

538 SRES TESTIMONIES BEFORE SRES (NOTEBOOK)

TRANSCRIPT OF TESTIMONY BEFORE
THE SENATE RESOURCES COMMITTEE
OF THE
ALASKA STATE LEGISLATURE

BY

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THE STANDARD OIL COMPANY (OHIO)

AT JUNEAU, ALASKA

ON FEBRUARY 10, 1978

CONCERNING PENDING OIL AND GAS INCOME TAX PROPOSALS

I am Dick Donaldson from Sohio and I'm glad to be back here. I should say that a couple of years ago when I first started appearing before this Legislature and indeed this Committee, I expressed the thought that we had come to the State of Alaska as a stranger but really with the hope of being engaged in business here for 25, 50, 100 years--who knows how long. In a sense those words are beginning to become prophetic. It might be worth reporting today that in almost every sense, we are now an Alaskan company. Some of you may have counted up that 75% to 80% of our assets as a whole company are here now, invested in this State, and given our merger with British Petroleum and a combination of those entities at the year's end, we now can say we have 700 plus employees who are residents of the State. Virtually all of our production of oil is here associated with Prudhoe Bay. And even though we have activities in twenty some states in the Lower 48 involving the manufacture, distribution and sales in different businesses, in terms of the lion's share of our business, we are Alaskan. I was also interested, I don't know whether I should say pleased, but interested at least, to see that the U.S. District Court here recently ruled that we are an Alaskan company. That puts the seal on it, if it was ever needed. And though we have not been an Alaskan company for long, we really are now, and personally

I'm kind of glad about it. I feel good about it. We've had a few problems, solved some, and others remain.

Your Committee has before it again a possible amendment changing Alaska's corporate income tax as applied to the oil and gas industry. In the last few days you've heard some thought provoking testimony, Milton Lipton's and gentleman. that you've heard this week and this afternoon. My purpose is not to rehash or go through what you already know. Last year, in March, I presented some rather extensive testimony on this subject. If you have interest in it, you'll find on pages 16 thru 23 of that testimony there were some remarks dealing with the legalities of the bills that you now have before the Legislature on income tax. Rather than repeat that, I simply want to call it to your attention and hope that someone will look at it again.

I would like to address what I think probably is the biggest problem in State revenues, and one which so far as I know the State of Alaska has really not begun to grapple with. It's probably one that affects each of us and all of us a lot more than anything else we are doing right now. It's interesting to me that Milton Lipton addressed this when he was here. In fact, he spoke of it several times. I read a

transcript of at least part of his remarks, and I thought I might begin by just picking up a couple of his points which introduce this subject. I have tried very hard not to take it out of context because he really was speaking of Alaska when he was saying this. These were his words:

"First of all, what you see is a kind of ad hoc taxing policy, increasingly year after year dedicated to the budgetary needs, revenue deficiencies, or whatever the case may be."

And another point he said, and I quote:

"I think it's true that insofar as the State's budgetary needs or revenue deficiencies always seem to be made up by oil industry taxation, this becomes a disabling and discouraging thing for industry. If it is perceived that this is the way in which the taxation proceeds in Alaska, that if there is a budgetary need or a revenue deficiency that almost without regard to (and there was a blank in the transcript) of taxation or the principle of taxation, the incremental revenue or budgetary needs will come from oil industry taxation. This cannot be a matter of indifference to companies that have their choice of operating any place," etc.

Concurrently in another brief comment and almost to the same effect, he again used the word "perception". That word jumped out of the page at me and I call it specifically to your attention. Mr. Lipton said this:

"I think this is one of the things the Legislature surely will want to consider, that if the perception is that changes in the tax structure, as it is applied to the oil and gas industry, are regularly taken, largely with the view to budgetary needs or revenue deficiency, and hardly ever with the long view as to what is a reasonable tax regime for the State, then I think it creates impressions which may be even more important in discouraging investment than the fact of the tax burden per se."

Well, my own plain statement of the problem runs like this. I think it might help to etch out what I believe to be the principal facts bearing on it. First, the budgets in the State of Alaska and in local government here have grown steadily, substantially, and almost relentlessly over the last eight or nine years. The State budget itself quadrupled between 1970 and 1976. Likewise, the number of government employees has also grown over this period. The cost of people is the biggest part of any budget, any year, in any government today. Today the State and local government as a category in Alaska is the largest employer.

I don't know but you might want to find out how many of these people working for government here today are now supported by revenues from Alaskan resources have come from the outside. That might be an interesting perspective on

some of your own problems, not that it's good or bad, but you ought to know who is involved and where your resources are going.

A document called, "The Alaska Economic Forecast--1978", which was published on January 20, 1978 by the Institute of Social and Economic Research of the University of Alaska, has focused on State and local government employment in 1977. It reported that the total number of employees by government in the State went from 31,096 people up to 34,370 people. This was an increase last year, 1977, in one year alone, of over 3,200 people. When I read this it struck me: that's half as many people as the whole oil industry has working in the State right now, that much of an increase in one year!

On page nine of this Forecast there is this comment:

"State and local government sector will again grow in 1978, mainly as a result of a growing state budget. Employment in the State and local government is forecast to rise about 7% over 1977."

Alaska's history, in my judgement, confirms again and again that your government's appetite to spend money is limited only by the amount available to spend, and not always by that. There is no indication that this trend over the last eight or

nine years here will change unless some serious thinking is done about it, and I believe right here in the Legislature. Even if the size of your government could begin to flatten out and not grow too fast, the size of your budgets is still going to grow just to support it in the future.

Thus, the first principal fact bearing on the State's basic problem is size and direction of its government.

The second principal fact is that today most of the cost of this government in Alaska is being funded by the oil industry, and so to speak, the State has gone back to the well a number of times in recent years. If you want to be plain about it, I would have to observe that the State is taxing and spending as if there was no bottom to Prudhoe Bay.

But Prudhoe Bay total production will be half done in eight to nine years and will gradually begin to decline in production as all oil fields do. I'm sure you remember as I do that it took eight or nine years from the time Prudhoe Bay was discovered to put it on stream where it is today. An interesting point: eight or nine years to get here, and eight or nine years of the fat level of production out ahead,

then the income and the production begin to decline. Frankly, if we found another Prudhoe Bay this afternoon, how long would it take to get through the applications, the permits, the approvals, the environmental impact statement, the litigation, some legislation that always seems to follow such projects, the design, the engineering, the drilling and construction, the whole works to put a major new field on stream? Seven, eight, nine, ten years? I don't know. Your numbers are probably just as good as mine.

Some have said it's not likely that another Prudhoe Bay will be found in Alaska. Maybe. It's probably something of a long shot. But even then, the question is when? I think a more realistic view is that there is a lot of resource potential here in oil and gas. There is a very good possibility of finding a number of smaller fields to fully offset that eventual decline of Prudhoe Bay's production. But you know, new fields are not usually found over night or in bunches, just when you may need them for oil production, or just when you may need them for State revenue purposes.

Another fact that bears on this is that it doesn't take very long today to count the drilling rigs that are doing exploratory work in Alaska. People have come here from other

parts of the world to look around and say, you know, this is only a small fraction of the exploratory work you might find going on elsewhere in the world where the resource potential is high.

So, taking these two principal facts, the growth of the State budgets and the present level of exploration here, let me tell you what I think the basic problem is that you face. No, let me say this, I think we both face it, it's a problem that we share.

On one hand you have got a large and growing government with a huge appetite for revenue. On the other hand you have got very little exploration going for you today to feed that appetite eight or nine years out when it's even hungrier, and when the Prudhoe production starts to decline, as it will. Out there is a revenue gap, and I don't believe the State has ever taken a hard look at it. It has always engaged in the wishful thinking that someone will find another Prudhoe Bay, or that somehow things will work out. Put it this way: if the oil industry wasn't here today to tax, you would have to increase the tax burden on all other Alaskan taxpayers, all of them, 200% or 300% just to support the government that you have going right now. It might be interesting to figure

that out. That's the kind of problem you have out ahead of you in this gap that I have been trying to describe, if you don't think about it today.

As a very practical matter, the principal source of the revenues the State will need to support its government and to sustain its economy, to sustain the jobs, the businesses, and the standard of living that most Alaskans enjoy today, will most likely have to come from some continuing, reasonable resource development in the State, and particularly development related to oil and gas. And that brings it back to us, the oil industry, whom you will eventually look to to do this job. You can't live with us, and you can't live without us!

It comes back to a couple of choices. Some will argue, well, let's tax the hell out of them and change the rules back when we've gone too far. I've heard that here occasionally in the last few years, but I think most Alaskans would agree that's a fairly shortsighted policy.

The other choice involves that matter of perception. Remember that word "perception" that Milton Lipton used. How will the companies in our industry perceive that they will be treated if they begin now to risk going out to find new oil and gas reserves in Alaska, whether it is a large one like

Prudhoe Bay or a number of smaller fields. If the size of the government and its budget are out of hand in the years ahead, a company can take very little comfort from the fact that it has an interest only in a small or medium sized field, and not a Prudhoe Bay. Its perception will be that it gets the tax bill, that government is a serious business risk here, and that it had better think seriously before undertaking that kind of risk.

At this point, you might like to consider a couple of other remarks that Milton Lipton made when he was here two weeks ago. He just didn't call the point of perception to your attention. What he also said was this, and again this is a quote:

"From the first time we appeared before this Legislature to discuss taxes, we did not think from the beginning that your tax policy had to be miquely constrained by the Cook Inlet experience. We did not think that the tax policy ought to be carried away by the exuberance of Prudhoe Bay. We thought your tax policies should be oriented pointing to a continuing incentive for the development of the potential oil and gas resources of the State."

Another point he had was a one liner, which I thought jumped right off the page:

"Because the industry is important to Alaska, no Legislature can be indifferent to the aggregate tax burden."

And then at several points in his testimony, he spoke about the importance of the continuity, of the stability of tax policy.

In different ways as he spoke to you this year, he was dredging up the points of perception and stability, and was really asking you to think about it because he couldn't decide things for you, nor can we. In this I think Mr. Lipton understands something about the State's needs. I know he understands the industry's needs because that's been the experience of his firm. He also understands the lead time necessary to get resource exploration and development going in the field and finally get production on stream.

The basic problem Alaska must face, its growing government, covering its costs, and keeping the State's economy going to support all the people who don't work for government, ties together the information that you've been receiving in pieces for the last two weeks. It makes clear the relevance of the Arthur Andersen work on total tax burden. Indeed, Mr. Lipton acknowledged the relevance when he said this:

"My first reading of the report suggests that it is a carefully prepared, highly useful document. I think it's been done in a highly professional manner. I think it is correct to say, as they conclude, that the aggregate burden of taxation on the oil and gas industry in Alaska is higher than in any of the other states."

It also shows the relevance of growing State budgets to the State's basic problem, the relevance of the growing numbers of State and local government employees, the relevance of growing State unemployment figures, and the relevance of the declining value in privately owned land with mineral potential as the aggregate tax burden increases.

I have some new information for you which I think you may be interested in. It also has relevance to the State's basic question. There's a man on my staff named Terry Schreiner. He looked into something that we were interested in this last week, and he gave me a brief report. I'd like to just read the summary of it. Terry said:

"I have looked at the drilling expenditures for oil and gas in Alaska for the years preceding Prudhoe Bay compared to more recent years. It shows that, although more money is being spent in Alaska for drilling, Alaska is getting a smaller proportion of the total drilling expenditures expended in the United States in recent years than it did in the years before Prudhoe Bay. For instance, in 1967 drilling expenditures in Alaska were (and I'll just

round the numbers out, he has the exact figures here) \$106 million or 4.62% of the total \$2.2 billion spent in the whole United States. In 1976 the drilling expenditures in Alaska were \$174 million or 2.34% of the total \$7.4 billion spent in the United States. This loss of share of the drilling expenditures occurred in spite of the fact that in 1976, Alaska had drilling expenditures which were locked in because of the requirements of Prudhoe Bay. As a marketer of investment opportunities in oil and gas, Alaska is losing market share to the other states in the United States. The source of these figures are the 1967 and 1976 Joint Association Surveys put out by the American Petroleum Institute."

Terry's point is that your share of the work going on in drilling measured by expenditures ten years ago was a little over 4½% of the whole United States. Today, you are down to less than 2½%. The relevance of that to your basic problem, to your future revenue gap, seems to me fairly apparent.

But matters of relevance are not limited to numbers. I can think of some other people that you might want to invite to appear before your Committee, Madam Chairman, on this matter of perception--Mr. Lipton's word perception. One might be Don Simasko of Simasko Drilling. They are no longer working in Alaska. You might want to find out why, and what his perception is of your situation. The second might be a man named Tennessee Miller, who walked into these halls last year out of the blue, and upset some members of

this Legislature. He rattled a few cages. Now Tennessee Miller and I had never met before. He's a dirt pusher by trade. He builds roads, air strips, work pads and what not for the oil industry. His message last year was that he works when the oil industry works, and he wasn't working. At least three of his spreads were idle, and he didn't like it. Another point of perception.

A third and totally different perspective might come from a man named David Goodman, a managing partner of Morgan Stanley, investment bankers in New York. Mr. Goodman's credentials are obvious. He personally raised \$5 billion of the money invested in Prudhoe Bay and TAPS, probably the Guinness indoor and outdoor record. Mr. Goodman has a perspective and a perception on how the investors who have the money needed here to do this work feel now and may feel about the questions that you are wrestling with.

Senator Ted Stevens is another one. I understand he'll be here shortly, I don't know the exact date, I think this coming Tuesday. In December he spoke before the OMAR Petrochemical Symposium in Anchorage, and he talked about this type of development here. One of his remarks was a point of perception which you may want to ask him about when he comes. He said:

"Alaska's total taxes and royalties are now the highest among energy producing states. We are also, obviously, the most remote. If we want to develop and diversify our economy, we must provide the incentives to be competitive with more accessible states. If we want major capitalization from the private sector, we must provide a return on investment that makes their participation profitable. If we want long term cooperation from the Lower 48, we must provide their economic interests equitable treatment."

Another man that might give you some perception from quite a different quarter is a man who can talk a good deal about the proposed ALCAN Project. That's terribly important to the State of Alaska, and to most of the companies represented by people in this room. Sy Orlofsky is a man who works for Columbia Gas. I think he's a Senior Vice President. He has long experience in the gas industry, buying gas, shipping it and selling it. I first met him when he was a member of the Northwest Gas Project Study Group, and then knew him in the Arctic Gas project which has now been rolled into ALCAN. I think Sy's perception might be interesting to you. He won't tell you that permits will fall out of the sky, and that the money to do that project can be picked off the trees. He can give you about as hardheaded an appraisal as anyone I know of the probabilities and timing of that project that I think is critical to our industry and to the State of Alaska. I don't know that he can come, but I expect that if you extended him

an invitation, he would do it. He's just that kind of a man. His perception on that project could be extremely valuable to this Committee and the Legislature.

Another one is Jess Carr, an interesting man. I've not seen much of him personally, but I heard him speak in Anchorage in October. What he said that day was that jobs and resource development and Alaska's economic health go hand in hand. He raises that point of perception again and perhaps this Legislature might want to get some comments from him about it.

Still another perspective. You have a man named Bob Richards that most of you know. He is one of Alaska's top economists. Bob is always an optimist, but ask him what his 1979 case for Alaska is, first from an optimistic point of view, and then from a worst case point of view, and consider both as a matter of perception. And there are other witnesses you might call.

It seems to me that what you have right here on your Committee's table is this very basic problem that the State hasn't begun to deal with. It's a terrible problem. The appetite of government for revenue, the people's needs to

be met, and a very visible revenue gap out there that can only be met if you go to work today, right now, and try to fill it with the most likely source of revenue based on some reasonable resource development.

All of this sounds pretty negative, but I think that there is a positive side to it as well. The truth is that we need each other, and the sooner we recognize that, the better. Frankly, I would much rather come to Alaska as a partner and not as an opponent.

What can you do? I suggest six things. I have no monopoly on knowledge about the subject, but looking at it from the industry's perception, these are six things that I'd hope would be on somebody's list in the Alaskan government.

First, recognize that since 1968 with the various changes that had been made in the State's tax laws on oil and gas, the State has done a pretty good job of putting itself in a position to pay its bills as far as its government is concerned, and it will be in that position for the next eight, nine or ten years. Its back is not to the wall.

As a footnote to this first point, because there is always the question when you have an income tax bill before you, how does Alaska stack up against other states? If you will take a look at Exhibits II and X in the Arthur Andersen Report, you will see that the total income tax revenues from Prudhoe Bay and the pipeline to the State of Alaska under its own present law exceeds in gross revenues to the State what Prudhoe Bay and the pipeline would pay under the income tax laws of the other seven states compared in the Arthur Andersen Study. Said another way, the income tax law you already have on the books will produce more revenue than the other seven states compared. You've already got the winning combination, if that's the thing that you're worried about. When you are looking at the income tax legislation before you, the question is not tax deficiency and not a better law; it simply comes down to more money and nothing else.

But the first point of the six is to recognize that you can pay your government's bills comfortably, on your own projections, for the next eight or ten years.

The second point is this. Decide for yourself, if you are going to fill your gap by looking to more resource development and sensible development in the State. If that's your

judgement, then try to convince the industry that this type of longer run development is really important to the State from the standpoint of its own revenue position out there eight or ten years from now. Do something to convince the industry that short-term experimentation with your tax laws no longer makes sense. With the history of the last eight or ten years, you've got some persuading to do. I don't say this in an unfriendly way, but recognize that the industry in many ways may be in a "show me" posture. I think you can do it. Again, it's a point that so much needs your attention. That stability is a key if you are going to solve your basic problem.

Third, do the best job you can to manage the size and direction of your State and local government. If you can just hold even, you will have done a lot to help a fairly tough situation that's right out there a few years ahead of you.

Fourth, run your Permanent Fund on a businesslike basis. Draw as much as you can from the experience of private fund management. It's there if you seek it.

Fifth, before extending or implementing new or old regulation of industry, ask yourself, is it necessary? What does it really do for the State?

Sixth and from the standpoint of the majority of Alaskans who work for themselves or for companies here, recognize that a program of continuing resource development will undergird the State's economy for many, many years as it affects these people. You'll also have to recognize that resources can't be found and developed if you can't get to them. The current, and I would characterize it as a "non-leasing policy" in the State of Alaska does not solve this need. You obviously cannot have resource development if you can't get to the acreage. This is so whether it's onshore or offshore. If you set up a simple leasing program, like the gentleman said earlier this afternoon, stick to it, unless there is a very major reason for change. All of these things boil down to stability and make sense all around.

Finally, and this is a personal note, Sohio, and I think probably this is true of all the other companies in our industry working here, has no desire to run the State, not to run your government, and not to pre-empt it, but we sure would like to work here. I think this is consistent with what most of the people in Alaska want too. Your basic problem is there. You've got to face it sooner or later.

It's much better sooner, and I wish you well in that endeavor.

I brought you something that you may or may not want, but it might be useful to you because it deals with the perception point. This week I was in Washington to testify in the proceedings on the pipeline tariff before the Federal Energy Regulatory Commission. The subject of my testimony is a little embarrassing. It is a factual account from which counsel will argue that government at the federal and state level has become a major business risk. What I was asked to do, and what we did from a whole room full of documents that I set up sort of as a library in my department, is to summarize the history that we lived through in the five years that preceded the start-up of construction of the pipeline and a lot of work at Prudhoe Bay, in dealing with government, at the Federal level and here in Alaska, in terms of legislation, in terms of permit negotiation, and in terms of litigation. It is not written to offend anybody. It is a factual account and it occurred to me--this has been filed in Washington, but I have not formally given my testimony--that your Committee and any others that want it in the Legislature, might find that this is a useful reference. Some

members of the Legislature weren't here when a lot of this happened. I think we all need to have some feel of this prologue to wrestle with the basic problem I have been describing. Maybe it's nothing more than a souvenir, but if you'd like it, I offer it for your record and indicate that while it's probably not complete in every detail, it's not a bad summary of that period.

I brought you one other thing that I think I ought to give you because your Committee has dealt with the subject of Coastal Zone Management. Some of you worked very very hard in trying to get a model piece of legislation. I read it, and I thought on the face of the legislation it was a good piece of work. I want to confess to you that one of my other odd jobs in our industry right now is serving on a national committee of the American Petroleum Institute, called the National CZM Steering Committee. We have found that in the 34 states and several territories that are concerned with coastal zone management, government and public interest bodies of various sorts, generally self-appointed, have come up with the idea that they really don't want anything going on on their shoreline. If I had to say what their strategy is, it's this: if they can keep us on the beach, we can't go offshore to find

energy and bring it ashore. It's as simple as that. In some states you have well drawn laws as you have here in Alaska, but they are capable of being distorted one way or another. The purpose of this national committee is straightforward. It says lock, national interest requires sensible development of energy. It requires attention to the environment, but you simply cannot lock up the shore. I think that this subject of coastal zone management is germane to your basic problem, since resource development onshore and offshore will have a lot to do with the economic health of Alaska in the years ahead. What I brought to you as another souvenir is a booklet that is just off the press that our national committee developed. In effect it sets forth what I think is a fairly balanced position, the viewpoint on the part of industry that all reasonable uses of coasts have to be considered. Its title is "A Shore for All Purposes". If you can't read all of it because you have so much to read, you'll see that there is an executive summary for legislators and executives inside the cover. I recommend it to you. I only have a few copies, but I just brought these for your Committee because I knew of your past interest.

Thank you very much. If you have questions, I would be happy to answer them.

Question: The first thing I wrote down here in my notes while I was listening to Dick was the point concerning the court decisions. A huge welcome to SOHIO as being an Alaskan citizen.

Answer: Thank you. This is my 49th trip to the 49th State.

Senator Huber: Professor Parkenson had written on iton this tax study about governments rising always to meet the available profits. I'm sure that Dick might even have discovered this separately.

Answer: You understand, Senator, I'm not trying to find fault. These are essentially observations. You come to a place and you just see this going on. We've known each other for a few years now, and I'm just telling it as it is.

Senator Huber: I really want to know, Dick, you said that all of the problems that the companies have in dealing with the tax policies, I get from you that it isn't just this jurisdiction, it's many other jurisdictions that the oil companies are in doing this. As the needs for taxes raise, it goes to the most logical places.

Answer: Let me respond to that. As a practical matter, you do see a similarity of problems in other states. There is a difference in Alaska which I will confess to, and that is the velocity of the problem. Decision here is notably faster. I don't mean that again in an offensive way, it just is an accelerating thing here.

Senator Huber: I don't think it is. Your problem seems to be parallel with another one. Your problem of the companies being able to interface with the taxes and how the burden builds. It seems to be like a man quite a few years ago in government stated. You probably want to comment on it. It is interesting that Franklin Delano Roosevelt said that you couldn't win an election in this country without the support of big oil, and you couldn't govern with it. So he was having trouble from that viewpoint; oil companies are having trouble from the viewpoint of being able to operate a business under the government's taxing policies.

Answer: That's why I said half seriously and half kidding, you can't live with us, and you can't live without us. Thank you.

TESTIMONY OF
COMMISSIONER STERLING GALLAGHER

BEFORE THE
RESOURCE COMMITTEE
OF THE
ALASKA STATE SENATE

February 22, 1978

STERLING GALLAGHER

MADAME CHAIRMAN AND MEMBERS OF THE SENATE RESOURCES COMMITTEE:

I WANT TO THANK YOU FOR GIVING ME THIS OPPORTUNITY TO TESTIFY TO YOU ON THIS IMPORTANT ISSUE OF INCOME TAXATION OF THE OIL INDUSTRY.

I HAVE TESTIFIED AT GREAT LENGTH LAST YEAR ON THE SPECIFICS OF THE INCOME TAX BILLS WHICH WERE BEFORE YOUR COMMITTEE, INCLUDING THE GOVERNOR'S FRANCHISE TAX BILL AND THE SEPARATE ACCOUNTING BILL WHICH IS NOW BEFORE YOU.

RATHER THAN REHASHING THOSE POINTS AND ARGUMENTS I WOULD LIKE TO SPEAK TO YOU ON WHAT I BELIEVE IS THE MOST IMPORTANT ISSUE - ESTABLISHING AN EFFECTIVE AND EQUITABLE INCOME TAX SYSTEM FOR THE OIL AND GAS INDUSTRY IN ALASKA.

BY EFFECTIVE, I MEAN A TAX SYSTEM WHICH IS FREE OF THE SPECIAL CORPORATE TAX LOOPHOLES AND WHICH IS ACCURATELY MEASURED BY ACTUAL BUSINESS ACTIVITY AND EARNINGS IN THE

STATE SO THAT EFFECTIVE TAX RATES APPROXIMATE STATUTORY TAX RATES ON INCOME PRODUCED IN THE STATE.

BY EQUITABLE, I MEAN A TAX SYSTEM WHICH PLACES MULTISTATE CORPORATIONS ON A PAR WITH LOCAL CORPORATIONS. THAT IS - MULTISTATE OIL CORPORATIONS MUST SHARE EQUALLY IN THE CORPORATE INCOME TAX PAYMENTS TO THE STATE BASED UPON THEIR EARNINGS AND ACTIVITIES WITHIN THE STATE.

UNTIL AN INCOME TAX SYSTEM WHICH IS BOTH EFFECTIVE AND EQUITABLE IS ADOPTED FOR THE OIL AND GAS INDUSTRY, I BELIEVE WE WILL HAVE TAX INSTABILITY. UNTIL THIS INEQUITY WITH THE INCOME TAX IS DEALT WITH ONCE AND FOR ALL THERE WILL BE CONTINUAL PRESSURE FOR CHANGE, AND IT WILL BE AN ISSUE BEFORE THE LEGISLATURE EVERY SINGLE YEAR UNTIL IT IS RESOLVED.

FOR SEVERAL YEARS NOW, THE LEGISLATURE'S OIL AND GAS CONSULTANTS, WALTER LEVY AND ASSOCIATES HAVE RECOMMENDED A REVAMPING OF THE CORPORATE INCOME TAX AS APPLIED TO THE OIL AND GAS

INDUSTRY. FOR THE LAST THREE YEARS SEVERAL BILLS HAVE BEEN INTRODUCED IN THE LEGISLATURE TO DEAL WITH THE INCOME TAX ISSUE. LAST YEAR BOTH THE DEPARTMENT OF REVENUE AND A SPECIAL SUBCOMMITTEE OF THE LEGISLATIVE COUNCIL MADE EXTENSIVE STUDIES OF ALASKA'S CORPORATE INCOME TAX AS APPLIED TO OIL AND GAS CORPORATIONS AND MADE SPECIFIC RECOMMENDATIONS TO REFORM THE INCOME TAX. I BELIEVE THAT THIS YEAR IS THE TIME TO FINALLY REFORM ALASKA'S CORPORATE INCOME TAX.

AS STATED BY THE DEPARTMENT AND OTHER SOURCES, THE OIL AND GAS INDUSTRY PAYS AN EFFECTIVE ALASKA INCOME TAX RATE OF BETWEEN 2 TO 3 PERCENT ON THEIR ALASKA INCOME. THIS RESULTS FROM TWO FACTORS - A SUBSTANTIALLY ERODED FEDERAL TAX BASE AND AN INAPPROPRIATE APPORTIONMENT FORMULA. THE COMBINATION OF THESE FACTORS THEN RESULT IN MULTISTATE OIL CORPORATIONS PAYING LESS TAX THAN THAT OF LOCAL CORPORATIONS ON THE SAME INCOME EARNED IN THE STATE.

THIS INEFFECTIVENESS OF OUR INCOME TAX IS EASILY DISPLAYED BY SIMPLY EXAMINING THE ACTUAL INCOME TAX PAYMENTS MADE BY

THE OIL INDUSTRY OVER THE PAST FEW YEARS AND LOOKING AT OUR PROJECTIONS OF FUTURE INCOME TAX COLLECTIONS.

FOR EXAMPLE, IT WASN'T UNTIL THE 1973 TAX YEAR THAT CORPORATE INCOME TAX PAYMENTS FROM THE OIL INDUSTRY FINALLY CREPT ABOVE THE \$1 MILLION DOLLAR MARK. AND DURING THE LAST 3 YEARS OIL COMPANY INCOME TAX PAYMENTS HAVE TOTALED \$2.1 MILLION, \$3.7 MILLION AND \$4.4 MILLION RESPECTIVELY. IN FACT, TOTAL CORPORATE INCOME TAX PAYMENTS OF THE OIL INDUSTRY FOR THE LAST SEVEN YEARS HAVE BEEN ONLY \$13,108,000. THIS REPRESENTS 9.4 PERCENT OF APPROXIMATELY \$140,510,000 IN TAXABLE INCOME OVER THE LAST SEVEN YEARS.

TO VIEW THIS TAXABLE INCOME REPORTED BY THE OIL INDUSTRY IN PERSPECTIVE YOU NEED ONLY MULTIPLY LAST YEAR'S OIL PRODUCTION FROM COOK INLET TIMES 50 PERCENT OF ITS AVERAGE WELLHEAD VALUE TO FIND THAT IT EXCEEDS THE TOTAL OIL COMPANY INCOME TAXED BY ALASKA FOR THE LAST SEVEN YEARS. IN FACT THE SEVEN YEARS OF REPORTABLE INCOME REPRESENTS A LITTLE LESS THAN .25 PER BARREL OF THE OIL PRODUCED FROM COOK INLET OVER THE SAME

SEVEN YEAR PERIOD. THESE REPORTED INCOME FIGURES DO NOT I BELIEVE REPRESENT THE NET INCOME EARNED NOR REFLECT THE ACTIVITIES IN ALASKA BY THESE COMPANIES DURING THIS PERIOD.

NOR IS THIS INEQUITABLE SITUATION LIKELY TO CHANGE MUCH IN FUTURE YEARS EVEN AS A RESULT OF THE HIGHER PROFITABLE PRUDHOE BAY PRODUCTION. BASED UPON ACTUAL TAX RETURN INFORMATION WE ARE ONLY ESTIMATING ADDITIONAL CORPORATE INCOME TAX REVENUES AS A RESULT OF PRUDHOE BAY PRODUCTION OVER THE NEXT TWO YEARS OF \$2.3 MILLION AND \$23.6 MILLION DOLLARS RESPECTIVELY. AGAIN THIS REPRESENTS ONLY A SLIGHT RETURN FROM THE SUBSTANTIAL INCOME EARNED AND ACTIVITIES TAKING PLACE IN THE STATE.

THIS INFORMATION IS IN MARKED CONTRAST TO THE PREDICTIONS OF LIKELY INCOME TAX REVENUES PROVIDED BY THE OIL INDUSTRY AND THEIR CONSULTANTS. FOR EXAMPLE, LAST YEAR IN SOHIO'S SUBMISSION #1, SOHIO ASSUMED CORPORATE INCOME TAX REVENUES TO THE STATE OF ALASKA OF \$27.4 MILLION DOLLARS IN 1977 AND

\$62 MILLION DOLLARS IN 1978 IF OIL WERE SOLD IN CALIFORNIA FOR \$13 PER BARREL.

IN ADDITION, THE ARTHUR ANDERSON STUDY SHOWS ALASKA INCOME TAX REVENUES OF \$1,747,100 OVER A 25 YEAR PERIOD OR AN AVERAGE OF \$69,884,000 PER YEAR.

THESE REPRESENTATIONS OF INCOME TAX COLLECTIONS JUST DON'T MATCH THE PAST TAX RETURNS OF THE OIL INDUSTRY OR THE LIKELY RETURNS IN THE NEAR FUTURE.

AGAIN LET ME EMPHASIZE THAT WE NEED AN EFFECTIVE CORPORATE INCOME TAX. ONE THAT TRULY REFLECTS THE BUSINESS ACTIVITY AND INCOME EARNED IN THE STATE.

IN RESPONSE TO FACTS OF THE ACTUAL EFFECTIVE INCOME TAX RATES PAID BY THE OIL INDUSTRY YOU HAVE HEARD SUBSTANTIAL TESTIMONY BY THE OIL INDUSTRY CONSULTANTS JUSTIFYING THE RESULT OF LOW EFFECTIVE TAX RATES IN THE NAME OF UNIFORMITY.

I TOO BELIEVE THAT UNIFORMITY IS A LAUDABLE GOAL FOR THE STATES AND THAT IS WHY I AND MY DEPARTMENT ARE ACTIVE PARTICIPANTS IN THE MULTISTATE TAX PROGRAM OF THE MULTISTATE TAX COMMISSION. THIS DOES NOT MEAN, HOWEVER, THAT WE SHOULD BLINDLY MARCH IN LOCK STEP IN THE NAME OF UNIFORMITY AND IGNORE OUR RESPONSIBILITY OF PROVIDING AN EFFECTIVE AND EQUITABLE CORPORATE INCOME TAX SYSTEM. I BELIEVE THAT WE HAVE A DUTY TO INSURE THAT THE CORPORATE INCOME TAX SYSTEM RETURN TO THE STATE, TAX REVENUES WHICH ACCURATELY REFLECT THE BUSINESS ACTIVITY AND INCOME EARNED IN THE STATE EVEN IF THE INCOME IS EARNED BY CORPORATIONS THAT DO BUSINESS THROUGHOUT THE WORLD. THE ACTUAL INCOME TAX REVENUES RECEIVED TO DATE AND PROJECTIONS OF FUTURE INCOME TAX REVENUES DO NOT, I BELIEVE, REFLECT THE SUBSTANTIAL BUSINESS ACTIVITIES AND PROFITS EARNED IN ALASKA IN PAST YEARS AND THE FUTURE BY THESE MULTINATIONAL CORPORATIONS.

I DON'T THINK WE CAN TOLERATE ANY LONGER A CORPORATE INCOME TAX SYSTEM ON THE OIL INDUSTRY WHICH ALLOWS MULTINATIONAL CORPORATIONS TO AVOID TAXES ON SUBSTANTIAL EARNINGS BY TAKING ADVANTAGE OF ALL THE SPECIAL FEDERAL TAX AND ACCOUNTING DEVICES AND BY THE USE OF AN APPORTIONMENT FORMULA WHICH DOES NOT ACCURATELY REFLECT OIL INDUSTRY ACTIVITY IN THE STATE. IN ADDITION, I DON'T THINK WE CAN TOLERATE A SYSTEM WHICH BECAUSE OF THESE LOOPHOLES AND UNREPRESENTATIVE FORMULAS ALLOW LOCAL CORPORATIONS TO PAY HIGHER EFFECTIVE TAX RATES THAN MULTINATIONAL CORPORATIONS FROM LIKE ACTIVITIES.

I THEREFORE ASK FOR YOUR FAVORABLE CONSIDERATION OF AN EFFECTIVE AND EQUITABLE CORPORATE INCOME TAX FOR THE OIL AND GAS INDUSTRY. I BELIEVE THAT THE TAX BILL WHICH WE HAVE PROPOSED MEETS THIS CRITERIA.

THAT BILL WOULD HAVE ELIMINATED ALL THE CORPORATE LOOPHOLES THROUGH THE ADOPTION OF A BOOK INCOME DEFINITION OF TAXABLE INCOME. IT ALSO WOULD HAVE SOLVED THE PROBLEM OF THE

APPORTIONMENT FORMULA BY SUBSTITUTING AN EXTRACTION FACTOR FOR THE SALES FACTOR AND THEREBY PROVIDING A MORE ACCURATE MEASURE OF OIL INDUSTRY ACTIVITY AND INCOME IN THE STATE.

I BELIEVE THAT THAT BILL WOULD FOR THE FIRST TIME PROVIDE BOTH AN EFFECTIVE AND EQUITABLE INCOME TAX FOR OIL AND GAS CORPORATIONS.

AS YOU KNOW, HOWEVER, I AM OPPOSED TO THE SPECIFIC BILL THAT IS BEFORE YOU SINCE I BELIEVE THAT IT COULD LEAVE US WITH JUST ANOTHER INEFFECTIVE INCOME TAX. I AM OPPOSED TO THIS BILL BECAUSE IT WOULD ALLOW ONE PART OF A BUSINESS TO CALCULATE ITS OWN TAX LIABILITY BASED UPON SUCH ITEMS AS INTERCOMPANY TRANSPORTATION CHARGES. THUS WE COULD POSSIBLY BE LEFT IN THE SAME SITUATION THAT WE FIND OURSELVES IN TODAY WITH SEVERANCE TAX AND ROYALTY COMPUTATIONS - THAT IS INCOME SUBSTANTIALLY REDUCED BY INFLATED TRANSPORTATION CHARGES.

THEREFORE, I WOULD ASK FOR YOUR FAVORABLE CONSIDERATION FOR THE APPROACH CONTAINED IN THE ORIGINAL HB 322 AND ESTABLISH AN EFFECTIVE INCOME TAX ON THE OIL AND GAS INDUSTRY.

INCOME TAX PAYMENTS
BY OIL AND GAS CORPORATIONS

1970-1976 Taxable Years

47 COMPANIES	1970	1971	1972 (thousands)	1973	1974	1975	1976	TOTAL
TOTAL	484,620	587,304	519,598	1,230,100	2,161,053	3,765,285	4,460,019	<u>13,207,979</u>

TESTIMONY OF RICHARD KILGORE
DIRECTOR OF RESEARCH FOR
W.J. LEVY CONSULTANTS

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 of 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 it's 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.E. 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 double 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 acpuisition 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 think 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 9% 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 - Sentor 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 less 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 oversight. 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.

KILGORE - 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 Alyeska 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 Alyeska 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 no one 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 amortize 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, is 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 once, 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 come 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