ALASKA LEGISLATURE COMMITTEE FILES 1987-1988 8672
4949 HRES HB 164 (FILE 3) (see ELF) 521

ESTIMATED SEVERANCE TAX RATES*

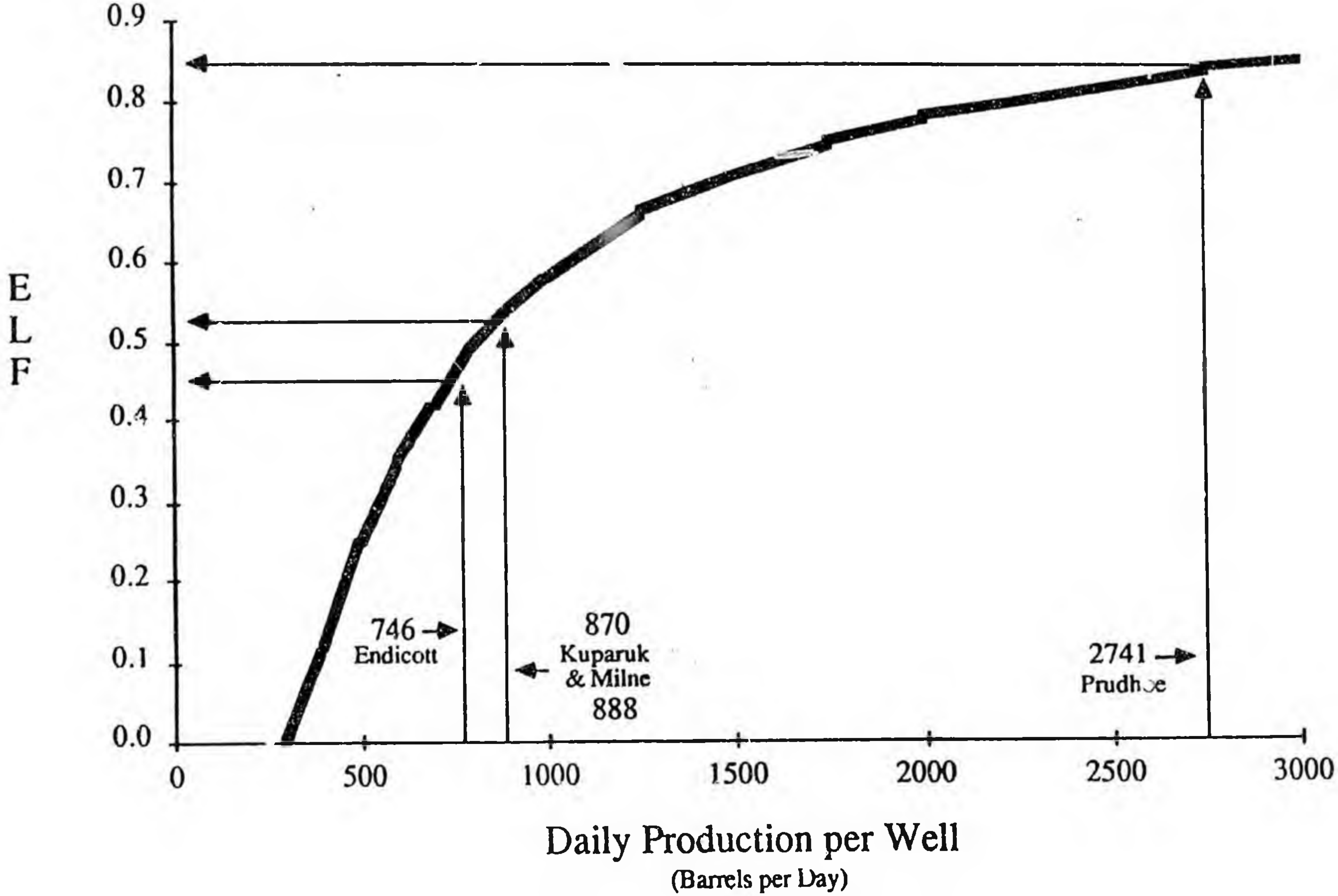
	Prudhoe Bay	Kuparuk River	Milne Point	Endicott	Lisburne	McArthur River	Granite Point
Existing Law	12.6%	7.8%	6.5%	5.6%	12.25%	1.1%	1.3%
CSHB-164 (Fin.)	14.8%	10.7%	0.3%	0.3%	3.6%	0.0%	0.0%
Percent Change in Tax Rate	***17.5%†***	***37.2%***	***-95.4%***	***-94.6%***	***-70.6%***	***-100.0%***	***-100.0%***

*North Slope values are forecast FY 88 averages; Cook Inlet values are estimated Dec 1986 rates;
Cook Inlet fields not listed have zero effective rates under all alternatives.

†CS reduces Prudhoe taxes by 1.4% compared with current (April 1987) rates.

OMB, Division of Policy, 3/30/87

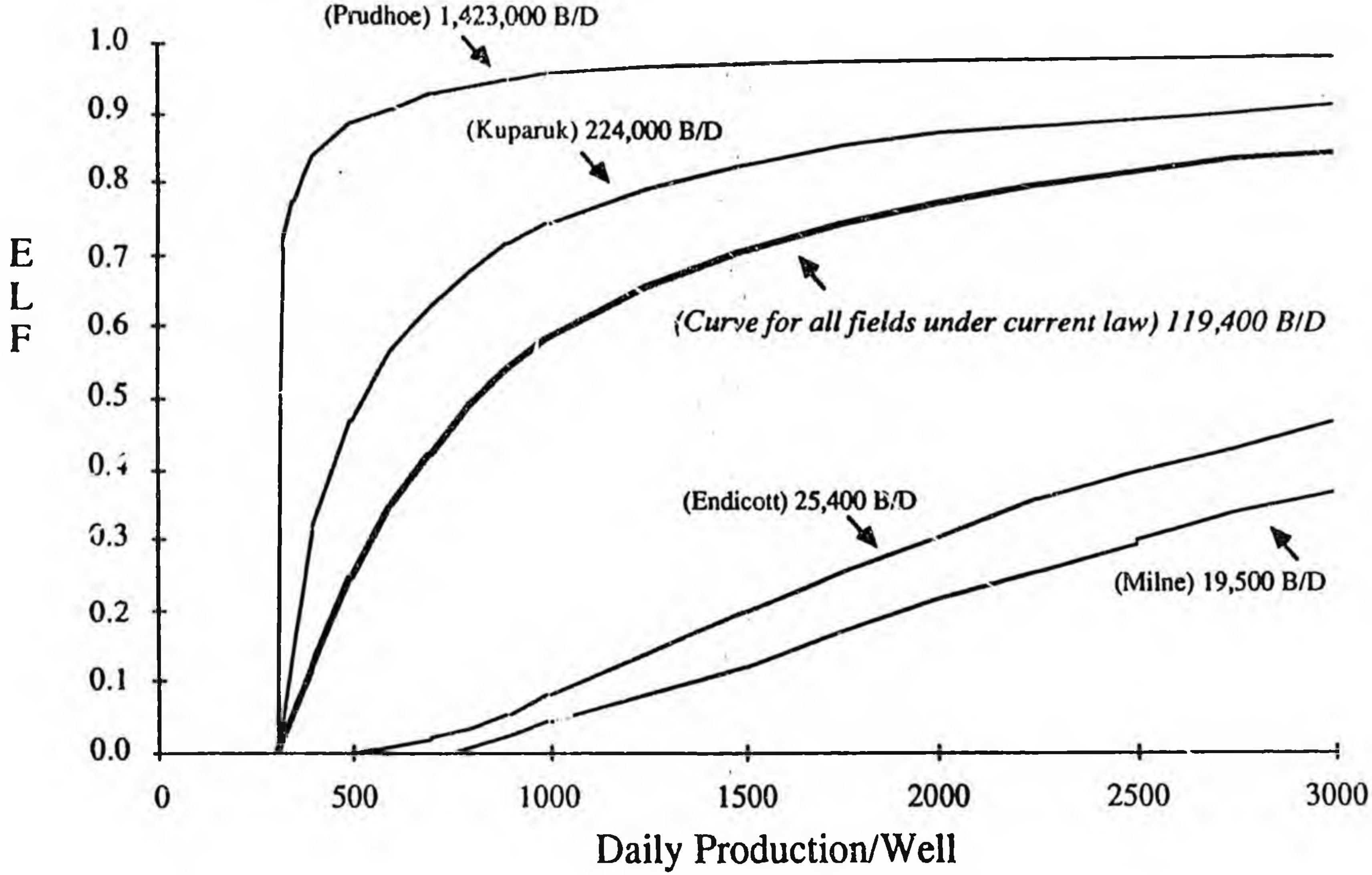
Current Law



0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
E L F
746
Endicott
870
Kuparuk
& Milne
888
2741
Prudhoe
0
500
1000
1500
2000
2500
3000
Daily Production per Well
(Barrels per Day)

Alternate ELF

Constant At 55,000,000



TECHNICAL NOTE
ON ARCO'S KUPARUK EXAMPLE
Tax Effects of Drilling an Additional Well Under Current Law

Mr. James Weeks, Kuparuk Unit Manger for ARCO, provided testimony to the House Finance Committee on March 27, 1987. Examples of severance tax effects (see following page) accompanied his testimony. The examples compare the severance tax effects of adding one additional well in the Kuparuk field under the current ELF and under the proposed ELF (CSHB 154 fin.). The examples show that the addition of one well producing just under 300 barrels per day would increase output from 90,168,000 barrels of oil per year (BOPY) to 90,277,000 BOPY. At the $9.00 per barrel price assumed in ARCO's example, annual gross revenue to the owners increases by $981,000.

(90,277,000 BOPY - 90,168,000 BOPY)*($9/barrel) =
(109,000 BOPY)*($9/barrel) = $981,000

The first of ARCO's two examples shows how under current law the owners would collect an annual severance tax *rebate* of $37,846 on this additional revenue. The effective severance tax rate on the new production is thus -3.9 percent. The effect is analagous to a personal income tax where the effective tax rates become lower as increasing income moves the taxpayer into a higher bracket.

The second ARCO example illustrates how this will be changed under the proposed law. Instead of giving the owners a $37,846 windfall, the proposed law will collect $58,611 (6.0 percent) of the incremental $981,000 for the state in severance tax. The table below summarizes the effects under the current and proposed severance tax laws, as shown in the ARCO examples.

TAX EFFECTS OF DRILLING ONE ADDITIONAL WELL
(ARCO Kuparuk Example)

	Change In Annual Gross Revenue	Change In Annual Severance Tax	Tax Rate On Incremental Production	Average Tax Rate Before Drilling	Average Tax Rate After Drilling	Percent Change In Average Tax Rate Due To Drilling
Current Law	$981,000	($37,846)	-3.9%	7.820%	7.806%	-0.180%
Proposed Law	$981,000	$58,611	6.0%	10.944%	10.938%	-0.055%

DRILLING/WORKOVER DISINCENTIVE
COMMITTEE SUBSTITUTE HB 164

SEVERANCE TAX CALCULATION

CURRENT LAW

$$\textit{Field Rate} \times \textit{Wellhead Price} \times \textit{Severance Tax} \times \textit{ELF}$$

$$90{,}168{,}000\,BOPY \times \$9/BO \times 0.15 \times 0.52134$$

$$= \$63{,}461{,}050/year$$

Addition of 1 well :

$$90,277{,}000\,BOPY \times \$9/BO \times 0.15 \times 0.5204$$

$$= \$63{,}423{,}203/year$$

A decrease of $37,846 year

PROPOSED LAW

$$\textit{Field Rate} \times \textit{Wellhead Price} \times \textit{Severance Tax} \times \textit{ELF}$$

$$90{,}168{,}000\,BOPY \times \$9/BO \times 0.15 \times 0.7296$$

$$= \$88{,}811{,}873/year$$

Addition of 1 well :

$$90,277{,}000\,BOPY \times \$9/BO \times 0.15 \times 0.7292$$

$$= \$88{,}870{,}484/year$$

An increase of $58,611 year

[ARCO Handout, March 27, 1987]

COMPUTING THE ALTERNATE ELF

The alternate Economic Limit Factor formula is:

ELF = (1-PEL/TP)EXP[(55,000,000*WD)/(PEL*TP/Days)]

PEL (Production at the Economic Limit) =
(300 barrels per day)*
(average number of operating wells during the month)*
(number of days of production for the month).
For example:
*300 barrels * 519 wells * 30 days = 4,671,000 barrels per month at the Economic Limit.*

TP (Total Production for the field) =
(average number of operating wells during the month)*
(number of days of production for the month)*
(average daily production per well).
For example:
*519 wells * 30 days * 2750 barrels per well = 42,817,500 barrels of production per month.*

WD (Well Days) =
(average number of operating wells during the month)*
(number of days of production for the month).
For example:
*519 wells * 30 days = 15,570 well days.*

Days = the number of days in the month for which the tax is paid.
For example: In April, 30 days.

CALCULATION EXAMPLE

Alternate ELF
(1- PEL / TP) EXP[(55,000,000* WD)/(PEL * TP / Days)]

(1 - 4,671,000/42,817,500) EXP[(55,000,000*15,570)/(4,671,000*42,817,500/30))]

= (1 - .1091) EXP (.1285)

= (.8909) EXP (.1285)

= .9856

Comparison of the March 1987 DOR Petroleum Production
Revenue Forecast and CSHB164
(Million $)

Fiscal Year	March Official 30%	CSHB164 30%	March Official Mean	CSHB164 Mean	Delta 30%	Delta Mean
1987	1108.87	1114.39	1162.46	1168.36	5.52	5.9
1988	1189.59	1277.73	1437.59	1545.8	88.14	108.21
1989	1319.14	1427.18	1630.92	1759.88	108.04	128.96
1990	1441.42	1559.42	1753.22	1895.31	118	142.09
1991	1330.42	1446.18	1656.81	1800.41	115.76	143.6
1992	1431.66	1554.83	1808.98	1953.48	123.17	144.5
1993	1503.92	1638.57	1937.47	2084.7	134.65	147.23
1994	1550.06	1668.68	2289.29	2429.46	118.62	140.17
1995	1512.66	1625.97	2368.06	2504.08	113.31	136.02
1996	1470.59	1580.59	2329.13	2463.01	110	133.88
1997	1455.73	1568.57	2695.79	2832.53	112.84	136.74
1998	1424.09	1526.25	2658.19	2795.12	102.16	136.93
1999	1366.82	1471.58	2594.32	2728.56	104.76	134.24
2000	1312.73	1395.79	2541.24	2681.29	83.06	140.05
2001	1269.4	1345.11	2489.63	2630.86	75.71	141.23
2002	1223.23	1291.24	2454.13	2593.14	68.01	139.01
2003	1198.75	1258.23	2537.33	2674.64	59.48	137.31
2004	1174.99	1216.68	2516.98	2646.47	41.69	129.49
2005	1161.32	1190.35	2486.44	2588.74	29.03	102.3

NOTE: The column headed "Delta 30 %" shows the the revenue increase expected from the ELF bill sent to the Senate, as figured using the state's conservative "30th percentile forecast." The column headed "Delta Mean" shows the revenue increase expected if the state's more optimistic "mean forecast" is used.

Offered: 3/30/87
For Today's Calendar

wo1257hL

Original sponsor: Rules/Governor

IN THE HOUSE BY THE FINANCE COMMITTEE

CS FOR HOUSE BILL NO. 164 (Finance) am

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to the oil and gas properties production tax; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 43.55.013(b) is repealed and reenacted to read:

(b) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

(1-[PEL/TP]) exp ([55,000,000 X WD]/[PEL X TP/Days])

where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid;

Days = the number of days in the month for which the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

* Sec. 2. AS 43.55.013(d) is amended to read:

(d) The monthly production rate at the economic limit for a lease or property is presumed to be 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. The taxpayer <u>or the department</u> may rebut this presumption at a formal hearing under AS 43.05 240 by providing clear and convincing evidence of a different monthly production rate at the economic limit for the lease or property. The hearing shall be held before February 15 of the year or within six months after commencement of oil production for a lease or property. The monthly production rate at the economic limit for the lease or property based upon the clear and convincing evidence of the taxpayer <u>or the department</u> shall be calculated by dividing the value determined under (f) of this section into the average monthly direct operating cost determined under (e) of this section and shall be used for purposes of this section for all oil production during that calendar year from the lease or property.

* Sec. 3. This Act applies to oil produced after May 31, 1987.

* Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

TABLE 1

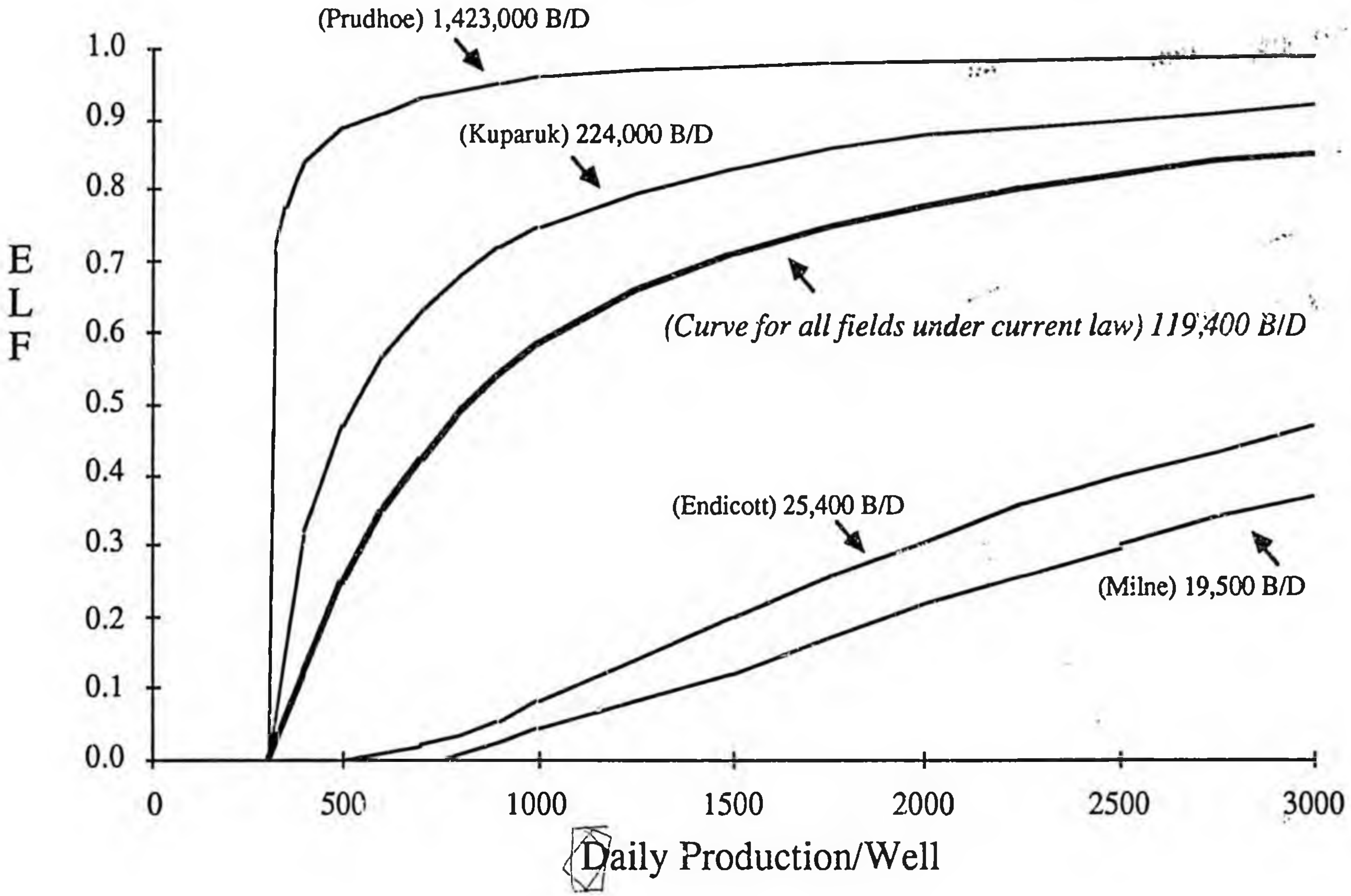
GIANT OIL FIELDS OF THE U.S. BY TOTAL RECOVERY
(Source: Oil & Gas Journal, Feb. 24, 1986)

Field Name	Total Recovery Billion Barrels	Percent Recovery	Oil In Place Billion Barrels
Prudhoe Bay, AK	9,365	39.3	23,800
East Texas, TX	5,529	79.0	7,000
Willmington, CA	2,504	25.8	9,693
Midway-Sunset, CA	2,091	33.8	6,190
Yates, TX	2,000	50.0	4,000
Kern River, CA	1,947	47.9	4,062
Wasson, TX	1,803	38.0	4,748
Slaughter/Levelland, TX	1,522	53.9	2,822
Elk Hills, CA	1,473	53.0	2,780
Panhandle, TX	1,403	23.2	6,060
Sho-Vel-Tum, OK	1,373	44.3	3,100
Kuparuk River, AK	1,300	40.6	3,200
Kelly/Snyder/Dimond, TX	1,252	57.9	2,161
Ventura/Rincon, CA	1,119	18.7	6,000
Greta/Tom, TX	930	68.0	1,376
Long Beach, CA	930	28.0	3,317
Goldsmith-Andector, TX	921	43.4	2,124
Eunice Area, NM	900	45.0	2,000
Hawkins, TX	837	61.7	1,356
Coalings, CS	784	17.4	4,505
Conroe, TX	759	62.9	1,207
Belridge, S, CA	755	53.9	1,400
Oklahoma City, OK	749	29.7	2,520
Rangely, CO	716	42.6	1,682
Hasting, TX	699	37.6	1,860
Cowden Complex, TX	658	54.4	1,209
McElroy-Dune, TX	658	25.9	2,544
Buena Vista, CA	657	25.0	2,630
S. Timbalier, LA	656	38.0	1,726
Bradford, PA	653	17.8	3,500
Santa Fe Springs, CA	622	28.3	2,200
Salt Creek, WY	616	40.6	1,518
Caillon Island, LA	612	54.0	1,133
May Marchand, LA	603	38.4	1,571
Sprayberry, TX	584	6.6	8,088
Greater Seminol, TX	583	50.8	1,148
Webster, TX	567	76.5	741
Wichita Co., TX	556	27.8	2,000
Smackover, AR	553	36.6	1,512
Pt. Argeuello, CA	547	18.2	3,000
Burbank, OK	531	24.6	2,160
McArthur River, AK	531	39.7	1,336
San Ardo, CA	530	36.6	1,450
Van, TX	517	57.9	893
Lima-Indiana, IL	514	49.9	1,030
Elk Basin, WY	500	35.0	1,430
Golden Trend, OK	500	30.0	1,650
Kettleman, CA	500	25.0	2,000
Old Illinois, IL	500	35.0	1,430
West Sak, AK	-0-	0.0	25,000
Total U.S. 52 Fields	59,174	31.49*	187,861
Total Alaskan 4 Fields	11,196	20.99*	53,336

* Average

Alternate ELF

Constant At 55,000,000



No. 2

203

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST

Bill Version: CSHB 164(Res)
Publish Date: HOUSE 3/20/87

Revision Date:
Title: An act relating to the oil and gas production tax.
Sponsor: Rules/Governor
Requestor: House Resources

Agency Affected: Revenue
BRU: Audit
Components: Oil & Gas

EXPENDITURES/REVENUES: (Millions of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES	-	-	-	-	-	-
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	-	-	-	-	-
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	88.7	108.5	117.6	112.9	117.8

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: The above numbers represent the increase in general fund revenues if this bill becomes law. The key assumptions are introduction of a 55,000,000 scaling factor into the exponent of the current ELF formula and fixing the value of the Production at the Economic Limit (PEL) at 300 barrels per well per day. The production impact from FY88 through FY2005 represents a cumulative total loss of 20.9 million barrels.

Prepared By: Chuck Logsdon
Phone: 276-5364
Division: Office of the Commissioner
Date: 3/19/87

Approved by Commissioner: [signature]
Date: 3/19/87
Agency: Revenue

Distribution (by Agency preparing fiscal note):
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

page 1 of 1

HB 164 - Jt Hs Rscs/Fin'c
#3

3/19 Tom Williams CIRI

hard times

> 1/2 PB oil has bn recov'd

tax increase will chill new dev't

Sund: p 22 of Tax Ct -

Kay: price of oil the most impt consid'n Wms: several assumptions > imp't than the tax - decis to drill add'l dev't wells are > dep't on taxn (a factor) - price is more important - (Gleeson, west end) Sen: ELF is a method of reducing taxes - stability in state revenues - Wms: June 20 triggering can be avwd as a idea, but need stability, PB desvs to be subj. to ELF -

Navarre: ~~[illegible]~~ dev't decns at PB aff'd by sev'c tax? Wms: indy has pretty recovered its costs, not marginal prodn now but poss'y after June 20 it would be - CIRI interest in ~~[illegible]~~ Endicott - small matters will hv an effect

Kerttula: separate acctg part of the problem

Mark Hazlewood ARCO

CS is substantially more onerous

taxes are incr'ly impt in tight condns for oil dev't

Wyo/La hv rec'ly reduced state taxes - Kansas, OK, MT are propg tax rdxns; Herrington tax rdxn prop'ls -

mature fields, outer-field dev't

What prodn impact? → 15% sev'c wd reduce infield dev't by up to 30%, shorten prodn by 3 years -

State Chamber sez > 60% of state's economy is related to oil

most impact wd be on new dev't, decns whether or not to drill, infield dev't -

HB 164 #3 3/19 Cont.

Sund: does past profit affect decisions now? Hazlewood: hist sev'c tax rate is in AK - Sund: how much prodxn wd be lost? Hazlewood: PB only, HB 164, even w/ slightly hir prices, cd leave ~ *100 MM bbls in the ground - Kay: - oblig'n to maximize prodxn under statutes/leases/unit agmts - Hazlewood: don't blv the lease req's prodxn of uneconic barrels - have to date att'd to accel. Kuparuk prodxn - new tax policy wd be a factor that might reduce pace of dev't -
Navarre: need to know rev. impax to state if the 100 MM bbls fig. is accurate
Sam: TAPS tariff
Kerttula - royalty better in other states?

Tom Painter - CONOCO - This legn can positively inflc dev't of mgl fields - not speaking on beh. of Milne Unit -
mutual benefit for state + ind'y - need tax + other econic incv's -
substantial num. inc'v for fields ≤ 120k bbls/day
Conoco supp's + rec passage of CSHB 164
insight econx of mgl fields, foresight for rsc dev't
future dev't decins will be much affected by state gov't's abilities to deal w/ econ probs - all US producers are marginal -
Sund: Milne prodin decin · Tom: price, then margins
Pourchot: ~~TAPS~~ Milne pipeline tariff - Tom: $1.91/bbl, owned by wkg interest owners (among state prod'rs)
Zawacki - % of Conoco prodxn Tom: not producing now

CSHB 164 #3 3/19 cont

Don Cornett(?)/Exxon - 48% rdxn in dom. cap. spending -
Ak places a very hi burden on ind'y -
state share of wellhead value up to 73% -
prop'd CS - assumes large fields can assume hi'r costs -
inaccurate -
"covenant" in 1978
Navarre/Sund

Bob Van Hook Standard + Jim Palmer
last year's testimony
3 maj. projs 86-87 - Lisburne/Endicott/ctrl gas facly at PB - 1.4 B bbls
HB 164 - reflects a theory that ELF shd apply everywhere but Prudhoe - Ak has hi'st sev'c taxes - $460-610m
tech'l progress - DOR doesn't account for these - major proj's cd be foregone - can't accurately predict foregone prodn -
CSHB - > exp'r to enlarge a field -
Davis/Porcher
exploration is geared tow disc'y of large prod'v fields -
Sund
PB is going to be a very diff't field in the future -
K - econ'x of west end dev't - Van Hook - PB prodn tax treatment - will be treated diff'ly than Lisburne - K - the CS wd create inc'v for dev't of stand-alone Lisburne-type dev't - Van Hook - CS might enhance Lisburne, but avail funds for dev't are most imp't - econ'x of alt'v invts..
Sam: PEL hy/reb-ttal, 300 bbl wlcy OK, see any need to use?
Van Hook - very imp't IF prices are very low - also when major fields are in decline Sam: poss "double-whammy"

CSHB 164 #3 3/19 cont

Gary Shelby - Starting - RDC / Common Sense -

Chuck Becker ASIA
4-6 yr. transition in spending is needed

Geo Krusz - State Chamber

LouAnn / John H / Ned

field approach -

1) shd repeal the 10-year provision?
Kuparuk shd hv an ELF -
what wd be the diff'c betw. today's ELF, the
1.0 ELF, and .75 if the 10-years provision is
repealed?
strategy: include + discuss vs discuss + amend?

Gregg/Chuck impx on Lisburne

2) which exponent to use?
55 -

Chuck get the other charts done

3) do include the PEL hrg Δ -
4) title?
5) org'z the hrg Wed. -
Sund-descr CS? or Sam -
Gregg/ Chuck -
6) Tom Wms' paper -

Hugh - 7) royalty comparison - Frank -
impax of ELF on roy'ly and corp inc. tax -
do we lose income in other areas?

Chuck Logsdon

field approach -

rund various exponents -

37/42/55/70

tables, charts -

parameters - oil prices / field size -

Vince has copies of all of it -

main diff'c is that the ~~forecast~~ basis is different - will eventually need the March assumptions - will take a week or so -

forecasting is on the field ~~ap~~ basis

hv r'ud Tom Wms' analysis -

indicates effect on inc'v to drill wells

b/w it's incomplete - simplified, too specific

there are impt econ'c issues - other costs than tax effects

repealing 10-year wd be redundant - only Lisburne + Prudhoe hv > .7 ELF; cd get to a point where a small, prod'v field wd fall under it -

~~[illegible]~~ 1) law currently stats ELF for Prudhoe 4.80 floor is not a floor - to address sev'c tax

Adj PEL doesn't help on floor or $ sev'c tax revenue tends to minimize the trap door problem -

need a trap door provision - the Admin'n attempt to set the

PEL is a halfhearted attempt to close trap-door –
ch has low prices, cont to produce, + has a low ECI
that reduces its floor

Gregg:

- repeal PEL hrg
  Lisburne
  Kuparuk

- fn's - field + well

- experiments? - the range - 55, 48, 37 - most $ -
  charts comparing

- Tom Williams' paper - criticisms of field approach

- repealing 10 year?

Official Business

Alaska State Legislature

House

P.O. BOX V
State Capitol
Juneau, Alaska 99811

TO: Rep. Sam Cotten, Co-Chair
Rep. Adelheid Herrmann, Co-Chair
Resources Committee members
FROM: Ned Farquhar, staff Ned Farquhar
SUBJECT: Proposed CSHB 164 (Res)
DATE: March 18, 1987

Attached is a proposed committee substitute for HB 164 which will be presented at today's joint Resources-Finance hearing by Rep. Sund. Administration representatives will be present to explain the import of the changes described below.

Section 1 of the bill repeals the existing ELF formula and the ten-year moratorium provision for certain fields, and reinstates a new ELF formula based on the production of fields rather than wells.

Section 2 eliminates the opportunity for a producer to attempt to rebut the presumption that the PEL (production at the economic limit) is 300 bpd.

Section 3 repeals existing law that relates to the PEL rebuttal and hearing provision, eliminated in Section 2.

Section 4 makes the bill retroactive. There is some question as to the constitutionality of this section because tax payments have already been made, on a monthly basis, under existing law.

Section 5 establishes an immediate effective date for the bill.

cc: Finance Committee members and staff

wo1257hcB
Bannister
3/17/87

Original sponsor: Rules/Governor

IN THE HOUSE BY THE RESOURCES COMMITTEE

CS FOR HOUSE BILL NO. 164 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to the oil and gas properties production tax; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 43.55.013(b) is repealed and reenacted to read:

(b) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

(1-[PEL/TP]) exp ([55,000,000 X WD]/[PEL X TP/Days])

where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid;

Days = the number of days in the month for which the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

* Sec. 2. AS 43.55.013(d) is amended to read:

(d) The monthly production rate at the economic limit for a lease or property is [PRESUMED TO BE] 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. [THE TAXPAYER MAY REBUT THIS PRESUMPTION AT A FORMAL HEARING UNDER AS 43.05.240 BY PROVIDING CLEAR AND CONVINCING EVIDENCE OF A DIFFERENT MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE LEASE OR PROPERTY. THE HEARING SHALL BE HELD BEFORE FEBRUARY 15 OF THE YEAR OR WITHIN SIX MONTHS AFTER COMMENCEMENT OF OIL PRODUCTION FOR

A LEASE OR PROPERTY. THE MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE LEASE OR PROPERTY BASED UPON THE CLEAR AND CONVINCING EVIDENCE OF THE TAXPAYER SHALL BE CALCULATED BY DIVIDING THE VALUE DETERMINED UNDER (f) OF THIS SECTION INTO THE AVERAGE MONTHLY DIRECT OPERATING COST DETERMINED UNDER (e) OF THIS SECTION AND SHALL BE USED FOR PURPOSES OF THIS SECTION FOR ALL OIL PRODUCTION DURING THAT CALENDAR YEAR FROM THE LEASE OR PROPERTY.]

* Sec. 3. AS 43.55.013(e) and (f) are repealed.

* Sec. 4. Sections 1 - 3 of this Act are retroactive to January 1, 1987.

* Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

Current Law (MM BD)

	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	Total
Sohio	262.915268	4.917486	0	2.594634	2.116	272.543398
Arco	113.033944	20.571351	0	.000758	4.232	[illegible]
Exxon	113.033944	.154476	0	.795659	4.232	[illegible]
Mobil	9.86062	.150105	0	0	0	[illegible]
Phillips	[illegible]	.107075	0	0	0	9.760303
Chevron	3.604758	.047201	.105212	0	0	3.857171
Texaco	2.802492	0	0	0	0	2.802492
A. Hess	2.750594	0	0	0	0	2.750594
Shell	.726572	0	0	0	0	.726572
Marathon	.25949	0	0	0	0	.25949
BP	.051098	14.765331	0	0	0	14.817229
LL & E	.207592	0	0	0	0	.207592
Union	0	2.196992	0	.39795	0	2.594942
Conoco	0	0	.474788	0	0	.474788
CIRI	0	0	0	.024635	0	.024635
Total	518.93	42.91	.58	3.814635	10.58	576.864635

COMPANY FIELD EFFECT ADMIN. PROPOSAL

	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	Total	Delta Base
Sohio	310.718044	4.97364	0	2.847936	2.182	320.72162	48.178232
Arco	133.585452	20.80596	0	.000832	4.364	158.756244	20.918588
Exxon	133.585452	.15624	0	.874432	4.364	138.980124	20.763146
Mobil	11.65346	.1519	0	0	0	11.80536	1.794555
Phillips	11.408124	.1085	0	0	0	11.516624	1.756321
Chevron	4.354714	.04774	.25396	0	0	4.656414	.819243
Texaco	3.312036	0	0	0	0	3.312036	.509544
A. Hess	3.250702	0	0	0	0	3.250702	.500108
Shell	.858676	0	0	0	0	.858676	.132104
Marathon	.30667	0	0	0	0	.30667	.04718
BP	.061334	14.93394	0	0	0	14.995274	.178045
LL & E	.245336	0	0	0	0	.245336	.037744
Union	0	2.22208	0	.4368	0	2.65888	.063938
Conoco	0	0	1.14604	0	0	1.14604	.671252
CIRI	0	0	0	.02704	0	.02704	.002405
Total	613.34	43.4	1.4	4.18704	10.91	673.23704	96.372405

COMPANY FIELD EFFECT FIELD ELF

	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	Total	Delta Base
Sohio	305.345012	8.250054	0	.780444	.794	315.167516	42.624120
Arco	131.274594	34.512006	0	.000228	1.588	167.374828	29.537172
Exxon	131.274594	.259164	0	.239628	1.588	133.361386	15.144408
Mobil	11.45187	.251965	0	0	0	11.703835	1.69303
Phillips	11.210778	.179975	0	0	0	11.390753	1.63045
Chevron	4.279383	.079189	.003628	0	0	4.3622	.525029
Texaco	3.254742	0	0	0	0	3.254742	.45225
A. Hess	3.194469	0	0	0	0	3.194469	.443875
Shell	.843822	0	0	0	0	.843822	.11725
Marathon	.301365	0	0	0	0	.301365	.041875
BP	.060273	24.771759	0	0	0	24.832032	10.014803
LL & E	.241092	0	0	0	0	.241092	.0335
Union	0	3.685888	0	.1197	0	3.805588	1.210646
Conoco	0	0	.016372	0	0	.016372	-.458416
CIRI	0	0	0	.00741	0	.00741	-.017225
Total	602.73	71.99	.02	1.14741	3.97	679.85741	102.992775

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: HB 154
Publish Date:

REQUEST

Revision Date: March 16, 1987
Title: Extending imposition of economic limit factor-oil and gas production tax.
Sponsor: Governor
Requestor: Rules

Agency Affected: Revenue
BRU: Audit

Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	-	-	-	-	-
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	-	-	-	-	-
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Attach a separate page if necessary

Prepared By: Steven E. Kettel Steven E. Kettel
Division: Audit

Phone: 465-2320
Date: March 16, 1987

Approved by Commissioner: H. Malone
Agency:

Date: 3/16/87

Distribution (by Agency preparing fiscal note):
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

page ____ of ____

COMPUTING THE ALTERNATE ELF

The alternate Economic Limit Factor formula is:

ELF = (1-PEL/TP)EXP[(55,000,000*WD)/(PEL*TP/Days)]

PEL (Production at the Economic Limit) =
(300 barrels per day)*
(average number of operating wells during the month)*
(number of days of production for the month).
For example:
*300 barrels * 519 wells * 30 days = 4,671,000 barrels per month at the Economic Limit.*

TP (Total Production for the field) =
(average number of operating wells during the month)*
(number of days of production for the month)*
(average daily production per well).
For example:
*519 wells * 30 days * 2750 barrels per well = 42,817,500 barrels of production per month.*

WD (Well Days) =
(average number of operating wells during the month)*
(number of days of production for the month).
For example:
*519 wells * 30 days = 15,570 well days.*

Days = the number of days in the month for which the tax is paid.
*For example: In April, **30 days**.*

CALCULATION EXAMPLE

Alternate ELF
(1- PEL / TP) EXP[(55,000,000* WD)/(PEL * TP / Days)]

(1 - 4,671,000/42,817,500) EXP[(55,000,000*15,570)/(4,671,000*42,817,500/30)]

= (1 - .1091) EXP (.1285)

= (.8909) EXP (.1285)

= .9856

FISCAL EFFECTS OF ELF ALTERNATIVES

Additional Revenue (Millions) At the 30th percentile

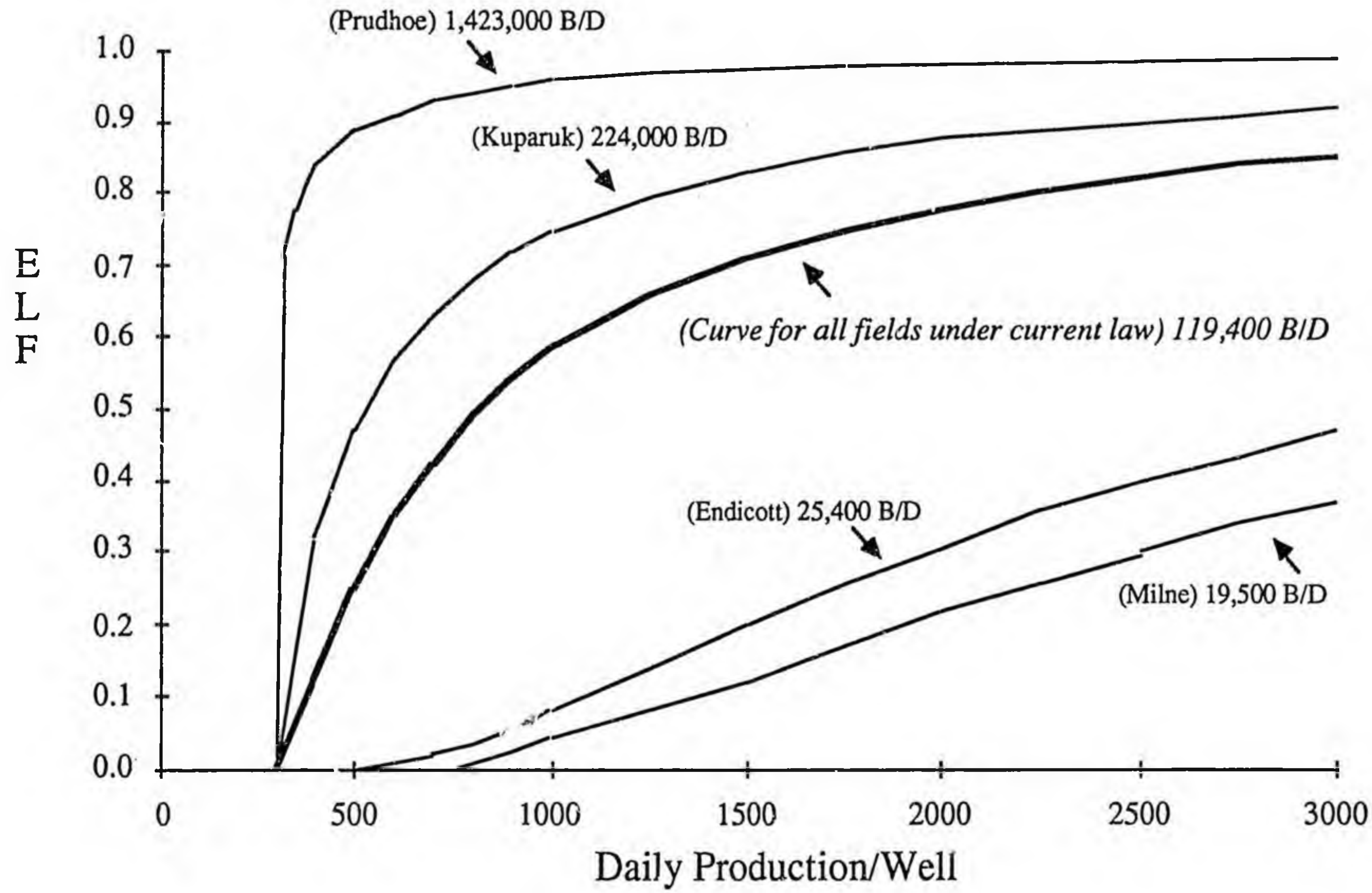
	HB 164	CSHB 154
1987	*0.0*	*0.0*
1988	*76.7*	*88.7*
1989	*92.0*	*108.5*
1990	*98.5*	*117.6*
1991	*99.9*	*112.9*
1992	*105.6*	*117.8*
1993	*5.7*	*129.1*
1994	*3.9*	*110.4*
1995	*3.7*	*102.1*
1996	*4.5*	*97.7*
1997	*3.7*	*100.4*
1998	*2.0*	*88.2*
1999	*-0.2*	*90.9*
2000	*-0.1*	*69.0*

Source: DOR fiscal notes, 3/2/87 and 3/19/87.

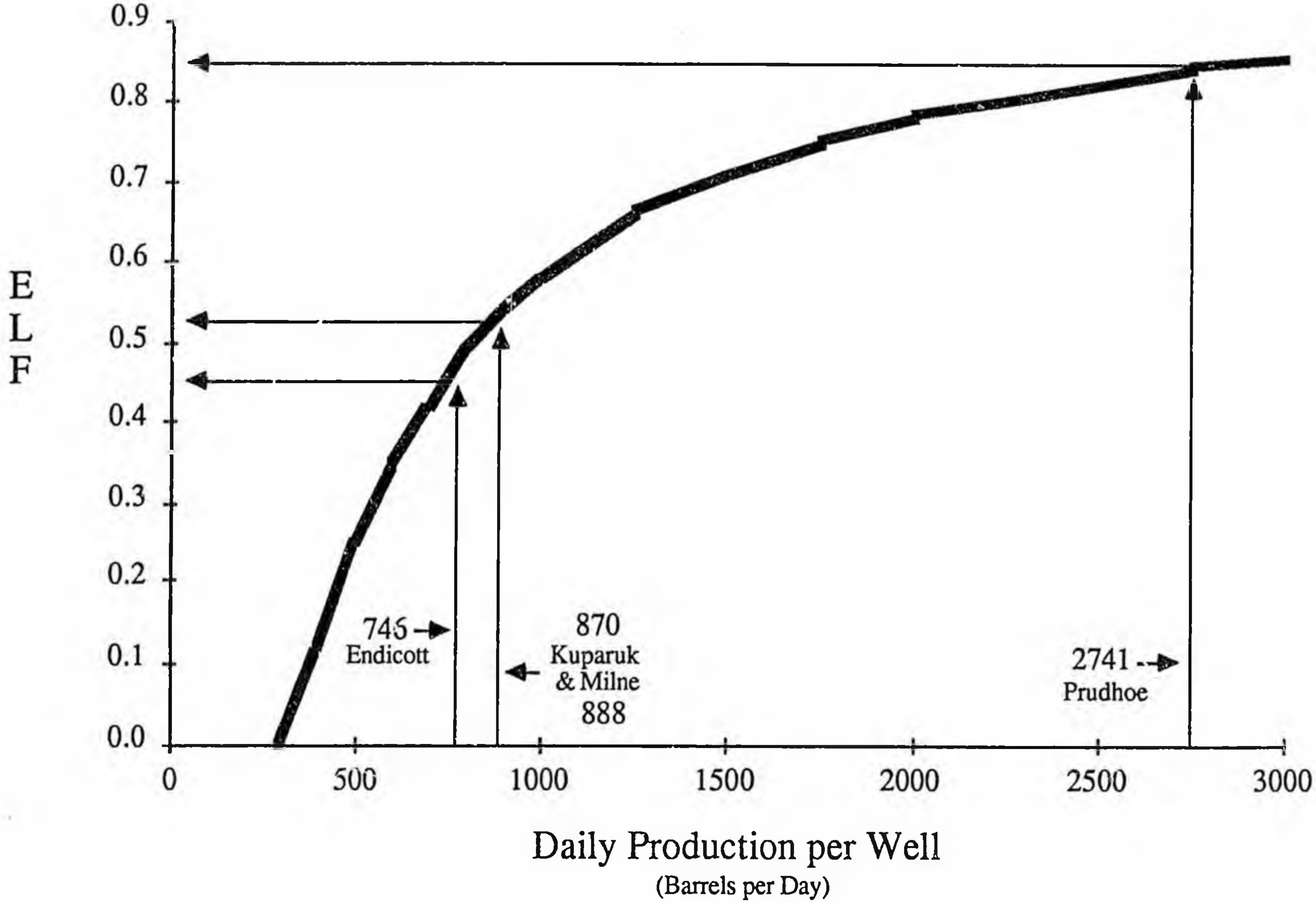
Prepared by OMB/Division of Policy, 3/20/85.

Alternate ELF

Constant At 55,000,000



Current Law


0.9
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E
L
F
746
Endicott
870
Kuparuk
& Milne
888
2741
Prudhoe
0
500
1000
1500
2000
2500
3000
Daily Production per Well
(Barrels per Day)

STATE, FEDERAL AND INDUSTRY SHARES OF ALASKA OIL RESOURCE INCOME: FISCAL 1982-1985
(millions of dollars except as noted)

Fiscal year	[1] Total Revenue	[2] State Royalty	[3] Sever. Conser. tax	[4] Total Prop. tax	[5] Total Oper. Costs	[6] Total Deprec.	[7] Total Acquis. Costs	[8] Windfall Profits Tax
1982	$16,456	$1,553	$1,581	$276	$940	$602	$1	$2,018
1983	$15,470	$1,448	$1,494	$307	$1,101	$780	$1	$1,018
1984	$14,955	$1,409	$1,393	$358	$1,259	$998	$1	$412
1985	$15,136	$1,390	$1,389	$397	$1,449	$1,093	$1	$70

Fiscal Year	[9] Uncap. Interest Expense	[10] Explore. Costs	[11] Admin. Costs	[12] Other Deducs.	[13] Total Deducs.	[14] State Taxable Net Income	[15] Corp. Petrol Income Tax	[16] Federal Taxable Income
1982	$721	$191	$236	$149	$8,268	$8,188	$669	$7,519
1983	$676	$204	$252	$142	$7,423	$8,047	$236	$7,811
1984	$614	$219	$265	$136	$7,064	$7,891	$265	$7,626
1985	$566	$234	$278	$130	$6,997	$8,139	$169	$7,970

Fiscal Year	[17] Federal Corp. Income Tax	[18] Oil Industry Alaska Profits	[19] Total Federal Tax	[20] Total State Tax & Royalty	[21] ----Share of Oil Income---- State	[22] Federal	[23] Industry
1982	$2,098	$5,421	$4,116	$4,079	30%	30%	40%
1983	$2,140	$5,671	$3,158	$3,485	28%	26%	46%
1984	$2,242	$5,384	$2,654	$3,425	30%	23%	47%
1985	$2,343	$5,627	$2,413	$3,345	29%	21%	49%

SOURCES AND FORMULAS --

Column [1]: Vincent Wright, chief of research, to Mary Nordale, Commissioner of Revenue, Memorandum of October 31, 1985, Table 3.
Columns [2] & [3]: January 1986 DOR Revenue Sources, p. 39.
Columns [4] to [12]: Vincent Wright, loc. cit.
Column [13]: sum of columns [2] through [12]
Column [14]: column [1] - column [13]
Column [15]: Revenue Sources, p. 39.
Column [16]: column [14] - column [15].
Column [17]: column [16] * (production-weighted average tax rate -- 1982 = .279; 1983 = .274; 1984 = .294; 1985 = .294). Company effective rates for '82-84 from R. McIntire and R. Folen, "Corporate Income Taxes in the Reagan Years," Oct. 1984, pp. 32-36; '85 estimated by OMB.
Column [18]: column [16] - column [17].
Column [19]: column [8] + column [17].
Column [20]: sum of columns [2], [3], [4], and [15].
Column [21]: (column [18])/(sum of columns [18], [19], and [20]).
Column [22]: (column [19])/(sum of columns [18], [19], and [20]).
Column [23]: (column [20])/(sum of columns [18], [19], and [20]).

Office of Management and Budget
Division of Strategic Planning
revised April 11, 1986

Production Impact of Expo55 (Million bbls/yr)

Fiscal Year	Prudhoe Bay	Kuparuk	Milne Point	Endicott	Lisburne	West Sak	Other Onshore	Other Offshore	Total
1987	0	0	.05	0	-.03	0	0	0	.02
1988	-1.97	-.32	.23	.65	-.05	0	0	0	-1.46
1989	-1.77	-.33	.37	2.16	-.06	0	0	0	.37
1990	-1.59	-.33	.39	2.13	-.07	0	0	0	.53
1991	-1.46	-.29	.39	2.1	-.1	0	0	0	.64
1992	-1.41	-.26	.36	2.01	-.1	0	.28	0	.88
1993	-1.25	-.23	.38	1.94	-.12	0	.51	0	1.23
1994	-2.59	-.38	.32	1.41	-.47	0	.53	0	-1.18
1995	-2.24	-.37	.29	1.69	-.41	-.63	.56	0	-1.11
1996	-2.16	-.3	.18	1.22	-.37	-.77	.48	0	-1.72
1997	-3.12	-.27	.19	.77	-.31	-1.13	.41	0	-3.46
1998	-2.57	-.16	.18	.41	-.28	-1.13	.38	.13	-3.04
1999	-2.18	-.1	.16	.06	-.21	-1.23	.58	.17	-2.75
2000	-1.93	-.07	.03	-.18	-.17	-1.23	.51	.18	-2.86
2001	-1.77	-.02	-.03	-.3	-.11	-1.26	.43	.21	-2.85
2002	-1.46	-.01	-.09	-.36	-.07	-1.32	.34	.23	-2.74
2003	-1.31	0	-.06	-.33	-.02	-1.12	.24	.23	-2.37
2004	-1.27	-.01	.01	-.34	-.02	-1.11	.22	.23	-2.29
2005	-1.13	-.04	-.03	-.26	-.04	-1.08	.18	.28	-2.12
Total	-33.18	-3.49	3.32	14.78	-3.01	-12.01	5.65	1.66	-26.28

THE EFFECT OF THE FIELD SIZE ELF ON THE PRUDHOE BAY SEVERANCE TAX RATE

	Producing Wells	Production (Bbl/day)	Current Elf	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1989	New Effective Tax Rate FY 1989	Increased Effective Tax Rate FY 1989
December DOR 1988 Mean	520	1510000	.8460	.9833	.1269	.1475	.0206

Sensitivity Table

Producing Wells	Production (Bbl/day)	Current Elf	New ELF Field Size Factor	Current Effective Tax Rate FY 1989	New Effective Tax Rate FY 1989	Increased Effective Tax Rate FY 1989
500	1450000	.8453	.9863	.1269	.1479	.0211
	1500000	.8500	.9872	.1276	.1481	.0205
	1525000	.8532	.9876	.1280	.1481	.0202
	1550000	.8555	.9880	.1283	.1482	.0199
	1575000	.8577	.9884	.1287	.1483	.0196
520	1450000	.8399	.9857	.1260	.1479	.0219
	1500000	.8450	.9867	.1268	.1480	.0212
	1525000	.8475	.9871	.1271	.1481	.0209
	1550000	.8499	.9875	.1275	.1481	.0206
	1575000	.8522	.9879	.1278	.1482	.0204
540	1450000	.8339	.9851	.1251	.1478	.0227
	1500000	.8393	.9861	.1259	.1479	.0220
	1525000	.8418	.9866	.1263	.1480	.0217
	1550000	.8443	.9870	.1266	.1481	.0214
	1575000	.8467	.9874	.1270	.1481	.0211
550	200000	.0691	.2024	.0104	.0304	.0200
	225000	.1318	.3406	.0198	.0511	.0313
	250000	.1913	.4533	.0287	.0680	.0393
	275000	.2454	.5429	.0368	.0814	.0446
	300000	.2939	.6139	.0441	.0921	.0480

THE EFFECT OF THE FIELD SIZE ELF ON THE KUPARUK SEVERANCE TAX RATE

	Producing Wells	Production (Bbl/day)	Current Elf	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Increased Effective Tax Rate FY 1988
December DOR 1988 Mean	260	250000	.5299	.6569	.0795	.0985	.0191

Sensitivity Table

Producing Wells	Production (Bbl/day)	Current Elf	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Increased Effective Tax Rate FY 1988
250	200000	.4864	.6500	.0730	.0975	.0245
	225000	.5370	.7187	.0806	.1078	.0272
	250000	.5787	.7638	.0868	.1155	.0287
	275000	.6137	.8087	.0921	.1213	.0293
	300000	.6133	.8388	.0965	.1258	.0293
260	200000	.4686	.6357	.0703	.0953	.0251
	225000	.5206	.7069	.0781	.1060	.0279
	250000	.5636	.7601	.0845	.1140	.0295
	275000	.5926	.8006	.0899	.1201	.0301
	300000	.6302	.8319	.0945	.1240	.0303
270	200000	.4511	.6213	.0677	.0932	.0255
	225000	.5014	.6951	.0757	.1043	.0286
	250000	.5486	.7504	.0823	.1126	.0303
	275000	.5857	.7925	.0879	.1189	.0310
	300000	.6172	.8250	.0926	.1238	.0312
280	200000	.4330	.6069	.0651	.0910	.0260
	225000	.4884	.6833	.0733	.1025	.0292
	250000	.5337	.7406	.0801	.1111	.0310
	275000	.5718	.7843	.0858	.1176	.0319
	300000	.6043	.8101	.0906	.1227	.0321

THE EFFECT OF THE FIELD SIZE ELF ON THE HILINE SEVERANCE TAX RATE

	Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
December DOR 1988 Mean	22	20000	.5411	.0094	.0663	.0011	-.0651

Sensitivity Table

Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
15	10000	.3998	0	.0490	0	-.0490
	15000	.5787	.0128	.0709	.0016	-.0693
	20000	.6765	.0967	.0829	.0118	-.0710
	25000	.7376	.2333	.0904	.0286	-.0618
	30000	.7794	.3704	.0955	.0454	-.0501
20	10000	.2454	0	.0301	0	-.0301
	15000	.4569	.0019	.0560	.0002	-.0557
	20000	.5787	.0380	.0709	.0047	-.0662
	25000	.6565	.1336	.0804	.0164	-.0641
	30000	.7102	.2557	.0870	.0313	-.0557
40	10000	0	0	0	0	0
	15000	.0848	0	.0104	0	-.0104
	20000	.2454	.0002	.0301	0	-.0300
	25000	.3669	.0083	.0449	.0010	-.0439
	30000	.4569	.0441	.0560	.0054	-.0506
60	10000	0	0	0	0	0
	15000	0	0	0	0	0
	20000	.0295	0	.0036	0	-.0036
	25000	.1420	.0001	.0174	0	-.0174
	30000	.2454	.0037	.0301	.0005	-.0296

THE EFFECT OF THE FIELD SIZE ELF ON THE ENDICOTT SEVERANCE TAX RATE

	Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
December DOR 1988 Mean	69	62500	.5397	.2227	.0661	.0273	-.0388

Sensitivity Table

Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
50	40000	.4864	.1160	.0596	.0142	-.0454
	60000	.6433	.4152	.0788	.0509	-.0279
	80000	.7273	.6214	.0891	.0761	-.0130
	100000	.7794	.7423	.0955	.0909	-.0045
	120000	.8149	.8155	.0998	.0999	.0001
75	40000	.2815	.0226	.0345	.0028	-.0317
	60000	.4864	.2378	.0596	.0291	-.0305
	80000	.6027	.4692	.0738	.0575	-.0164
	100000	.6765	.6267	.0829	.0768	-.0061
	120000	.7273	.7282	.0891	.0892	.0001
90	40000	.1785	.0058	.0219	.0007	-.0212
	60000	.3998	.1609	.0490	.0197	-.0293
	80000	.5519	.3892	.0652	.0477	-.0175
	100000	.6172	.5616	.0756	.0688	-.0068
	120000	.6765	.6775	.0829	.0830	.0001
110	40000	.0691	.0003	.0085	0	-.0084
	60000	.2939	.0872	.0360	.0107	-.0253
	80000	.4424	.2956	.0542	.0362	-.0180
	100000	.5411	.4799	.0663	.0588	-.0075
	120000	.6107	.6118	.0748	.0749	.0001

THE EFFECT OF THE FIELD SIZE ELF ON THE LISBURNE SEVERANCE TAX RATE

	Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
December DOR 1988 Mean	20	35000	.7495	.2855	.1124	.0428	-.0696

Sensitivity Table

Producing Wells	Production (Bbl/day)	Current ELF	New ELF Field Size Factor = 55000000	Current Effective Tax Rate FY 1988	New Effective Tax Rate FY 1988	Decreased Effective Tax Rate FY 1988
20	25000	.6565	.1336	.0985	.0200	-.0784
	35000	.7495	.3734	.1124	.0560	-.0564
	50000	.8220	.6258	.1233	.0939	-.0294
	75000	.8800	.8156	.1320	.1223	-.0097
	100000	.9095	.8920	.1364	.1339	-.0025
35	25000	.4338	.0184	.0651	.0028	-.0623
	35000	.5787	.1544	.0868	.0232	-.0637
	50000	.6967	.4213	.1045	.0632	-.0413
	75000	.7935	.6916	.1190	.1037	-.0153
	100000	.8436	.8160	.1265	.1224	-.0041
50	25000	.2454	.0012	.0368	.0002	-.0366
	35000	.4240	.0533	.0636	.0080	-.0556
	50000	.5787	.2704	.0868	.0406	-.0462
	75000	.7102	.5796	.1065	.0869	-.0196
	100000	.7794	.7423	.1169	.1114	-.0056
80	25000	.0072	0	.0011	0	-.0011
	35000	.1695	.0023	.0254	.0003	-.0251
	50000	.3669	.0909	.0550	.0136	-.0414
	75000	.5536	.3896	.0830	.0584	-.0246
	100000	.6565	.6046	.0985	.0907	-.0070

LAW OFFICES
PRESTON, THORGRIMSON, ELLIS & HOLMAN
420 L STREET · SUITE 404
ANCHORAGE ALASKA 99501
(907) 276-1969

MEMORANDUM

TO: Deborah Vogt

FROM: Joseph K. Donohue

DATE: April 28, 2986

RE: **Retroactive Amendments to ELF Factor**

You have requested an opinion concerning the constitutionality of enacting a bill which would retroactively either repeal, or amend the methodology for calculating, the economic limit factor under AS 43.55.013. Specifically, you have asked whether a bill enacted in February 1987 and made retroactive to January 1, 1987 would present any due process problem under the Fifth Amendment to the United States Constitution or under Article I, Section 7 of the Alaska Constitution.

The gross production tax on oil or gas is payable monthly. The tax is due on the 20th day of each month for oil or gas production which occurred during the preceding month. The tax is delinquent if not paid before the end of the month following the month of production. AS 43.55.020(a). Thus, the tax on January production is due on February 20 and is delinquent if not paid on or before February 28.

The economic limit factor is defined in AS 43.55.013 and the Department of Revenue has promulgated a number of regulations which interpret and implement of the provision. See 15 AAC 55.010-.040 and .090. The economic limit factor (ELF) is a concept which is designed to reduce the effective rate of taxation on a producing field as production from that field becomes increasingly marginal. The ELF is multiplied by the percentage-of-value amount set forth in AS 43.55.011(b) or the cents-per-barrel amount calculated under (c) to determine the tax due. AS 43.55.013(b)(2) and (3) provide that during the first 10 years of commercial production from a lease or property, an economic limit factor which is greater than .7 is deemed to be one for purposes of the calculation of tax liability. For example, for the period since 1981 when the .7 threshold was enacted as part of Ch. 116 SLA 1981, the ELF at Prudhoe Bay has been greater than .7 and, therefore, one. This, in turn, means that the ELF does not have any operative effect unless it is found to be less than .7 during the initial 10-year period. For Prudhoe Bay, the 10-year period expires in June 1987.

The ELF is derived by the use of a rather complicated mathematical formula which in turn is based on certain simplifying assumptions. For oil, the monthly production rate at the economic limit is presumed to be 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. AS 43.55.013(d).

The taxpayer may rebut this presumption at a formal hearing by providing clear and convincing evidence of a different monthly production rate. The determination of the monthly production rate at the economic limit is made by dividing the value at the point of production under AS 43.55.013(f) into the average monthly direct operating costs calculated under subsection (e). The hearing must be held before February 15 of a year or within 6 months after commencement of oil production from a lease or property. The results of the hearing "shall be used for all oil production during that calendar year from the lease or property." AS 43.55.013(d). Therefore, the statute expressly calls for an annual determination with some retroactive effect on the monthly tax period preceding the hearing on the appropriate monthly production rate. This procedural approach makes administrative sense since it is more efficient to have this potentially difficult issue decided on an annual basis rather than on a monthly basis.

Perhaps the leading case on the question of whether a tax statute can apply retroactively to previous tax periods is Welch v. Henry, 305 U.S. 134 (1938). There, the United States Supreme Court upheld a corporate income tax amendment enacted by Wisconsin in March 1935 which was applicable to receipt of corporate dividends in 1933. The court held that, except for a narrow category of gift taxation cases, the legislature had broad authority to adjust or amend tax liability retrospectively.

The exception to this rule mentioned by the court pertained primarily to instances where voluntary irrevocable actions of taxpayers (e.g., making a bequest) were impacted by the retroactive imposition of a tax. The Supreme Court stated that the critical part of the constitutional test was whether "the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event." 305 U.S. at 147. The cases cited by the court, e.g. Nichols v. Coollidge, 274 U.S. 531 (1927), and Untermeyer v. Anderson, 276 U.S. 440 (1928), were instances where the donor might well not have acted as he did had he anticipated the tax. The court said that the facts of each case and the nature of the tax would have to be examined to determine if retroactivity gives rise to such harsh and oppressive results that it offends the Constitution. The court stated "there are other forms of taxation whose retroactive imposition cannot be said to be similarly offensive, because their incidence is not on the voluntary act of the taxpayer." 305 U.S. at 147. The court specifically listed property taxes, income taxes and benefit assessments. 305 U.S. at 147-148. The Supreme Court also noted that it was historically the practice of Congress and the Wisconsin Legislature to enact revenue or tax legislation in a given year and to give it effect to the entire calendar year.

The United States Supreme Court more recently upheld the retroactive increase in the minimum tax on preferences in United States v. Darusmont, 449 U.S. 292 (1981). There, an amendment to the Internal Revenue Code enacted in October 1976 was applied to the entire 1976 tax year. In addition to relying on Welch v. Henry, supra, the Supreme Court cited its earlier decision in Cooper v. United States, 280 U.S. 409, 411 (1930), which upheld the taxation of gains from "prior but recent transactions." The Supreme Court also relied on the analysis of Judge Learned Hand in Cohan v. Commissioners, 39 F.2d 540, 545 (2d Cir. 1930). Judge Hand, in resolving a similar issue involving retroactivity of a tax, held that nobody had a vested right in the rate of taxation. In responding to the question of whether the tax law change was foreseeable, Judge Hand stated that once a system of taxation is already in place, a taxpayer "must be prepared for such possibilities ... ." 39 F.2d at 545.

Other decisions which uphold tax law changes with arguably retroactive impacts in the face of due process challenges include Buttke v. Commissioner, 625 F.2d 262 (8th Cir. 1980) (involving the same minimum tax amendments subsequently upheld by the U.S. Supreme Court in United States v. Darusmont, supra) and Neild v. District of Columbia, 110 F.2d 146, 153 (D.C. Cir. 1940) (involving the constitutionality of the application of a new gross receipts tax measured by the prior year's receipts).

Sometimes retroactive tax laws are challenged under state constitutional provisions barring retrospective laws per se or interference with vested rights. The analytical approach taken by the courts is substantially similar. Under the first line of cases, tax bills which are applied to the entire calendar year in which they are enacted are generally found not to be retrospective in operation. See, e.g., Martin v. Board of Assessment Appeals, 707 P.2d 348 (Colo. 1985). In the Martin case, a law changing the factors to be considered in appraising condominiums which took effect in May 1982 and which was used to assess property values as of January 1, 1982 was upheld. The court held that to find an unconstitutional retrospective effect required a showing of an impairment of a vested right. The court concluded:

> ... [P]roperty owners have no vested right to have their taxable property assessed by particular methods employed in prior years. ... Since the statute only alters the factors which may be considered in determining actual value, it does not impair the taxpayers' vested rights, and therefore is not unconstitutionally retrospective in its operation. 707 P.2d at 352.

A "vested rights" challenge in the context of a severance tax increase led to an identical conclusion. In Belco Petroleum v. State Board of Equalization, 587 P.2d 204 (Wyo. 1978), a 1975 amendment to the state severance tax increased the amount of tax due for the previous year. Under the Wyoming severance tax, a taxpayer paid his 1974 tax in July 1975 computed on the value of gross production for previous year. In upholding the application of the 1975 increase to the July assessment, the court ruled that such an increase was not retrospective but merely called for a tax measured by or computed on the basis of antecedent facts or transactions. The court also found that there was no vested right in a specific tax rate.

On the basis of the foregoing state and federal cases, one can conclude that there is no vested right in a particular tax rate or in a particular method of determining a tax liability. The U.S. Supreme Court cases focus on whether the transaction was taxable during the period of retroactive coverage and whether said period is reasonable, whether the transactions were "prior but recent" in time with respect to the tax law change, whether the change was reasonably foreseeable and whether or not the taxpayer might have voluntarily acted as he did had he but known of the change.

The question before us involves the proposed repeal or modification of the ELF factor in February 1987, effective January 1, 1987. The retroactive period is at most two months. It would adjust a factor which is determined on an annualized calendar basis under present law. The affected taxpayers are those whose decision to invest and produce oil or gas has already been made and whose production is already subject to taxation. In the State of Alaska, amendments to the oil and gas production tax must certainly be viewed as foreseeable. In fact, the Legislature has discussed and debated changes to the ELF factor during the 1986 legislative session. Under these circumstances, I conclude that neither state nor federal due process limitations would be abrogated by the repeal or amendment of the ELF factor under consideration here. Furthermore, under the analyses set forth in Martin and Belco Petroleum above, a change in the tax rate or ELF methodology prior to February 20, 1987 might not even be viewed as having "retrospective" operation.

147.JKD:ls

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-[illegible]

M E M O R A N D U M   March 17, 1987

SUBJECT: Retroactivity of proposed committee substitute (CSHB 164(Resources)

TO: Representative Sam Cotten
Chair, House Resources Committee

FROM: Theresa L. Bannister TB
Legislative Counsel

This memo accompanies the committee substitute that you have requested for HB 164, a bill relating to the oil and gas properties production tax. That bill includes a provision that would make the bill retroactive to January 1, 1987.

Please be aware that the retroactivity provision may violate federal and state constitutional provisions against enacting ex post facto laws (art. I, sec. 15 of the Constitution of the State of Alaska; art. I, sec. 9, cl. 3 of the U.S. Constitution). In this instance, the tax is incurred and remitted on a monthly schedule. AS 43.55.020. Therefore, the taxpayers under the chapter will have already paid or become obligated to pay an amount certain for the months of January, 1987, through the month before the month of enactment.

You may wish to make the bill retroactive to the beginning of the month in which the bill takes effect. That would not create retroactivity problems since the tax liability would not have become due yet.

If I may be of further assistance, please advise.

TLB:mkr
m10/011

Enclosure

HB 23

Recommending do pass (3): Boucher (Chairman), Hudson, Ulmer

No recommendation (2): Pettyjohn, Collins

A zero fiscal note with analysis was published March 4, 1987.

HB 23 was referred to the Labor & Commerce Committee.

INTRODUCTION OF CITATIONS

The following citation was received:

Honoring - Fielson Ravens Boys Basketball Team,
Class AAA State Basketball Champions
by Representative Miller and Senator Coghill

The citation was referred to the Rules Committee for placement on the calendar.

INTRODUCTION, FIRST READING AND REFERENCE OF HOUSE RESOLUTIONS

HCR 14

HOUSE CONCURRENT RESOLUTION NO. 14 by Taylor:

Relating to training of police officers.

was read the first time and referred to the State Affairs and Finance Committees.

INTRODUCTION, FIRST READING AND REFERENCE OF HOUSE BILLS

HB 160

HOUSE BILL NO. 160 by Boucher and Davidson, entitled:

"An Act establishing the Commission on the Future of the Permanent Fund; providing for public testimony on the use that should be made of the income and principal of the permanent fund; and providing for an effective date."

was read the first time and referred to the State Affairs, Judiciary and Finance Committees.

HB 161

HOUSE BILL NO. 161 by Taylor, Phillips and Zawacki, entitled:

"An Act authorizing an advisory vote on the permanent fund dividend program and on imposition of an income tax on individuals."

was read the first time and referred to the State Affairs, Judiciary and Finance Committees.

HB 162

HOUSE BILL NO. 162 by Ulmer, Hudson, Taylor and Pearce, entitled:

"An Act relating to work in underground mines and workings."

was read the first time and referred to the Labor & Commerce and Judiciary Committees.

HB 163

HOUSE BILL NO. 163 by Goll, entitled:

"An Act relating to advisory elections on certain annexation proposals."

was read the first time and referred to the Community & Regional Affairs and Finance Committees.

HB 164

HOUSE BILL NO. 164 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the oil and gas properties production tax; and providing for an effective date."

was read the first time and referred to the Resources and Finance Committees.

A fiscal note was published March 4, 1987.

The Governor's transmittal letter, dated March 3, 1987, appears below:

"Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the oil and

HB 164

gas properties production tax. The primary effect of the bill is to postpone the application of the "true" economic limit factor (ELF) to the Prudhoe Bay field. The bill also amends the economic limit factor provisions applying to all oil fields so that the ELF is not sensitive to changes in the value of oil.

Existing AS 43.55.011(a) provides that an oil producer must calculate its production (severance) tax by multiplying the nominal rate calculated under AS 43.55.011(b) and (c) by the economic limit factor determined under AS 43.55.013. The ELF is a formula that has the effect of reducing the severance tax rate. In 1981, the legislature made several changes in oil and gas taxes: the income tax was changed to substitute modified apportionment for separate accounting; the nominal rate of the severance tax was increased for some fields; and the application of the ELF to a lease or property with an ELF of more than .7 was suspended until after that lease or property had been in commercial production for 10 years. Ch. 116, SLA 1981. Suspension of application of the ELF was accomplished by providing that, if the ELF was more than .7, then the ELF was considered to be "one." AS 43.55.013(b)(3). Thus, when multiplying the severance tax rate by the ELF, the full amount of the tax is the product.

Only the Prudhoe Bay and Lisburne fields currently have an ELF greater than .7. The Lisburne ELF is expected to fall below .7 after fiscal year 1988, but the Prudhoe Bay ELF is expected to remain about .7 for a number of years. Prudhoe Bay will have been in production for 10 years in June, 1987; thus, absent an amendment to AS 43.55.013(b)(3), the "true" ELF, as calculated under AS 43.55.013(b)(1), will begin to apply to that field at that time.

The fiscal note on the 1981 legislation did not include projections beyond FY 1985, but an analysis by the Legislative Finance Division showed that application of the "true" ELF provision would cause state revenue to fall precipitously in FY 1988. Governor Hammond noted this possibility, but expressed "full confidence in the ability of the legislature to deal at that time" with adverse revenue consequences, should they prove to be serious. Statement of Governor Hammond on signing FCCSSB 524 (ch. 116, SLA 1981); see July 27, 1981 press release on oil and gas legislation, fourth page.

Application of the "true" ELF to Prudhoe Bay would result in serious consequences for the state in the coming fiscal year: state severance collections would be reduced by over 15 percent, and FY 1988 revenue would fall by $93,000,000 (already accounted for in the official "mean" forecast). Section 1 of the attached bill would prevent this precipitous decline in revenue by amending AS 43.55.013(b)(3) to delay the applicability of the true ELF to Prudhoe Bay for an additional five years. Section 1 of the bill also makes a conforming amendment to AS 43.55.013(b)(2) and (4). So

HB 164

long as the "true" ELF does not apply, the severance tax rate will be the full 15 percent of value, or $.80 a barrel, whichever is greater, subject to the adjustment in AS 43.-55.012.

The bill also changes the ELF provisions for all oil fields to remove the sensitivity of the ELF to price fluctuations. An element of the ELF calculation is the "PEL," or "production at the economic limit." The PEL represents the number of barrels a producer must produce in order to recover the costs of production. Currently, the PEL is presumed to be 300 barrels per well per day, but the taxpayer may rebut this presumption at a hearing before the Department of Revenue. At the hearing, the PEL would be calculated by dividing the cost of production into the value of the oil. AS 43.55.013(d). If the price of oil drops, the producer may be able to prove an entitlement to a PEL in excess of 300 barrels; if so, the ELF for that producer will go down. Thus, if prices fall drastically, the state loses severance tax revenue not only because the severance tax is applied against a lower value of oil, but also because the severance tax rate itself goes down as the result of a PEL hearing. Earlier in 1986, because of low prices, we were faced with the possibility that the state might suffer from this double reduction in severance tax revenue.

Section 2 of the attached bill deals with that problem by repealing the portion of existing law that provides for a hearing to change the PEL. The PEL is then simply set at 300 barrels per day. As a result, the ELF will be sensitive to changes in the amount of production, but will no longer be sensitive to fluctuations in price or the costs of production. Section 3 of the bill repeals two subsections in AS 43.55.013 dealing with the two elements of the hearing: costs and values. These changes to not apply to the production of gas.

I urge your early consideration and passage of this bill.

Sincerely,

/s/

Steve Cowper
Governor"

HB 165

HOUSE BILL NO. 165 by the Rules Committee by request of the Governor, entitled:

> "An Act amending an appropriation to the Alaska Power Authority for the Bradley Lake Hydroelectric Project; and providing for an effective date."

was read the first time and referred to the Resources and Finance Committees.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST:

Bill Version :
Publish Date :

Revision Date:
Title : An Act Relating to the Oil and Gas Properties Production Tax
Sponsor : Rules/Governor
Requestor : Rules

Agency Affected : Revenue
BRU :
Components :

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						
REVENUE		76,730.0	91,950.0	98,480.0	99,850.0	105,610.0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

SEE ATTACHTED ANALYSIS

Vincent Wright

Prepared by : for Chuck Logsdon   Phone : 276-5364
Division : Revenue/Research   Date : March 2, 1987

Approved by Commissioner : Hugh Malone   Date : 3/2/87
Agency : Department of Revenue

Distribution (by preparer) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

M E M O R A N D U M

STATE OF ALASKA

Department of Revenue

Petroleum Research Section

February 27, 1987

To: Vincent D. Wright, Chief of Research

From: Charles Logsdon, Petroleum Economist Clogsdon

Subject: More ELF

Per your request, I have examined the revenue and production impact of extending the 10 year period during which the ELF is subject to the .7 or greater test to 15 years and fixing the value of the Production at the Economic Limit (PEL) at 300 barrels per well per day. Prudhoe Bay and Lisburne are the fields currently producing with a calculated ELF greater than .7 and thus would be directly impacted by this change in the State severance tax law. On average, the calculated ELF for Prudhoe is not expected to fall below 0.7 over the next 5 years. We expect the Lisburne ELF to fall below 0.7 in FY 1989 and subsequent years.

By setting the PEL at 300, the ELF no longer would be sensitive to the price of oil or the cost of producing oil and would be totally dependent on per barrel productivity for a producing lease or property. Over the next 5 years as Prudhoe Bay production begins to decline the only reason for an ELF less than 0.7 would be if a significantly greater than expected number of additional wells were drilled. For example we currently expect Prudhoe to produce on average, 0.984 million barrels per day in 1992 from 465 wells providing an ELF of.7911. If this same amount of oil were produced from 705 wells, the ELF would be equal to .6906.

The following tables illustrate the revenue impact and production impact of extending the ELF time line to 15 years and fixing the value of PEL at 300. These results are generated by the DOR revenue simulation model using the December 1986 input assumptions. The most significant result other than the revenues generated is that there is almost no average expected effect on North Slope production.

Revenue Impact of Extend5 (Million $)

Fiscal Year	Delta 30%	Delta Mean
1987	0	0
1988	76.73	96.26
1989	91.95	118.06
1990	98.48	128.33
1991	99.85	132.92
1992	105.61	139.09
1993	5.73	7.3
1994	3.9	7.64
1995	3.66	6.56
1996	4.55	5.28
1997	3.67	5.55
1998	2.01	3.91
1999	2.53	2.62
2000	-.16	2.08
2001	-.1	2.79
2002	-.82	2.68
2003	-.73	2.28
2004	.53	2.1
2005	.49	1.87

Production Impact of Extend5 (Million bbls/yr)

Fiscal Year	Prudhoe Bay	Kuparuk	Milne Point	Endicott	Lisburne	West Sak	Other Onshore	Other Offshore	Total
1987	0	0	0	0	-.01	0	0	0	-.01
1988	-.77	-.12	-.04	-.02	-.02	0	0	0	-.97
1989	-.69	-.12	-.07	-.04	-.03	0	0	0	-.95
1990	-.6	-.12	-.11	0	-.03	0	0	0	-.86
1991	-.57	-.11	-.15	-.03	-.05	0	0	0	-.91
1992	-.52	-.1	-.15	-.06	-.05	0	0	0	-.88
1993	-.49	-.09	-.14	-.06	-.06	0	0	0	-.84
1994	-.44	-.11	-.14	-.04	-.07	0	0	0	-.8
1995	-.39	-.07	-.09	-.05	-.05	0	0	0	-.65
1996	-.35	-.06	-.12	-.05	-.05	0	0	0	-.63
1997	-.32	-.08	.01	-.04	-.06	0	0	0	-.49
1998	-.43	-.05	.03	-.03	-.09	0	0	0	-.57
1999	-.25	-.04	.02	-.01	-.02	0	-.02	0	-.32
2000	-.22	-.03	-.02	-.01	-.03	0	-.02	0	-.33
2001	-.2	-.03	.02	0	-.02	0	-.02	0	-.25
2002	-.18	-.02	.01	0	-.02	0	-.02	0	-.23
2003	-.16	-.01	-.01	0	-.01	0	-.01	0	-.2
2004	-.19	0	.04	0	-.01	0	-.01	0	-.17
2005	-.13	.01	.04	0	0	0	-.01	0	-.09
									0
									0
Total	-6.9	-1.15	-.87	-.44	-.68	0	-.11	0	-10.15

Official Business

Alaska State Legislature
House

P.O. BOX V
State Capitol
Juneau, Alaska 99811

TO: Rep. Sam Cotten, Co-Chair
Rep. Adelheid Herrmann, Co-Chair
Resources Committee members
FROM: Ned Farquhar, staff Ned Farquhar
SUBJECT: Proposed CSHB 164 (Res)
DATE: March 18, 1987

Attached is a proposed committee substitute for HB 164 which will be presented at today's joint Resources-Finance hearing by Rep. Sund. Administration representatives will be present to explain the import of the changes described below.

Section 1 of the bill repeals the existing ELF formula and the ten-year moratorium provision for certain fields, and reinstates a new ELF formula based on the production of fields rather than wells.

Section 2 eliminates the opportunity for a producer to attempt to rebut the presumption that the PEL (production at the economic limit) is 300 bpd.

Section 3 repeals existing law that relates to the PEL rebuttal and hearing provision, eliminated in Section 2.

Section 4 makes the bill retroactive. There is some question as to the constitutionality of this section because tax payments have already been made, on a monthly basis, under existing law.

Section 5 establishes an immediate effective date for the bill.

cc: Finance Committee members and staff

wo1257hcB
Bannister
3/17/87

Original sponsor: Rules/Governor

IN THE HOUSE BY THE RESOURCES COMMITTEE

CS FOR HOUSE BILL NO. 164 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to the oil and gas properties production tax; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 43.55.013(b) is repealed and reenacted to read:

(b) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

$$(1-[PEL/TP]) \exp ([55,000,000 \times WD]/[PEL \times TP/Days])$$

where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid;

Days = the number of days in the month for which the tax is to be paid; and

wher

* S

A LEASE OR PROPERTY. THE MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE LEASE OR PROPERTY BASED UPON THE CLEAR AND CONVINCING EVIDENCE OF THE TAXPAYER SHALL BE CALCULATED BY DIVIDING THE VALUE DETERMINED UNDER (f) OF THIS SECTION INTO THE AVERAGE MONTHLY DIRECT OPERATING COST DETERMINED UNDER (e) OF THIS SECTION AND SHALL BE USED FOR PURPOSES OF THIS SECTION FOR ALL OIL PRODUCTION DURING THAT CALENDAR YEAR FROM THE LEASE OR PROPERTY.]

* Sec. 3. AS 43.55.013(e) and (f) are repealed.

* Sec. 4. Sections 1 - 3 of this Act are retroactive to January 1, 1987.

* Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

IN THE HOUSE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - FIRST SESSION

A BILL

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WD = the total number of well days in the month for which the tax is to be paid;

Days = the number of days in the month for which the tax is to be paid; and

Where "exp" indicates that the expression following it is an exponent.

* Sec. 2. retroactive to January 1, 1987.

* Sec.

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

IN THE HOUSE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

HOUSE BILL NO.

IN THE LEGISLATURL OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - FIRST SESSION

A BILL

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where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid;

Days = the number of days in the month for which the tax is to be paid; and

Where "exp" indicates that the expression following it is an exponent.

* Sec. 2. Section 1 of this Act is retroactive to January 1, 1987.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

1) also add Sec 2 from HB 164

2) need to repeal the existing ten-year
provision in ELF ([illegible]).

[illegible]

 [illegible]

FISCAL EFFECTS OF ELF ALTERNATIVES
Additional Revenue (Millions) At the 30th percentile

	FY 87-88	FY 89	FY 90	FY 91	FY 92
HB-164	*76.7*	*92.0*	*98.5*	*99.9*	*105.6*
Proposed CSHB-164 (Res.)*	*98.6*	*98.1*	*109.6*	*96.1*	*94.2*

*Indicates provisional OMB estimate pending DOR fiscal analysis due next week.

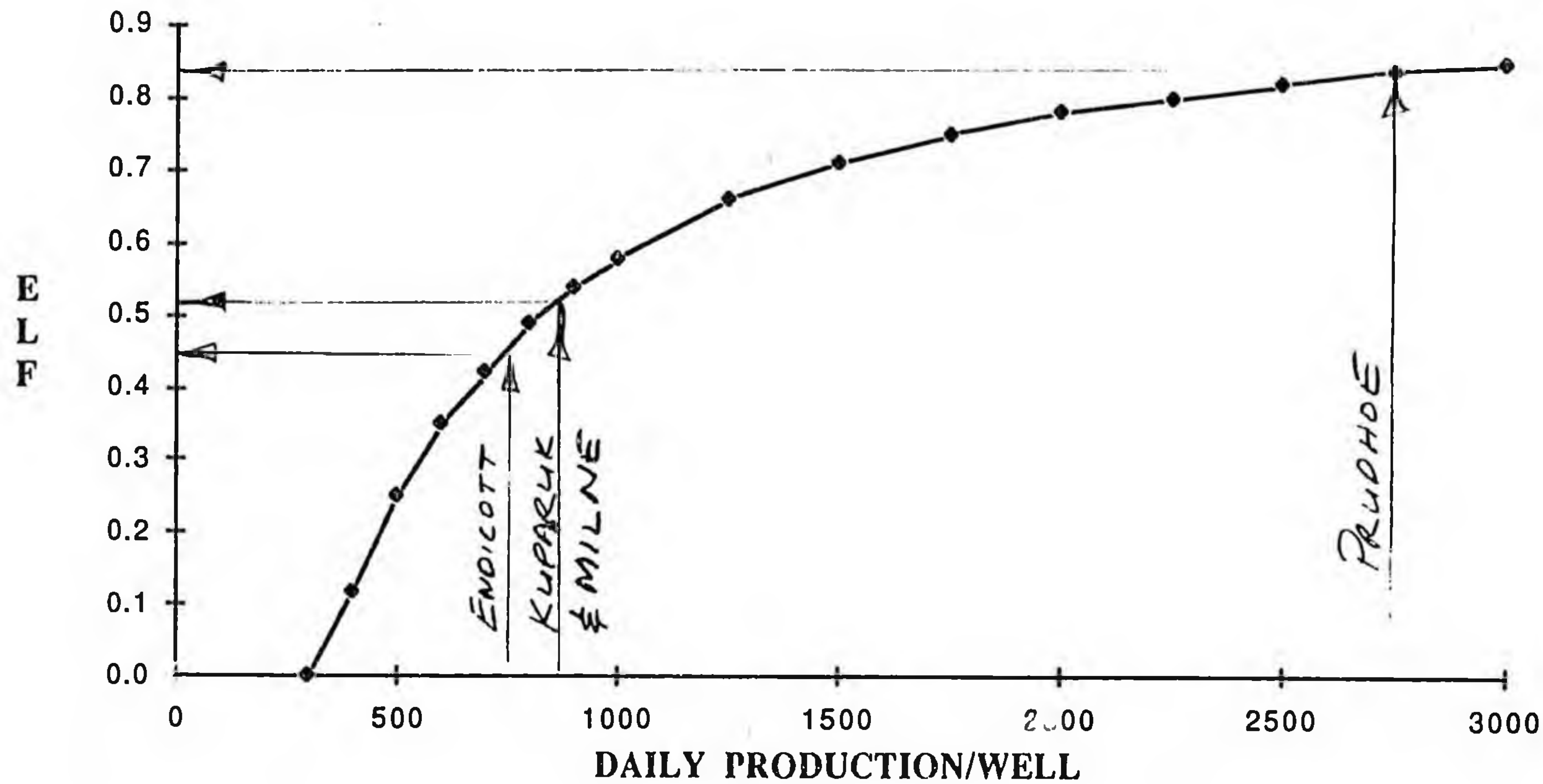
ESTIMATED SEVERANCE TAX RATES*

	Prudhoe Bay	Kuparuk River	Milne Point	Endicott	Lisburne	McArthur River	Granite Point
Current Law	12.6%	7.8%	6.5%	5.6%	12.3%	1.1%	1.3%
HB-164	15.0%	7.8%	6.5%	5.6%	12.3%	1.1%	1.3%
Proposed CSHB-164 (Res.)	14.8%	10.7%	0.3%	0.3%	3.6%	0.0%	0.0%

*North Slope values are forecast FY 88 averages; Cook Inlet values are estimated Dec 1986 rates;
Cook Inlet fields not listed have zero effective rates under all alternatives.

OMB, Division of Policy, 3/18/87

CURRENT LAW



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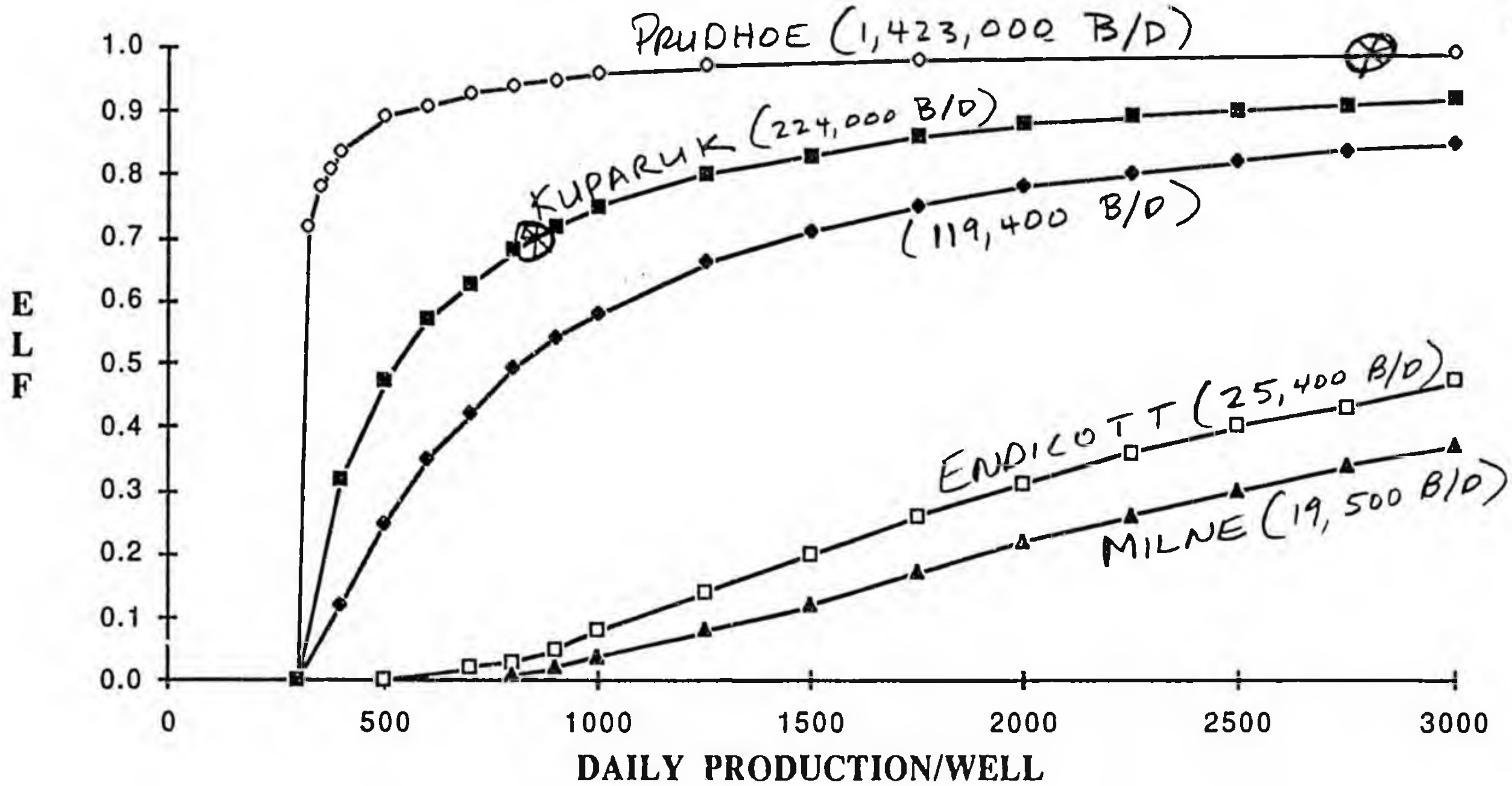


DEPARTMENT OF REVENUE

ALASKA

OIL AND GAS AUDIT DIVISION

ALASKA TAX VALUE
"ATV"

PETROLEUM TAX PRICING

INFORMATION EXCHANGE

STATE OF ALASKA
UNITED KINGDOM
NORWAY

MAY 17-20, 1988

April 8, 1988

Meetings in Europe
Oil Tax Reference Price System

Legislative Itinerary

<u>Saturday, May 14, 1988</u>

12:25 p.m. Depart Anchorage British Airways

<u>Sunday, May 15, 1988</u>

6:05 a.m. Arrive London
(Rest and Recuperation from Jet Lag)

<u>Monday, May 16</u>

Unscheduled

<u>Tuesday, May 17</u>

9:00 a.m. Ms. Margaret Hill, Ms. M.E. Williams
Inland Revenue
Oil Taxation Office
Melbourne House
Aldwych
London, WC2B 4LL

7:00 p.m. Dinner, guests of British Petroleum

<u>Wednesday, May 18</u>

9:00 a.m. Meeting with officers, Britsh Petroleum
Britannica House

Lunch [illegible] + [illegible]

2:00 p.m. Depart London British Airways
4:55 p.m. Arrive Oslo

<u>Thursday, May 19</u>

9:00 a.m. Mr. Kjell Eikland
Oil and Gas Group
Norsk Hydro
N-1321 Stabekk
Oslo, Norway

<u>Friday, May 20</u>

9:00 a.m. Mr. Odd Sverre Haraldsen
Director
Energy Policy Department
Royal Ministry of Petroleum and Energy
~~Tollbugaten 31~~ → 3 Plocasgate
Oslo, Norway Oslo 1, Norway

Saturday, May 21

8:15 a.m.	Depart Oslo	British Airways
9:25 a.m.	Arrive London	
12:15 p.m.	Depart London	
12:10 p.m.	Arrive Anchorage	

TABLE OF CONTENTS

INTRODUCTION

In November 1987 within the Oil and Gas Audit Division the "ATV" was conceptualized. ATV is the acronym for the Alaska Tax Value or Alaska's idea of a tax reference price. Alaska is not unlike the United Kingdom or Norway or any of the petroleum producing countries in that it attaches a value to its crude oil for purposes of royalty and taxes. The OPEC nations set the value of OPEC oil at a "posted price." This price may or may not be indicative of actual market prices, and many times is not.

Alaska, however, has historically affixed its royalty, income and production taxes on the value or receipts for its crude oil in the market place. Controversy over the administration of Alaska's statutes and contracts centers around the components of value with protracted litigation between the State of Alaska and oil producers becoming all too often the outcome of disputed values.

The ATV promises to avert protracted litigation and concurrently establish a value for royalty and tax purposes that will withstand scrutiny while promulgating certainty and equitable administration. To this end, policy makers within the Department of Revenue polled other oil producing nations to gain insight into their valuation processes. As questions were posed, it became evident that two countries, the United Kingdom and Norway, approach the establishment of value of their crude oil in two very different and functional manners; the United Kingdom establishes for PRT (petroleum revenue tax) purposes a weighted average of arm's length sales in an applicable market whereas Norway appears to establish by committee a "norm" price.

To this end, contacts were made witn government officials in both the United Kingdom and Norway with the intent of establishing a dialogue regarding oil production pricing. This dialogue begins May 17-20, 1988 in face to face meetings to gain insight into the methodologies utilized by both countries in approaching the valuation process.

ALASKA TAX VALUE

OBJECTIVES

1. Accelerate the Audit Program
2. Provide Current Tax Value
3. Reduce Taxpayer Conflict
4. Obtain Current Market Data for Forecasting
5. Reduce Cost of Tax Administration

ALASKA TAX VALUE

CONCEPTS

1. Market price is established by using volume weighted average of all arms length transactions during the tax period.

2. Market price is established for two markets:

   (a) West Coast
   (b) Gulf and East Coast

3. A single market price is established for each market for all taxpayers.

4. Prevailing value is the net back value at point of production.

5. An average marine transportation cost is established for each market from each shipping point.

ALASKA TAX VALUE

ACTION PLAN

1. Develop proposed regulations under AS 43.55.
2. Distribute regulations to producers for comment.
3. Develop proposed statute changes under AS 43.55.
4. Distribute statute changes to producers for comment.
5. Develop a plan for informing the public of changes.

April 19, 1988

Background

Petroleum revenues accounted for $1.5 billion to the State of Alaska in 1987, 79 percent of total State revenues. These took the form of severance taxes, royalties, corporate income taxes, property taxes, bonuses, rents, and intergovernmental receipts. Of these, 80 percent were derived from either severance taxes or royalties.

Nearly all revenues accrue from the North Slope. Alaska North Slope crude oil (ANS) is produced and transported thousands of miles by pipeline and tanker to oil markets on the West, Gulf of Mexico, and East coasts of the United States, before a deemed or actual sale occurs. There is no single market area into which the oil is shipped and there is no representative market or fixed price. The markets are separate and function independently of each other. Further, the oil that arrives at these markets is either sold to third parties, exchanged with other companies for oil to be delivered elsewhere, or processed at the producers own refineries. Tax administration in such an environment has been difficult.

As a solution to this dilemma, we have developed the concept of the Alaska Tax Value (ATV), which is similar to the "market price" or "norm price" employed in your jurisdiction. Thus, we felt it would be fruitful to discuss the nuances of implementation with you.

The following is a brief description of our existing statutes, an outline of our proposed Alaska Tax Value, and a suggested meeting agenda.

Alaska Production Tax Statute

Generally, the Alaska production tax for oil is 12.25 percent of the gross value at the point of production produced prior to June 30, 1981, and 15 percent of the gross value at the point of production after June 30, 1981. This tax is reported to the Department of Revenue on monthly returns. The gross value at the point of production is the value of the oil at the point it is metered or measured in a condition of pipeline quality on the premises from which it is removed. In the case of Alaska North Slope (ANS), all this is at Pump Station One of the Trans-Alaska Pipeline System. Because there is so little oil sold at that point, a "netback" computation is used for determining value. This involves establishing a sales price at the point of delivery and deducting the actual cost of transportation through the Trans-Alaska Pipeline and marine transportation to the point of delivery. In general, prevailing value is used in lieu of sales price if the sales price is substantially lower than the prevailing value.

Over the years, several different methodologies were used to compute prevailing value. Because there was no established market or spot price for ANS in the earlier years, the Department used a market basket of three foreign crudes delivered to the same market as a production value. In later years, as the market developed, actual sales contracts of ANS were used to establish prevailing value.

As a result of using these methods for computing prevailing value, there is a large backlog of cases waiting for litigation. The oil companies are disputing every step in the process of setting the sales prices, arriving at netback costs, computing the prevailing value, and the Department's right to establish the methodologies. Similar problems exist for the establishment of marine transportation costs. These issues affect royalty collections as well. It has taken several years for the Department to accumulate sufficient knowledge and information about the companies and the markets to establish consistant and fair policies concerning the administration of the law. We believe there is a better way for administration of the tax law that would reduce the conflict between the producing companies and the State of Alaska.

Alaska Tax Value Determination

We believe a tax value can be established by a volumn weighted average of all arms-length contracts for disposal of ANS. We also believe there is a reasonable method for establishing an average cost of marine transportation to be applied to the sales price.

The following is a description of the procedures we anticipate using to establish a retroactive value for Alaskan crude oil on a quarterly basis:

1) Immediately following the end of each calendar quarter, we would visit each producing company and obtain documents and data concerning all transactions conducted the past quarter. We would also obtain current data on marine transportation.

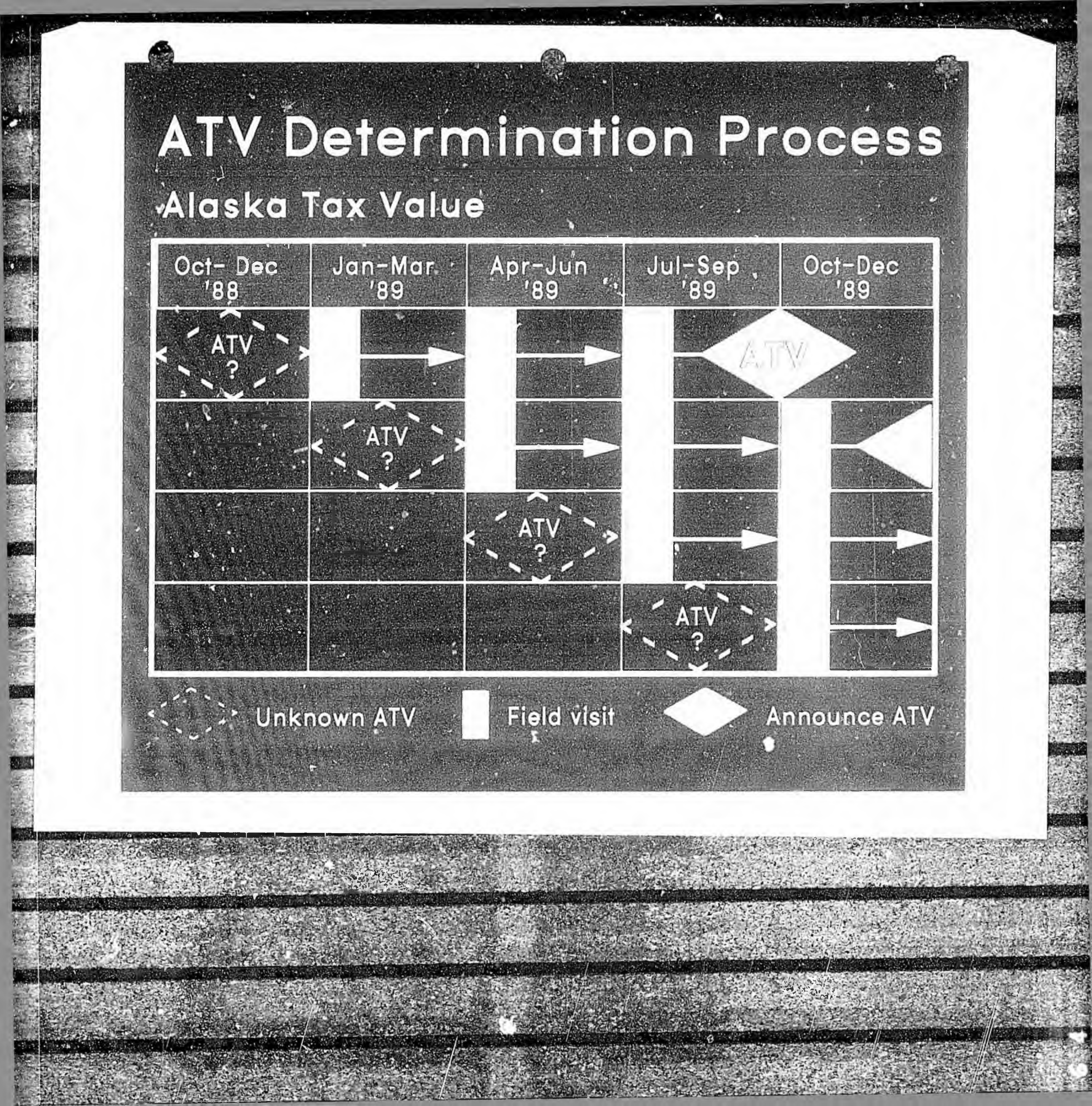
2) We would value all arms-length transactions:

   a) Sales - full cash consideration
   b) Exchanges - spot price for oil received plus or minus differentials.

3) On our return to the producers the following two quarters, we would pick up additional information relating to deliveries such as loadings and unloadings, amendments to contracts, escalations or de-escalations on price, and any other pertinent information.

4) At the end of three calendar quarters, we would arrive at the Alaska Tax Value for three months production and announce it to the producers.

5) In addition, we would compute the value for royalty oil based on the lease contract and issue it to the producers as well.


ATV Determination Process
Alaska Tax Value
Oct-Dec '88
Jan-Mar '89
Apr-Jun '89
Jul-Sep '89
Oct-Dec '89
ATV ?
ATV
ATV ?
ATV ?
ATV ?
Unknown ATV
Field visit
Announce ATV

Proposed Meeting Agenda

1. What prompted the adoption of your approach for valuing oil?

2. Is the approach used for all tax (and royalty) purposes, or just some?

3. To what production does this norm price or "market value" apply?

   a. all volumes of all crude streams
   b. non-arms-length transactions only
   c. LPGs, condensate, gas, etc.
   d. other subgroups of production — do others exist in other jurisdictions? what are they?

4. Is the tax reference price calculated on a

   a. company by company basis?
   b. field by field basis?
   c. global (i.e. national) basis?
   d. other?

   participant

5. The reference point for tax value is:

   a. wellhead
   b. field gathering point/processing plant
   c. point of loading or export — UK
   d. other

6. Is the tax reference price calculated by the taxing authority or by an independent committee/panel? What are the advantages of each approach?

7. Sources of information used in calculating norm price or "market value":

   a. arms-length contracts
   b. published spot prices
   c. netback values
   d. data from other (e.g. local) government bodies

8. If netback values are used, what are the sources of information for transportation cost?

9. If one crude oil value is used as a reference point for valuing other crudes, what method do you use to determine the appropriate differential?

10. How are tax reference prices determined in markets where there are no arms-length sales for the subject crude, or few or no arms-length sales at all?

11. If actual arms length contracts are used in calculating a tax reference price, should
certain contracts be rejected if their terms appear atypical or extreme or otherwise suspicious? Who determines this?

12. Again, if actual contracts are used in calculating a tax reference price, how do you adjust for:

a. exchanges of crude or products?
b. differences in credit terms?
c. differences in flexibility of lifting times?
d. other, less quantifiable forms of compensation?

13. If actual contracts are used, what level of cooperation (i.e. in making contracts available) do you receive from taxpayers?

14. To what extent are taxpayers encouraged to bring forward (on their own initiative) other information which could be helpful in determining the norm price or "market value"? Do they take advantage of this opportunity?

15. Period covered by a single norm price or "market value":

a. arguments for monthly tax reference price
b. arguments for quarterly tax reference price
c. arguments for some other period

16. Lag between end of period and announcement of tax reference price

a. how long?
b. what factors dictate length of lag?
c. are there ways this might be shortened?
d. do taxpayers tend to prefer shorter period?

17. Are individual taxpayers allowed to plead for an exception from the tax reference price? Within what time period following announcement? What evidence could be used to justify an exception? What is the appeal procedure? How many appeals have been made, and with what outcomes?

18. Have taxpayers ever reacted to a tax reference price by reducing production or liftings, or by threatening to do so (e.g. when they consider the tax reference price to be unrealistically high)?

19. Do taxpayers ever complain of problems using tax credits in other (e.g. their domicile) jurisdictions because the host country tax is based on a reference price rather than on some other standard? How have such problems (if any) been resolved?

20. What did the oil industry think of your approach when it was first adopted? How do they regard it now?

21. Do independent analysts think your system is accurate?

22. What types of expertise are required to gather the necessary data and to calculate the tax reference price? How do you find or train individuals for these jobs?

23. If Alaska were planning to introduce a tax reference price, do you suggest that taxpayers be invited to contribute comments and ideas to the design of the system? At what stage and in what format?

24. Have you learned, through your experience, of any particular computer hardware or software which could be particularly helpful in assembling data for calculating a tax reference price? Do taxpayers and/or your auditors in the field record value information in a computer format? If so, please describe it for us.

25. Which of your laws and regulations, or their equivalents, should we read prior to our meetings?

This copy for C. Logsdon

Inland Revenue
Oil Taxation Office

R M Elliss
Controller

Melbourne House
Aldwych
London WC2B 4LL

Telephone 01-438 7719

Mr John C Gault
13 Chemin Aloïs-Pictet
1234 Vessy
SWITZERLAND

Your reference

My reference

Date 24 September 1987

Dear Mr Gault

Thank you for your letter of 2 September.

Valuations of oil for transactions not at arm's length (defined in paragraph 1 of Schedule 3 Oil Taxation Act 1975 - copy enclosed) were, for periods up to and including 31.12.86, made by reference to paragraphs 2 and 3 of Schedule 3 Oil Taxation Act of which a photocopy is enclosed.

For later periods the way in which market valuations are made has been altered and I enclose a copy of the Press Release of 18 November 1986 and the relevant legislation (Section 62 and Schedule 11 Finance Act 1987).

Yours sincerely

MEWilliams

MRS M E WILLIAMS

Encs

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01—438 6692 OR 6706

[0x]

18 November 1986

PETROLEUM REVENUE TAX: VALUATION AND PRICING

It was announced in the House of Commons today that the Government would be bringing forward in the 1987 Finance Bill legislation to amend the rules governing the valuation and pricing of oil for Petroleum Revenue Tax (PRT) purposes to take account of current market practices. The amendments to the valuation rule will make clear how monthly valuations are to be determined. A related revision to the pricing rule will apply to the computation of PRT liabilities in respect of certain arm's length sales of Brent Blend crude oil. Representations are invited on the detail of the changes.

In reply to a Parliamentary question, the Financial Secretary to the Treasury, the Right Honourable Norman Lamont MP, today gave the following Written Answer :

> The Government recognises that the operation of the current law on PRT valuation is uncertain in the sort of oil market we have today; and that this uncertainty creates problems for the industry. Accordingly, we propose to bring forward legislation in the next Finance Bill to put the valuation of oil for PRT purposes on a more certain and appropriate basis. At the same time we intend to introduce a related measure to determine what will be the basis of PRT liabilities in the case of oil sold at arm's length on the Brent market, where the number of deals done can result in the same cargo of oil being sold many times over. Such a measure is necessary if PRT revenue in these circumstances is not to be eroded. We propose to consult with the industry on the detail of these proposed changes, further details of which are set out in a Press Notice which the Inland Revenue is issuing today. The new legislation will apply from 1 January 1987.

DETAILS OF THE PROPOSED CHANGES

Valuation

1. When oil or gas is disposed of other than by way of a sale at arm's length - for instance, where it is transferred from a producing company ~~to a refining~~ affiliate within the same group - PRT is charged on the "market value" of that oil or gas. "Market value" is determined in accordance with the valuation rules in schedule 3 to the Oil Taxation Act 1975. But those rules were drawn up by reference to the market for North Sea oil as it was in the 1970s, and in some respects

/fail

fail to reflect the sort of market conditions which prevail today. Their operation in the context of today's market is thus open to uncertainty. The Government therefore proposes to amend the valuation rules to put them on a more certain basis, and to bring them more clearly into line with the operation of the oil market.

2. Under the proposed amendments to the rules, oil disposed of other than in a sale at arm's length, or appropriated to refining by the producer, will continue to be valued on a monthly basis. As at present, the market value will be determined as the price the oil would have fetched if it had been sold at arm's length under certain specified conditions (governing such matters as place of delivery, credit terms etc). But the Government proposes that the legislation should then go on to make clear that the monthly "market value" will be calculated by reference to an evidential base consisting primarily of prices obtained in arm's length sales of oil of the same kind made by participators and their associates. In the event that there are insufficient sales of a particular crude, account will also be taken of prices obtained in sales of other oil, adjusted as appropriate.

3. The Government further proposes that the legislation should itself specify the time-frame of deals to be taken into account in determining the monthly "market value". It recognises that this is an area where market practice is always liable to change, so what is indicative of monthly market values in today's market conditions may not necessarily remain so for the future. To guard against the new rule itself becoming out of line with future market practice, it proposes that the time-frame of the deals to be taken into account in the determination of monthly market values should be capable of being changed by Order. In the sort of market conditions which prevail today, the Government considers it would be right to take account of all contracts for delivery in the valuation month which have been made in the period starting on the first day of the month preceding delivery and ending on the middle day of the month of delivery. Market value would then be determined each month as an average of prices in deals within the evidential base outlined in this and the preceding paragraph.

Pricing

4. The basic rule in the existing PRT legislation is that where a company has sold the oil it has produced at arm's length, the price achieved in that sale is automatically accepted as the amount on which the company's PRT liability in respect of that oil should be based. This rule works satisfactorily where, for example, a company enters into a single contract covering the sale of a particular quantity of oil, and the producer in due course delivers the oil to the purchaser under the terms of that contract. It is not intended to disturb the operation of the existing legislation in circumstances like these.

Multiple sales on the Brent market

5. But the link between the oil produced, the contract of sale, and eventual delivery is less clear-cut in the sort of forward market which has developed recently in Brent Blend crude oil. A company producing such oil and selling both the oil it has produced and similar oil it has contracted to purchase is able to enter into a multiplicity of paper deals at a range of prices for cargoes for delivery in a

/particular

particular month. Often only a proportion of these will result in actual deliveries of oil, and an even smaller proportion in deliveries of oil produced by the company selling. The way in which the Brent forward market operates can thus give Brent producers the opportunity to choose which contract - and hence which price - to assign to those transactions which are liable to PRT (ie sales of their own equity production), and which to assign to their trading transactions.

6. The changes to the PRT pricing rules announced by the Financial Secretary are intended to protect PRT revenue in these circumstances. The changes will apply to specified kinds of oil (only Brent Blend crude oil will be specified in the first instance). In the case of such oil, each month the weighted average of the prices the producer returns for PRT purposes for his arm's length sales will be compared with the "market value" for that month, determined in accordance with the amended valuation rule described in paragraphs 2 and 3 above. In any month where the average of the producer's own returned prices is less than market value for that month, his PRT liability will - unless he has made an election for the alternative basis described in paragraph 7 below - be based, not on the prices returned, but on market value.

7. But a producing company in such circumstances who is able to demonstrate for the chargeable period in question that

(a) none of its associated companies also sold Brent Blend oil; and

(b) the total quantity of Brent Blend contracted to be sold during that period amounted to no more than twice the quantity of that part of its own equity production sold at arm's length

may elect for an alternative basis to apply for that chargeable period. For any month within the chargeable period in which the average of the company's own prices is below market value for that month, PRT will then be based - not on market value - but on the average of the company's own prices in all its sales (both equity and trading) for the month.

8. The measure described in paragraphs 6 and 7 above will not affect the present corporation tax treatment of sales on the Brent market.

Consultation

9. The Government has announced its intention to consult the industry on the detail of the proposed changes to the valuation and pricing rules. Any comments on the proposals set out in this Press Release should be sent to the Board of Inland Revenue, Room S2 West Wing, Somerset House, London WC2R 1LB, to arrive not later than 5 December 1986.

PART V

(5) In subsection (5) of section 2 of the principal Act (amounts to be taken into account in determining whether a gross profit or loss accrues to a participator in any chargeable period) at the end of paragraph (d) there shall be added "and

(e) the excess of the nominated proceeds for that period, as defined in section 61 of the Finance Act 1987."

(6) In relation to any calendar month, the proceeds of a participator's disposals and appropriations from an oil field means the total of—

(a) the price received or receivable for so much of any oil forming part of his equity production from the field in that month as was disposed of by him crude in sales at arm's length; and

(b) the market value, ascertained in accordance with Schedule 3 to the principal Act, of the rest of his equity production from the field in that month;

and in this subsection any reference to a participator's equity production from an oil field in any month shall be construed in accordance with paragraph 1(2) of Schedule 10 to this Act.

(7) The Treasury may by regulations made by statutory instrument make provision for any purpose for which regulations described as "Treasury regulations" may be made under Schedule 10 to this Act.

(8) The Board may by regulations made by statutory instrument make provision, including provision having effect with respect to things done on or after 9th February 1987,—

(a) as to oil which is excluded from this section, as mentioned in subsection (2) above; and

(b) for any purpose for which regulations, other than those described as "Treasury regulations", may be made under Schedule 10 to this Act;

and regulations made by virtue of paragraph (a) above may amend paragraphs (a) and (b) of subsection (2) above.

(9) A statutory instrument made in the exercise of the power conferred by subsection (7) or subsection (8) above shall be subject to annulment in pursuance of a resolution of the Commons House of Parliament.

Market value of oil to be determined on a monthly basis.

62.—(1) In the following provisions of the principal Act (which refer to the market value of oil at the material time in a particular calendar month) the words "at the material time" shall be omitted—

(a) in section 2 (assessable profits and allowable losses), in subsection (9), paragraphs (a)(i) and (a)(ii);

(b) in section 5A (allowance of exploration and appraisal expenditure), subsection (5B);

(c) in section 14 (valuation of oil disposed of or appropriated in certain circumstances), subsections (4) and (4A)(b); and

(d) in paragraph 2 of Schedule 2 (returns by participators), sub-paragraphs (2)(a)(iii) and (2)(b)(ii).

Part V

(2) In the following provisions of the principal Act (which refer to the market value of stocks of oil at the end of a chargeable period) for the words "at the end" there shall be substituted "in the last calendar month"—

(a) section 2(4)(b);

(b) section 2(5)(d); and

(c) in Schedule 2, paragraph 2(2)(d)(ii);

and in the provisions specified in paragraphs (a) and (b) above for the word "then" there shall be substituted "at the end of that period".

(3) In Schedule 3 to the principal Act (miscellaneous provisions relating to petroleum revenue tax) paragraphs 2, 2A and 3 (market value of oil) shall be amended in accordance with Part I of Schedule 11 to this Act; and the consequential amendments of the principal Act in Part II of that Schedule shall have effect.

(4) A participator in an oil field who is required by paragraph 2 of Schedule 2 to the principal Act to deliver to the Board a return for a chargeable period shall, not later than the end of the second month after the end of that period, deliver to the Board an additional return of all relevant sales of oil (as defined in subsection (6) below) stating—

(a) the date of the contract of sale;

(b) the name of the seller;

(c) the name of the buyer;

(d) the quantity of oil actually sold and, if it is different, the quantity of oil contracted to be sold;

(e) the price receivable for that oil;

(f) the date which, under the contract, was the date or, as the case may be, the latest date for delivery of the oil and the date on which the oil was actually delivered; and

(g) such other particulars as the Board may prescribe.

(5) Where two or more companies which are participators in the same oil field are members of the same group of companies, within the meaning of section 258 of the Taxes Act, a return made for the purposes of subsection (4) above by one of them and expressed also to be made on behalf of the other or others shall be treated for the purposes of this section as a return made by each of them.

(6) For the purposes of the return required by subsection (4) above from a participator in an oil field, a relevant sale of oil is a contract for the sale of oil to which the participator or any company which is resident in the United Kingdom and associated with the participator for the purposes of section 115(2) of the Finance Act 1984 is a party (as seller, buyer or otherwise), being a sale of oil— 1984 c. 43.

(a) for delivery at any time during the chargeable period referred to in subsection (4) above; and

(b) details of which are not included in the return made for the period under paragraph 2 of Schedule 2 to the principal Act (by virtue of sub-paragraph (3A) thereof); and

(c) which is for the delivery of at least 500 metric tonnes of oil; and

(d) which is not a contract for the sale of oil consisting of gas of which the largest component by volume over the chargeable period concerned is methane or ethane or a combination of those gases.

(7) A return under subsection (4) above shall be in such form as the Board may prescribe and shall include a declaration that the return is correct and complete; and if a participator fails to deliver a return under that subsection he shall be liable—

(a) to a penalty not exceeding £500; and

(b) if the failure continues after it has been declared by the court or the Commissioners before whom proceedings for the penalty have been commenced, to a further penalty not exceeding £100 for each day on which the failure so continues;

except that a participator shall not be liable to a penalty under this subsection if the failure is remedied before proceedings for the recovery of the penalty are commenced.

(8) Where a participator fraudulently or negligently delivers an incorrect return under subsection (4) above, he shall be liable to a penalty not exceeding £2,500 or, in the case of fraud, £5,000.

(9) This section has effect with respect to chargeable periods ending after 31st December 1986.

Blends of oil from two or more fields.

63.—(1) If, at any time prior to its disposal or relevant appropriation, oil won from an oil field is mixed with oil won from another oil field, the provisions of this section shall have effect to determine what is the share of a participator in one of those fields of the oil won from that field in any chargeable period ending after 1st January 1987; and in the following provisions of this section—

(a) "blended oil" means oil which has been so mixed; and

(b) "the originating fields" means the oil fields from which the blended oil is derived.

(2) If, for the purposes of commerce, blended oil is allocated to the participators in the originating fields in accordance with an agreed method, then, subject to the following provisions of this section, for the purposes of the oil taxation legislation, the blended oil which, in accordance with that method, is allocated to a participator in one of the originating fields in respect of any chargeable period shall be taken to be that participator's share of the oil won from that field in that period.

(3) With respect to any blended oil, each of the participators in the originating fields (either jointly or individually) shall, not later than 1st August 1987 or, if it is later, not later than thirty days after the date on which the first allocation is made in accordance with a particular method falling within subsection (2) above, furnish to the Board for the purposes of this section such details as may be prescribed with respect to that method and to the blended oil concerned; and if any participator fails to comply with this subsection he shall be liable —

(a) to a penalty not exceeding £500; and

SCHEDULE 11

Section 62.

MARKET VALUE OF OIL

PART I

AMENDMENTS OF PARAGRAPHS 2 2A AND 3 OF SCHEDULE 3 TO PRINCIPAL ACT

1.—(1) Paragraph 2 of Schedule 3 (definition of market value of oil) shall be amended in accordance with this paragraph.

(2) For sub-paragraph (1) there shall be substituted—

"(1) The market value of any oil in any calendar month shall be determined for the purposes of this Part of this Act in accordance with this paragraph."

(3) In sub-paragraph (2) for the words from the beginning to "to be delivered" in paragraph (b) there shall be substituted—

"(2) Subject to the following provisions of this paragraph, the market value of any oil in a calendar month (in this paragraph referred to as "the relevant month") is the price at which oil of that kind might reasonably have been expected to be sold under a contract of sale satisfying the following conditions—

(a) the contract is for the sale of the oil at arm's length to a willing buyer;

(b) the contract is for the delivery of the oil at a time in the relevant month;

(c) the contract is entered into within the period beginning at the beginning of the month preceding the relevant month and ending on the middle day of the relevant month or, if the Treasury by order so direct, within such other period as may be specified in the order;

(d) the contract requires the oil to have been subjected to appropriate initial treatment before delivery;

(e) the contract requires the oil to be delivered".

(4) In sub-paragraph (2), paragraph (c) shall become paragraph (f) and shall be amended as follows—

(a) for the words "as at a particular time" there shall be substituted "as in a particular month"; and

(b) for the words "as at that time" there shall be substituted "as in that month".

(5) At the end of sub-paragraph (2) there shall be added the words "and, for the purposes of paragraph (c) above, the middle day of a month containing an even number of days shall be taken to be the last day of the first half of the month, and the power to make an order under that paragraph shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of the Commons House of Parliament."

(6) After sub-paragraph (2) there shall be inserted the following sub-paragraphs—

"(2A) For the purpose of sub-paragraph (2) above, the price of any oil in a calendar month shall be determined, subject to sub-paragraphs (2B) and (2C) below, by taking the average of the prices under actual contracts for the sale of oil of that kind—

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(a) which are contracts for the sale of oil by a participator in an oil field or by a company which, for the purposes of section 115(2) of the Finance Act 1984, is associated with such a participator; and 1984 c. 43.

(b) which, subject to sub-paragraph (2B) below, satisfy the conditions in paragraphs (a) to (e) of sub-paragraph (2) above; and

(c) which do not contain terms as to payment which differ from those customarily contained in contracts for the sale at arm's length of oil of the kind in question.

(2B) For the purposes of sub-paragraph (2A)(b) above, a contract shall be treated as fulfilling the condition in paragraph (c) of sub-paragraph (2) above if it contains provisions under which the price for oil to be delivered in the relevant month either is determined or subject to review in the period relevant for the purposes of that paragraph or is determined by reference to other prices which are themselves determined in that period, being prices for oil to be delivered in the relevant month.

(2C) The average referred to in sub-paragraph (2A) above shall be determined—

(a) by establishing an average price for oil of the kind in question for each business day within the period relevant for the purposes of sub-paragraph (2)(c) above; and

(b) by taking the arithmetic mean of the average prices so established;

and in this sub-paragraph "business day" has the same meaning as in the Bills of Exchange Act 1882. 1882 c. 61.

(2D) If or in so far as the Board are satisfied that it is impracticable or inappropriate to determine for the purposes of sub-paragraph (2) above the price of any oil in a calendar month as mentioned in sub-paragraph (2A) above (whether by virtue of an insufficiency of contracts satisfying the conditions or of information relating to such contracts or by virtue of the nature of the market for oil of the kind in question or for any other reason), that price shall be determined,—

(a) so far as it is practicable and appropriate to do so by reference to such other contracts (whether or not relating to oil of the same kind) and in accordance with the principles in sub-paragraph (2C) above; and

(b) so far as it is not practicable or appropriate to determine it as mentioned in paragraph (a) above, in such other manner as appears to the Board to be appropriate in the circumstances."

(7) In sub-paragraph (3)—

(a) for the words "as at a particular time" there shall be substituted "as in a particular month";

(b) the words "at that time", where they first occur, shall be omitted;

(c) after the words "was disposed of" there shall be inserted "in that month";

(d) for the words "and (2)" there shall be substituted "to (2D)";

(e) for the words "as at that time" there shall be substituted "as in that month"; and

(f) for "(2)(b)" there shall be substituted "(2)(c)".

2. In paragraph 2A of that Schedule (modifications in the case of oil consisting of gas)—

(a) in sub-paragraphs (1) and (3) for "(1) and (2)" there shall be substituted "(1) to (2D)";

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(b) in sub-paragraph (2) for "(2)(a)" in each place where it occurs, there shall be substituted "(2)(d)"; and

(c) in sub-paragraph (3) for "(2)(b)" there shall be substituted "(2)(e)".

3. In paragraph 3 of that Schedule (aggregate market value of oil for purposes of section 2(5))—

(a) in sub-paragraph (1) the words "at the material time" shall be omitted; and

(b) in sub-paragraph (2) the words from "and 'the material time' " onwards shall be omitted.

PART II

CONSEQUENTIAL AMENDMENTS OF PRINCIPAL ACT

4. In section 5A (allowance of exploration and appraisal expenditure) in subsection (5C)(a) for "(c)" there shall be substituted "(f)".

5. In section 12 (interpretation) in subsection (1) in the definition beginning "calendar month" for the words from "and" to "have" there shall be substituted "has".

6. In section 14 (valuation of oil disposed of or appropriated in certain circumstances)—

(a) in subsections (1) and (2) for the words "at a particular time" there shall be substituted "in a particular month";

(b) in subsection (5) for the words from the beginning to "this Act", in the first place where those words occur, there shall be substituted "In subsections (4) and (4A) above "calendar month" means a month of the calendar year"; and

(c) in paragraph (a) of subsection (5) for "(2)(c)" there shall be substituted "(2)(f)" and for "(c)" there shall be substituted "(f)".

7. In Schedule 9 (sales etc. at undervalue or overvalue) in paragraph 6 (determination of arm's length price) for sub-paragraph (2) there shall be substituted—

"(2) In this paragraph "calendar month" means a month of the calendar year and "material time", in relation to a calendar month, means noon on the middle day of the month which, in the case of a month containing an even number of days, shall be taken to be the last day of the first half of the month."

Section 63.

SCHEDULE 12

SUPPLEMENTARY PROVISIONS AS TO BLENDED OIL

Interpretation

1. In this Schedule—

(a) "the principal section" means section 63 of this Act;

(b) "blended oil" and "the originating fields" have the same meaning as in the principal section;

(c) a "method of allocation" means such a method as is referred to in subsection (2) of the principal section; and

(d) "the oil taxation legislation" means Part I of the principal Act and any enactment construed as one with that Part.