in flair too.

GEORGE SILIDES - Madam Chairman, I might make another comment. I think that in view of the comments being made, we're going to have to look into the legality of being able to tax a safety feature.

SENATOR HUBER - No, we don't tax the safety feature. Let's not get crossways on that. We should put an exemption in here for the safety flair only, and somewhere we need to come up with a figure of what is the amount that may be flaired to date per well or per safety flair. We definitely shouldn't tax them on what is a safety requirement. But there isn't a provision. The gas that's being burned in significant, is not being burned in so called legal actual safety flairs. It's being flaired otherwise by legal permits by the board.

CHAIRMAN POLAND - I think we have to check with the Board as to why they are giving the tax.

SENATOR HUBER - That's why the Governor's bills has it in it. That's why committee's bills has had this for two years, and we should certainly, like Dick says, make sure that we don't tax the necessary safety flairs. I asked yesterday what

was, and they said a million cubic feet. That's a thousand MCF's a day. I'm not sure that that isn't considerably over what's needed to burn there in case, I need a good definition of a safety flair.

RICHARD KILGORE - I think also you might consider if you really feel the gas is being flaired that you don't want to be flaired other than as safety purposes or whatever, that's something you might consider as an alternative just tightening up your regulatory bill and your regulations rather than do it through a taxing approach.

SENATOR HUBER - We've done everything but tar and feather the board.

REPRESENTATIVE OSTERBACK - Madam Chairman, could anybody tell us how much gas they will be flairing at Prudhoe Bay? Anything that burns is energy. We're talking about we're running short of energy. Somebody talked about the railroad. If they took it in there, they could take out about a hundred tanks of gas a day, and they didn't think it would be enough to pack that out with flairing, and that would be an awful lot of energy, but most of us don't really know what this gas is with the flairing, but I know anything that burns is energy, and we're talking we're running out of energy. So I think there should be something done about it. Anything

that you can save as energy, you can sell. There's no problem in that.

RICHARD KILGORE - Well, I agree with you, if what we're really talking about is waste, then I think we should eliminate that. It is energy, and you're absolutely right, and I think you should look very carefully at what's going to happen at Prudhoe Bay, and how your regulatory people will handle it.

SENATOR HUBER - Might we, Madam Chairman, Al brought it up and it's very important. I think that it's understood that they have stopped flaring or are to stop flaring. It was only for that refinery that they flaired at Prudhoe Bay, and they didn't pump it back down the gas well even though they were drawing gas out to run the refinery because it would have cost more money than the gas was worth, so naturally the gas was worth nothing, so it wouldn't cost money to pump it back down into the ground. If it had a value of 20 cents an MCF, it would have been a lot cheaper to pump it back down into the ground, but just so that the record is straight, we aren't really looking for flaring at Prudhoe Bay, but if you will take a look at the Valdez terminal, you will find that we don't flair no more, but we've got three huge oxidizers there, and there's going to be a tremendous amount of energy unless the LPG's that are in that gas and the vapors that are in the gas at Valdez,

unless there's a plant built to recover those and use them which is not in the plan, it is going to effectively flair trillions of BTU's before Valdez is over with. That's because the plant and the tanks will not stand the pressure in the storage.

GEORGE SILIDES - Madam Chairman, I think the point is well made that something's got to be done about defining what is meant by safety gas, what is being wasted, and I think also that the bill had intended to address the bottom of the possible wasting of carbon dioxide. There was a considerable amount in this particular natural gas, and I suppose what we're getting to is that we have to do something about those things, either by definition or by amending the bill. I think this is a point that we're going to have to look into. I don't think we're going to get it solved right here.

SENATOR HUBER - I think they're willing, George, not to flair the carbon dioxide, but I'm not sure if they will get rid of it.

GEORGE SILIDES - It doesn't burn anyway, Senator.

CHAIRMAN POLAND - We'll be checking on this flaring part.

SENATOR HUBER - Well, it's important on both ends. I think that the bill needs to not penalize them, but by all means

should be retained in the bill, and we may of course have to put it in in some other places. I don't think this is going to effect it when it comes to the flairs in Valdez.

RICHARD KILGORE - I'd like to move on the the second severance tax bill, and that's HB 321, SB 238. Now, basically this tax changes the tax rate to 10%, but it also has a cents per barrel feature of 75 cents per barrel, so it has an effective floor price of \$7.50, and it also has what _____ for an economic limit factor built into it, and I think Mr. Wilson yesterday did quite a good job explaining how the mechanics of this worked, and he also provided an example for you that I think was probably quite useful. Basically what the bill does is give you the first hundred barrels a day as an allowance for operating costs is what it amounts to, and wells producing more than 100 barrels a day, they pay then an increasing fraction of the 10% for the 75 cent tax is the way it works, and it's a continually increasing thing as well productivity moves above average well productivity moves above 100 barrels a day. Very roughly, a 100 barrel a day well would pay no tax under this bill. A 200 barrel a day well would pay about 43% of the tax. It isn't 50% because as you might think by taking 100 to 200 because it's taxable barrels only that count. That is the 200 barrel a day doesn't produce 200 barrels that are entirely income to the company. Twelve and a half percent of those go to the State.

GEORGE SILIDES - Mr. Kilgore, it's 43%.

RICHARD KILGORE - It's 43%, 200 is 43% of either 10% of value or 75 cents a barrel depending on which it is.

GEORGE SILIDES - That's what I wanted you to say.

RICHARD KILGORE - For a 300 barrel a day well it would be 62% of these basic rates and on a 4,000 barrel a day well, it would be up to 89% of this. This is the way it works, and it amounts to a continuous function as against the step schedule that you have in your present legislation. As I said, it amounts to a continuous function and in principal we find it as kind of an appealing concept as against the step schedule. Now the other feature of it is that one can't apply for an economic limit factor greater than 100 barrels per day well average if you can prove it, and what you basically have to prove is that your operating costs that you require, out of pocket operating costs are greater than what you would get with 100 barrels of production per well. You would need more than this to recover your operating costs. Now, there appear to us to be a couple problems with how this actually works. First of all on Page 3 Line.....

SENATOR HUBER - Madam Chairman, I would note that we've got John Messenger here, too. This is the same problem that came

up yesterday in talking with the industries. We might want John to answer some of these.

RICHARD KILGORE - It has to do first of all with how costs are defined, and that starts on Page 3, Line 16, subsection C here, and as was pointed out in testimony yesterday, it is not clear that the cost category specifically allowed here really provide for all the kind of out of pocket expenses that a producer might have, and basically that's the concept that you're trying to get at, whatever is out of pocket expenses, and it's not clear to us that that is the case and some questions were raised yesterday and I think you ought to consider those too, but what I think is more important is that after calculating the costs here, you then have to determine how many barrels are necessary to recover, that is if more than the hundred that you are allowed anyway. Now the problem with it is that the way that the bill was written, you don't take your costs and divide through by the price of oil that you as a producer receive. That is your actual price, if you're an old oil producer and getting \$5.00 per barrel, you don't divide through by \$5.00 to see how many barrels you need to recover your costs, but you use another deemed price to do this, and the deemed price is acquisition, this is Page 3, Line 29, its acquisition costs CIF at westcoast refineries for imported oil of like quality and then you net this back to Alaska, so you're not doing it, on the price you actually

receive, you're doing it on a deemed price that you may not be receiving, and it seems to us this causes problems.

SENATOR HUBER - Could we at this point if it's convenient, I wonder, Sterling isn't here, but John is and this was the question yesterday, I understood from the testimony by the State that as of starting in December or sometime like that that these wells that were in economic trouble shall we say, that these figures that you have put in here talking about _____ price are actually what's happened. They are now being allowed, these higher prices on the producer's share, but not upon the State's royalty share. The argument yesterday, and I think we're right into it again today, is whether we're just talking about a possible deemed price working it back from San Francisco or whether we're truly talking about what they're going to get, and the industry said no this was unfair that wasn't what they were going to get, so we're right at the nitty gritty, and I think you can help us John.

RICHARD KILGORE - Perhaps, Senator, I'm going to give an example, maybe I ought to do this and then we can talk about it.

SENATOR HUBER - Okay, just so that John, he wasn't here yesterday, so he's alerted. My stand was or what I saw was that you fellows put this in here because that's actually

what the oil companies are getting, and so you were getting right to the nitty gritty, and they said no this is what they might give them, but I understood Sterling to say that this had actually started in December, and I don't think this was in testimony, I believe this was talking in the afterwards that it actually had started in December and the State had been denied that increase, but the producer's share had been allowed, so if that predicates it and as he goes on if you can straighten this out, it will help me a lot.

RICHARD KILGORE - I'd like to just give a little example of what we're talking about here. If we had an operating cost for a well or wells whatever the unit or something, and say \$2,800 a day, and these were direct operating expenses defined properly however, and if you didn't get these revenue enough to do this, you would shut down. Now, if one looked at the foreign price and then netted back to Alaska, let's say you came up with \$14 just to make the arithmetic easy, you came up with \$14. Now in calculating your economic limit factor here, you would divide through by that, and that would give you \$2,800 divided by \$14 is 200 barrels a day. You're economic limit you could then justify is 200, rather than the 100 which you had presumed. That means you're getting more, but let's say that the producer only gets \$5 a barrel for oil because he's receiving the old oil price in Cook Inlet. He doesn't get \$14, he gets \$5. Well for him to actually recover the

\$2,800 his total expenses at \$5 he's actually receiving for his oil, his real economic limit factor is \$2,800 divided by \$5 or 560 barrels, so that in fact, his limit factor, that is the number of barrels he needs before he's got to shut down, because he doesn't make it out of pocket cost of 560 under this bill it appears to me, he would only get 200. I don't think it really gives you the results that you intend. The result that you intend is to provide relief for marginal wells. It doesn't appear to really serve the intended purpose.

SENATOR HUBER - That's at \$5.61?

RICHARD KILGORE - That's at \$5.00 even.

SENATOR HUBER - But doesn't this other deal work to raise that?

RICHARD KILGORE - Well, the other thing we're talking about is price relief under FEA regulations. I think that's really something different here. I'm addressing.....

SENATOR HUBER - That's not five dollar oil. You know, if we're talking about his economical limit on the well then we assume it to be \$5.00 oil, but he is actually receiving \$10.95 for it because it's below a certain economic limit

already established, then we're dealing with something that doesn't exist, and that's what I'm trying to get into this, and I thought that that was why the State had drafted it.

RICHARD KILGORE - Because it assumes that the Federal government will always bail out people, is what you're saying, other than royalty owners.

SENATOR HUBER - My information was, it didn't only assume, it was based on what was happening. Can you clarify that John?

JOHN MESSENGER - Let me just make a couple comments. I guess it's true that one position that we've taken on this bill that our taxes should not be based on the artificial price set by the Federal government, and the Federal government set a price of \$5.00. Our position is that we shouldn't be content with the tax based on that artificial price, and that's why, one, we've set the cents per barrel floor, likewise when you're figuring the economic limit factor, again, we say the true economic limit is not how many barrel are produced at the artificial price, but the amount of barrels they would produce using the true value of that oil, pre-market oil. We should insure ourselves that so many cents to so many percent of that pre-market oil because that is our resource and we should get at least that percent out of it. Secondly, is that producers are

reaching their break even point which they will stop producing. There is a procedure by which they can make application to the FEA and get price relief and with that higher price they can produce longer, but the FEA has said that they will give price relief only to the producers, and not to royalty owners, so if a company is reaching its economic limit in Cook Inlet, and they go in for price relief, they are given that price relief. They will raise their price, but they will not raise that price in the terms of the amount of royalties which _____.

So, it's two things, one is the tax rate and the economic limit factor should be based upon the true value of the oil, and secondly that producers are protected through FEA regulations, but the State is not.

SENATOR HUBER - Then I guess what he's saying is that if someone's going to shut down the production there, by it being below economic limit on \$5.00 oil, the State is advocating that we put the monkey on the fed's back and say you did it, you set an artificial price, we're going to set our tax based on free market price, and if you want to save that resource, save that company, you can turn around and do likewise what's reasonable. I'd say it's what I call putting the monkey on the Fed's back. They caused the problem. I happen to be strongly in agreement with the State's stand on that, and compliment them for it because why should we throw away our royalty share and our

taxing ability because somebody forced an artificial price down our throat, and is forcing that same artificial price down the throat of the oil companies.

RICHARD KILGORE - Look, I'm going to address myself to the question of the artificial price, that's part of what I'm doing here, and I think the Commissioner took issue with earlier testimony I made when I said I thought this was a flaw in the thing, and it certainly was, I thought, a flaw in terms of its purpose of providing relief, and now I do understand why they do this which is another objective, than what appeared to be the intent of the bill, and I'm going to come back to the whole question of the artificial price. It's very clear they did this by design. I'd like to again, as you asked, talk about just very roughly what it does to Prudhoe Bay and then to Cook Inlet, and then discuss the consequences of that. Again, for Prudhoe Bay, looking at 5,000 and 10,000 barrel a day wells at Prudhoe Bay, this bill also raises taxes significantly on those wells as does the other bill, as does HB 321 that we looked at before, excuse me HB 144, that we looked at before, but it does not raise them as sharply as the other tax. If we take a 5,000 barrel a day well, I said that, and I'm not going to run through all the numbers here, I think, but that the other tax for a 5,000 barrel a day well raised the tax about 39% on a 5,000 barrel a day well. This tax would raise it about 29% it appears to us using the presumed hundred

barrel figure. The discrepancy between the two gets larger at very productive wells because of the steep rates near the end of the schedule in the other bill, and for a 10,000 barrel a day well, HB . . . it 5% this would raise it about 27% on the very . . . as, so if it both increased taxes on Prudhoe Bay, clearly the one, HB 144 would increase them significantly.

SENATOR HUBER - That would be effective of what of 5 and 10.

RICHARD KILGORE - Okay, the effective rate would be very close to, on taxable barrels it would be very close to 10%. On 5,000, it would be 9.8% and 9.9% on the 10,000. It approaches 10%.

SENATOR HUBER - Just slightly under ten percent for a total maximum. Or fully 2 and 1/2 percent, a little over 2 and 1/2 percent below Louisiana. Using the Administration's bill.

RICHARD KILGORE - That's correct.

SENATOR HUBER - And it would be right at Louisiana with the other bill.

RICHARD KILGORE - Close to it. That's correct.

Now, let's look at what happens to the Cook Inlet old oil price here. This bill as the other one for a 100 barrel a day well eliminates the tax altogether. It does exactly the same thing, but what we find troublesome is that is you go to 300 barrel a day wells, these are the wells that we're concerned with because of their productivity and the old oil price they have to bare, they get the tax there doesn't go down, but it increases. It goes up from 26.6 cents on gross barrels to 40.6 cents. It goes up by 14 cents a barrel. This tax raises it that much. On a 500 barrel a day well, it raises it by about 13 and 1/2 cents, and on a 1,000 barrel a day well. I'm sorry 14 cents increase on a 300 barrel a day well, 22 cents on a five hundred barrel a day well, and 28 cents on a 1,000 barrel a day well. What I think are particularly disturbing are the increases on the lower productivity wells. A well as low as 300 barrels a day which we already have some concern for because of the effective rate on the old oil thing has actually a fairly substantial increase in its tax burden. As Commissioner Gallagher stated correctly, you get this result because of raising the floor price essentially. You are raising the floor price from \$6.10 to \$7.50 and you have higher tax rates at the same time, and it's deliberately designed to do this. Now, we really feel that this kind of goes against what we feel are good principals of severance taxation. What you're saying is the producer in Cook Inlet he received a relatively low old oil price established by

the Federal government. This in turn restricts his own profitability, but then the State adds to his burden by taxing him as if he received \$7.50, and it seems to us that rather than help his producing situation, this only makes the situation worse. One of the reasons given for doing this is that the Federal government is following an unwise, or I think it was described as a foolish price policy. Now, this may or may not be the case. I'm not willing to pass a judgement on that, but they're, you should know that the Federal government does have reasons for doing this. It's not capricious, they do have reasons. They have concern over the effect. What they're concerned with is this, we've had a fantastic increase in the oil prices outside the United States by the OPEC nations and if one frees the oil, the old oil price, it will go up very, very sharply. It will, perhaps in some cases, close to triple in price, and the people are concerned about the consequences of this. Rightly or wrongly, they are concerned about the inflationary impact on consumers. They're concerned about when _____ producers, because these are on old oil wells, wells production which is established at old costs and so on and therefore you have to question whether you want to give them huge increases in the price and windfalls. There is concern over that. So there are reasons, and you can argue one way or another, but there are reasons for this.

SENATOR HUBER - Would it be fair to say that those reasons are exactly on a par with the same reasons for having controlled gas prices as would be in inter-state commerce as well as setting a free-market price. It's the same principal in both cases.

RICHARD KILGORE - As deregulation of natural gas prices. Yes.

SENATOR HUBER - Deregulation of natural gas. Deregulation of petroleum would do the same thing, it would increase the price at the burner or the price at the gas tank as it comes in out of the nozzle, but all of the other factors of pro and con are the same.

RICHARD KILGORE - Yes, that's right, and the concern is that if you let it go up to, and I really object to the word free-market price because we're not talking about free-market price, what we're talking about is it goes to a price administered by OPEC. That's what we're talking about going from price administered by the Federal government to a price administered by OPEC. This is by no means a free-market price. It's a market price, but one set by OPEC, and set by political reasons as much as for economic reasons.

SENATOR HUBER - Some of us are referring to free-market price though as to this free-market price that exists that we talk

about what the price would be if OPEC were not controlling it. Some of us are talking about a true free-market price

RICHARD KILGORE - Senator, I don't know what the price would be if OPEC were not controlling it.

SENATOR HUBER - We don't know. We have projections just like we do on what Prudhoe Bay is going to cost.

RICHARD KILGORE - One the one hand, if OPEC did not exist one would certainly expect over time that the price would rise at some point in time to the level of alternative energy sources which are quite high in the \$20 - \$25 range. On the other hand, in the short run, you do have an overhang of surplus productive capacity in the world, and if there were no OPEC, and it were perfectly free market, there's no reason why the price couldn't drop to less than \$1.00 per barrel, because that's what costs are in their surplus capacity. If there were truly competitive free market, one would have \$1.00 a barrel oil or less because that's what the costs are in the middle east, less than that so but as time went on, and this surplus which overhangs the market now, and which would push it down, gets eaten up and it will, one would then have prices moving off in the other direction. I don't know what the price would be. But anyway, we're talking about not letting the price, the U.S.

government as a matter of policy, not letting it go to a price set outside its own borders by an organization of petroleum exporting companies, and that's what we're talking about. It's the intent apparently of the Congress not to do this because basically the idea is concerned with price impacts, concerned with windfalls, and also that there's no way of assuring that the price that would be set by OPEC is an appropriate price for our internal markets for our own costs and so forth. There's no way of knowing whether they will set a price appropriate to our cost circumstances in the United States or a price that may be very much higher than people think it is now or maybe even a price lower. Not good enough for development of our domestic resources. So this is a matter of national policy and people can quarrel.

SENATOR HUBER - Feable minded or otherwise.....

RICHARD KILGORE - Well, I don't want to characterize it. I'm trying to give you a few of the reasons for doing this, and this is a matter of federal policy. Now, but even if it is a foolish policy, or at least if Alaska views it as one, or the people who did this legislation think it is, I think that you have to ask, if that is the case, still, why do you want to then punish producers for this price policy basically. They already suffer enough from it in terms of the revenues they receive, why do you want to go an

added step and raise their taxes because of this. I don't think it's reasonable to assume that if you do this you will force national policy to change by what you do in the way of taxation here in Alaska. That seems to be reasonable.

GEORGE SILIDES - Madam Chairman, may I ask a question?

In addition to your comment of being unable to force national policy, would you think that this kind of tax is counter-productive?

RICHARD KILGORE - I suppose it's possible, I don't really know the answer to that, but I suppose there are reasons that might want to lead one to that result, and if the FEA has procedures for relief of these kinds of situations, then it sees the State of Alaska in fact imposing higher and higher taxes on such low productivity wells. I don't know. It's not inconceivable that it would enter into their thinking in this matter. Rather than providing relief, it seems that the State of Alaska goes in the other direction in this situation.

SENATOR HUBER - George brought something up here. Isn't this the fact that it effects these 300 barrel wells just because of the total tax maximum that we pay and then how we apply the mechanics of the formula. They could for instance, modify, and the mechanics of it I would have

to find out from somebody else how, so that that point would hit, maybe, more on a five or six hundred barrel a day well and maybe give as much as 10.3% or 10.4% out of Prudhoe Bay instead of an even 10%, and the formula diddled with enough to change that point to where it would be correct. Couldn't that be done?

RICHARD KILGORE - Yes it could be. If you like the basic approach of the continuous formula

SENATOR HUBER - Apparently you do, and I do too, and we might consider, and George's question pointed up that we might consider something from being John Messenger is here, that they might give us an alternative is that reasonable Madam Chairman?

CHAIRMAN POLAND - Well yes, except today we have Mr. Kilgore with us. He's leaving on a plane and we want to take advantage of this. We can bring this up.

SENATOR HUBER - I have considered this, Madam Chairman, to be a work session with him, and it's more valuable to me, the way we've been conducting it here today, than anything that we've had.

CHAIRMAN POLAND - Well fine. Let's give him a chance to get with it.

RICHARD KILGORE - Okay, we really are concerned with how this aspect works. There are two parts where Alaska is attempting to impose its own view of what the proper price policy should be, that is if they want the OPEC price. It comes on the floor, and it also comes as I said before in this calculation of the economic limit factor again. It enters in two places, and we have serious questions about this and what you really want to do. If the basic intent of the legislation is to provide relief that you don't go off in the other direction simply because you're unhappy with the prices because this throws all the burden on the producer, and then you're going exactly against what you really want to do, and you could have economic consequences to this.

I understand your concern with the prices that you get for your oil, and you'd rather get higher prices than lower prices, and that's fine, but the question is if the price is not set at a level that you think is appropriate then what do you do about it, and I guess, it's just bothersome to us that what you do about it is throw a burden back on a producer here. That's what you're doing about it, and that then goes against what we feel is an appropriate kind of severance tax because then you run into all the kind of economic problems with this gross tax and that's our concern, and we appreciate why you think in terms of floors and why you want to get an adequate value for your oil, and so forth,

and we understand why you do it, it's the consequences.

This tax also raises the tax on natural gas. If you'll recall our testimony before, we were always pointing out to you that if you did this you would have an impact on Alaskan consumers, that would flow through to Alaskan consumers. I noticed that there is another bill which is HB 329, SB 239 which is a residential fuel credit, and I presume that the intent of this is to mitigate to some extent the impact that raising the gas tax would have on Alaska. Consumers - we're not really in a position to know how adequately it does this because this has to do with what fuel bills really are in Anchorage and so on. We really don't have the information to calculate how adequately that does that, but obviously, you are concerned with that aspect to it, and the balance of the increase of course would be assessed against exports. I think that the other thing I should point out is that here you have in this not only an increase in the tax rate from 4% to 10%, but also introduce a floor price here, that is a minimum 6.4% per MCF, which is an effective floor price of 64 cents per MCF, and I think we have the same reservations here about this as you do on the oil side. If you have oil flowing, producers getting less than 64 cents, someone mentioned 42 cents the other day, but less than 64 cents, then you start to raise the effective rate of it, and I think we have the same problems with it here as we would anywhere else, and this

also has a gas flaired feature taxation, but it's only double, not five times, and all my comments on that go for this too.

SENATOR HUBER - That is in the equalization deal?

RICHARD KILGORE - No, it's in the severance tax, itself. There's a provision.

In the end, I'd like to talk a little bit about this whole question of the overall tax burden and how you assess it, the kind of questions that Senator Rader has been talking about, but I would first just like to make a few comments on the property tax bill, unless there are some other questions here on the severance tax.

CHAIRMAN POLAND - No. I was going to suggest that when you are finished on the bill, and before you kind of wrap up, that we take a five minute break.

RICHARD KILGORE - Okay, shall I just say a few things about the property tax. I have relatively limited comments here. HB 323, SB 237, now, this extends the property tax to some other areas as you know to refineries, gas plants, and also to marine transportation, and L & G liquifaction facilities, and so forth. So it extends the kinds of things that you would tax with your property tax. Now, the only real comments

that we have here are that for each of these areas that you're thinking of proposing a property tax on, you think carefully about where that tax will actually be borne. You're talking about taxing properties for crude oil production that largely obviously is borne by producers. They realize prices in the lower '48 that are set for them, and the tax you impose is a tax which they have to bare in terms of their own profitability, but that's not necessarily the case with each of these other areas that you are extending, and what I think you ought to think about what you are doing, because if you're looking at property taxes on refining in Alaska, we would expect that most of the refining capacity in Alaska for some time to come would be basically capacity oriented to supplying low markets so that the tax that you impose on those refineries presumably would over the long run be borne by Alaskan consumers. You're assessing a tax which goes to the treasury, but eventually that tax would have to be borne by consumers if the refineries are to operate properly. So you have to worry about the incidence of the tax. If you're looking at L & G facilities you have to worry again about the consequences of this and what will happen, and who will actually bare this. Will it be a cost that will simply be passed along because the facilities under an FPC jurisdiction will be passed along as probably may be the case. It's not clear that if it's L & G or export to foreign countries whether this would be the case. Who would bare it, it's not entirely clear.

GEORGE SILIDES - Would it not also have an effect on a decision as to whether to locate in Alaska.

RICHARD KILGORE - Yes, it could under certain circumstances. If it's a cost which basically the person thinking of putting in the facility has to bare himself because he hasn't got an automatic pass along or he can't pass along to Alaskan consumers, or he can't through his regulatory process, pass it along, then surely, it would be one of those tax entering into his decision as to whether to locate in Alaska. Noone can say whether this is the thing that would swing it in the balance, but obviously, it's part of the package of doing business, if it's a higher cost, it could have some effect, yes.

The last one is marine transportation, and there, well there's a question of legality, I guess, but we can't address ourselves to those, but it seems to me you might have some concern about this one too, because you already face a problem where you are concerned with the fact that your oil may have to move to quite distant markets, for example the U. S. gulf and the eastcoast, and you're very much rightly concerned about that long haul and those high transportation costs and what it may do to your wellhead value, and if you go this route of taxing marine transportation, you obviously add to the cost of transportation, I don't know how much would be thrown up by this tax, but you are in principal anyway

adding to the cost of transporting your oil which certainly works in the direction of lowering the value of your oil, so I think that you ought to consider this as well, as I say, in each case consider the consequences, but here you're putting an added cost on transportation and it may be small, but it certainly works in the direction of lowering your wellhead value. Basically that concludes my remarks on the specifics of the bill.

I would like to conclude with a few remarks about this old question of the total tax burden in Alaska. What fair share is, and at what point do you destroy incentives, undermine profitability and the like, and of course Senator Rader has been pressing a number of people for answers to this, but as he himself in asking the question admits, there obviously is no easy answer to this question. If there were, somebody would have given it, and I can't give you an easy answer. A number of things have been suggested, all of which make a certain amount of sense. What kind of activity is there in the State has been suggested. A number of people have suggested looking at the total tax burden in Alaska, relative to other states. I have a few comments on that aspect too. It clearly is important what the total tax burden is on the oil and gas industry, there's just no doubt about that and how it compares with other states. It certainly is not just the absolute amount of dollars being paid or dollars per

barrel of production being paid to the State. What really matters for the economics of the industry for their incentives to go in and so forth really are these aggregate dollars or dollars per barrel things put into context of the profitability of the operation in the various states. This is what really counts in the end, not just the amount that one pays. If one is paying a high tax, but in a situation where profitability is very large it's one thing, if they're paying perhaps even a lower level of taxation in a situation where profitability is low can be another thing. So, you really have to put it in the context of profitability. This doesn't make it any easier to answer obviously because profitability is elusive and difficult to measure, but certainly one has to put it in this context, not just in the dollars themselves. And the second thought about it is, I think that although some people have said this, that the mix in which you get your taxes out of this total burden to your state and other states is really not irrelevant. Someone suggested that a dollar is a dollar, but this isn't really quite so it seems to me if you're looking at the burden of those dollars on people. If you have taxes that are relatively based or geared closely to income, that is income taxes in kind of a true income tax in a sense that it is directly trying to measure income, it's one thing if you collect it that way as against certain just gross taxes or property taxes and the like, because if you have taxes based on income, they have a different economic impact than gross taxes.

If you have a severance tax, it's not a matter of indifference how it comes. If you're collecting high severance taxes in Alaska because you have wells that are extremely productive and that's the way your tax is structured that's one thing, if you're just doing it flat out on everything that's another. So, that it's not just the total dollars, these dollars have different effects, and that high taxes in one circumstance where they're thrown up out of a total tax package that's more closely geared to income and costs and so forth may be less of a burden than in another case where you have somewhat lower taxes, but their generated by things that have nothing to do with profitability, and you have a low profitability situation, so that I think it isn't strictly the total, it is the mix and the types of taxes that you have 'also, that also matters, and to the extent that the closer these are geared to income, the better you really are. The second thought I have on this whole question is the State, I'm thinking in terms of the burden of its taxation also has to remember that it has a role not only as a taxing authority, but you also in this State, and this is different from other states, most other states anyway, you have also a role as a land owner, you have lots of land and you will have leased that land and you will be leasing more, and you have to realize that the higher and higher you put your own taxes, this will have some effect on the kinds of terms that you're going to be able to get for your land. No matter how you lease it.

If you lease it on a bonus basis, the higher your taxes, the lower your bonus. If you go on a royalty bidding basis, the higher your taxes, you'll get lower royalty bids out of all that, or if you have a net carried interest or a net profit interest kind of leasing arrangement which you may turn to. Your profit people are willing to give you also _____ part of the taxes.

GEORGE SILIDES - This matter came up before in a different form, and the comment was made by the speaker was that not to be so terribly concerned because the competition in leasing would take care of that matter.

RICHARD KILDGOR - Well what I'm saying is that I think the competition in the leasing is going to reflect your taxation. That is, if you have higher taxes, I would expect in general you will get out of the competitive process when people are bidding for leases on whatever variable they're bidding, whether it be royalty or bonus or whatever, the amount of the tax that they will perceive you will take in the future will effect their bids, and they'll bid competitively and it will be reflected on how much money they're willing to offer you initially, or how much percentage of the thing they're willing to give you and so forth, so that your tax will effect the terms you're able to get on your own land.

REPRESENTATIVE OSTERBACK - I would like to ask a question. We listened to all this testimony, but we never came down yet with how much are we getting for our oil. And another question on leasing, it doesn't seem to make any difference, the bids I say that came out from the State or from outside the three mile limit seem to be about the same value they are bidding into the millions for off-shore leasing. What kind of a deal could you answer that on off-shore leasing? And the taxes, what kind of taxes are they paying? Are we going to get a benefit out of the off-shore leasing taxes?

RICHARD KILGORE - Well, on off-shore leases, where they're on Federal waters, you basically will not get the state severance tax from those barrels or MCF's of gas being produced out _____ there, and basically the tax that that oil in Federal waters will be subjected to is basically just the Federal income taxation, and you will not get severance or other kinds of tax revenues unless one's able to go through some franchise tax kind of thing. I just don't know whether that's legally possible for you to do that, but unless you can think of something ingenious of that sort, basically it will be just federal taxation on that, and the bids that would be received if you had comperable prospects on shore Alaska, lets say off shore but in Alaska waters similar prospects to something over the line in Federal waters, and you put these up for bonus bidding,

presumably what you would get since you have no severance tax on the offshore, you would presumably get higher bonus bids to the federal government, than you in Alaska would get for your exactly comperable prospects. I don't know if that answers the question or not.

REPRESENTATIVE OSTERBACK - One other thing, somebody brought up the other day that since we get 10%, or we pay 10% of the federal tax, I don't know, I know you know more about, . would we be getting a share of the federal tax in the amount of 10%?

RICHARD KILGORE - Yes, to the extent you share in federal revenues and so on, yes you do get some share that way. That is correct, but the other thing is that as you know, there is some move afoot in the Congress to provide some sort of sharing of royalties and other income from offshore productions with the coastal states, and I would think that the State of Alaska should push very hard for this kind of thing, and I would also think that in the past this was probably not the kind of thing that the Congress would pass because there were relatively few states which would benefit from that basically Texas, Louisiana and California that would benefit from that kind of thing, that is sharing the revenues, some portion of the royalties and bonuses in the federal waters off their shores, but the situation seems

to be quite different today because we now are talking about exploration along basically the whole eastcoast of the United States, so there are an awful lot more states which potentially could benefit from this and presumably would support such a measure in Congress. There seems to be a lot more support for that kind of thing than before, and perhaps you will get something like this. I think there's a lot of merit in doing this from a national standpoint too, because as you know on the eastcoast there are all kinds of environmental opposition to this drilling and everything and bringing this oil ashore and everybody is up in arms about the environmental problems, well, I would think that if the states including my own where I live, New Jersey, really thought they had the prospect of getting some direct share of the income from oil and gas in federal waters offshore New Jersey, I think they would view the environmental matters somewhat differently, or at least be willing to look much more realistically at them and have greater support for this activity, so I think that this is something that Alaska should be looking for, and maybe it's another way you would be able to benefit, and if you were able to get some benefit, in that way some share of royalties, bonus income and so on from federal waters offshore Alaska, I think the amounts of money, I don't know what the share would be, I think the amounts of money that you would be getting would be very very much larger than any kind of fooling with apportionment factors

in that franchise bill to try to pick up something. We're talking about much larger potential amounts of money I would think.

REPRESENTATIVE OSTERBACK - Talking about the environmental condition and everything, you're going to get a lot of static from fishermen, _____ coming out that the oil won't take Kachemak Bay for example. Now, Kachemak Bay, only produces about 6 million pounds of shrimp, but you come up towards the chain around Kodiak, what we do, that's just a drop in the bucket, and we're buying that back, so there's going to be a lot of static, say in the Bering Sea, is one of the richest crab, herring, shrimp, and out along the chain, so if there is no revenue for the _____ then we're going to kill off our fisheries and there _____ ng to be a lot of static coming from that on the offshore drilling, because you can see what happened in Kachemak Bay, which is just a small little thing, and we're going to pay I don't know how many million dollars to buy that back to save that fishery. And what I'm trying to get across, if we're not going to get no sharing off the offshore, there's going to be a big fight to try to stop it.

RICHARD KILGORE - Absolutely, because then you say what do you need it for, to get nothing whatsoever out of it. I don't want anything I say to be construed that I'm against environmental concerns, they obviously are very real, but

I think what you're saying is correct and this goes for other parts of the country too, if what you're talking about is development of Federal waters, and off your shore with the potential environmental problems from which you will suffer, and you get absolutely no benefit, then what do you need it for. In those circumstances one would take a very extreme, I think, position on viewing the environmental damages. That is, one would say, I don't care if the chances are one in a million, I don't want it because I don't get anything out of it anyway. If there's any chance whatsoever, let's just don't do it, because I don't gain anything anyway, but if you have something to gain from it, I think perhaps people may very well take a more realistic view of what the potential hazards are, what might happen, and with the odds have been happening and so forth, but if people are in the position where they have absolutely nothing to gain, and any possibility of something happening to their environment, that's really going to be against them.

REPRESENTATIVE OSTERBACK - One more, if I may. Take say a barrel of oil is worth what \$12.00, \$11.00, what? A barrel of fish is worth about \$200.00. So what do we want?

RICHARD KILGORE - Sure, if you're going to destroy a valuable industry.....

GEORGE SILIDES - One of the things the administration has put forth through the federal government in my recollection is that, it is just that, and this is why they were hoping to hold off some of the offshore production was to submit a proposition to the Federal government on revenue sharing. I think you are familiar with that, and I think you touched on it. My recollection, and I ask this only for informational purposes as you know, it seems to me that we also suggested a two tier affair. I know you hate everything with two tiers in it, but in that all of the states were able to get a portion of the offshore revenues, so that you gain a broader base of support.

RICHARD KILGORE - Yes, and I think that's a sensible approach to this whole thing too. One can gain broader support where you have some approach as you're saying. Where you have everybody benefits to some extent, but those who are directly effected or so on, get some larger share.

I am saying that you do have this interrelation when you thir' about how high you put your taxes. There is this interrelation between what your taxing policy will be and how much you are raising taxes, and what you're going to get in terms of economic benefits when you lease lands, and that's very very clear, so to some extent you're taking one area through higher taxes and you give up in another through lower, whatever it is, bonuses and so on. So to some

extent they are offsetting, but of course at the same time you have to appreciate that while this is true on new leases for people under existing lease terms, obviously they can't change their contracts with you if you raise taxes, so if you raise taxes they are hurt. You also through your tax policy, obviously effect the value of lands or the value that one can get out of other landowners in the State, and of course the native corporations are obviously the ones who will be effected to the extent that you raise taxes and they make new arrangements on their lands, they will be effected, and they will get less in the way of.....

SENATOR HUBER - I wanted to just for a moment on that same subject to lead Dick back across the cannon ball range and the mud flats, and back to dry land for a minute on these leasing policies, and you were talking about bonus leasing when we got into this, and isn't it true that the price paid for a bonus lease whether it's offshore or onshore, mud flats or whatever, it is based upon what they're willing to pay for the price to gamble on what may be down there in a huge gamble and if we wanted to minimize what our tax would do on that, the minimum would be no tax, and other than that to have a tax that would have a minimum effect, would be a tax that was a percentage of a net profit, and if you had a percentage of net profit tax, that would be the kind of tax that would provide the minimum for losing money in your bonus, because they would all figure when they were bidding

that there would be no tax on anything that we don't get anything on and it will only be a maximum of this amount of exposure on the net when we do make, and if we don't make, we don't pay.

RICHARD KILGORE - That's correct, but that's assuming of course that the income tax that you have really is taxing what is real kind of income in Alaska. If you are on, as the gentleman from EXXON testified the other day, if you're on an apportionment formula, you may pay income tax anyway.

SENATOR HUBER - I didn't mean to lead you back into the net proceeds tax which you happened to design, but I'm thinking about any fair income tax that would.....

RICHARD KILGORE - The income tax works differently, that's right, in the sense when he factors it in and if it's true income tax, he only pays if he wins, so it does effect what he's willing to pay.

SENATOR HUBER - I just wanted to get it to where we actually, what kind of tax we've heard so much, so many times about how you discourage your front end money in bonus bidding, and in some cases, it's absolute milarkey, you don't do it at all, and there you hardly do any discouragement when you do it on a net profit basis. If you get a portion of that in there in a gross manner, you've got a problem.

RICHARD KILGORE - My only point here was to leave you with the idea that we do have an interrelation between the taxes and what you will get on your lands when you lease them, but you also will effect, of course, the value that other people get from their lands and _____ the native corporations.

Well in the end, this whole question of the relative tax burdens and the effects, and when do you have to _____ incentives, when do you discourage, obviously there are no easy answers as I said at the outset. There are many things you would obviously have to look at, and many of these have been suggested. One would obviously be an economic study of the industry, some of which have been done. Levels of activity would be another indicator of your total tax package, lease bids and so on, comparisons with other states and all these things are things that one would look to and try to assess how far you have gone in your taxation policy.

I think one of the really best safe courses, so one would really know where one is in this whole thing, even after you look at all these sort of measures, one of the best safeguards is probably to try to design taxes in your state that relate reasonably well to profitability. I think you run less of a risk if you do this. If you are able reasonably, or in some fashion to relate them to profitability, then you're not going to impose a very big tax burden if the industry isn't

very profitable, and if it is very profitable, you tend to throw up higher taxes and you run less of a risk really that you end up imposing on reasonable taxes on people, and this probably in the end is one of your best safeguards to kind of keep those principals in mind which means taxes related either directly related to income or taxes sort of semi-related to income as the step schedule that you have or the continuous schedule as is proposed where you really impose high taxes only in circumstances that seem to indicate high profitability, that is high well productivity which tends to be associated with high profitability, so I think the more that you keep to these kind of principals, the less of a problem you're likely to have in terms of really going too far in your tax burden on the industry.

GEORGE SILIDES - I have questions on two matters which concern most of us. One of them I know particularly concerns Senator Huber also, and if I may I would like to ask them now. One is do you have any comment on wipping out all the industrial incentive taxes in the State.

RICHARD KILGORE - We really don't have a comment on that.

GEORGE SILIDES - And the other one then is something which was discussed back in 1973 when we had a bill before us to own part of the TAAPS line. Now we have some bills in front of us which concern the possibility of again acquiring

an equity interest in gas lines or other lines, and I wonder if you could comment on that, whether your position has changed or what it might be now.

SENATOR HUBER - George, would you _____ bills particularly is for an industrial incentive, or for a state sponsor corporation which would operate on its own under the so called industrial incentive type bonding 100% if you could expand your question

GEORGE SILIDES - Senator, yes, I was going to make it into two parts, one is just to get a general statement on the State being an equity owner, and secondly of course we have SB 251 which is Senator Huber's bill actually.

RICHARD KILGORE - I haven't seen the bill itself.

SENATOR HUBER - It establishes an authority Dick, and with all of the powers, 100% of the authority to build the gas line.

RICHARD KILGORE - Well, frankly I would prefer, if you don't mind kind of deferring an answer to this question, and give it a little more thought. I know we have in the past, I guess, generally kind of questioned states being involved in things of this sort, and I don't want to give a general answer.

SENATOR HUBER - I don't want to force it either, but the reason that you might give it some consideration when you go back home is that the bill is not this one that is just an idea of whether we do it next year. This particular bill is an either now or never type of thing because it is designed, the whole purpose of it is to supply the North Slope gas to the lower '48 at an economically feasible price to make the project feasible, so it don't have to be subsidized either by users or the government, and if with the FEA setup and everything is set up with the President's approval and everything, it's an either pass it, so it's a method or else it will not be a factor. It's kind of a forced thing but it's now or never. It's timely.

RICHARD KILGORE - Senator, there are a lot of ramifications and a lot of things to think through on this particular kind of thing. I would prefer rather than just giving it off the top of my head, if we did especially take a look at the bill in itself, think it through carefully, and either come back to you with a written response or on the occasion of our next visit be prepared to respond.

MEETING ADJOURNED.

ADDRESS TO HOUSE (SENATE) RESOURCES COMMITTEE

ON

PROPOSED NEW OIL AND GAS TAXATION
(HB 638, 803 - SB 620, 621)

Mr. Chairman, members of the committee. My name is Oliver Leavitt. I am a resident of Barrow, Alaska and am appearing before you today as Treasurer and Director of the Arctic Slope Regional Corporation. I also serve as an officer and director of AFN, Inc.

As you are aware the native regional corporations and AFN, Inc. have gone on record unanimously in opposition to a package of proposed bills in both the house and senate. These bills, if enacted, will greatly increase taxes on oil produced in the state.

Uniquely, out of a commonality of purpose rather than by design or intent we find ourselves aligned with all present and potential future producers of oil. This includes any individual or corporate entity who holds or may ever hold an interest in oil produced in this state.

The cliché that "Politics makes strange bedfellows" is appropriate to emphasize that we are not here in collaboration with the oil industry. No conspiracy or plot by design or inference exists, but by coincidence we find ourselves on the same side of the playing field. Simply stated it is a case of the well worn expression "whose ox is getting gored."

While our self-interests or, better stated our economic survival is at stake we would also like to bring out in a few brief remarks why we believe the consequences of enactment of the proposed legislation at this time could have damaging effects on organized labor, the general business sector, and the individual consumer/taxpayer in Alaska.

Some of you may think that it is out of context for the native people of Alaska to argue for or against anything but preservation of our culture or historic life style including a subsistence living pattern. The Alaska Native Claims Settlement Act in recognition of the value of extinguishment of aboriginal rights and title, provided for compensation

in the form of land and its attendant resources as well as cash dollars. The primary vehicle for management of the assets that were granted are the regional corporations. Congress expressly mandated that the corporations be structured as profit making organizations who have an obligation and responsibility to improve the economic well being of their shareholders. So, like it or not, our task is similar to any other non-public corporation. Maybe because we are relatively new in this game we enthusiastically embraced the free enterprise concept. An individual through hard, honest work is entitled to make a buck and to be allowed to keep some of it.

That is what we have been led to believe. The intent of the Settlement Act was to provide a means to economically develop in a free society without the shackles of subservience or bondage of governmental domination. But, in truth, we are not there yet and we have a long way to go before our economic stability is assured.

Now, let us examine the whole spectrum of what is involved with this proposed legislation.

I. THE CONCEPT OF TAXATION:

Everyone in this nation let alone the State of Alaska understands why governmental authority from the largest to the smallest imposes taxes. Also we know what the taxes are supposed to do - provide services for the public. Taxes run the machinery of government which in turn provides the taxpayers with necessary services that they otherwise cannot effectively and efficiently do for themselves. Education, health, protection, transportation, economic stimulation, aid for those who need it, management of renewable and non-renewable resource belonging to the public - all these and more are the charge of government. Our system is to provide funds through taxes to support the level of need. The idea of taxing beyond the immediate and discernible need is not our system - it best fits those societies who think confiscation or expropriation are the way of life.

Some of you may believe that industry is such a greedy creature that no matter what tax is levied they will hang on. I won't belabor this point other than to cite a recent example that has been accurately statistically documented.

The action by the Western Canadian Provinces, especially British Columbia, in the past few years saw a sharp percentage drop until many people wised up and changed the make up of the government.

II. THE POSSIBLE EFFECT OF USUROUS TAXATION

Both our U.S. Senators have recently commented publicly that Alaska may be on the verge of being considered a "bad little rich boy." We obtain more in federal support per capital annually than any other state - exceeded only by Washington D.C. But more than this Alaska receives 90 percent of the revenues from Federal Oil and Gas leases in the state and receives 25 percent of the stumpage from Federal Timber Sales. The latter is common to other forest product producing states but should be mentioned because the revenues flow directly to the local communities.

If the present proposed tax laws are enacted and the federal treasury loses from 25 to 38 percent over what it otherwise would receive from income of Alaska producers from sale of Alaska resources, why in the name of heaven would the preferential treatment continue? Lost distribution of federal receipts affect everyone - consumer, housewife, and individual taxpayer.

III. THE IMPACT ON ASRC AND OTHER REGIONAL CORPORATION

I have attached to copies of this written testimony our interpretation of how the proposed taxes would effect our income from oil produced on ASRC lands, under both the House and Senate versions of the bills.