ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990 8672
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constitutional mandate to ensure that all Alaskans benefit fully from Alaska's resources. If the ELF were not to be modified, or if the application date was not made retroactive to July 1987, the people of Alaska would not be fully benefiting from Alaska's resources and revenue would be lost because of this loophole.

(4) Why is the retroactive application date reasonable in its nature, circumstances, and effect?

(A) Did the oil companies have reason to believe that the ELF might be modified and the loophole removed and the change applicable back to July 1, 1987?

The answer is: The retroactive date of July 1, 1987 is reasonable because it is retroactive only two years and because HB 164, a similar bill modifying the ELF, was introduced in January 1987, prior to this retroactive date, so the affected oil companies were on notice prior to this date that the ELF could be changed. In addition, even prior to 1987, the oil companies were on notice that the ELF could be modified and the loophole eliminated. In 1981, when the loophole was created, public officials indicated their expectation that the loophole would be reassessed and possibly changed by 1987, so the oil companies could not have reasonably expected the ELF not to be modified and to not have a change applicable to July 1987, preventing the oil companies from benefiting from the loophole.

(B) Will the retroactive application have an unduly harsh effect on the oil companies required to pay the retroactive tax?

The answer is: No. While the modification of the ELF and the retroactive date serves to raise the amount paid for the severance tax for Prudhoe Bay and Kuparuk oil fields beginning July 1987, it does not raise the amount paid above the 15% statutory nominal rate for the severance tax. Neither does it raise the amount that will be paid above the amount that had been paid by the affected oil companies for Prudhoe Bay oil fields prior to July 1987. The modification and the retroactive date is thus reasonable.

The Committee substitute also provides for payment of the tax on the 20th day of the calendar month following the effective date of the Act. It indicates that delinquent taxes are subject to payment of interest and to the provisions in AS 43.10, which relate to enforcement and collection of delinquent taxes, and also indicates that tax overpayments will be credited against the taxpayer's future tax liability.

MEMORANDUM

State of Alaska
Department of Law

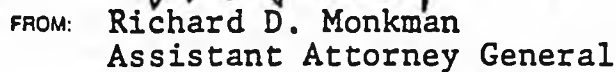
TO: Mary Halloran
Director
Division of Policy
Office of Management and Budget
Office of the Governor

DATE: March 31, 1988

FILE NO.: 663-88-0432

TEL. NO.: 465-3600

SUBJECT: Retroactivity of HB 164



FROM: Richard D. Monkman
Assistant Attorney General

You requested our opinion as to whether CSHB 164(Fin) am ("HB 164"), which would retroactively apply changes to the economic limit factor in the Oil and Gas Properties Production Tax (AS 43.55), would be likely to be held constitutionally permissible. If not, you ask our advice on "the maximum degree of retroactive application that would likely be held permissible."

The short answer is that the sections which would make HB 164 retroactive to June 1, 1987, would likely be held constitutional. If the law was retroactive to January 1, 1988, it would certainly be held constitutional.

1. Article II. The first step in analysis is the Alaska Constitution, article II, section 18:

> Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date.

This section was designed to give the public three months notice of a new law before it is applied to them - unless the legislature, by a two-thirds vote, provides otherwise. State v. A.L.I.V.E. Voluntary, 606 P.2d 769 (Alaska 1980). In line with this provision, the general state policy is against retroactive statutes, based on the philosophy that people "should be able to rely on existing laws with reasonable certainty." Norton v. State, ABC Board, 695 P.2d 1090, 1093 (Alaska 1985). Retroactive application of new laws requires an express statement in the statute itself:

> No statute is retrospective unless expressly declared therein.

AS 01.10.090.

03-002

The leading case on point is Atlantic Richfield v. State, 705 P.2d 418, 438 (Alaska 1985). In this challenge to Alaska's former "separate accounting" oil tax statute, the Supreme Court upheld retroactive application of the statute back from the date of enactment to the beginning of the calendar year. The bill in question was signed into law on July 8, 1978. It provided:

> * Sec. 4. This Act applies to taxable income earned or received after December 31, 1977.
>
> * Sec. 5. The Act takes effect immediately in accordance with AS 01.10.070(c).

Ch. 110 SLA 1978.

Retroactive application was challenged by the oil companies. The Supreme Court held that the statute was "properly retroactive to January 1, 1978," because (1) the statute expressly stated it was to be retroactive, in accord with AS 01.10.090 and (2) the two-thirds vote requirement on the immediate effective date clause was met. The Court rejected oil company arguments that a separate two-thirds vote was required for retroactivity:

> AS 01.10.090 states that "[n]o statute is retrospective unless expressly declared therein." A two-thirds vote requirement does not appear in that section, or elsewhere in Alaska law. The legislature, however, has recognized that where retroactive application of a portion or all of a bill is desired, an immediate effective date, which does require a two-thirds vote under article II, sec. 18 and AS 01.10.070(a), should be used in conjunction with the retroactivity section.

705 P.2d at 438, citing Legislative Affairs Agency, Manual of Legislative Drafting 11 (1977 ed.) and Uniform Rules of the Alaska State Legislature, Rule 10 (May 3, 1977); accord, Legislative Affairs Agency, Manual of Legislative Drafting 28-29 (1987 ed.).

The language of sections 3 and 4 of HB 164 is similar to the language approved by the Supreme Court in Atlantic Richfield. Ch. 110 SLA 1978. If passed by the legislature with the requisite two-thirds vote on the effective date clause, the bill is certain to pass this first constitutional hurdle. Without passage of the effective date clause by a two-thirds vote, the retroactive application section will be void, and the bill will operate prospectively only.

2. Due Process. The next constitutional question is whether the bill would offend guarantees of due process of law. Generally speaking, there is no vested right in any particular rate of taxation. Cohan v. Commissioner, 39 F.2d 540, 545 (2d Cir. 1930) (Learned Hand, J.). Both Congress and state legislatures can change tax statutes and apply the changes retroactively:

> Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

Welch v. Henry, 305 U.S. 134, 146-147 (1935).

The federal rule on retroactivity is that "the application of an income tax statute to the entire calendar year in which enactment took place does not per se violate the Due Process Clause of the Fifth Amendment." United States v. Darusmont, 449 U.S. 292, 297 (1980). A tax rate "may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset..." Cohan, 39 F.2d at 545, quoted in Darusmont, 449 U.S. at 298. The rule is based in large part on Congressional history:

> For more than seventy-five years it has been the familiar legislative practice of Congress in the enactment of revenue laws to tax retroactively income or profits received during the year of the session in which the taxing statute is enacted, and in some instances during the year of the preceding session.

Welch, 305 U.S. at 148.

Welch upheld a Wisconsin tax on dividends passed in 1935, and made retroactive to tax years 1933 and 1934. The Court noted that the Wisconsin legislature meets every other year, and thus the 1935 session was "the first opportunity after the tax year in which the income was received" at which the tax could be changed. Reaching back twelve months (1933 taxes were due in

1934) did not "exceed" the "limit of permissible retroactivity." Welch, 305 U.S. at 151.

The federal rule is based largely on questions of "fair notice", whether "the nature or amount of the tax could not have reasonably been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event." Welch, 305 U.S. at 147. Changes to tax rates are presumed to be foreseeable. In Darusmont, for example, the Court flatly rejected a taxpayer's argument that retroactivity of an income tax change was barred by due process concerns. The Court stated that the proposed rate increase had been under public discussion in the form of bills before Congress for about a year, and therefore, the taxpayer "had ample advance notice of the increase." 449 U.S. at 299. */

State courts generally follow the federal rule, noting that "[t]ax provisions, as key components in a system designed to fairly apportion the costs of government, seldom remain static. Rather, we expect them to change in response to changing conditions." Martin v. Board of Assessment Appeals, 707 P.2d 348, 354 (Colo. 1985). The Alaska Supreme Court, as noted above, approved retroactive application of the Oil Tax Act to the full year in which it was enacted. Atlantic Richfield. In another case, the Alaska court had "no doubt" that a license fee increase could have been retroactive to the start of the year of enactment, if the legislature had followed AS 01.10.090 and "stated expressly that it intended the revised fee schedule to be retroactive." State, ABC Board v. Odom, 671 P.2d 375, 377 (Alaska 1983), quoting United States v. Hudson, 299 U.S. 498, 500 (1937) ("it has been the practice of Congress to make [income tax statutes] retroactive for relatively short periods ... and repeated

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* The Court also rejected the taxpayer's argument, based on gift tax cases, that he "could have altered his behavior to avoid the tax if it could have been anticipated by him at the time the transaction was effected." Darusmont, 449 U.S. at 299. Gift taxes seem to be the only tax area where the Court has been receptive to arguments against retroactivity. The Court has refused to consider income in the same light as the "one time transaction" of a gift. "[A] tax on the receipt of income is not comparable to a gift tax. We cannot assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or an increase of an old one." Welch v. Henry, 305 U.S. at 148-149.

decisions of this court have recognized the practice and sustained it as consistent with the due process clause of the Constitution.").

Because HB 164, as written, goes back beyond the start of the calendar year in which it will be passed, we cannot absolutely assure you that the retroactivity section will be held constitutional. By contrast, there is "no doubt" that the bill could be retroactive to January 1, 1988. Odom, Atlantic Richfield. However, going back further is not an insurmountable problem by any means. The proposed effective date of May 31, 1987 is less than twelve months prior to the presumed date HB 164 will be enacted. Twelve months is a "short period," approved by the United States Supreme Court in Welch and again, albeit implicitly, in Darusmont. The bill proposes to change tax rates, an area which is presumed to be subject to legislative change on a regular basis. In this particular case, the taxpayers have been on actual notice that the tax rate might be changed since HB 164 was introduced in January, 1987. Thus, it can be argued that the May 31, 1987 effective date does not violate due process. We believe these arguments to be very strong, although, given the widespread adherence to the "calendar year" approach by the courts, not absolutely certain of success.

RDM:nb

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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

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M E M O R A N D U M February 6, 1989

SUBJECT: Retrospective application of the economic limit factor tax amendments, CSHB 118 ( )

TO: Representative Cliff Davidson, Co-Chair
House Resources Committee

FROM: Jack Chenoweth
Legislative Counsel

The amendments requested are enclosed. The drafts differ only as to the date of retrospective application of each. The draft identified as 6-0652E applies the economic limit factor (ELF) retrospectively to oil produced after June 30, 1987; the draft identified as 6-0652H applies the economic limit factor retrospectively to oil produced after December 31, 1988. (A subsequent memo from your office specified different alternative dates. Mechanically changing a date in any of these drafts is not a significant drafting problem.)

It is my understanding that these provisions limit the applicability of the ELF to the state's major producing fields and that, as a consequence, the tax liability of some taxpayers subject to the severance tax, AS 43.55, would be increased, while the liability of others may decrease. 1/

1/ Under AS 43.55.020(a):

> The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As a committee substitute for HB 118 is considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the adjustment a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, this office has discouraged retrospective application of severance tax adjustments beyond the narrow period recognized under AS 43.55.020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

I

RETROSPECTIVE APPLICATION OF THE AMENDMENTS:

Tax statutes may be made retroactive. 2/ The threshold

2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal consideration is that the retrospective application of the measure must not impair an obligation of contract.

The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985). To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

> . . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:
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> > Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).
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> 455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

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statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

U.S. at 187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at 508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

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3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

> The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

> Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

> It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)] . . . .
>
> . . .
>
> Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

> The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

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Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

> Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:
>
> > Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.
>
> A. Magnano Co. v. Hamilton, 292 U.S. 40, 54 S.Ct. 599, 601, 78 L.Ed. 1109.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

The state's strongest case would be one that suggests that the purpose of the retroactive provision was remedial and that its impact was limited to the shortest period practicable. One benchmark date that might serve that purpose is July 1, 1988 (start of the current fiscal year, if, indeed, the principal purpose of the retroactive application is to meet revenue shortfalls in this fiscal year); a number of cases would sustain the argument that the legislation may be retrospective over the calendar or fiscal period of its enactment. An alternative--riskier because of the length of the period over which that retroactivity would reach back, but perhaps stronger from the point of view of public policy considerations--would be that date in 1987 when the ten-year exemption from the ELF's operation expired

and the economic limit factor became applicable to the state's major producing fields. But this would probably be justified only if the state could demonstrate that the conditions that suggested in 1981 that adoption of the ELF would benefit production are now shown to have been inaccurate or incorrect.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test" approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record--and the April, 1988, "ELF Policy Perspective" document may be sufficient--the ELF adjustments now proposed, adding to tax liability on the major producing fields that are most profitable but continuing or reducing rates on marginally producing fields, seems to bear a strong correlation to the state's efforts to impose a tax burden on an oil field's production that is consistent with the field's economics. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

II

IS THERE A NEED FOR A SEVERABILITY CLAUSE?

A severability clause is not needed, and one has not been included in either draft. In the absence of a severability clause, you may rely on AS 01.10.030.

III

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, MAY THE LEGISLATURE PROVIDE FOR THAT TAX

REDUCTION BY A CREDIT AGAINST THE TAXPAYER'S FUTURE TAX LIABILITY, OR IS THE PAYMENT OF AN IMMEDIATE [CASH] REFUND REQUIRED?

If retrospective application of the ELF adjustment reduces the tax liability of any taxpayer, the revenue having been received and deposited into the general fund, the state would not be able to refund amounts that have been previously paid by the taxpayer to that taxpayer without an appropriation. However, article IX, section 6 of the state constitution provides that appropriations of public money may be made only for a public purpose. In states operating with a constitutional provision comparable to Alaska's in which there has been a proposed payment of a retroactive refund of a validly enacted tax, the appropriation has been held to violate those constitutional provisions. Japan Line, Ltd. v. MacCaffree, 558 P.2d 211 (Wash., 1977); City of Yakima v. Huza, 407 P.2d 815 (Wash., 1965); In re Estate of Skinner, 303 P.2d 745 (Cal., 1956); San Bernardino County v. Way, 117 P.2d 354 (Cal., 1941). These considerations then would favor the use of a credit due the taxpayer against the taxpayer's future tax liability, for the use of this approach would necessarily avoid a "public purpose" challenge under article IX, section 6.

IV

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, IS INTEREST PAYABLE ON THAT REDUCTION? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the draft makes a retroactive tax reduction, I would treat the reduction as the equivalent of a refund of taxes legally collected. In a refund situation, the legislature may shape the conditions and limitations of that refund. While interest is generally recoverable on the amount of the refund, the few Alaska precedents suggest that payment of interest is discretionary and depends principally on whether or not the legislature, by statute, has authorized its payment.

By statute, interest is allowed on an overpayment of a tax levied and collected under AS 43. See AS 43.05.280. That statute is, of course, more generally applicable to instances involving tax payments made in regular fashion, and not to adjustments made by retrospective application of a change of the tax law. But it would seem to have applicability to the changes suggested under AS 43.55. Apart from the statute, I know of nothing that mandates

payment of interest on a tax refund due for a tax that, at the time of levy, was legally collectable, and suggest that the state may act with respect to interest on the tax refunds as it sees fit.

The committee should determine what it wants to do and give instructions, and the draft will be prepared accordingly.

V

TO THE EXTENT THAT THE BILL INCREASES A TAXPAYER'S LIABILITY, IS THE TAXPAYER OBLIGATED TO PAY INTEREST ON THE INCREASED LIABILITY? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the committee substitute serves to establish a greater liability on the part of certain taxpayers for one or more "past due" months, that liability arises not under AS 43.55.020(a), but by operation of this law. The legislature has authority to determine whether interest should be paid, and from what date it should be paid.

The bill should not leave taxpayers subject to the assertion that they failed to remit taxes by the deadlines established in AS 43.55.020(a). In each measure, I have incorporated an additional provision that sets a date certain for reporting and paying the retroactive tax liability. Thereafter, if the amount due has not been timely remitted, provisions governing delinquency should apply.

*

Your January 30 memo asks other questions concerning retroactive application of the proposed ELF changes. Let me briefly respond.

As should be clear from the decision in Atlantic Richfield v. State, there is sound benefit in adhering to the requirements outlined in the Agency's drafting manual. The current manual, at pp. 27, 28, instructs that

> The language providing for retroactive application of a bill or part of a bill should be set out in a separate section immediately preceding the effective date section. The retroactive section and the sections in the bill that are to be retroactive should have immediate effective date clauses.

I am bound to follow the drafting manual, and any draft version of legislation prepared for the committee's

consideration that contained a retroactive provision would necessarily include an immediate effective date. All the drafts I would provide for the committee's consideration would contain the effective date clause. However, if, in a mark-up, the committee directs (on the record) deletion of the clause with the immediate effective date, I would provide the bill with that section omitted. But, before departing from the directive of the manual, I would want to have committee instruction, for I think it is important that the record show why there has been a departure from standard drafting procedure.

If one house or both houses fail to adopt an immediate effective date for legislation having a retroactive provision, the bill would still take effect. The effective date would be delayed 90 days, however, but the retroactive elements of the legislation would not be impaired by that delay.

JBC:kb
wkk1/109

Enclosure

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

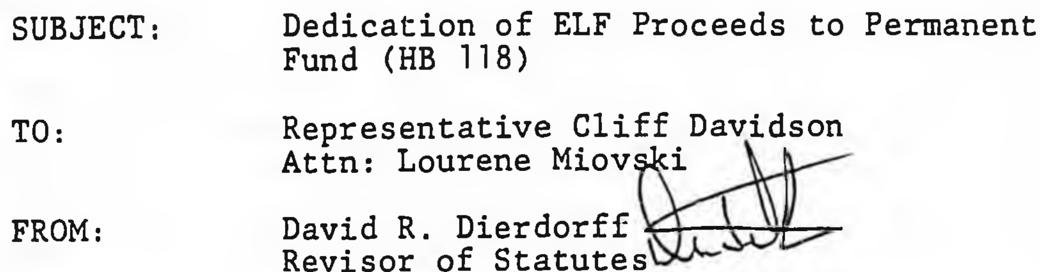
LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M   February 23, 1989

SUBJECT: Dedication of ELF Proceeds to Permanent Fund (HB 118)

TO: Representative Cliff Davidson
Attn: Lourene Miovski

FROM: David R. Dierdorff
Revisor of Statutes



This morning I discussed with Lourene Miovski your desire to provide that 30 percent of the additional revenue received under the oil and gas properties production tax by reason of the ELF amendments go into the permanent fund. As I told Lourene, the state constitution (Art. IX, sec. 7) prohibits the dedication of state revenue to a specific fund or purpose. However, the legislature could enact a provision that embodies the present intent that certain revenue be appropriated for certain purposes. The provision would not be legally binding on future legislatures.

Enclosed are two amendments that provide alternative means of enacting the legislature's intent. I drafted them as amendments to the original bill rather than for one of the draft CS's prepared for you. Amending the draft CS's would require several technical amendments in the sections after sec. 3, and the exact nature of those amendments will vary from version to version. Consequently, I determined that the simplest way to provide you with the language in amendment form was to amend the bill as introduced.

DRD:gc
WKG7/046

Enclosures(2)

6-0652Aa
Dierdorff

AMENDMENT

OFFERED IN THE HOUSE BY DAVIDSON

TO: HB 118

Page 1, following line 8:

Insert a new bill section to read:

"* Section 1. LEGISLATIVE INTENT. It is the intent of the legislature that 30 percent of any additional revenue received by the state under AS 43.55 as a result of the amendments made by this Act be appropriated annually to the principal of the permanent fund."

Page 1, line 9:

Delete "Section 1."

Insert "Sec. 2."

Renumber remaining bill sections accordingly.

2/23/89

6-0652Ab
Dierdorff

AMENDMENT

OFFERED IN THE HOUSE BY DAVIDSON

TO: HB 118

Page 1, following line 24:

Insert a new bill section to read:

"* Sec. 3. AS 43.55.013 is amended by adding a new subsection to read:

(l) The commissioner of administration shall separately account for 30 percent of any additional revenue received by the state under this chapter as a result of the 1989 amendments to this section that the department deposits in the general fund. The annual estimated balance in the account may be used by the legislature to make appropriations to the principal of the permanent fund."

Renumber remaining bill section accordingly.

2/23/89

Alaska State Legislature

HOUSE OF REPRESENTATIVES

COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

M E M O R A N D U M

TO: The Majority Caucus

FROM: Representative Cliff Davidson
Representative Curt Menard
Co-Chairs, House Resources Committee

DATE: February 3, 1989

SUBJECT: House Bill 118 - The ELF Bill

Our staff has prepared the attached paper on the ELF and the history and issues surrounding it, which we think will be helpful in understanding the bill. We would be happy to talk to you about this bill if you have any questions.

WHAT IS THE SEVERANCE TAX?

The Severance (production) tax is a tax that the state imposes on the extraction of oil, gas, and other nonrenewable resources. The severance tax is a mechanism designed to give the people a share in the nonrenewable resource wealth of a state. In Alaska, this tax is one of the largest sources of oil revenue to the state. Other oil revenue derives from the corporate income tax and the property tax, but these taxes are a small source of state revenue by comparison. These taxes are different from a royalty, which is the amount that a company contractually agrees to pay the owner (which in this case is the state) in the oil lease for the extraction of the oil from the owner's land.

The statutory nominal rate of severance tax on oil production in Alaska is 15%. (The "nominal rate" refers to the amount of the tax prior to the application of the ELF formula. The amount of tax after the application of the ELF formula is called the "effective rate".)

WHAT IS THE ELF?

"ELF" means "economic limit factor". In simple terms, the ELF is a tax formula that serves to reduce the severance tax by variable amounts, depending on per-well production at individual fields. The ELF was designed to lower the tax rate for the less profitable oil fields to encourage continued production as the productivity of the well declined and to encourage development of the less profitable oil fields. As an oil field's production declines, the ELF reduces the tax burden. As the field's oil production reaches the point at which it would be forced to shut down further oil development, the severance tax would be reduced to zero. Thus, it was designed to provide a substantial tax cut for less profitable oil fields.

The original ELF was created by the legislature in 1977. In 1981, as a result of lawsuits by oil companies challenging the constitutionality of Alaska's separate accounting method of computing corporate income taxes (which was later found to be constitutional), the oil and gas taxation statutes were revised to provide for another accounting method. This tax package provided Alaska's oil producers a large reduction in their corporate income taxes on the assumption that most of the revenue lost from the income tax would be offset by the gains from a modification of the ELF that would raise the effective rate of the severance tax. This was devised as a temporary fix.

In this legislation, for all oil fields in their first ten years of commercial production, the ELF was fixed at 1.0 if the oil field's calculated ELF exceeded 0.7. (This has been called the "ten-year rounding rule".) At the time the 1981 legislation was passed, several policy makers, including then Governor Hammond, stated that the legislature could reassess Alaska's oil tax structure, after the courts determined the constitutionality of Alaska's method of separate accounting.

For Prudhoe Bay, the most productive and most profitable oil field, the ten-year rounding rule resulted in the severance tax being temporarily raised back up to the statutory nominal rate of 15%. Prudhoe Bay's ten-year anniversary was on June 20, 1987. On June 20, 1987, the rounded ELF of 1.0 expired, resulting in an effective tax cut from 15% t[illegible] 12[illegible]5% for Prudhoe Bay.

Because oil revenues account for more than 84% of state revenues, much of it from Prudhoe Bay, state revenues were immediately reduced by more than 5% as a result of the expiration of the rounded ELF for Prudhoe Bay that occurred in 1987 -- more than $100 million per year. The state's budget crisis is partially attributable to this loss of revenue.

A change to make the ELF work as it was supposed to work, and to reverse the tax cut for Prudhoe Bay, was proposed in 1987 and passed the House but was never considered in the Senate. Changes to the ELF were recently proposed in HB 118, now under consideration in the House. HB 118 is similar to the bill that passed the House in 1987, but would raise taxes on Prudhoe Bay and Kuparuk more, and cut taxes on all other oil fields more, than the 1987 proposal.

WHAT DOES THE ELF BILL DO?

The ELF bill provides a greater tax relief for all oil fields in Alaska except Prudhoe Bay and Kuparuk, the two most productive oil fields in Alaska (and the United States), and are two of the most profitable. Under the revised ELF, the taxes for these two oil fields will increase but will still remain below the nominal statutory rate of 15%. The only oil fields besides Prudhoe Bay and Kuparuk whose severance taxes are not reduced by the ELF bill are those fields which have a zero tax rate under current law.

WHAT DATE SHOULD THE ELF'S APPLICATION BEGIN?

There is currently no beginning application date specified in the ELF bill. If passed as is, the ELF rate change would apply to all oil produced beginning 90 days after the bill is signed by the Governor. Amendments have been drafted to provide other choices of dates for beginning application of the ELF rate change.

The other choices of dates for beginning application of the ELF rate change are June 20, 1987 (when the ten-year rounded ELF expired for Prudhoe Bay, reducing the effective tax rate from 15% to 12.45%), January 1, 1989 (the beginning of this calendar year), or immediately upon being signed by the Governor.

The earliest choice will recapture the entire $397 million revenue lost from the period from June 20, 1987 through to the end of the 1990 fiscal year. The later the application date, the more the revenues that will be lost. If a January 1, 1989 beginning date is used, $222 million of revenue would be lost. If a June 1, 1989 beginning date is used, $271 million of revenue would be lost. If a September 1, 1989 beginning date is used, $301 million would be lost.

Alaska State Legislature
HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

MEMORANDUM

TO: All Resource Committee members

FROM: Representative Cliff Davidson
Representative Curt Menard
Co-Chairman, House Resources Committee

DATE: February 21, 1989

SUBJECT: ELF hearing, Wednesday, February 22

The Resources Committee will be having an evening hearing on HB 118, Oil and Gas Properties Production Tax. The purpose of the hearing is to allow the industry and the administration to answer questions while side by side.

We will have Greg Erickson from OMB presenting the administration's position and Tom Williams from BP Exploration presenting the oil industry's position. It is our intention to keep the format fairly structured and to allow the participants to make their best case without interruptions. During their exchange, spontaneous questions will not be allowed. However, we have scheduled a work session on Thursday at which all interested parties will be available to answer any questions from Committee members.

Under this hearing format, each side will first be allowed seven minutes to summarize their position on the question of the ELF legislation. A question from the Committee will follow the opening statements. The first witness will be allowed three minutes to outline their organization's position. The second witness will then be allowed to outline the opposing position. Finally, the first witness will be allowed one additional minute for a summary. For the next Committee question, the witness order will be reversed. Responses and counter-responses will be timed so that both witnesses stay within their allotted time.

Each Committee member will be allowed to ask two questions during the presentation. Our staff has prepared a list of 20 sample questions from which you may select your two questions, or you may draft your own questions. However, you must provide copies of your questions to the Committee staff by our Wednesday 3 p.m. Committee meeting so that any overlap in questions can be resolved. The witnesses will be given a a copy of the questions prior to the evening meeting.

If you have any questions or comments about the structure of the hearing, please contact the Committee staff at 3715.

POSSIBLE DEBATE QUESTIONS

1) The ELF is designed to provide incentives for wells in marginal oil fields. Which oil fields are considered marginal in Alaska and why are they considered marginal.

2) How do Alaska's taxes and royalties compare with those of other oil-producing states?

3) Describe the function of the current ELF and give your assessment of how well it is functioning.

4) What effect do you think the new ELF (HB-118) will have on oil production in Alaska?

5) In June of 1987 the Economic Limit Factor kicked into operation at the Prudhoe Bay oil field. As a result the oil companies have been paying less severance tax. What have the oil companies done with their extra revenue?

6) How much revenue is being generated from the Prudhoe Bay by the oil companies? How much revenue is being generated for the State of Alaska? Please compare their respective shares of the oil wealth.

7) What oil prices are industry using to evaluate whether or not to proceed with development of projects?

8) At current prices, how much per barrel is this expected to cost the industry (your company) and how does this cost compare with a drop in oil prices.

9) How do profits from operation of the Trans Alaska Pipeline affect oil company d[illegible] as to profitability?

10) How much profit does your company (or "do the companies") make currently on North Slope operations. Please include TAPS profits.

11) Compare the profitability of oil industry operations in Alaska with the profitability of the refining of that oil.

12) How many additional jobs have been created at Prudhoe Bay since the ELF became effective in June of 1987?

13) What effect will the ELF in HB-118 have on employment at the large oil fields? At the small oil fields?

14) How much will the oil industry reduce or modify operations in Alaska if this ELF legislation passes? How sensitive is this to oil price considerations?

15) Is it true that oil field size, in addition to well productivity, is an indicator of profitability.

16) What rate of return does the oil industry require when deciding on oil development projects?

17) What is your company's (or "the oil industry's) record on local hire. Is local hire improving among the oil industry?

18) Please compare and contrast Alaska's oil tax policies with the oil tax policies used in other countries.

19) Please explain the difference between severance tax and royalties and how they affect the oil companies and the state.

20) In his (your) testimony earlier, Mr. Williams (you) stated that the ELF formula in HB-118 does not work. Please provide your analysis of the ELF formula in this legislation and why it does or does not work.

21) Compare the oil industry and oil production in Alaska with that of other states.

22) Explain what happened to Alaska's oil tax laws in 1981.

23) Are their mechanisms to encourage production from marginal oil fields that are not being used in Alaska? Give some examples.

Please select two questions or write two questions for the House Resources Committee ELF hearing. We would like a copy of your questions by the Resources meeting this afternoon.

Alaska State Legislature

HOUSE OF REPRESENTATIVES

Official Business

Sent to
BP Alaska
Exxon Inc
ARCO Alaska
Dept of Revenue

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

MEMORANDUM

TO: Industry

FROM: Representative Bert Sharp

DATE: February 21, 1989

SUBJECT: ELF

1. What is the average investment cost of each production well drilled since 1978 in the Prudhoe Bay field?

2. Other than the additional production wells, what is the approximate total cost of Prudhoe Bay investment in production enhancements facilities in the period 1978 through 1988 (by major projects if available)?

3. What is the projected industry Prudhoe Capital Expenditure Budget for the next 5 years; 10 years?

TO: Representative Bert Sharp

FROM: Department of Revenue

DATE: February 21, 1989

SUBJECT: ELF

1. A. Prudhoe Bay produced 1.090 million barrels a day in 1978 and 1.528 million in 1988.
   B. The average well count was 148 in 1978 and 751 in 1988.
   C. Average production per well was 7,365 barrels per day in 1978 and 2,035 barrels per day in 1988.
2. Total state revenue from oil production from 1978 through 1988 has been approximately $28 billion.

Alaska State Legislature

HOUSE OF REPRESENTATIVES

COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

February 5, 1989

!TITLE! !FNAME! !LNAME!
!COMPANY!
!ADDRESS!
!CITY!, !STATE! !ZIP!

Dear !TITLE! !LNAME!:

As you were previously notified, the House Resources Committee will be holding public hearings on HB-118, "An Act relating to the oil and gas properties production tax", from February 9 to 13.

We have scheduled time for your testimony, 1:00-4:00 p.m. on Saturday, February 11. You may testify in person or from any site on the teleconference network.

Our staff will be preparing briefing books for the Resources Committee. We would like to invite you to forward to us a summary of your position totaling not more than three (3) pages of text and four (4) pages of graphics for inclusion in the briefing book. Please provide this material to the Committee staff at least 24 hours before your testimony to allow time for copying and assembly of the materials.

There is no limit to the amount of additional material that may be given the Committee prior to or during the hearing, although we would request that you provide at least 25 copies of any materials.

We look forward to hearing from you.

Sincerely,

Representative Cliff Davidson
Co-Chairman
House Resources Committee

Representative Curt Menard
Co-Chairman
House Resources Committee

January 31, 1989

!TITLE! !FNAME! !LNAME!
!COMPANY!
!ADDRESS!
!CITY!, !STATE! !ZIP!

Dear !TITLE! !LNAME!

The House Resources Committee will be holding public hearings on HB-118, "An Act relating to the oil and gas properties production tax", between February 9 and 14.

This measure, introduced by the House Finance Committee, will modify the computation of the economic limit factor, commonly known as ELF. The House Resources Committee would like to invite a representative of your company to testify on this measure and how it would affect your operations in Alaska.

As currently envisioned, we will be having two days of testimony by the State of Alaska from 3:00-5:00 p.m. on Thursday and Friday, February 9 and 10. These hearings will be listen only on the Alaska teleconference network.

We have scheduled time for oil industry testimony for 1:00-4:00 p.m. on Saturday, February 11. For your convenience, we have reserved the teleconference network so that testimony may be taken from Anchorage and other locations.

Finally, the Resources Committee will hear public testimony on Monday February 13 from 3:00-5:00 p.m. and again from 7:00-9:00 p.m..

We would appreciate hearing from you as to your availability to testify during this period.

Sincerely,

Representative Cliff Davidson
Co-Chairman
House Resources Committee

Representative Curt Menard
Co-Chairman
House Resources Committee

1	M O.	Adamson	Amerada Hess Corporation	Box 2040	Tulsa	OK
2	Beverly	Ward	ARCO Alaska Inc.	134 N Franklin	Juneau	AK
3	J.B.	Rigg	Amoco Production Company	Box 800	Denver	CO
4	Tom	Gallagher	Chevron USA Inc.	Box 107839	Anchorage	AK
5	Al	Hastings	Conoco Inc.	3201 C Street #200	Anchorage	AK
6	Dave	Parrish	Exxon Co. USA	421 Judy Lane	Juneau	AK
7	Thomas	Cirigliano	Exxon Co. USA	Box 196601	Anchorage	AK
8	C.E.	Schwobel	Marathon Oil Company	Box 3128	Houston	TX
9	Waco	Shelley	Mobil Oil Corporation	310 2nd Street	Juneau	AK
10	B.A.	Stallsworth	Phillips Petroleum Company	8055 E. Tufts Avenue Parkway	Denver	CO
11	C.	Waddington	NW Alaska Pipeline Company.	295 Chipeta Way	Salt Lake City	UT
12	Gorden	Evans	Shell Western E & P Inc.	318 4th Street	Juneau	AK
13	Jim	Palmer	Standard Alaska Production Co.	Box 196612	Anchorage	AK
14	E.H.	Nelson	Texaco Incorporated	550 W 7th #1325	Anchorage	AK
15	Norman	Gorsuch	UNOCAL	Box 240504	Douglas	AK
16	Rick	Neal	MAPCO	1800 S. Baltimore A.	Tulsa	OK
17	Debra	Reinwand	Resource Development Council	Box 100516	Anchorage	AK
18	Morris	Thompson	Doyon, Ltd.	201 1st Street	Fairbanks	AK
19	Roy	Hundorf	Cook Inlet Regional Corp.	2525 C Street	Anchorage	AK
20	L.A.(Ardie)	Merbs	Alaska Oil & Gas Association	121 W Fireweed Lane Suite 207	Anchorage	AK
21	Willie	Hensley	NANA Regional Corporation	Box 49	Kotzebue	AK

PHILLIPS PETROLEUM COMPANY
8055 East Tufts Avenue Parkway, Phone: 303 850-4383
DENVER, COLORADO 80237-2898

Corporate Affairs

BRUCE A. STALLSWORTH
Director
Government Relations and Public Affairs
Western States

RECEIVED FEB 20 1988

February 10, 1989

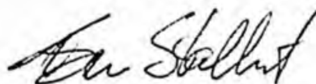
The Honorable Cliff Davidson
and Curt Menard
Co-Chairman
House Resources Committee
House of Representatives
State of Alaska
State Capitol Building
Juneau, AK 99811

Dear Representatives Davidson and Menard:

I am in receipt of your letter dated February 5, 1989, concerning H.B. 118. Thank you for providing Phillips Petroleum Company the opportunity to provide material for the briefing books being prepared for the Resources Committee. Although we are opposed to the legislation, we, unfortunately, were not able to have our tax specialists put the information together within your timeframe.

Again, we appreciate your interest and regret we were not able to provide material for the briefing books.

Sincerely,



Bruce A. Stallsworth

BAS/cyk

Chevron U.S.A. Inc.

3001 C Street, Anchorage, AK 99503 • Phone (907) 563-2556

RECEIVED FEB 9 1989

T. P. Gallagher
Public Affairs Manager

February 6, 1989

Representative Cliff Davidson
Representative Curt Menard
Alaska State Legislature
House Resources Committee
Pouch V
Juneau, Alaska 99811

Dear Representatives Davidson and Menard:

Thank you for your letter of January 31st inviting Chevron to testify on HB-118.

Chevron's comments on subject bill will be incorporated into testimony provided by the Alaska Oil & Gas Association - Tax Committee.

As a result of the hearings scheduled on February 9-14, Chevron may wish to comment further at a later date.

I appreciate your contacting Chevron and look forward to continue working with you and your staff.

Sincerely,

Tom Gallagher

TPG:mw

AMERADA HESS CORPORATION

February 7, 1989

P. O. BOX 2040
TULSA, OKLAHOMA 74102
918-599-4200

Representative Cliff Davidson
Co-Chairman
House Resource Committee
Pouch V
Juneau, Alaska 99811

RECEIVED FEB 10 1989

Representative Curt Menard
Co-Chairman
House Resources Committee
Pouch V
Juneau, Alaska 99811

Re: Alaska HB118
Public Hearings

Dear Sirs:

Amerada Hess Corporation thanks you for the opportunity to provide testimony on the potential effect of HB118 on its present and future Alaska oil and gas operations. Certainly, Amerada Hess has some very serious concerns about the referenced proposal and its effect on our outlook for future operations in Alaska. We are active members of the Alaska Oil and Gas Association which plans to provide comments and/or testimony to the House Finance Committee; however, our discussions with AOGA personnel on this matter indicates that AOGA will encompass most of the points we would raise. For this reason, and in the interest of time and efficiency, Amerada Hess will not burden the record with individual testimony.

Thank you again for this opportunity, and be assured of our continued interest.

Very truly yours,

Marilyn O. Bernhardt
General Attorney

MOB:sgb

xc: L. A. (Ardie) Merbs
Alaska Oil and Gas Association
121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035

Alaska State Legislature
HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

TO: Whom it may concern

FROM: Representative Cliff Davidson, Co-Chair
Representative Curt Menard, Co-Chair
House Resources Committee

DATE: February 10, 1989

SUBJECT: Questions

The Committee appreciates the efforts you have made in informing the Committee of the facts and issues concerning HB 118. In order to get a better perspective, questions have been prepared on this bill. The Committee would appreciate answers to the attached questions by the administration and each participating oil company. Answers are requested to be received by Friday, February 17, so that they can be distributed to the Committee for discussion prior to a vote on any legislation.

ELF QUESTIONS

I AMOUNT OF OIL EXTRACTED

(1) The ELF is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

(2) How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

(3) How many barrels per day are extracted from Prudhoe Bay? from Kuparuk?

(4) How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels-per-day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

(5) Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

(6) Oil Companies: How much oil did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

(7) Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

II TAXES PAID

(8) Which oil fields will receive tax breaks from this ELF Bill? Which oil fields will receive tax increases from this ELF bill?

(9) Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

(10) Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

(11) How much is being paid to the State of Alaska in severance taxes each year?

(12) How does the amount that Alaska receives in severance taxes compares to the amount that other oil-producing states and nations receive? How much would the

fields in the lower 48 pay if they were placed under the Alaska tax structure?

(13) Oil Companies: Do you have North Sea productions? If so, what percent of the total economic rent do you realize from your Alaska production and what percent do you realize from your North Sea production?

III PROFITS

(14) Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

(15) Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

(16) How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

(17) Does this include TAPS? If not, what is the profit on TAPS?

(18) What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

(19) How much profit is made from refined products from Alaskan oil?

(20) What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

(21) What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much money is sent outside?

IV IMPACTS ON ALASKANS

(22) How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

(23) How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

(24) What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

(25) How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely

to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

(26) What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

ALASKA DEPARTMENT OF REVENUE

POSITION PAPER

QUESTIONS AND ANSWERS ON

HOUSE BILL 118

Why should the Legislature modify the ELF?

This legislation promotes economic development, creates jobs, raises revenue, and protects the interests of the people of Alaska in their resources.

What tax does the Economic Limit Factor formula affect?

The Economic Limit Factor (ELF) formula affects the severance tax on oil. The severance tax -- also called the production tax -- is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources. The severance tax has provided more than a third of the state's unrestricted General Fund revenue in the past decade.

What is the Economic Limit Factor?

The ELF is a formula which reduces the severance tax actually paid on oil. The ELF formula produces a fraction which reduces severance taxes as the productivity of a well declines. This reduced severance tax rate is the "effective" severance tax rate -- that is, it is the rate the producer actually pays. The effective severance tax rate is the "nominal" severance tax rate (the one set out, or "named" in statute, which is normally 15 percent for mature fields) multiplied by the ELF. Here's an example:

15% nominal tax rate

multiplied times ELF of 0.66

equals an effective severance tax rate of 9.9%

The higher the ELF, the higher the actual tax paid. The lower the ELF, the lower the actual tax paid. A low ELF provides a large tax break.

Why do we have the ELF?

The ELF was originally created in 1977 to encourage oil companies to develop marginal oil fields, and to extend the life of producing fields when production at those fields became marginal.

How did we get to where we are today?

In 1981, the Legislature sharply reduced the state's corporate income tax on oil and gas producers by abandoning separate accounting. (The changes were made because the separate accounting law had been challenged in court, but the state later won the lawsuit.) In an attempt to compensate for the expected loss of revenues from the changes made in the corporate income tax, the Legislature raised the severence tax rate from 12.25% to 15%. Because the ELF formula would have cut into this needed revenue, the Legislature as a stopgap measure -- suspended the ELF at Prudhoe Bay until 1987.

Even at the outset, this attempt to compensate failed. The 1981 changes in the income tax and severance tax had the net effect of costing the state more than $1 billion in lost revenues between fiscal years 1982 and 1987.

In 1987, the impact of the 1981 tax changes became even more negative for the state. When the stopgap provision ended in 1987, this additional tax break caused the effective severance tax rate at Prudhoe Bay to drop sharply. (Graphic #1 shows this sharp drop for Prudhoe Bay.) This sharp drop immediately cut Alaska's total revenue by $135,000,000 in FY88.

Why do people want to change the ELF now?

The current ELF is not giving Alaska an attractive enough tax climate to encourage development of marginal oil fields. Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all -- Prudhoe Bay and Kuparuk. These are the largest oil fields in the United States, and two of the most profitable as well.

House Bill 118 would target tax breaks toward marginal fields and away from these two large, high-profit fields. The bill would give tax breaks to currently producing marginal fields such as Endicott and Lisburne and to prospective marginal fields at Niakuk, Point Thomson, Milne Point, and Seal Island. It would leave taxes at zero at West Sak and all the Cook Inlet fields. (See Graphic #2.)

In fact, HB 118 would cut -- or leave at zero - the taxes on every oil field in Alaska except Prudhoe Bay and Kuparuk.

HB 118 would reduce the tax breaks given to Prudhoe Bay and Kuparuk. The current ELF gives a 20 percent tax break to Prudhoe Bay, and more than a 40 percent tax break to Kuparuk. HB 118 would reduce -- but not eliminate -- the tax breaks given to these two large fields.

Graphic #3 shows the tax savings provided by HB 118 for producers at all other fields except Prudhoe Bay and Kuparuk. Graphic #4 shows the increased revenues generated from Prudhoe Bay and Kuparuk by HB 118. The legislation on balance raises substantial revenues.

How much revenue would HB 118 raise?

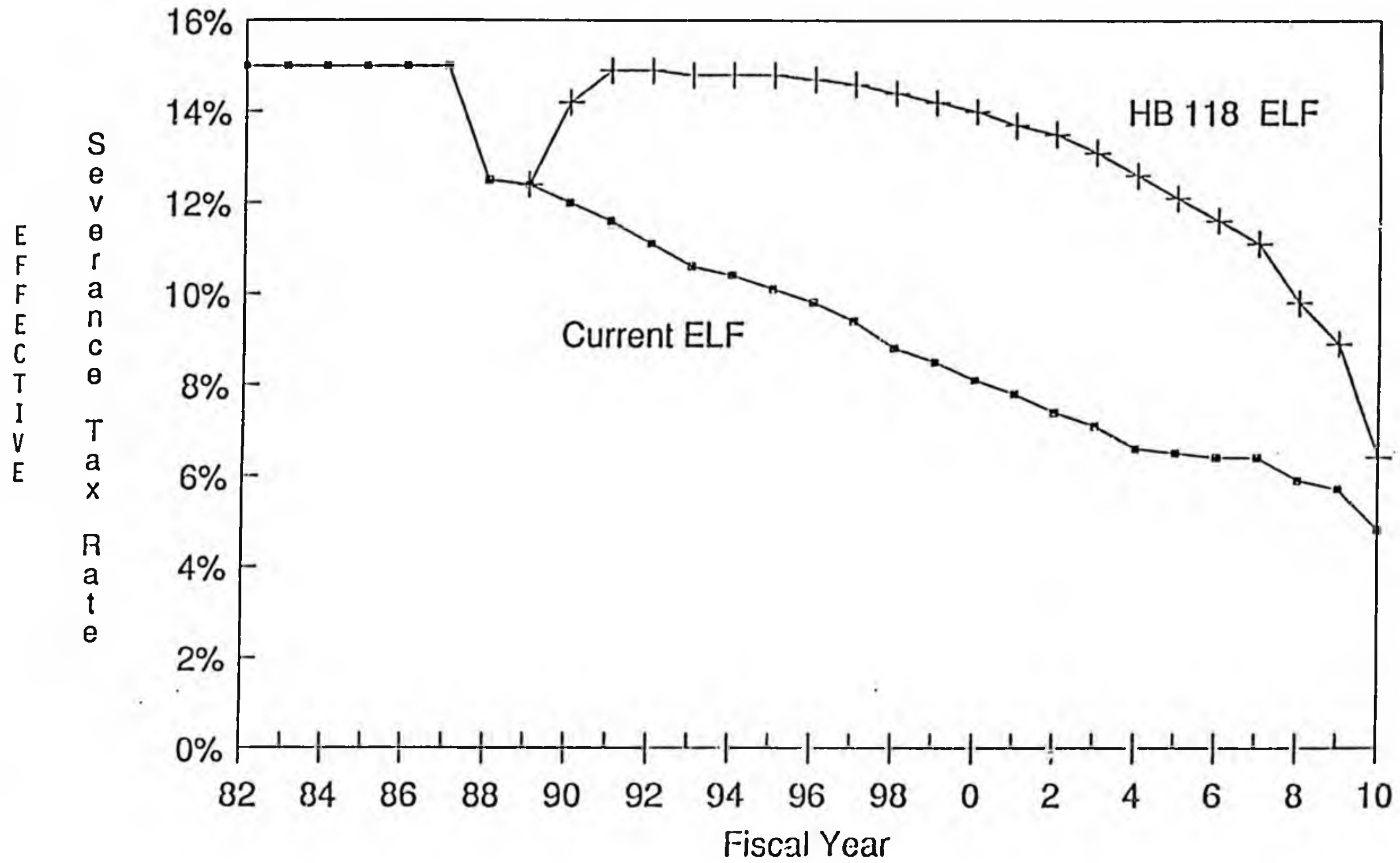
HB 118 does not provide for an effective date, nor does it specify when it begins to apply. Assuming that the bill went into effect September 1, 1989 and applied to oil produced after August 31, 1989 -- and assuming the mid-case scenario projections of the Fall, 1988 Department of Revenue forecast -- the bill will raise $96 million in Fiscal Year 1990.

The legislation would raise much more money if it were retroactive. If the bill applied to oil produced after December 31, 1988, it would generate $175 million for FY89 and FY90. If the bill applied to oil produced after June 30, 1987, it would generate $397 million in FY89 and FY90.

The long-term fiscal impact is substantial as well. For the FY91-FY95 period, the legislation would raise $848 million.

GRAPH #1

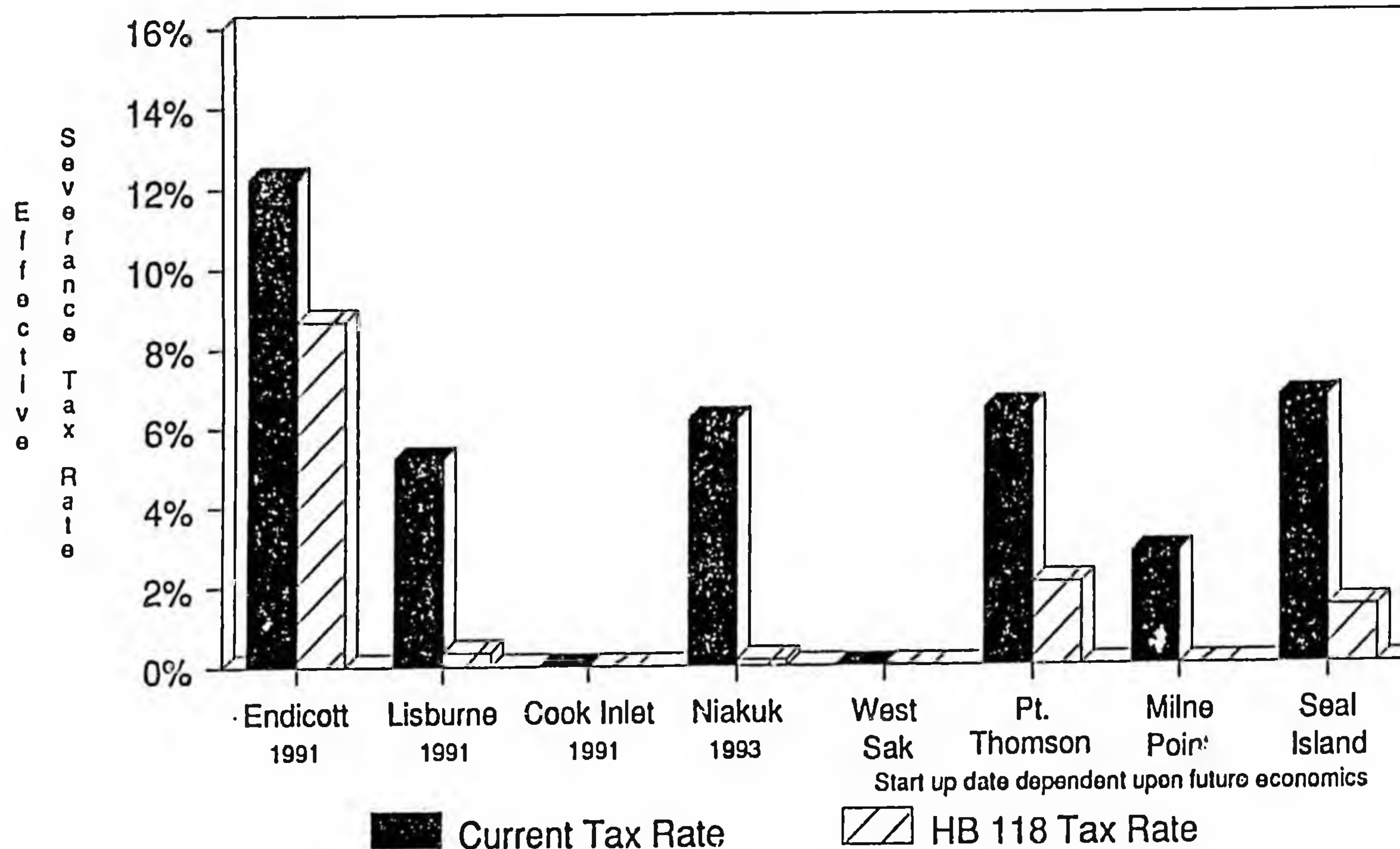
The Tax Rate on Prudhoe Bay Has Dropped Sharply



GRAPH #2

Fields Where Taxes Would Decrease Under HB 118

(For Representative Years)

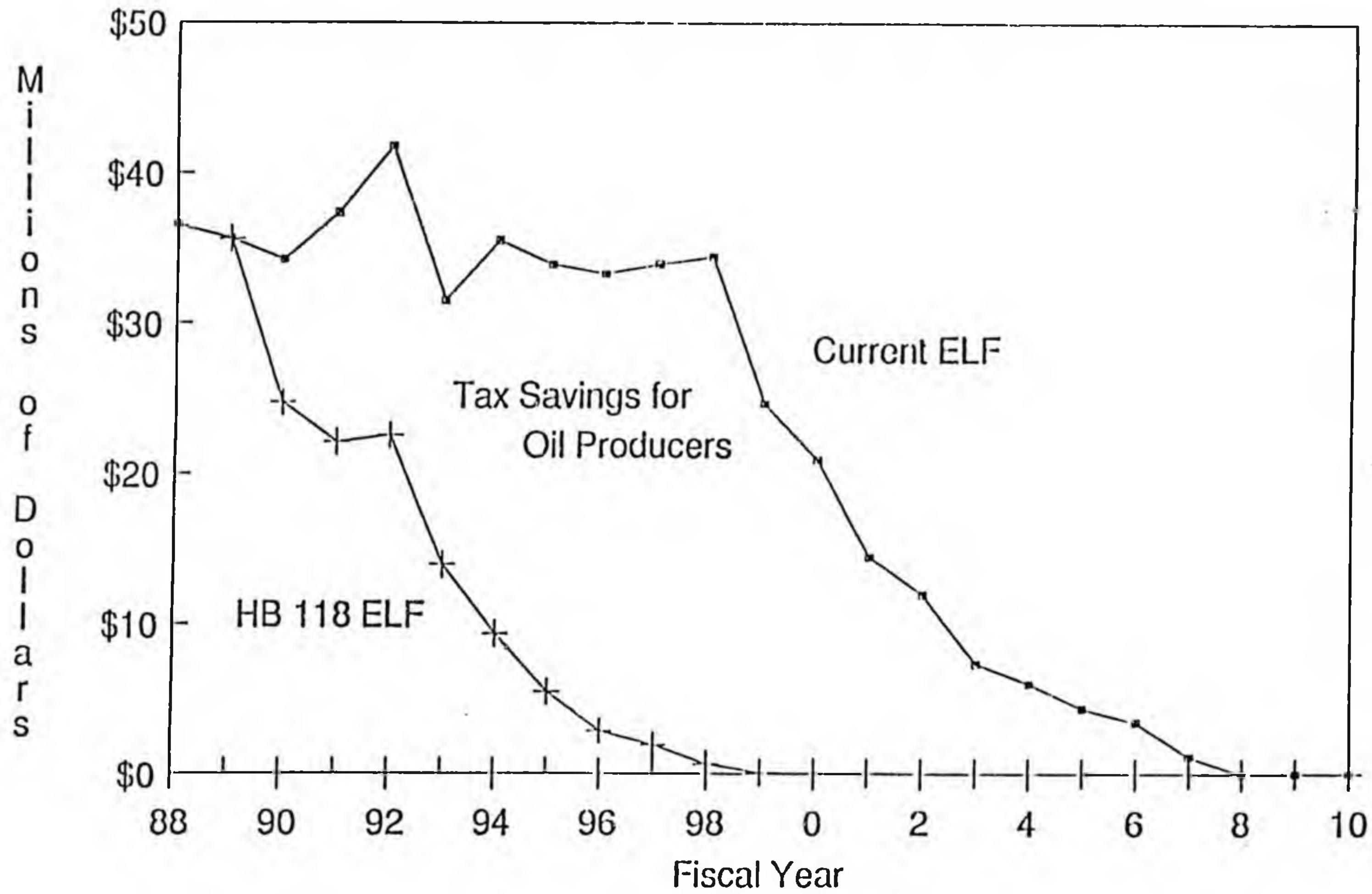


Source: Department of Revenue

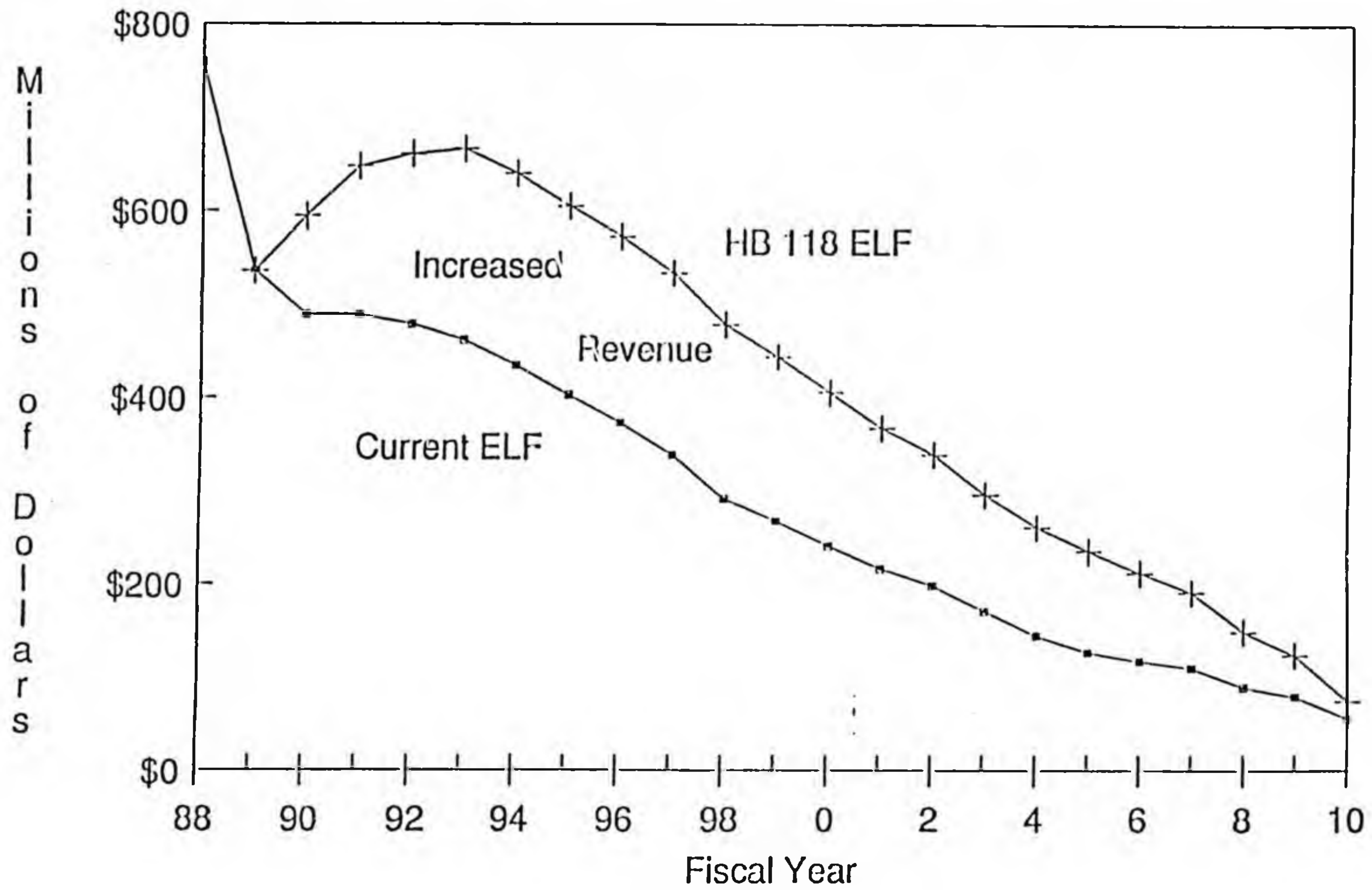
Date: February 7, 1989

GRAPH #3

HB 118 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



GRAPH #4



BP EXPLORATION (ALASKA) INC.

POSITION PAPER

QUESTIONS AND ANSWERS ABOUT THE "ELF"

Q. What is the ELF?

A. The Economic Limit Factor (ELF) is just a number ranging from zero to one (1.00) that is multiplied times the base tax rate to figure out the actual tax rate on oil and gas production. The ELF is computed according to a formula set out in the production tax statute.

Q. Why have the ELF?

A. It allows oil and gas to be produced that would stay in the ground without it. This gives the State of Alaska additional royalties and gives the State and municipalities a higher property tax base because the tangible field investment is depreciated over a longer economic life.

A production tax is based on the gross value of the production, not the profit from it. Operating costs rise as time passes. Eventually they reach the total value of the production, leaving nothing for profit. Since the tax does not change when profits are shrinking, it squeezes profits even further and hastens the time when there is no profit left at all. The field then gets shut down even though more oil and gas could be economically produced if there were no tax.

The ELF avoids this by lowering the actual tax rate as the field becomes less profitable. However, the ELF formula is carefully designed so that the tax rate is not reduced very much until the field is very close to closing down. Then the ELF falls rapidly to zero and so does the tax.

Q. Last year the state House of Representatives passed a change to the ELF formula that they say would lower tax rates for small fields like Endicott. Wouldn't this change be better for marginal fields than the present ELF formula?

A. Don't confuse smallness with being marginal. A field in Cook Inlet about 1/20 the size of Prudhoe Bay has had a higher internal rate of return than Prudhoe. On the other hand, West Sak has as much or even more oil in place than Prudhoe, but it will be so difficult and expensive to produce that it is only a marginal field economically.

All small fields would get a tax break under the House bill, whether they need it or not.

The House bill would calculate the ELF using field-wide production, instead of production per well. Under the House

bill, drilling new wells to increase production would actually raise the tax burden per barrel for the field. This would be a disincentive to full development. The present ELF provides an incentive.

Q. Isn't the ELF just a give-away that was made in 1981?

A. No, the present ELF formula was enacted in 1977. Our present governor, Steve Cowper, was the House Finance Committee chairman then and endorsed the ELF concept:

> "Given the tax relief that the [ELF] proposal will afford the economically marginal oil and gas fields and the relatively modest increase in taxation the proposal places on the highly productive and profitable oil and gas fields, House Finance Committee Substitute for CS for SB 238 represents a balanced and reasonable adjustment to the present tax law."

Source: 1977 House Journal, Supp. 60 (May 7, 1977), p. 8.

The 1981 legislation raised the actual tax rate for Prudhoe Bay to 15% by increasing the base rate from 12.25% to 15% and by "rounding off" the ELF to 1.00 until June 1987, the 10th anniversary of Prudhoe production. The actual tax rate with the ELF today is 12.1% -- higher than the 11.7% it was prior to the legislation in 1981.

Q. When Governor Hammond signed the 1981 legislation, he said he had full confidence in the ability of the Legislature to deal with the situation when the ELF would start up again for Prudhoe Bay in mid 1987. Didn't he mean that the ELF would have to be fixed of changed then?

A. No. Governor Hammond's most important concern was that the State's share should remain at or above 30%. He was told that the bill would keep the State's share just over this 30% minimum until the ELF started working again in mid 1987 for Prudhoe Bay. Everyone agreed the ELF would reduce the State's share, but no one in 1981 was prepared to predict whether the reduction would drop the State's share below 30%. If it did drop below that minimum level, Governor Hammond had full confidence in the Legislature's ability to remedy the situation.

Q. Has the State been getting its 30% share? If so, is it still getting it now that the ELF has kicked in again for Prudhoe Bay?

A. Yes to both questions. The following table shows the State's actual share through FY 87 and its projected share for FY 88 through FY 91.

	Actual State Share
FY 82	35.02%
FY 83	33.80%
FY 84	36.53%
FY 85	36.89%
FY 86	37.40%
FY 87	52.35%

	Projected State Share	
	$9 Oil at Wellhead ($13-14 at market)	$11 Oil at Wellhead ($15-16 at market)
FY 88	79%	57%
FY 89	92%	61%
FY 90	96%	63%
FY 91	103%	67%

Sources: For FY 82-85 actuals, Alaska Department of Revenue (Research Section), "ANALYSIS OF HB 353" (October 31, 1985), Mean Case Summary Tables, Table 2a ("Calculation of State Petroleum Revenues as a Percent of Adjusted Production Income"), column 12 ("State / Net Rev %"); for FY 86-87 actuals, Petroleum Intelligence Weekly; for FY 88-91 projections, Alaska Department of Revenue (Larson, Logsdon and Marks), "SENSITIVITY ANALYSIS OF PROJECTED REVENUE COLLECTIONS" (December 1986), pp. 82 (for $11 wellhead figures) and 93 (for $9 wellhead figures).

Q. How much is the impact of the ELF? Last year in June the State was saying it would be $200 million for FY 88 and 89 together. This past February the Department of Revenue said it will be $300 million, and the Speaker of the House recently said $400 million.

A. As a percentage of the State's petroleum revenues, the ELF represents a reduction of slightly less than 7%. The dollar amount depends on the price levels you assume. The higher your prices are, the greater the impact in dollar terms.

Both the Speaker and the Department of Revenue tell only part of the story when they focus only on the extra "cost" of the ELF due to their higher price assumptions. Despite the ELF, higher prices mean higher production tax and royal-

ty collections. While Revenue bemoaned the "loss" of another $100 million because of the ELF, its higher price assumptions indicate an increase of $189 million in production tax from Prudhoe Bay alone, plus another $260 million in royalties.

Less than 1/6 of the Department of Revenue's latest $300 million figure is due to an increased number of producing wells.

Q. Prudhoe Bay isn't a marginal field. Why should it get a tax break like the ELF?

A. Prudhoe Bay is a lot more marginal these days than people think. A major indicator of field profitability is daily production per well. Ten years ago Prudhoe was producing 1.2 million barrels a day from only 120 wells -- an average of 10,000 barrels a day per well. Today it produces 1.55 million barrels a day from 669 wells. While total production for the field has increased, the average production per well has declined by 76.8% to a little over 2300 barrels per day. Yet the ELF has declined by only 15.3%, from 0.954370 to 0.808459.

Q. Isn't the ELF providing a tax incentive for oil companies to drill extra wells at Prudhoe Bay that aren't really needed?

A. No unnecessary wells are being drilled just for the tax benefit of the ELF. Based on the Department of Revenue's price forecast for FY 89 ($10.43 at the wellhead), the difference in production tax in FY 89 due to having 715 wells in the ELF calculation (as Revenue has in its forecast this past February) instead of 590 (as it had in its forecast last June) is $26.8 million. For the extra 125 wells, the average tax benefit per well is only $0.21 million -- not enough to justify the $2 million that each well costs.

CONOCO INC.

POSITION PAPER

Tom Painter
Division Manager

Conoco Inc.
3201 C Street
Suite 200
Anchorage, AK 99503

February 7, 1989

RECEIVED FEB 9 1988

Representative Cliff Davidson
Co-Chairman
House Resources Committee
Pouch V
Juneau, AK 99811

Representative Curt Menard
Co-Chairman
House Resources Committee
Pouch V
Juneau, AK 99811

Gentlemen:

I have received your letter of January 31 inviting a representative of Conoco to testify on HB-118. Conoco appreciates this invitation to present our views on HB-118; however, the most appropriate person to testify, Conoco's Division Manager Tom Painter, will be out of town during the hearings. Conoco's position favoring a modification of the ELF to make the production tax structure a progressive tax based on field size as well as well productivity remains unchanged from our prior testimony in the hearings on CSHB-164 in 1987. We continue to believe such change would offer a positive first step in encouraging the development of Alaska's small, marginal fields.

Oil field development in remote areas of Alaska, such as the North Slope, offshore, or interior, requires high fixed cost components of investment and operation. All fields, regardless of size, must possess living quarters, roads, pipelines, and personnel transportation infrastructure in addition to the normal production handling facilities. In Alaska's high cost environment, these factors result in significant diseconomies of scale for smaller fields. For smaller fields to be economically developed, we believe some adjustments must be made in the tax or royalty structure.

Conoco remains desirous on becoming a more active participant in the Alaskan economy. For Milne Point, the North Slope's smallest field, a change in the production tax structure would help. The economics of resuming development and production at Milne Point would be more enhanced by a change in our royalty rate, which, at 20%, is the largest fixed royalty for any field in the state. HB-128, which has recently been introduced by Representative Brown, has the potential to provide royalty relief. For Milne Point to be a success, a sufficient differential between crude price and costs, including taxes and royalty, must exist to generate a profit. While oil price continues to be the controlling factor, any incremental improvement in taxes and royalty would have the same effect as an increase in price.

We must caution that our position on modifying the ELF to provide an incentive for small field development should not be misconstrued as support for increasing taxes on any currently producing field in Alaska. Alaska's sustainable economic growth has and will continue to come from private sector investment to develop Alaska's natural resources. From our observations, the tax reductions initiated

at Prudhoe Bay are benefitting both the State and the Prudhoe Bay owners as additional production and reserves are being developed, investments are being made, and new jobs are being added to the Alaska economy.

It is possible to provide both an incentive for small field development and to maintain continued investment in the state's larger fields by adopting the modified ELF proposed in HB-118 and simultaneously reducing the production tax rate, resulting in a "tax neutral" position.

I hope this information will suffice to adequately define Conoco's position on HB-118. If you so choose, you may submit this letter as testimony at the hearing.

Very truly yours,

A. E. Hastings
Sr. Staff Engineer

AEH/(jah)

COMMITTEE TO REPEAL THE ELF

POSITION PAPER

Committee to Repeal the ELF

P.O. Box 1114 • Fairbanks, AK 99707 • (907) 452-3360

POSITION PAPER ON HB118
February 6, 1989

Based upon our research, the Committee to Repeal the Elf maintains it's stated position of being committed to the total repeal of this flawed and complex formula.

We support HB118 as a step in the right direction until such time as a repeal is effected, particularly as it is retroactive to July 1, 1987. But only a step because the bill deals with the application and not the formula itself.

Our information indicates that the built-in subsidy which provides the first 300 barrels, per well, per day, on the average in a "field" to be totally tax free was:

1. based upon 1975 - 76 Cook Inlet data, which has absolutely nothing to do with fields such as Prudhoe Bay and Kuparek and at best is unintelligible to all but geologists and engineers,

2. a massive, unwarranted and unnecessary incentive to the industry giants,

3. if appropriate at all, more logically done on a National, rather than State, level,

4. so illogical that by simply punching another hole in the ground, and by producing more over-all oil, the "average" production can be "decreased", the[illegible]re decreasing total taxes,

POSITION PAPER ON HB118
FEBRUARY 6, 1989
PAGE TWO

5. a blanket concession methodology not used by any other state, and

6. in a phrase, simply too complex, open to possible abuse, interpretation and litigation.

Some of the greatest service the Resources Committee could provide to Alaska and it's future would be to:

1. Pass through this bill, with a clear, concise definition of "field", as a temporary halt to the raid.

2. Fund an independent study by a third party of impeccable reputation, to determine, among other things:

- how to break the monopoly enjoyed by the major producers and assure real competition in lease bidding

- what we could and should be doing to guarantee now and into the future a fair share of the proceeds for our non-renewable resources.

JEAN MANNING
CAMPAIGN CHAIR

DON LOWELL
COMMITTEE CHAIR

Committee to Repeal the Elf

RESOURCE DEVELOPMENT COUNCIL FOR ALASKA INC.

POSITION PAPER

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Box 100516, Anchorage, Alaska 99510-0516 – 907/276-0700

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Senator Ted Stevens
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RDC Position Paper on HB 118

The Resource Development Council appreciates the opportunity to submit its comments for the record on HB 118. A non-profit membership organization, RDC supports responsible resource development. RDC's membership consists of resource developers from all sectors, small and big businesses, communities across the state, and individuals.

Our broad-based membership strongly supports a stable tax policy in the 49th state - a policy that fosters new investment and development, but provides a return to the state.

Gov. Steve Cowper in his combined state of the state and budget speech in mid-January said that Alaska owns the fields at Prudhoe Bay and Kuparuk. Let us not forget that the oil companies obtained the right to extract that oil by paying for it, and provide the state with a royalty as well.

As in any sound business arrangement, both sides have something to gain - the state sees its resource developed and profits from that production, while the oil industry provides infrastructure and achieves its profit through the sale of the commodity it paid for.

Like most business ventures, the arrangement between the state and the oil industry involved some bargaining, a long list of ground rules and some give-and-take during the development process.

One of the agreements forged during this stage was the ELF.

As most involved in the ongoing tax debate know, ELF was proposed in 1977 as a way to encourage the industry to drill additional wells in all fields. Once a mature field begins to decline, there is an incentive for new investments that will extend the life of the field. This incentive is accomplished through the ELF formula.

State officials, as well as elected leaders, have heard many times that Alaska's current tax structure compels the oil industry to pay higher taxes here than in any other state. Yet it seems that message has not penetrated, because the oil industry is confronted with yet another proposed increase through the ELF legislation before you. The industry in question already pumps 85 percent of the state's revenue into the treasury.

All Alaskans understand state government is facing a fiscal crunch. Without perpetuating the finger-pointing syndrome, RDC respectfully suggests that while massive

cuts are not the answer, neither are increased taxes, particularly on the one industry which fuels so much of Alaska's budget. When all the smoke and mirrors fade, the reality is that Alaska needs a healthy, productive oil industry, and the best way to foster that is through a stable tax structure.

Alaska needs to stop thinking about the short-term quick-fixes, such as increasing the money flow into the treasury through HB 118, and start thinking of the long-term ramifications of such a move. Those include the job losses associated with higher taxes, projects being stalled or shelved completely, the loss of long-term state revenue from marginally economic projects as well as the loss of oil and gas reserves due to early abandonment, and delays in technological advances that could extend the lifespan and productivity of all Alaska fields.

The oil companies are no different than state government when it comes to cash flow - when more money is taken out of an entity, cuts must occur somewhere else. Right now, state government has more expenses than the sum of its expected income. If state government truly wants to increase its income, the most sound way to do just that is by providing a good business climate and stable tax policy. By encouraging the industries that currently fuel the state's operations and continuing its current tax policy, the state has a better chance of achieving a long-term payoff in the end, when oil companies are able to explore, develop and bring new fields on line, thus increasing the state's future income.

In closing, RDC hearkens back to a statement made by Gov. Cowper in his January speech. He said that in order to retain the benefits and services of government, people have to pay for "what you get."

RDC would submit that the oil industry has not only paid its own way, but picked up a good share of the load for the rest of the state through the years.

ALASKA OIL AND GAS ASSOCIATION

POSITION PAPER

Testimony of the
Alaska Oil and Gas Association
before the
Alaska State House of Representatives
Resources Committee
on
HB 118, An Act Relating to the
Oil and Gas Properties Production Tax

February 13, 1989

My name is Gerald Serena and I am a tax lawyer with Exxon Company, U.S.A. I am here today to present testimony of the Alaska Oil and Gas Association (AOGA). AOGA is a trade association whose member companies account for the majority of oil and gas exploration, production and transportation activities in Alaska.

AOGA believes that it is in Alaska's best interest to encourage responsible exploration and development of its hydrocarbon resources. We oppose the tax increases included in HB 118 since its passage would act to discourage continued development in Alaska's larger fields. In general, marginal developments in these fields that are already at risk due to soft crude price forecasts would be further burdened by the proposed tax increases. Increasing taxes on existing fields, after significant investment decisions have been made under the existing tax structure, is counterproductive to the complete development of these vast resources. In general, changes in the tax structure will require different ris analysis techniques, which could be a hindrance to future exploration and development.

Alaska's current tax structure has our industry paying higher taxes in this state than in any other. As you are probably aware, the production tax rate is the highest in the country, peaking at 15 per cent on gross production value. Taxes and royalties have provided 80 to 90 per cent of the state's unrestricted revenues in recent years and created the $10 billion Permanent Fund. Surely oil and gas is paying its fair share by any measure.

Turning to the oil industry for more tax revenues would not be an effective approach to solving revenue problems brought on by crude price volatility, and which will be exacerbated in the near future with production declines from the major fields. This would only increase the State's enormous dependence on oil revenues while not addressing the long term problem of state spending levels.

In conclusion, AOGA strongly opposes the increased taxes in HB 118. Passage would unreasonably increase an already high tax burden, and would increase the state's dependence on volatile crude price swings.

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Oil Revenue Update

RECEIVED

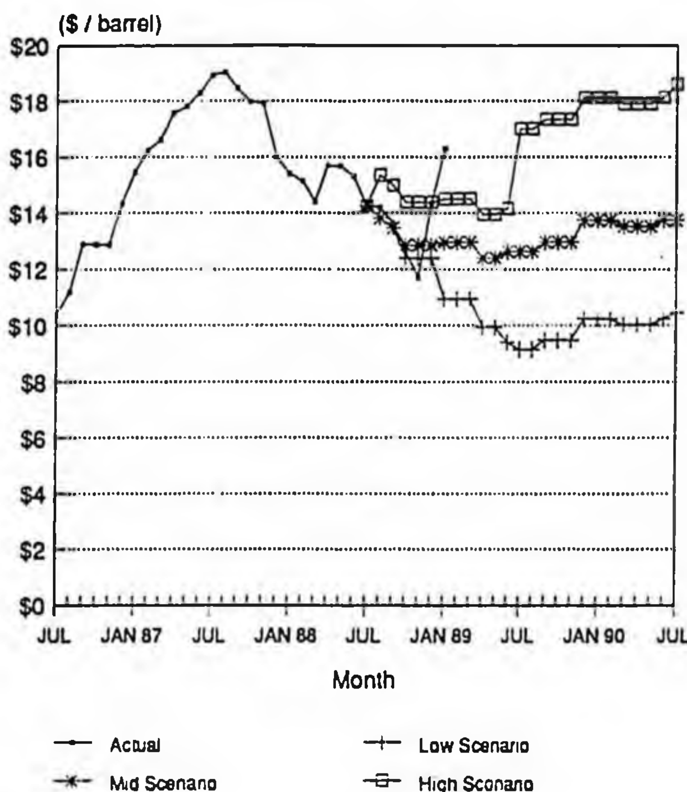
March 1989

The purpose of this note is to briefly update the oil revenue situation to reflect events which have occurred since our last revenue forecast released November 1988.

Oil Prices

World oil prices have remained strong through December and January in response to the November OPEC production agreement. It appears that OPEC production has averaged 19.5 million bbl/day through January. Although this is 1 million bbl/day over the agreed upon quota, strong demand and supply disruptions in the North Sea have kept Saudi Light oil prices near $15.00/bbl on the spot market. BP Exploration, the largest producer of Alaska North Slope (ANS) crude oil, recently announced a February price for ANS of $16.30/bbl for Gulf Coast delivery. The figure below illustrates the current Department of Revenue scenarios and actual ANS Gulf Coast prices.

ANS at the U. S. Gulf
(Nominal data)



The TAPS tariff filing for calendar 1989 sets the average tariff for the pipeline at $3.01/bbl. This is $0.04/barrel higher than assumed in the Fall Forecast.

Oil Production

Production from Alaska's North Slope held firm through year end at well over 2.0 million bbl/day. It is still not clear if the production slide at Prudhoe Bay of 50,000 bbl/day, which ARCO envisions, can be avoided in calendar 1989. Based on preliminary information from Conoco, it looks like Milne Pt. may recommence production sometime this Spring barring another price drop.

Oil Revenues

Higher prices, and higher than expected production through year-end result in a slightly improved outlook for the remainder of the fiscal 1989. The high scenario we developed last Fall outlined a revenue stream predicated on a successful OPEC production agreement. So far events outlined in the high scenario continue to unfold with the result being oil prices which correspond roughly to those characterizing this scenario. For example, under the high scenario the world economy was expected to increase at 3.5% in both 1989 and 1990. OECD growth appears to have been 4 percent for 1988. World oil consumption growth for 1988 has been revised upward by Energy Security Analysis, Inc. to an estimated 3.6%, or about 1.8 million barrels/day. The The high scenario assumes a growth in demand of 1.5 million barrels/day for 1989 and 1990. In the November OPEC meeting Iran and Iraq were given a quota of 2.6 million barrels/day, about 14% higher than the 2.3 million barrels/day of production from these countries assumed by the high scenario. The high scenario was based on a total OPEC quota of 18.7 million barrels/day, with continued cheating by the member counties. The current OPEC quota is 18.5 million barrels/day. Over production by member countries has resulted in an estimated production in January of 19.5 million barrels/day.

There is, however, no guarantee that conditions within OPEC will remain the same. In particular the seasonal drop in oil consumption during the second quarter may present serious problems to cartel cohesiveness.

Table 1 outlines the price/revenue sensitivity for the remainder of FY 1989 and FY 1990. The FY 1989 outlook incorporates our most recent data on actual revenue collections through December and substitutes current spot market price data for January 1989. A summary of the current mid case assumptions, as well as actual collections through December production month and corresponding January revenue month, is shown on Table 2.

Table 1

PRICE/REVENUE SENSIVITY SCHEDULE
Unrestricted State Revenue[1]
(Millions $)

ANS Price Lower 48[2]	FY 1989	FY 1990
$10 /bbl	1724	1139
11	1769	1238
12	1827	1373
13	1885	1507
14	1943	1641
15	2001	1775
16	2060	1909
17	2117	2043
18	2176	2178
19	2240	2312
20	2292	2446

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[1] Based on Department of Revenue mid scenario assumptions Fall 1988 Forecast updated for actual marketing and production data through December 1988, new 1989 TAPS tariff filing, and spot price information for January 1989.

[2] The average ANS price for all lower 48 sales is approimately $0.80/bbl less than the U. S. Gulf price.

Table 2

Updated with actual data thru DEC/JAN FY 1989 and calendar year 1989 TAPS filing   Spot prices added for JAN/FEB   Assumptions based on October 1988 forecast by DOR - Mid scenario   14 Feb 89

PRODUCTION/REVENUE MONTH/FY	1988	JUNE/JUL	JULY/AUG	AUG/SEP	SEP/OCT	OCT/NOV	NOV/DEC	DEC/JAN	JAN/FEB	FEB/MAR	MAR/APR	APR/MAY	MAY/JUN	1989	90-Q1	90 Q2	90 Q3	90 Q4	1990
14 OPEC MARKER - $/bbl	16 2900	14 3100	13.3200	13 3100	11 8100	10 4600	10 6100	12 6800	14 3667	12 5000	12 5000	12 0000	12 0000	12 4889	11 5300	11 8300	12 5300	12 3300	12 0550
15 TRANS & MARKET DIFFERENTIAL	0 5389	1.0700	0.9700	0 8900	1 8200	2 1900	1.1000	0 1079	1 9333	0 4470	0 4470	0 3880	0 3880	0 9793	0 8580	0 7830	0 8776	0 8306	0 8373
16 AVG. ANS OIL PRICE @ U.S. GULF $/bb	18 0289	15 3000	14.2900	14 2000	13 6300	12 6500	11.7100	12 7879	16 3000	12 9470	12 9470	12 3880	12 3880	13 4682	12 3880	12 6130	13 4076	13 1606	12 8923
17 AVG. ANS OIL PRODUCTION MMbbls/day	1.8940	1.8399	1.9160	1.9654	1 9748	1.9674	1.9833	1 9510	1 9270	1 9270	1 9270	1 9270	1 9270	1 9444	1 8310	1 8290	1 8290	1 8290	1 8295
18 AVERAGE ANS WEST/GULF MARKET DIFFER	2.4796	-0.4878	-0.8756	-0 5250	-0 6687	-0.5837	-0.7966	-0.7438	-0 5230	-0 5330	-0 5430	-0 5390	-0 5490	-0 6140	-0 5810	-0 6190	-0 6640	-0 6880	-0 6380
19 TRANSPORATION TO U.S. GULF		2.7820	3.1640	2 7186	3 0014	3 0527	2 8004	2 7399	3 1730	3 1830	3 1930	3 1890	3.1990	3 0163	3 2310	3 2690	3 3140	3 3380	3 2880
20 AVG. TAPS TARIFF $/bbl	3.6827	3.1860	3.1770	3.1700	3.1640	3.1610	3 1660	3.1611	3 0100	3 0100	3 0100	3 0100	3 0100	3.1029	3 0100	3 0100	3 1310	3 1440	3 0738
21 AVG. NON PRUDHOE TCOST/QUAL/MKTDIF	0.1984	0.1984	0.1984	0.1984	0.1870	0.1870	0 1870	0.1872	0.1872	0 1872	0 1871	0 1871	0.1871	0.1899	0 1866	0 1866	0 1866	0 1866	0 1866
22 WT. AVG. ANS OIL ROY WHV $/bbl	10.4682	9.7012	8 6262	8 6380	7.9463	6 8330	6 3532	7.4435	10.4528	7 0998	7 0999	6 5409	6.5409	7.7730	6 5414	6 7664	7 4400	7 1800	6 9820
23 AVG. CGF NGL MM bbl/DAY	0.0457	0.0587	0 0547	0 0555	0.0604	0.0597	0 0612	0 0607	0 0550	0 0550	0 0550	0 0550	0 0550	0 0572	0 0543	0 0540	0 0540	0 0593	0 0554
24 AVG. PROCESS COST NGL	5 5200	5 5200	5 5200	5 5200	5.5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200
25 DAYS IN PRODUCTION MONTH/YEAR	368	30	31	31	30	31	30	31	31	29	31	30	31	365	92	92	90	92	365
26 AVG. PET REV ELF	0.7950	0.7963	0.7938	0.7930	0.7906	0.7876	0.7863	0.7835	0.7898	0.7896	0 7894	0.7892	0.7890	0 7899	0.7807	0.7609	0 7644	0 7637	0 7674
27 SEVERANCE RATE ADJ. FACTOR	0 9939	0.9707	1.0010	0 9772	0 9651	0 9942	1 0282	1.0046	0 9894	0 9862	0 9850	0 9914	0 9912	0 9981	0 9831	1 0143	1 0261	1 0058	1.0073
28 AVG. EFFECT FLOOR ADJ ELF	0.7902	0.7730	0.7946	0.7749	0 7630	0.7830	0 8085	0.7871	0 7815	0 7787	0 7776	0 7825	0 7821	0 7822	0 7675	0 7718	0 7843	0 7682	0 7729
29 WT. AVG. NOMINAL SEV TAX RATE	0.1496	0.1480	0.1480	0.1481	0.1481	0.1481	0.1491	0.1481	0 1479	0 1479	0 1479	0 1479	0 1479	0 1480	0.1477	0 1477	0 1477	0 1477	0 1477
30 ANS OIL SEVERANCE TAX MM$	789 8297	56 4826	52 6900	52.7948	46 5105	42.2525	39.5738	45.8803	63.1047	39 9555	42 6497	38 2626	39 5202	559 6773	109.1890	113 4763	124 0300	119 8400	466 5353
31 ANS NGL SEVERANCE TAX MM $	7.2386	0 6438	0.4604	0.4692	0 3845	0 2124	0.1339	0.3164	0.7353	0 2203	0 2355	0.1473	0.1522	4 1111	0 4462	0 5412	0 8155	0 7920	2 5949
32 ANS TOTAL OIL&NGL SEVERANCE TAX MM	797 0683	57.1263	53.1504	53.2640	46 8949	42 4649	39.7077	46.1968	63 8401	40 1758	42 8852	38 4099	39 6724	563 7884	109 6352	114 0175	124 8455	120 6320	469 1302
33 ANS OIL CONSERVATION TAX MM $	2 4319	0 2036	0.2078	0 2132	0 2073	0 2147	0.2082	0.2110	0 2100	0 2000	0 2100	0 2000	0 2100	2.4959	0 5800	0 5800	0 5800	0 5900	2 3200
34 AVG. ANS OIL ROYALTY RATE	0.1254	0.1257	0.1257	0.1257	0 1257	0.1257	0.1257	0.1257	0.1257	0 1257	0 1257	0 1257	0 1257	0.1257	0 1260	0.1260	0 1260	0 1260	0 1260
35 ROYALTY RATE ADJ. FACTOR	0 9918	1.0332	1.0303	0 9504	0 9649	0.9510	0.9536	0.8547	0.9963	0 9928	0 9918	0 9936	0 9938	1 0132	1 0111	1 0224	1 0356	1.0149	1 0210
36 EFFECTIVE ROYALTY RATE	0.1244	0.1299	0.1305	0.1195	0.1213	0.1195	0.1199	0.1074	0.1252	0.1248	0 1247	0 1249	0.1249	0 1227	0 1274	0.1288	0.1305	0.1279	0 1286
37 AVG. ROY FIELD COST DEDUCT $/bbl	0.5790	0.6500	0.6500	0.6500	0.6500	0.6500	0.6500	0.6500	0 6521	0 6543	0 6564	0.6586	0 6607	0 6527	0 6591	0 6656	0 6722	0 6788	0 6689
38 ANS OIL ROYALTIES B4 PF&PSF CONTRIB	897.6531	68.4139	61.8312	58.1441	52.4285	45.0786	40 6759	44.1424	73 3201	44 9522	47.9849	42 4723	43 8791	623 3232	126 2430	132 2397	145 3700	139 8900	543 7427
39 ANS NGL ROYALTIES B4 PF CONTRIB	10.3787	0 9255	0.6620	0.6746	0.5527	0.3054	0.1024	0.4550	1.0572	0 3167	0 3386	0 2117	0 2188	5 9107	0 6433	0.7802	1.1757	1.1417	3 7410
40 TOTAL ANS OIL&NGL ROYALTIES B4 PF M	908.0318	69.3394	62.4932	58 8187	52 9812	45.3839	40 8684	44.5973	74 3773	45 2690	48 3235	42 6840	44 0979	629 2339	126 8863	133 0199	146 5457	141 0317	517 4837
41 ANS OIL ROY PF&PSF GF ADJ FACTOR	0.7450	0.7398	0.7398	0.7398	0.7398	0.7398	0 7398	0.7398	0.7398	0 7398	0 7398	0 7398	0 7398	0 7398	0.7395	0 7395	0 7395	0 7395	0.7395
42 ANS OIL ROYALTIES NET GF MM$	676.4837	51.2973	46 2325	43 5141	39.1955	33.5750	30 2344	32.9931	55 0243	33 4900	35 7497	31 5777	32 6236	465 5072	93 8324	98 3682	108 3706	104 2930	404 8642
43 TOTAL GF ANS OIL PRODUCT REVS MM $	1475.9838	108 6273	99 5908	86 9913	86 2977	76 2546	70.1503	79 4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031.7915	204 0477	212 9657	233 7961	225 5049	876 3144
44																			
45 ANS OIL PRODN REV CURRENT FY MOLY CASI	FLOW ANALYSIS AND COMPARISON WITH OFFICIAL DOR FORECAST																		
46 GF ANS OIL PROD REV ACT COLL	1475 9838	108 6273	99.5908	86.9913	86 2977	76.2546	70.1503	79.4009											
47 LAST DOR REVENUE FORECAST (OCT88)	1475 9838	108 2807	98 2827	8? 5195	79 8616	77.9302	75 3884	77.8927	79 7896	74 3863	79 3770	70 6931	73 0164	983 4183	205 3520	214 1787	233 7961	225 5049	878 8326
48 UPDATED DOR ANS REVENUE FORECAST	1475 9838	108 6273	99.5908	[illegible].913	86 2977	76.2546	70.1503	79.4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031.7915	204 0477	212 9657	233 7961	225 5049	876 3144
49																			
50 UPDATED REVENUE FORECAST DIFFERENCE	0 0000	0.3466	1.3081	8.4717	6 4361	-1.6756	-5.2381	1.5082	39.2848	-0 5205	-0 5321	-0 5055	-0 5104	48 3733	-1 3052	-1 2131	0 0000	0 0000	-2 5182
51 YTD CUM UPDATED FORECAST DIFFERENCE	0 0000	0 3466	1.6547	10.1264	15 5625	14.8869	9.6488	11.1570	50 4418	49 9213	49 3892	48 8837	48 3733	48 3733	-1 3052	-2 5182	2 5192	2 5182	2 5182

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Actual Data

ADMINISTRATION PRESENTATION ON HOUSE BILL 118--
LEGISLATION REVISING THE ECONOMIC LIMIT FACTOR (ELF)
HOUSE RESOURCES COMMITTEE
FEBRUARY 9-10, 1989

Thursday, February 9, 1989

I. INTRODUCTION TO ALASKA'S OIL REVENUES AND TAXATION

A. Overview

B. Alaska's Oil Revenues

1. Severance Tax
2. Income Tax
3. Property Tax
4. Royalties

C. The Severance Tax and the ELF

1. Importance of Severance Tax to Alaska's Revenues
2. Definition of ELF
3. Application of ELF to Produce Effective Tax Rate

II. HISTORY OF ELF

A. 1977 Creation

B. 1981 Oil Tax Changes

1. Income Tax
2. Severance Tax
3. Comments of Policymakers

C. 1987 --End of suspension on Prudhoe Bay

III. HB 118

IV. ELF'S EFFECTS ON ALASKA FIELDS

A. Fields Where ELF Will Increase Under HB 118

1. Prudhoe Bay
2. Kuparuk

B. Marginal Fields -- Fields Where ELF Will Decrease Or Remain at Zero Under HB 118

1. Endicott
2. Lisburne
3. Cook Inlet
4. West Sak
5. Niakuk
6. Milne Point
7. Point Thomson
8. Seal Island

V. THE ELF AND ALASKA'S REVENUES

A. Marginal Fields -- Tax Savings for Oil Producers

B. Large, High-Profit Fields of Prudhoe Bay and Kuparuk -- Increased Revenues for the State

Friday, February 10, 1989

VI. PROFITS AND RE-INVESTMENT OF THE OIL INDUSTRY IN ALASKA

VII. COMPARISON OF GOVERNMENT REVENUE FROM OIL PRODUCTION BETWEEN ALASKA AND OTHER OIL-PRODUCING AREAS

VIII. EFFECTS OF CHANGING ELF ON JOBS FOR ALASKANS

IX. EFFECTS ON CHANGING ELF ON PRODUCTION

X. WAS THERE A DEAL IN 1981?

XI. WAS THERE A DEAL IN 1987?

ADMINISTRATION TESTIMONY ON HB 118

BRIEFING MATERIALS

HB 118
Modifying the ELF

Briefing materials provided to the:

Alaska State House of Representatives
Resources Committee
Rep. Cliff Davidson, Co-Chairman

Office of the Governor
Division of Policy
February 10, 1989

"The session of the 15th Territorial Legislature just concluded brings out more clearly than ever the basic issue that confronts the people of Alaska. That issue is whether Alaska shall be built up for Alaskans..., or whether it shall continue to be governed for and by outside interests whose sole concern is to take out of Alaska as much as they can, as fast as they can, and leave as little as possible."

Governor Ernest Gruening
Message to the people of Alaska
March 28, 1941

"We must have stable tax policies in order to make the risks associated with marginal fields worth taking."

Mr. George Nelson
Sohio Alaska Petroleum Company
as quoted in the Alaska Journal of Commerce and Pacific Rim Reporter
March 11, 1985

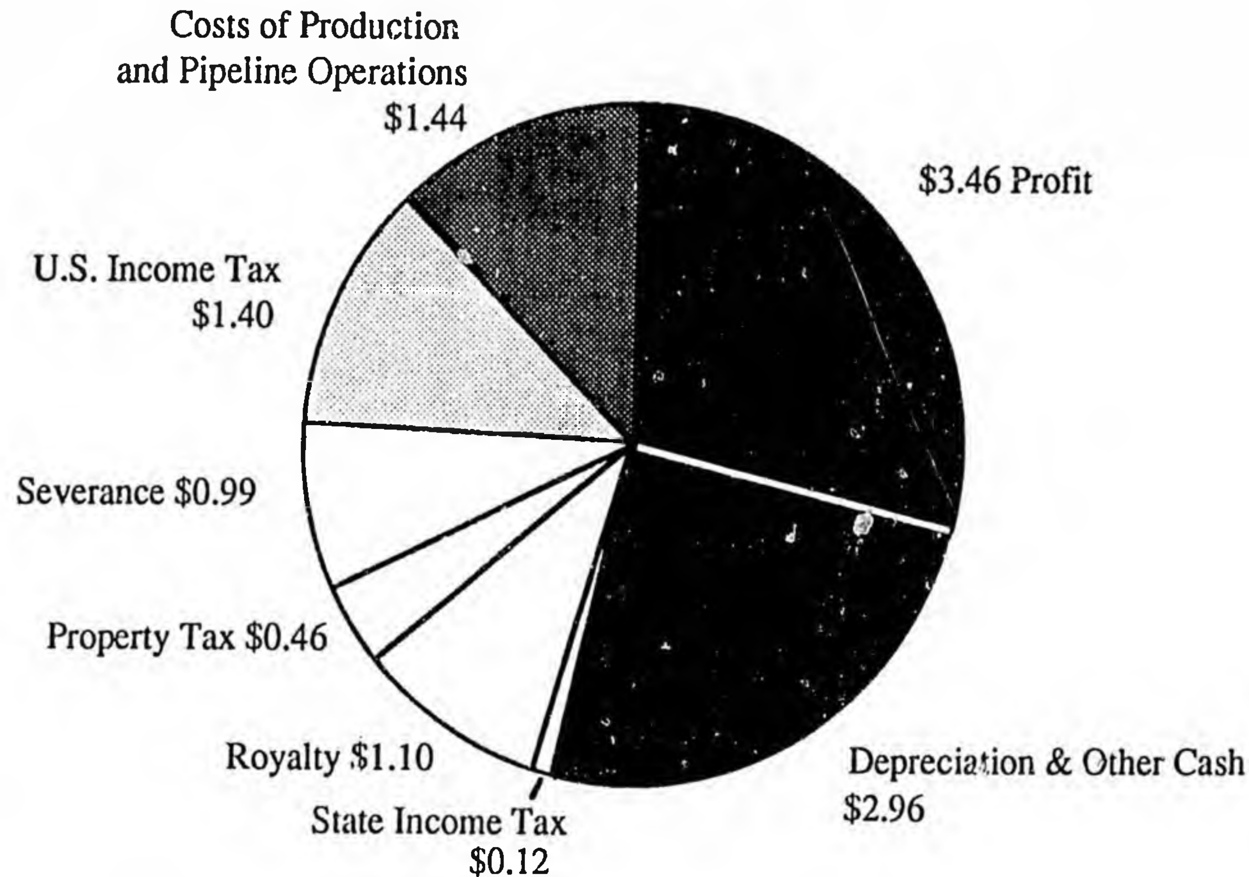
"The state must provide an investment climate that will encourage oil companies and other businesses to develop new ventures....[S]maller fields already have been discovered on the North Slope. But they are marginal fields...."

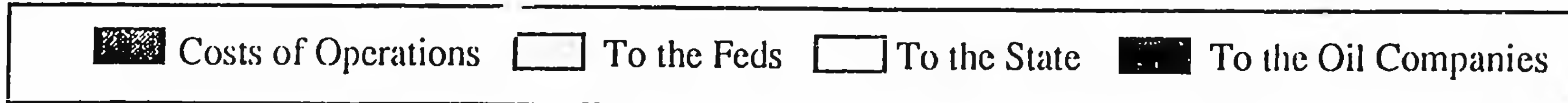
ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 14, 1985

Chart 1

In February 1988, A Barrel of Oil at Valdez Was Worth $11.93.

This is how the $11.93 Was Divided:





Division of Policy, 9/9/88

"[A]s my profit decreases I have less money to invest....But what is a reality and what you need to understand is that the amount of money I have to spend affects the pace at which things happen. And the pace at which things happen, in terms of employment, means the Alaskan economy. If we slow down our investment pattern because of a lack of funds, because of discouragement of investment in Alaska...that has an effect on the economy of Alaska."

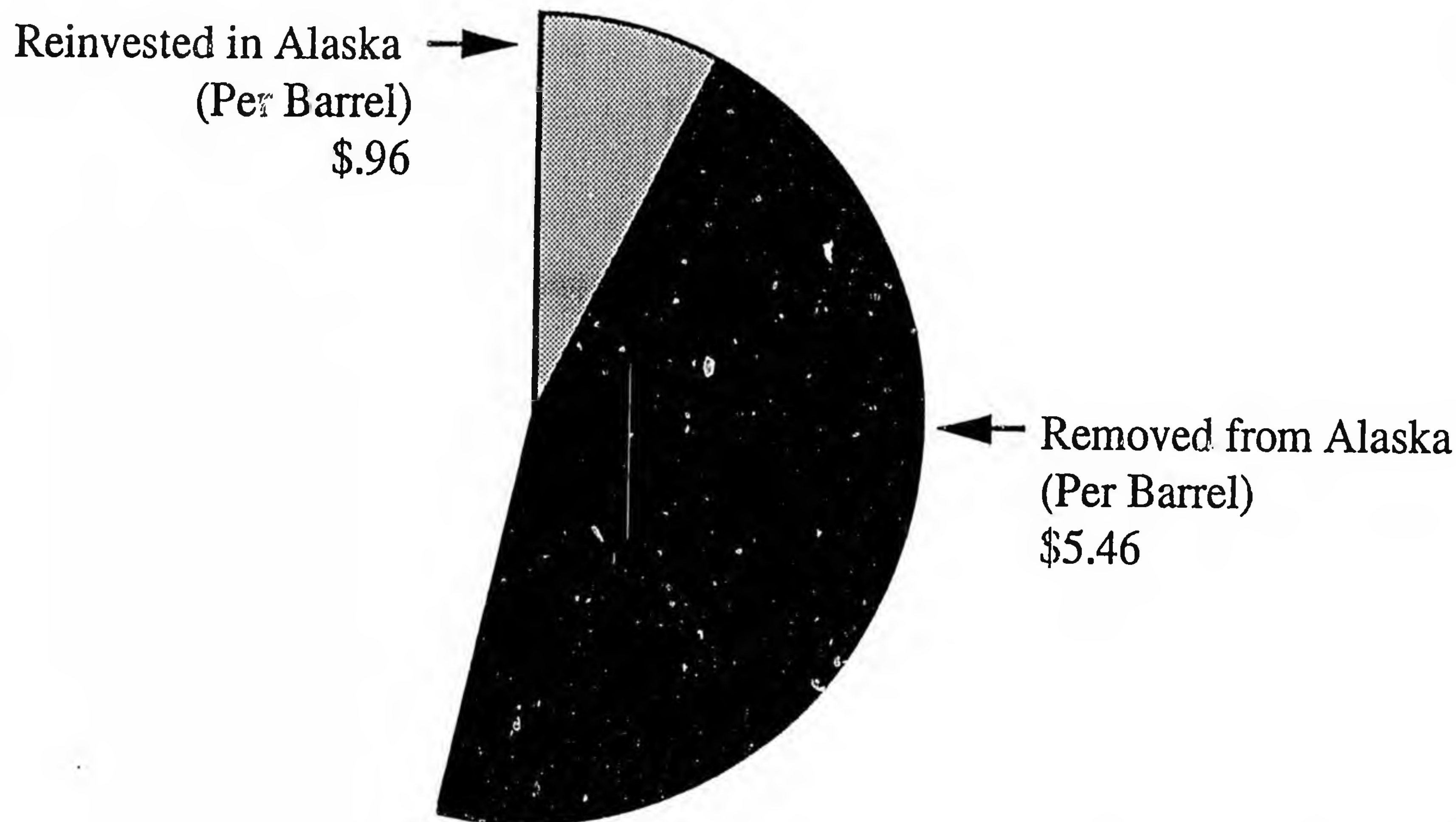
Mr. Harold Heinze
ARCO Alaska Inc.
Testimony to the House finance Committee
April 12, 1985

"If the state government increases our taxes we will have less cash to develop new fields."

ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 7, 1985

Chart 3

How Much Money Do The Oil Companies Reinvest in Alaska?



Division of Policy, 9/9/88

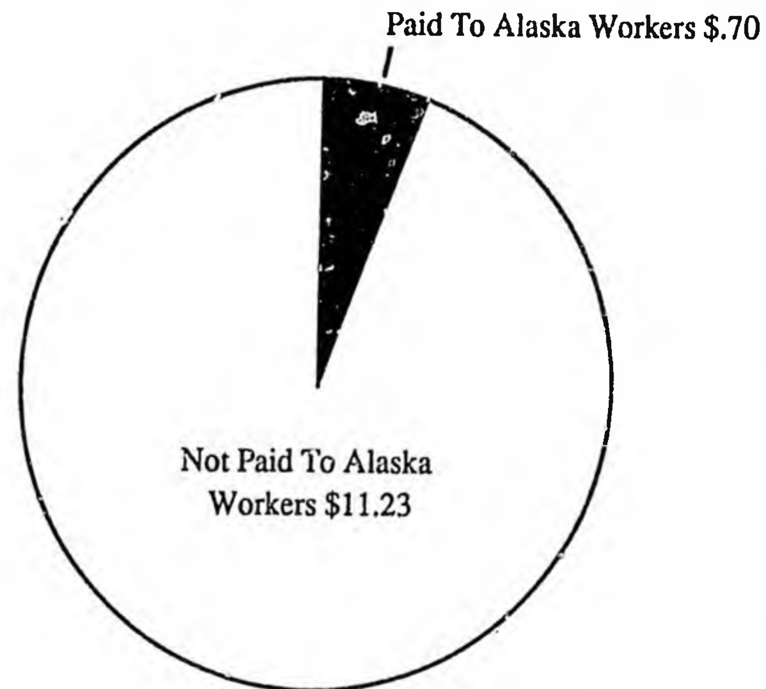
U.S. oil companies are in the process of liquidating. U.S. oil reserves are the leftovers of an enormous feast. Faced with a relentlessly declining reserves base, a good management is one that can intelligently liquidate its asset base.

Robert O. Anderson
former chairman and CEO
Atlantic-Richfield Co.
January 14, 1988

Chart 4

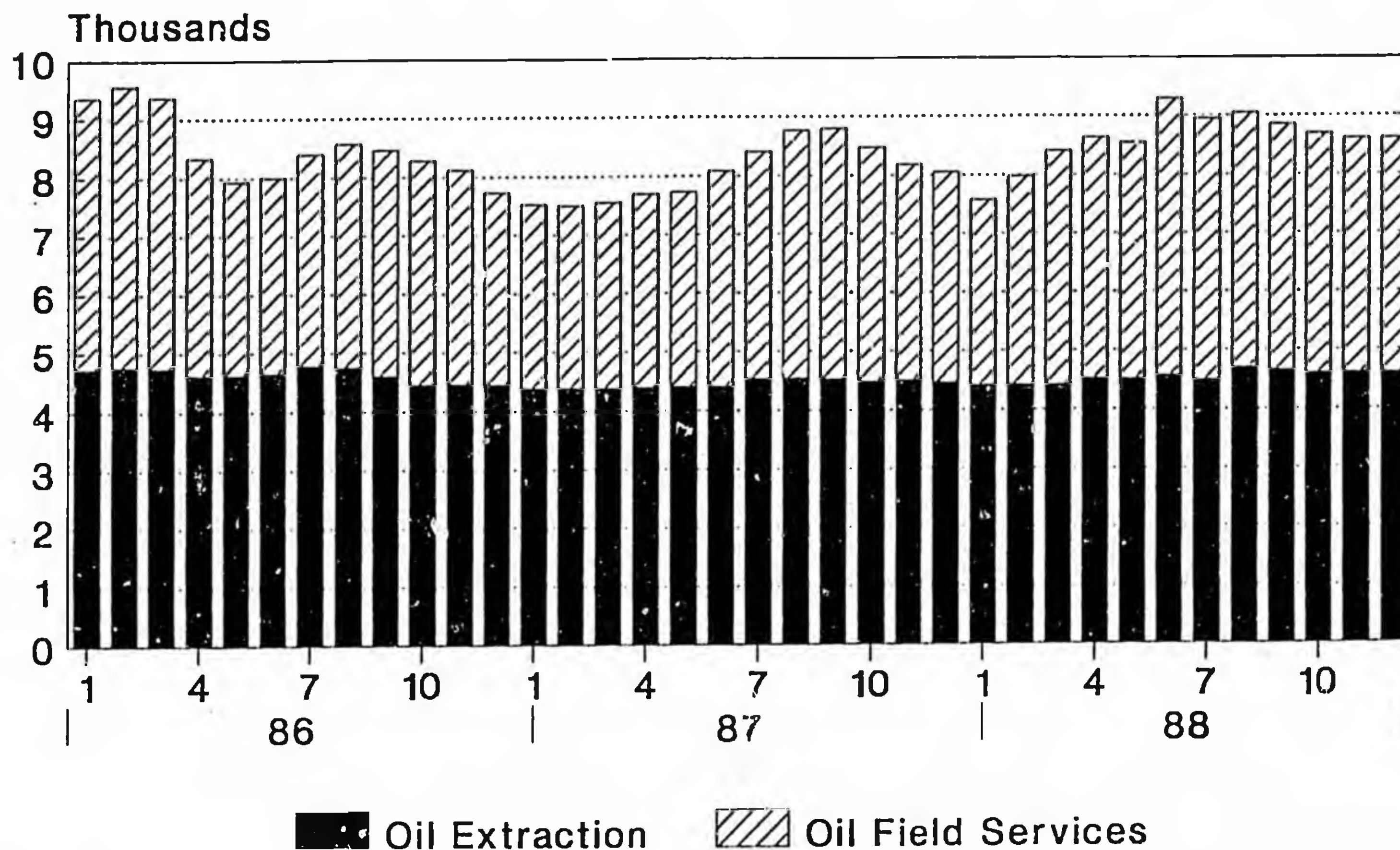
How Much of The $11.93 Revenue Per Barrel Gets Paid To Alaska Workers?

($/Barrel)



Division of Policy, 9/9/88

Alaska Oil Industry Employment
1986-1988



Source: Alaska Dept. of Labor
BLS 790 Survey