

12284

HOUSE RES



Goals for Fiscal Design

- **Based on hearings, discussions and other dialog we see the following as the goals you are trying to achieve in this special session:**
 - Fields with larger **profitability** should be paying more taxes
 - Encourage investment in existing units
 - Reinvestment in producing assets
 - Investment in new developments
 - ❖ Conventional
 - ❖ Unconventional (i.e. heavy oil)
 - Encourage new investment outside legacy units
 - Level playing field for incumbents and new entrants
 - Durability
 - Don't want to be back 'fixing' things
 - Build on prior tax dialogue



Encourage New Investment

- **Fiscal system should encourage investment in new fields**
 - Investment credits
 - Net Operating Loss credits
 - Aid to new entrants with no existing tax base
 - Lower tax rate for fields with higher cost structure
 - More distant from infrastructure
 - Heavy Oil
 - Gas
- **Is base rate low enough?**
 - Additional barrels down TAPS extends production from existing reservoirs



The Fiscal Design Challenge

- **The Take**

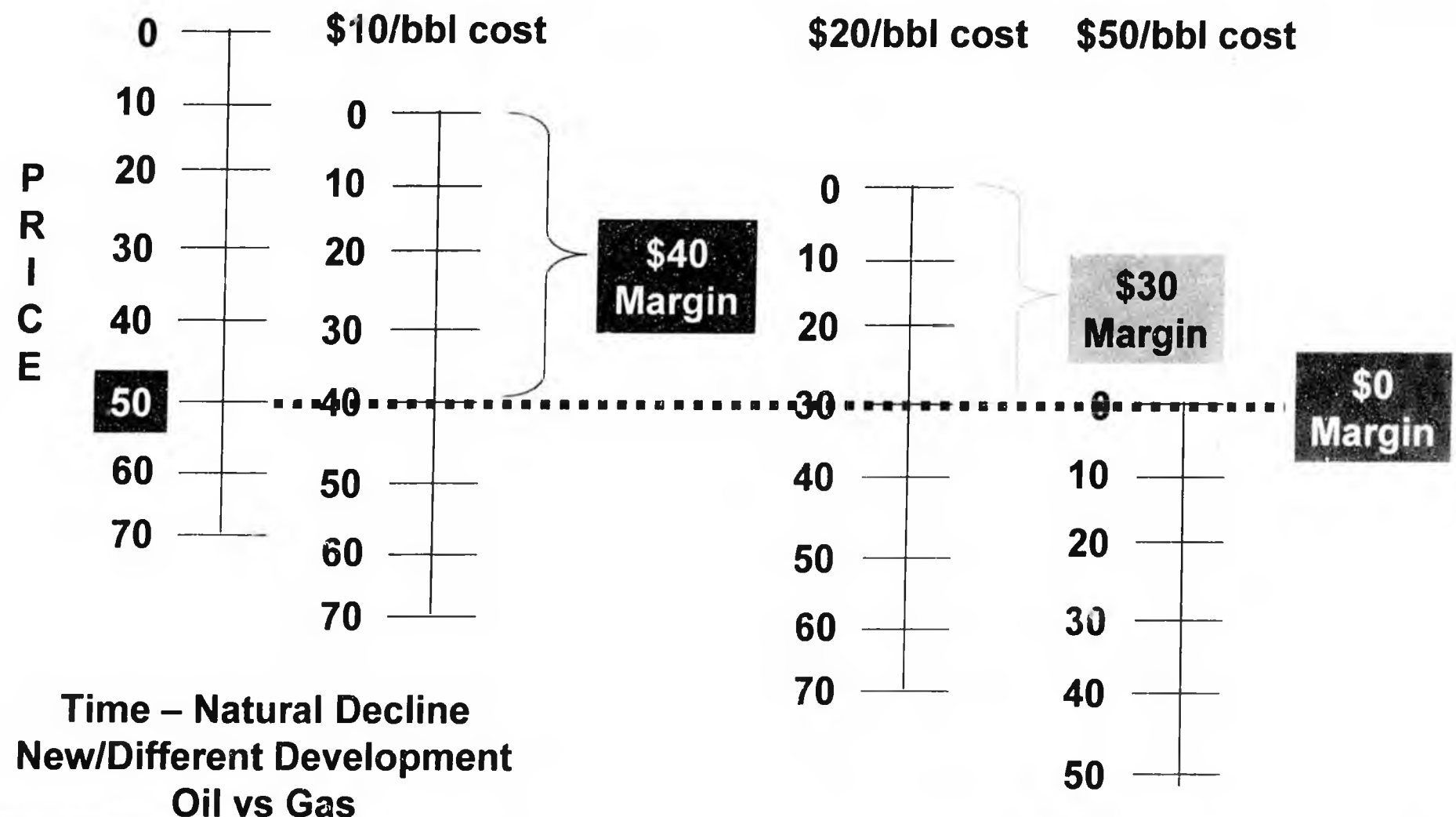
- Fair share of the high margins currently being realized
- Progressive structure to adapt to changes in:
 - Price
 - Production
 - Cost

- **The Give Back**

- Encouragement to reinvest profits for more development inside legacy units

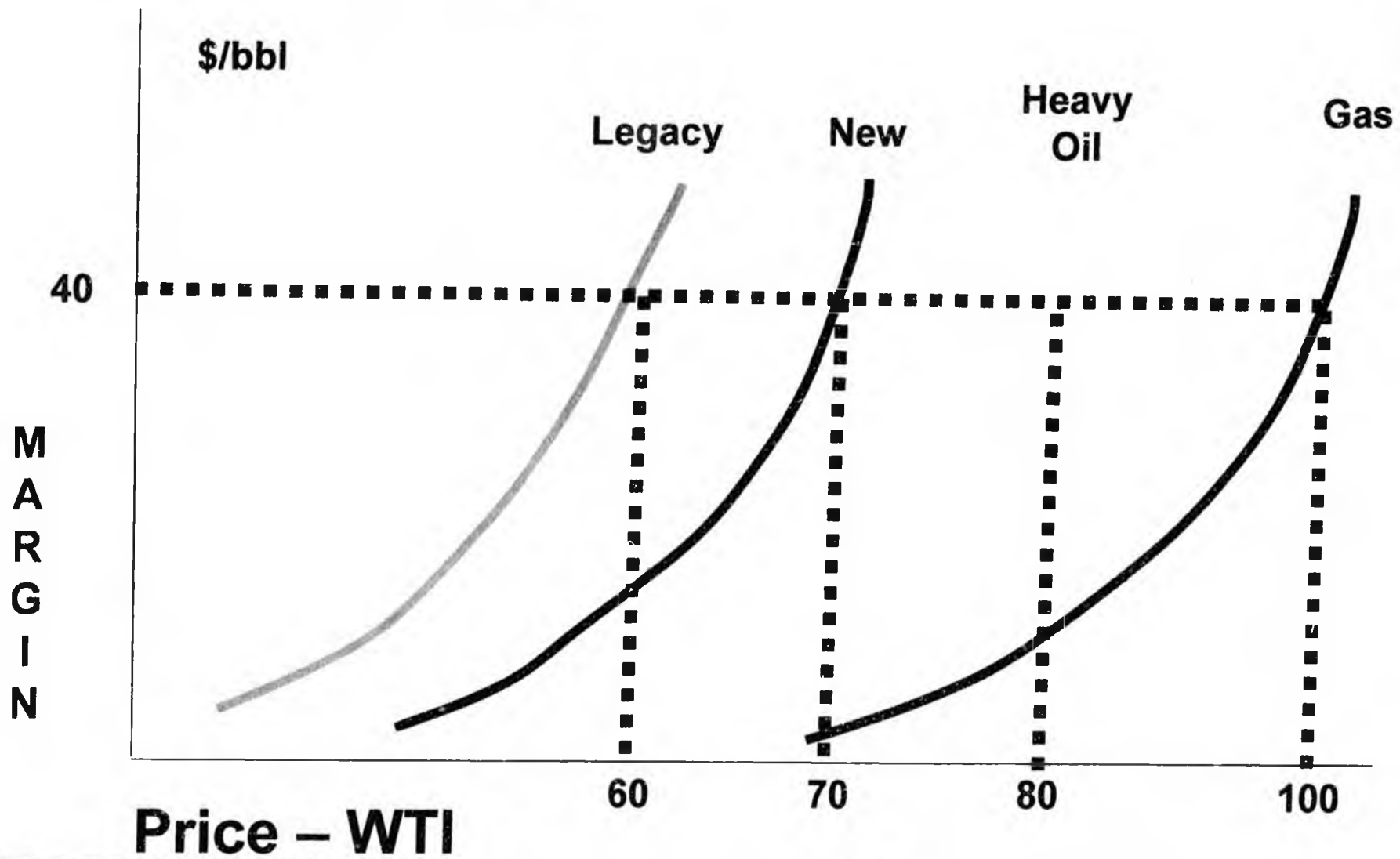


Price versus Margin



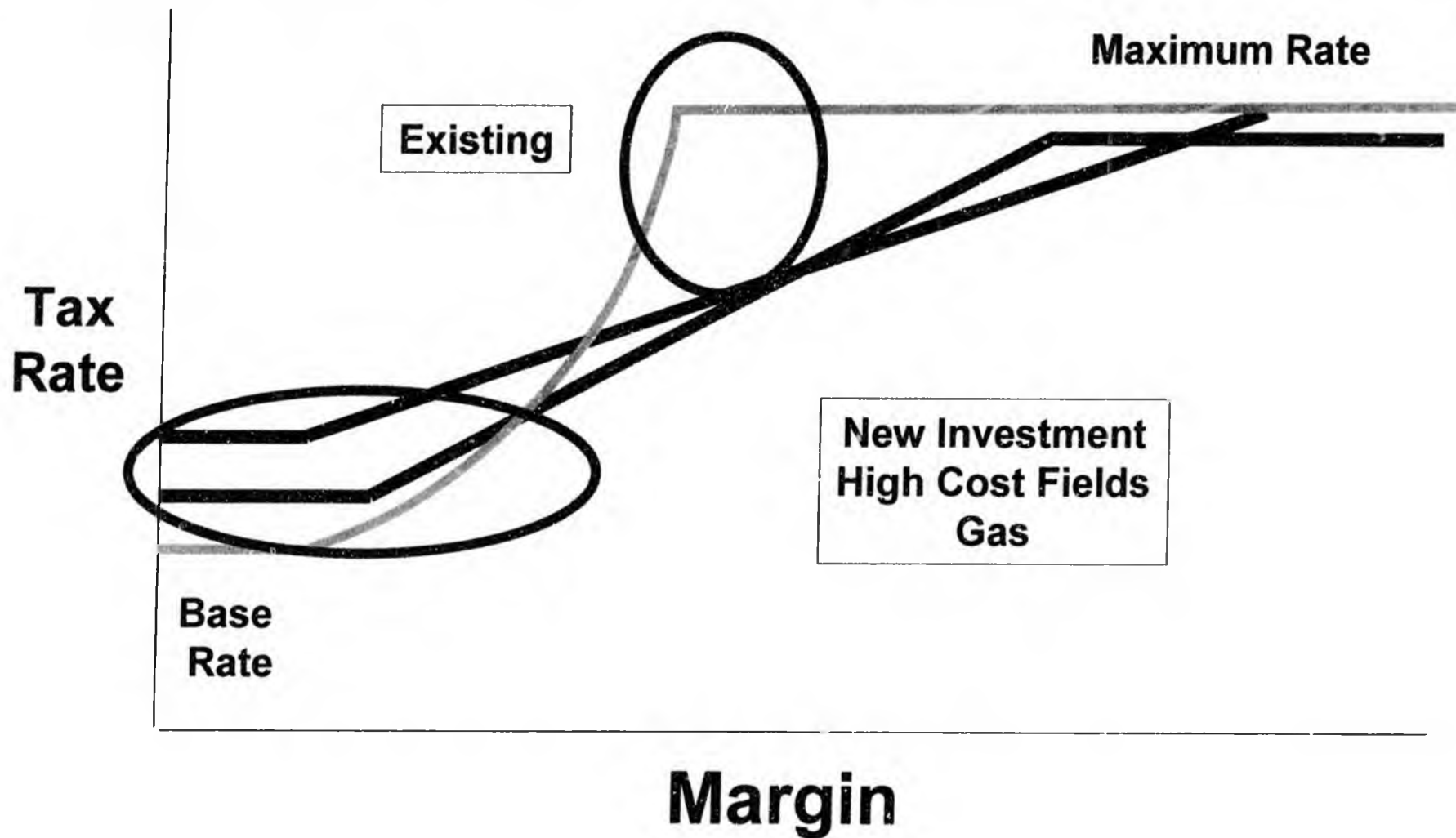


Margin versus Price





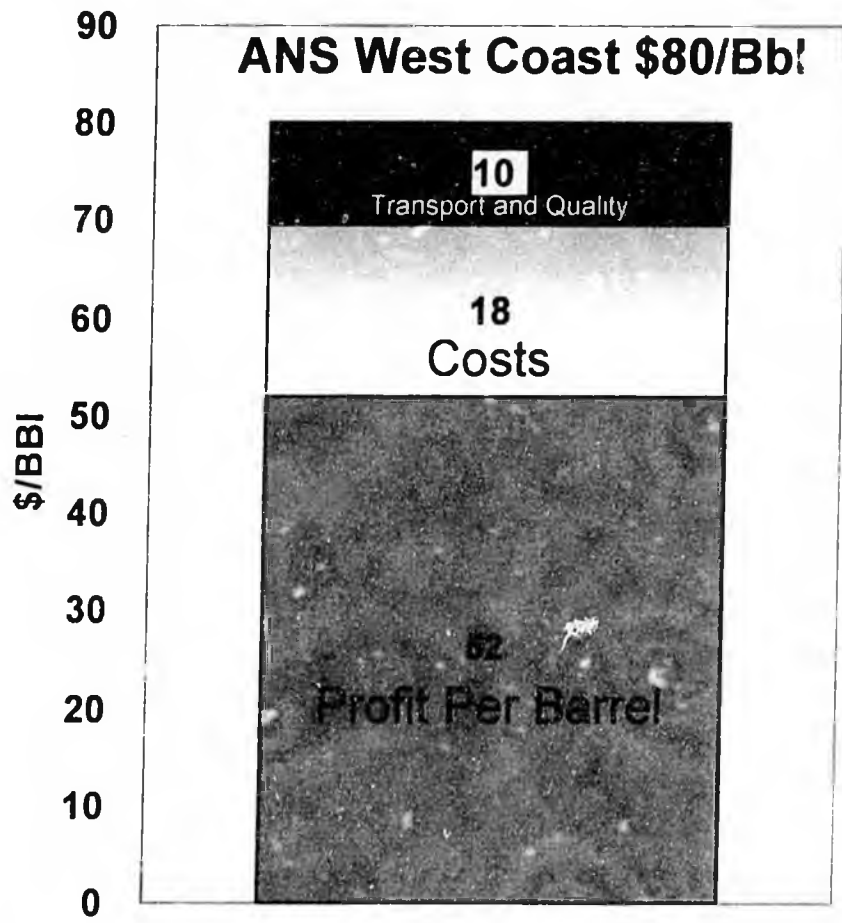
Pulled Into a single mechanism





The Information Used

Portfolio Profitability



The Net Tax Story



PPT As Often Described

- Tax on net profits
- Contains progressivity feature that increases tax rate with increasing profitability per barrel
- Ringfenced so that profit per barrel reflects a company's entire portfolio

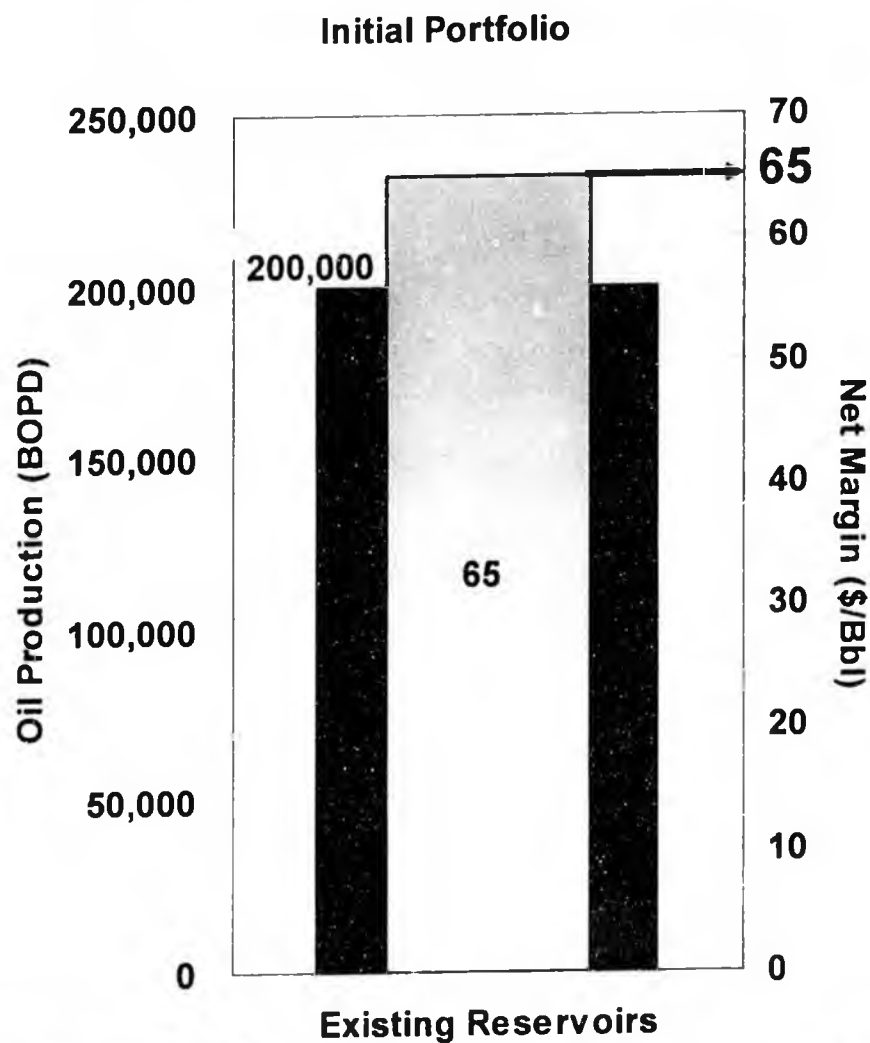
Progressivity



- **“Net” taxes all fields at a single rate**
 - No, it taxes different fields or reservoirs based on their individual profitability



Start With A Portfolio Of One Investment



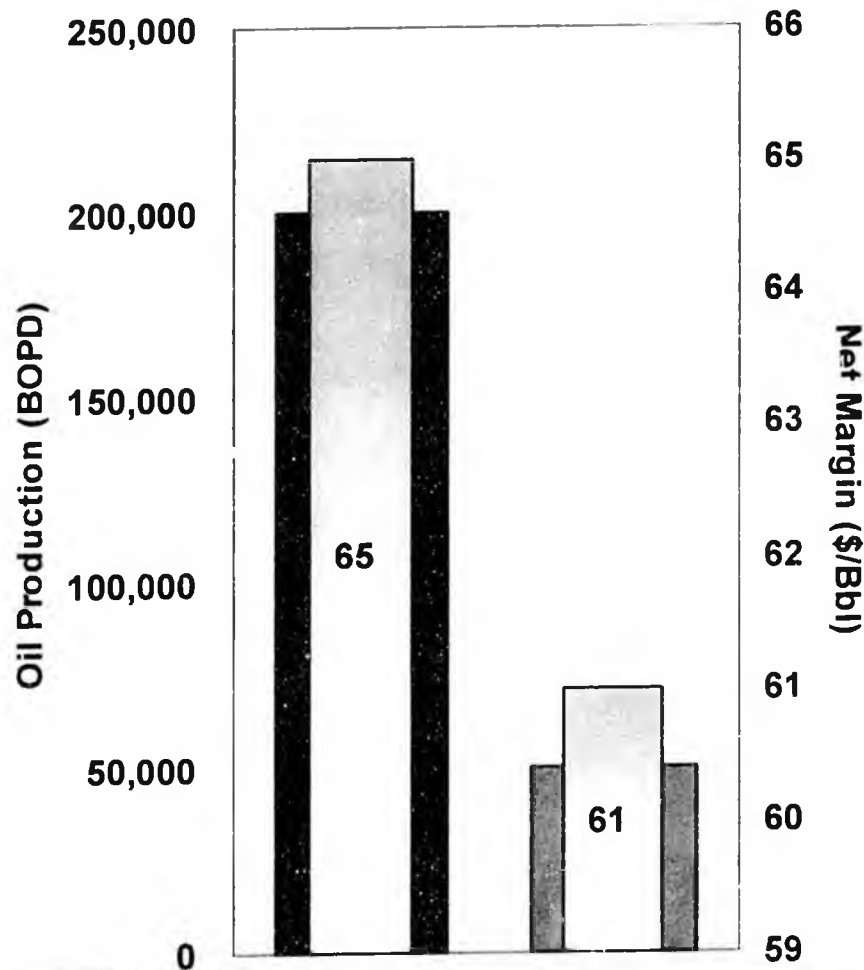
PPT Rate on this would be
28.4%

Understanding The Rate Structure



Now, Add Another Field

Expanded Portfolio



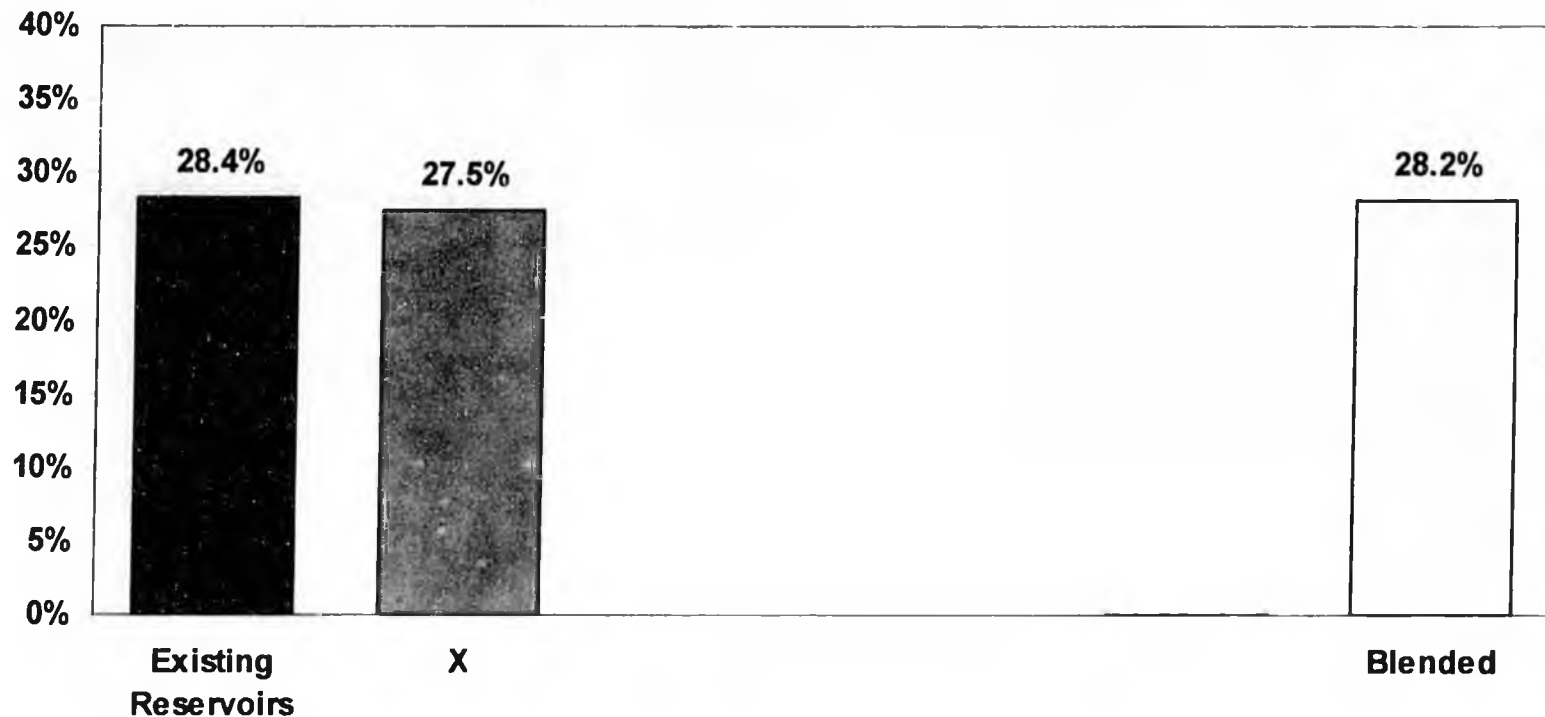
**PPT Rate on these fields
Combined would be
28.2%**

**Average Net Margin Is
\$64.20**

So, Does That Mean I Am Paying 28.2% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending



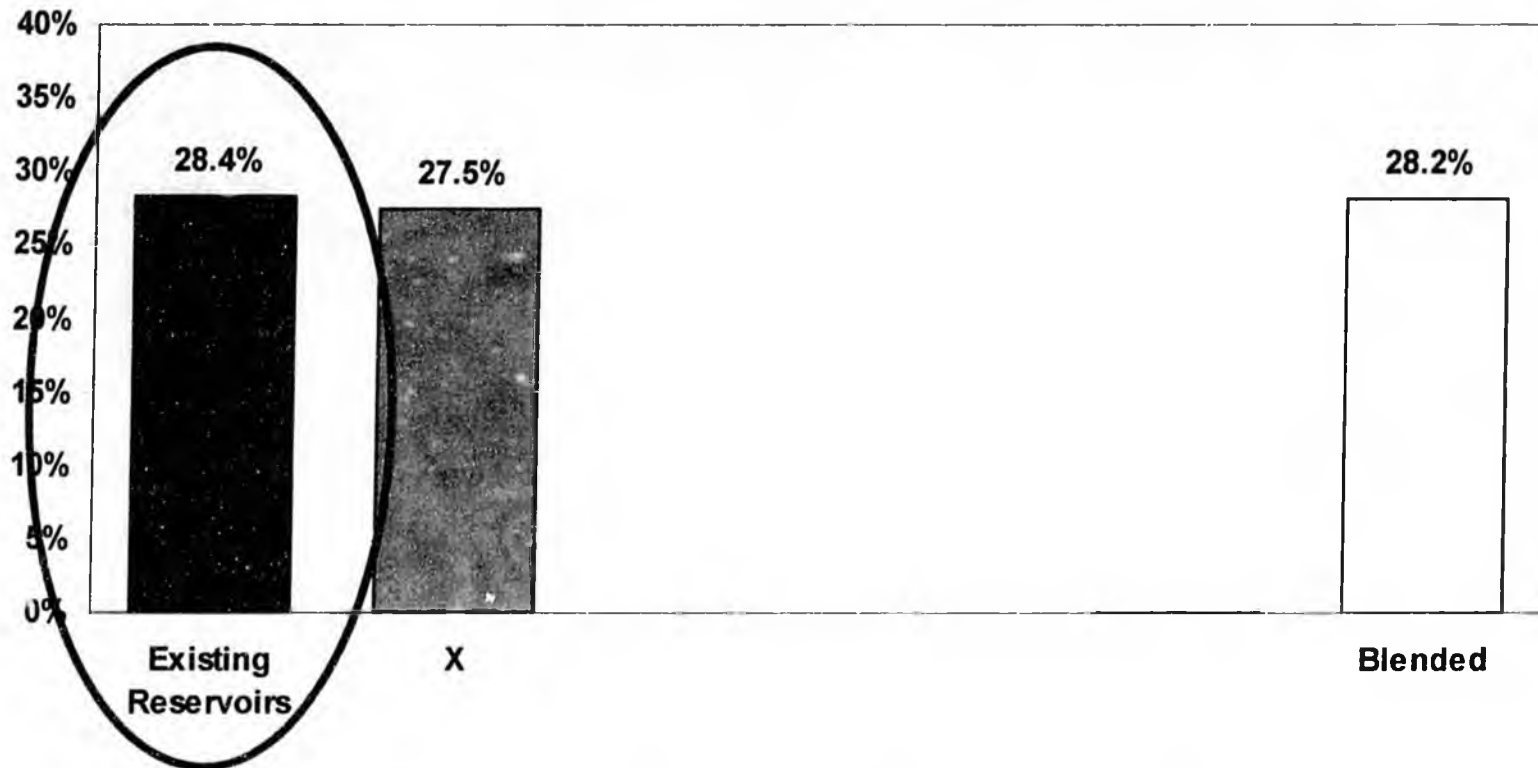
No

Look at this in the way that companies look at it when they make investment decisions

So, Does That Mean I Am Paying 28.2% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending

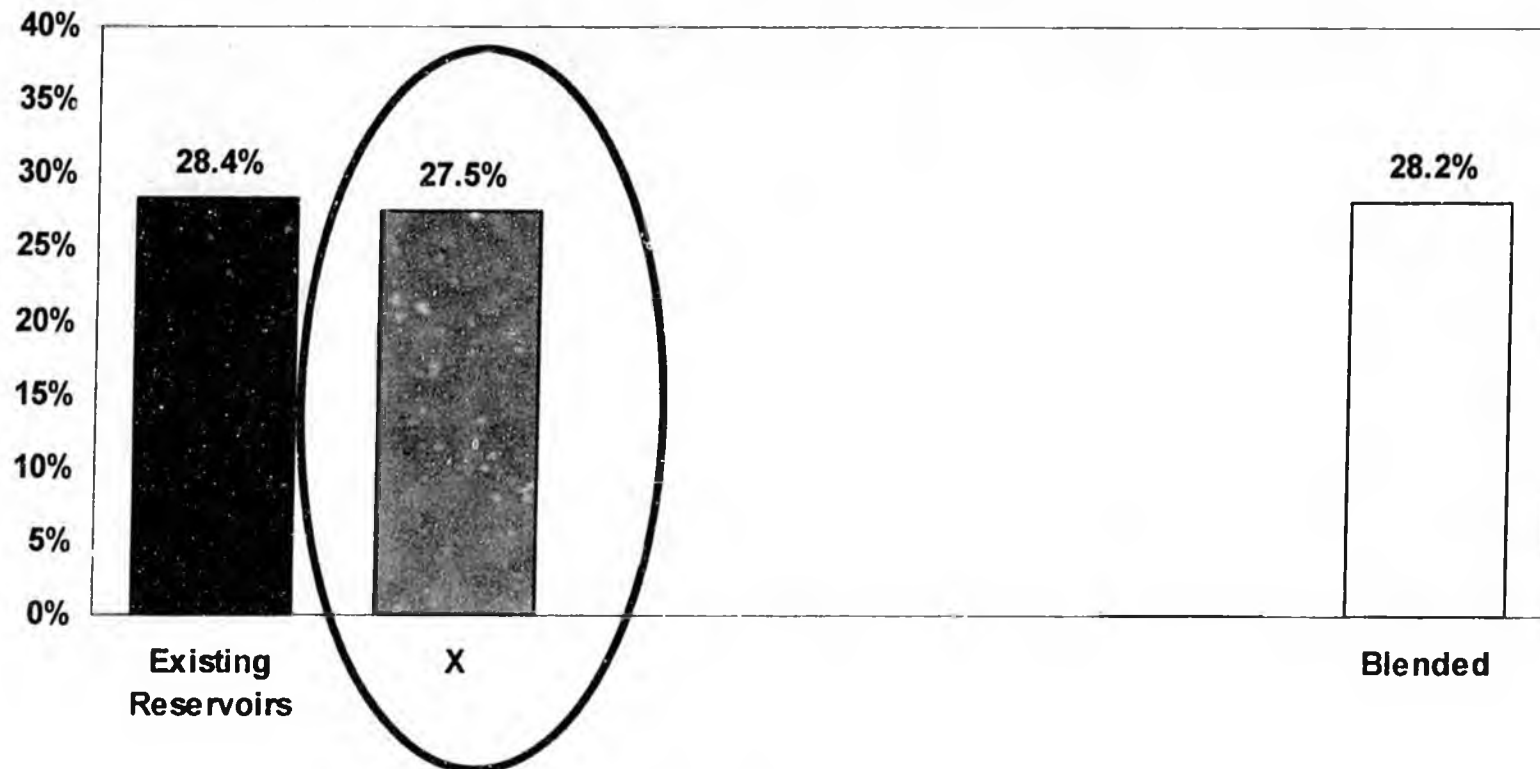


If I had just Existing Reservoirs, and did not develop anything new, I would pay tax on my profits at 28.4%

So, Does That Mean I Am Paying 28.2% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending

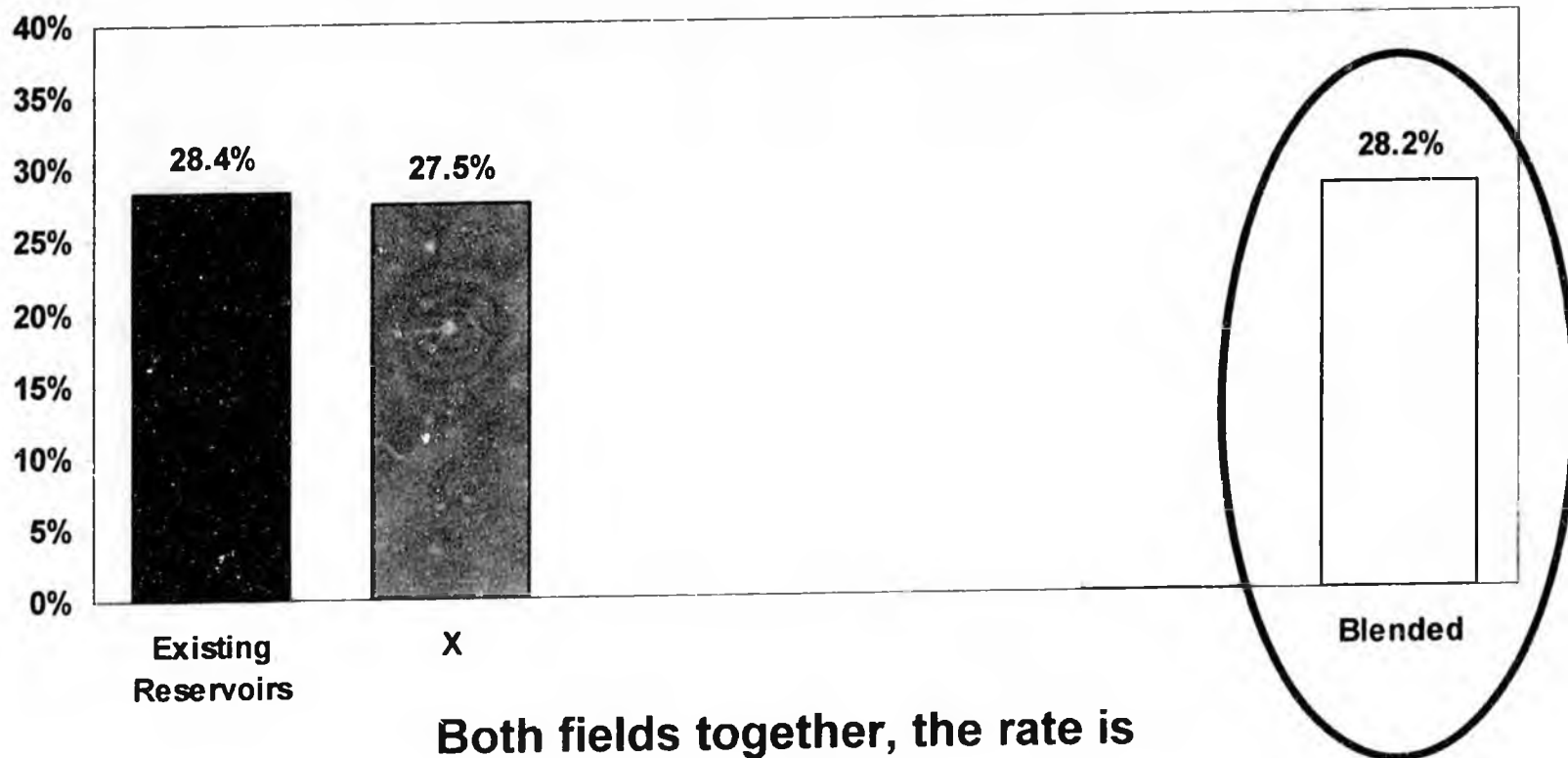


If I had just Field X, I would pay tax on my profits at 27.5% - its margin is slightly lower

So, Does That Mean I Am Paying 28.2% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending



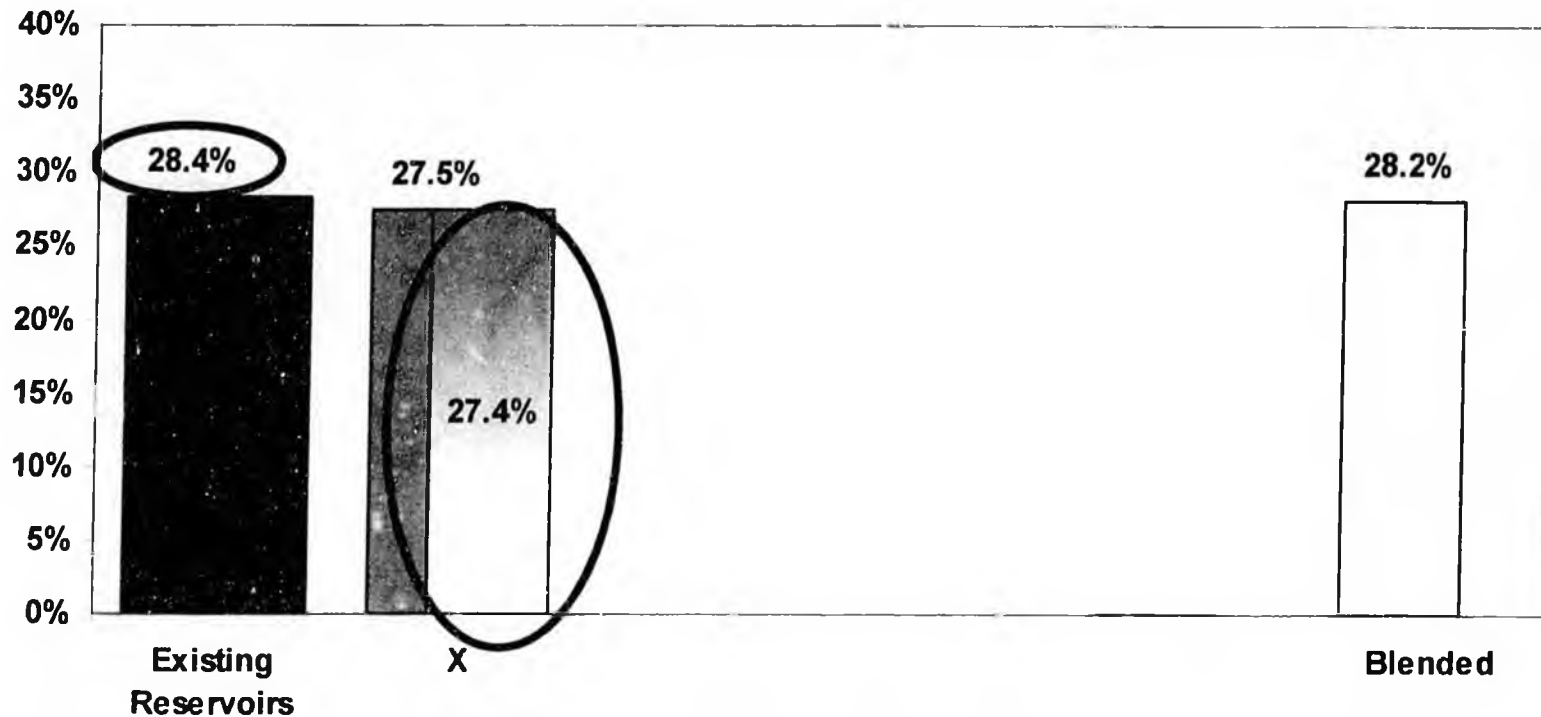
Both fields together, the rate is 28.2%

However, this is not all ...

So, Does That Mean I Am Paying 28.2% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending

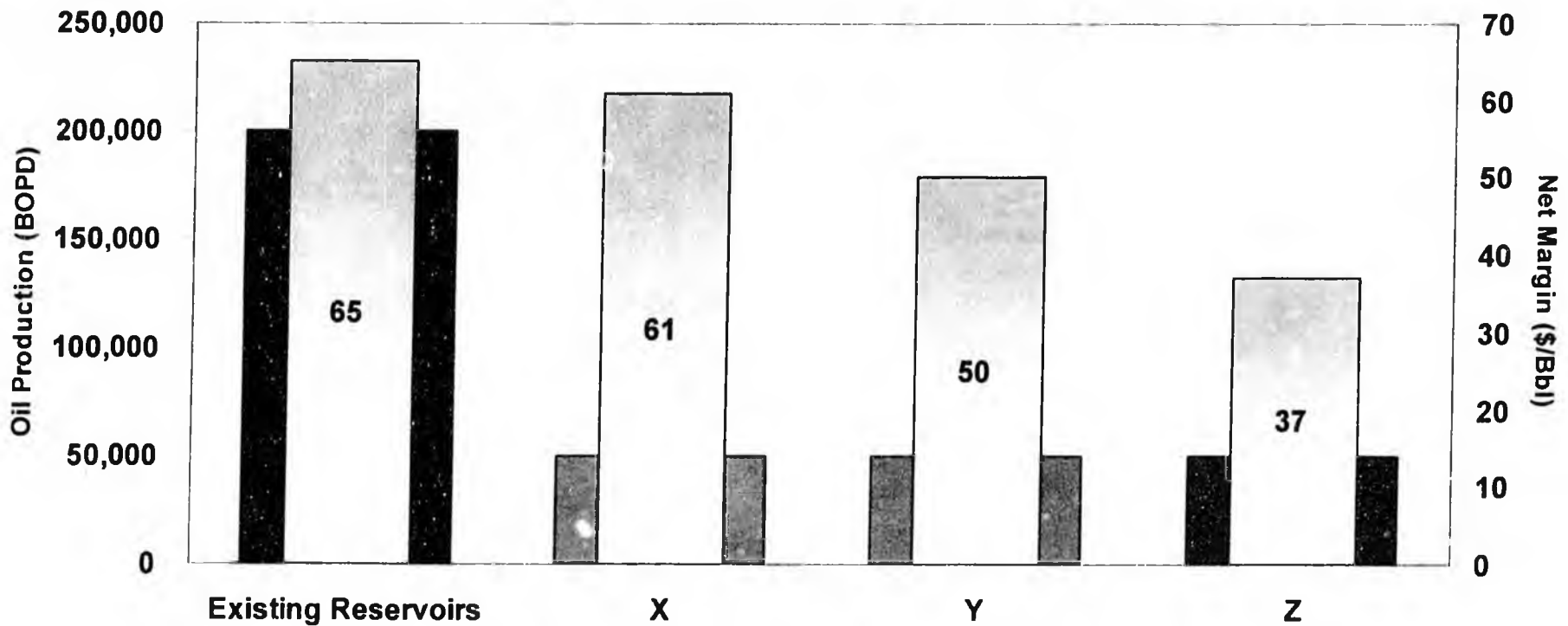


The mathematics of this reduction means that actually while Existing Reservoirs continue to pay tax at a rate of 28.4%,
The effective rate on Field X is actually 27.4%
... less than it would be if it were developed stand-alone

This Impact Can Be Seen In A Broader Portfolio



Portfolio Production Rate and Net Margin

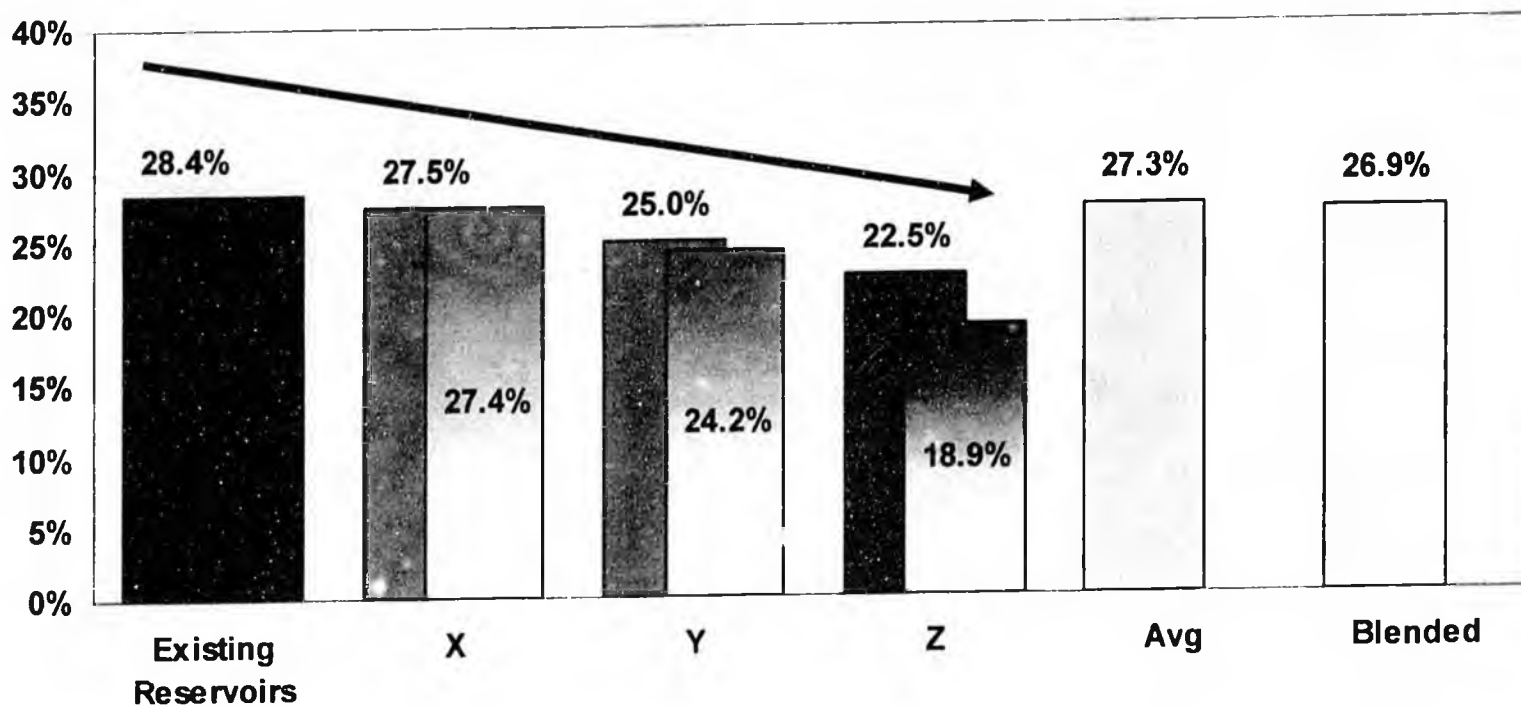


In this example we have four fields ...
.. One producing 200,000 bopd and
three others each producing 50,000 bopd but of decreasing profitability

The Impact On The Lower Margin Fields Is More Noticeable



Tax Rate By Field Within A Company - As Affected By Portfolio Blending

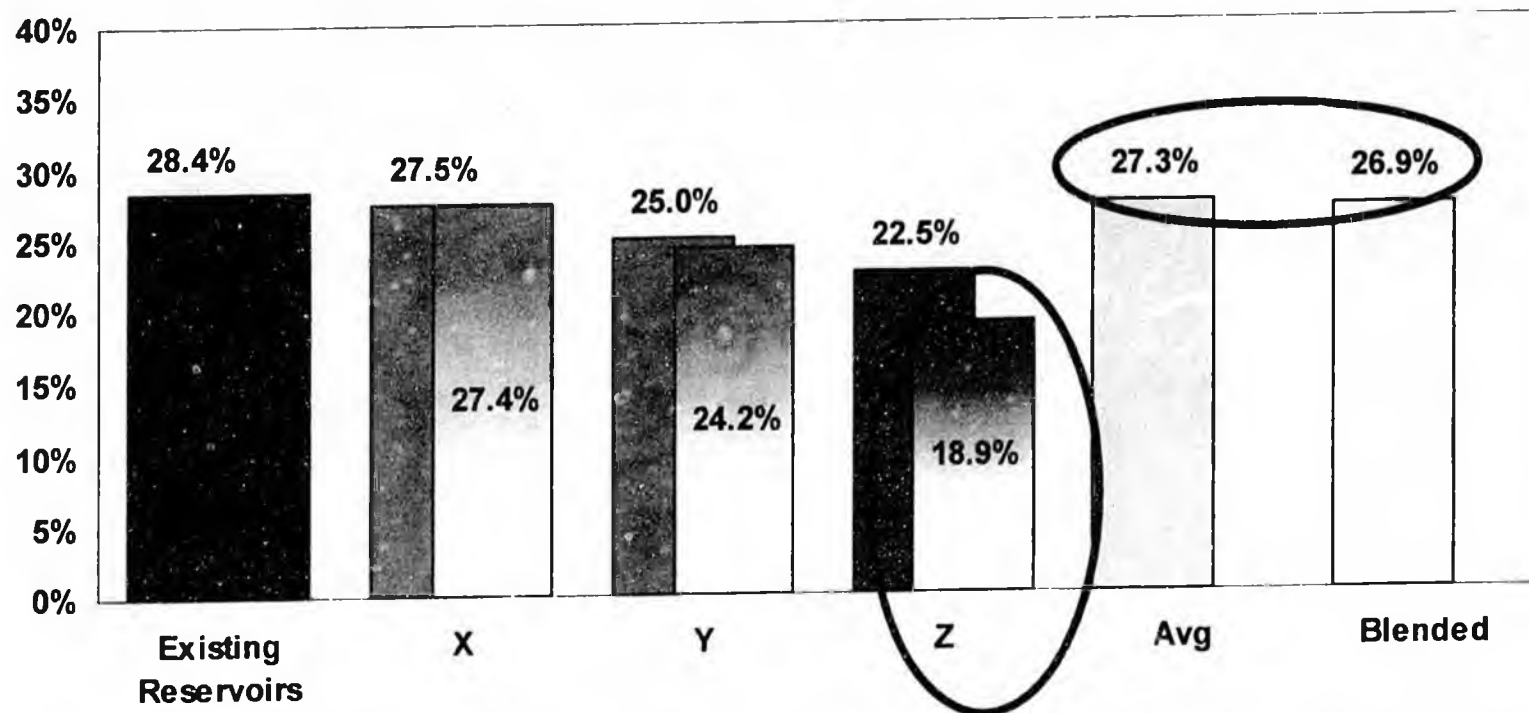


The progressivity can be seen through the lower effective tax rate on lower margin fields

The Impact On The Lower Margin Fields Is More Noticeable



Tax Rate By Field Within A Company - As Affected By Portfolio Blending



The effective rate on some lower-margin fields may even be lower than the basic rate (22.5% in PPT)

This is manifested in the blended rate being lower than the weighted average rate

The Impact Of Capital Investment



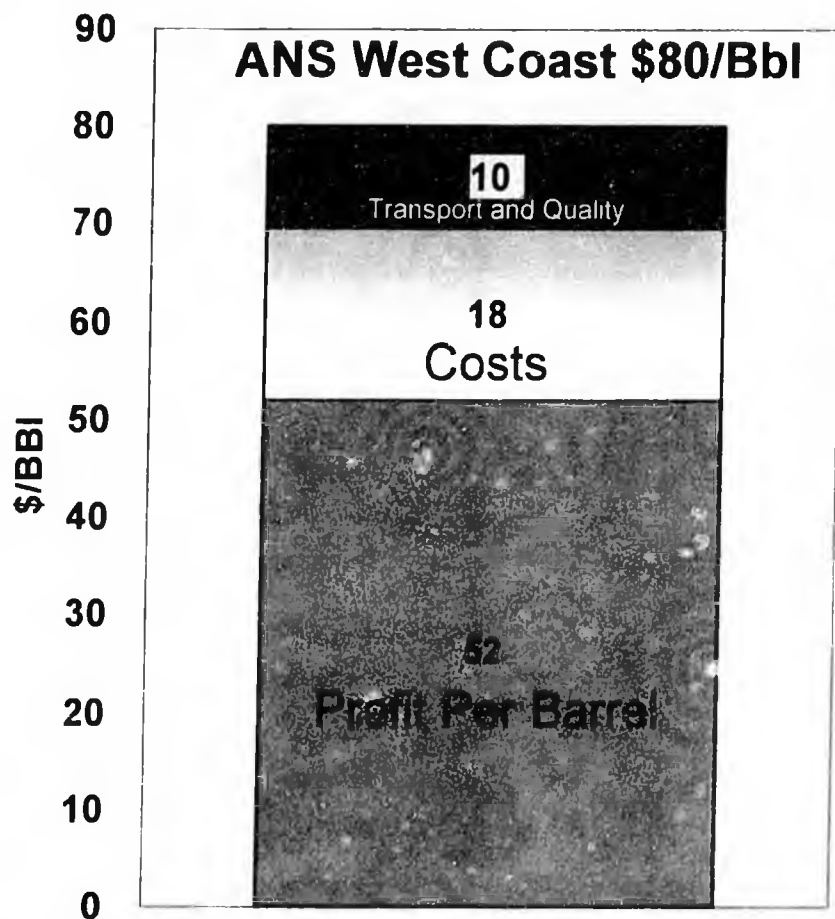
Cash Flow, Not Profit

- PPT taxes all fields at a single rate
 - No, it taxes different fields or reservoirs based on their individual profitability
- **Is based on profit per barrel**
 - Not exactly, it is based on net cash flow per barrel after capital investment (for future production)



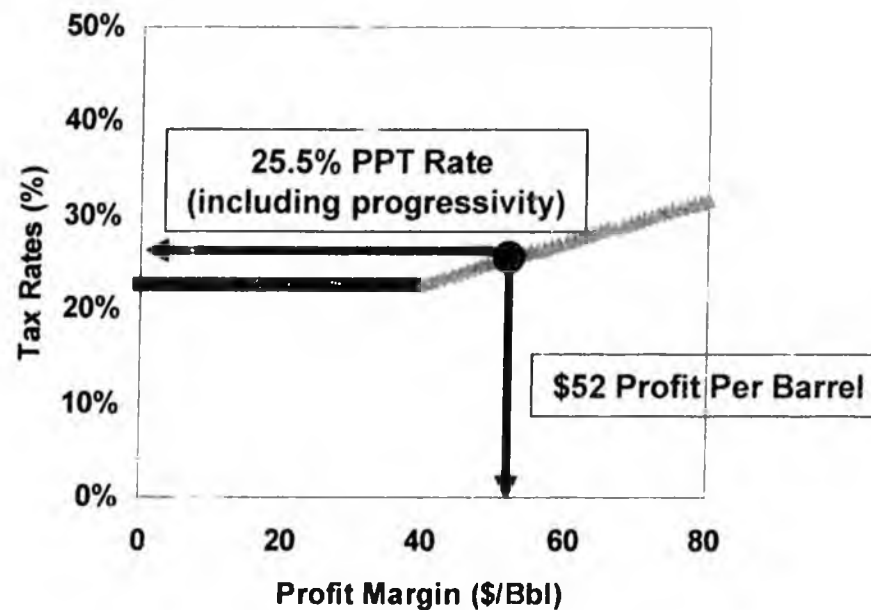
Remember These Slides ?

Portfolio Profitability



The portfolio on the previous slides had a blended rate of 26.9%, not 25.5%

Tax Rate Structure (Incorporating Progressivity)



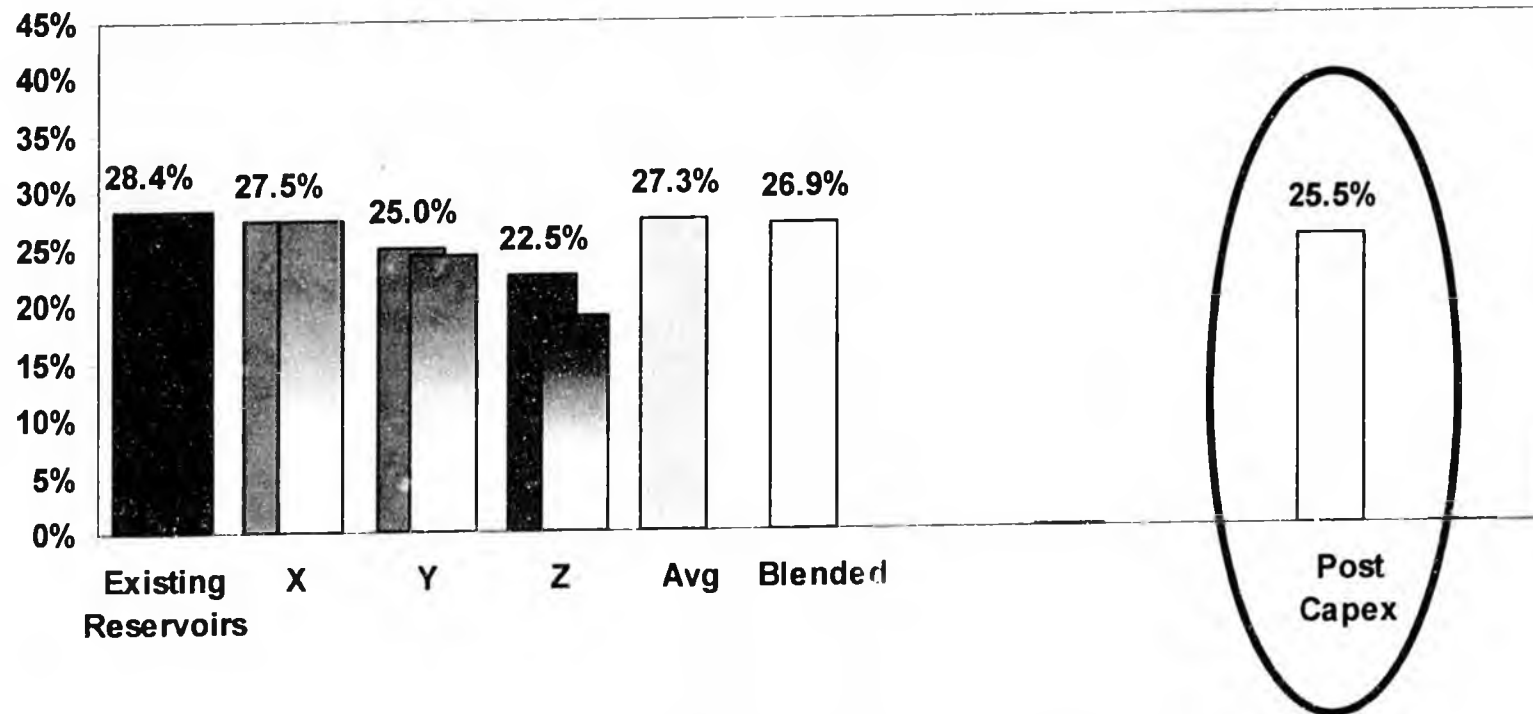
**Assume that 26.9% is the rate that will
be payable before further capital
investment decisions are made ...**

... in this example \$800 million

Capital Spending Has An Impact On Rate, Too



Tax Rate By Field Within A Company - As Affected By Portfolio Blending, Capex And Tax Credit



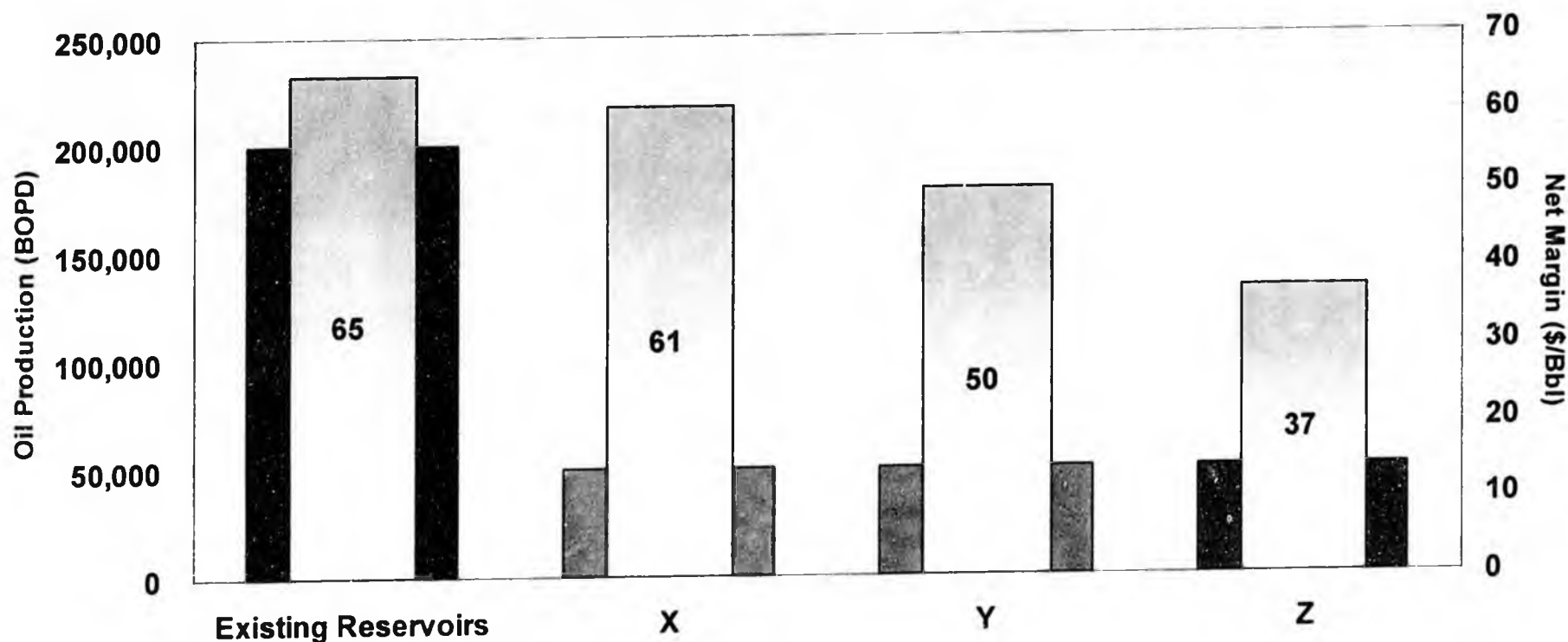
This reduces the rate payable to 25.5%

How ?

\$800 million amounts to \$6.26 Per Barrel Based On This Portfolio



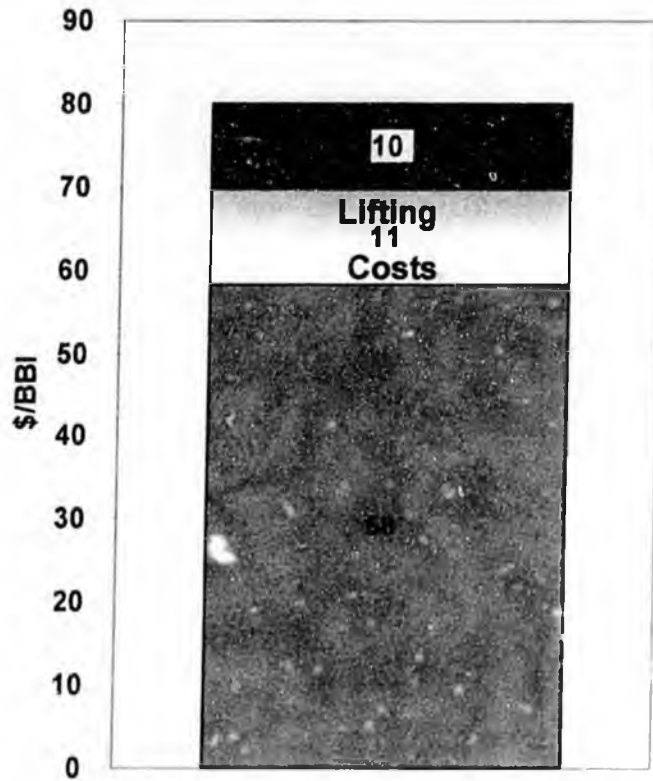
Portfolio Production Rate and Net Margin



The \$6.26 Per Barrel Capital Increases "Costs" And Lowers The Tax Rate

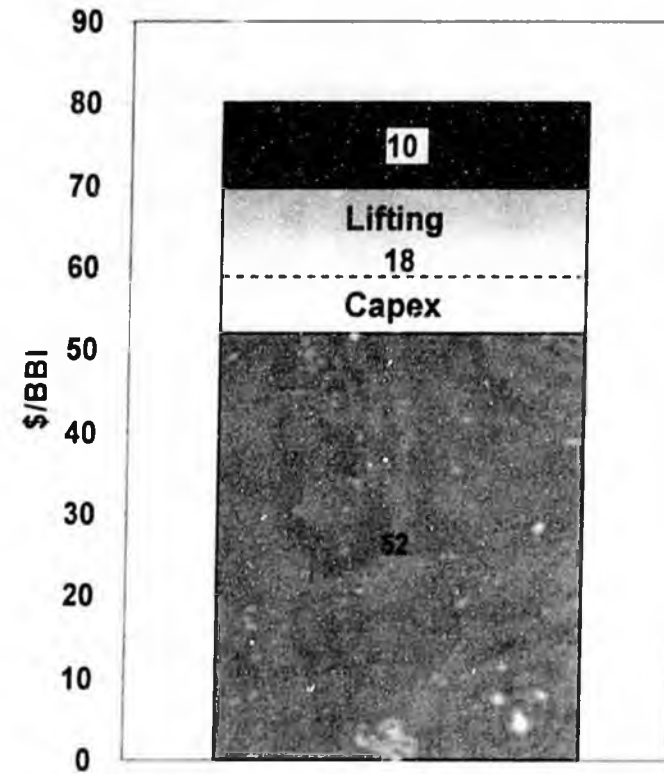


Pre-Capex Margin



**Tax Rate
26.9%**

Portfolio Profitability

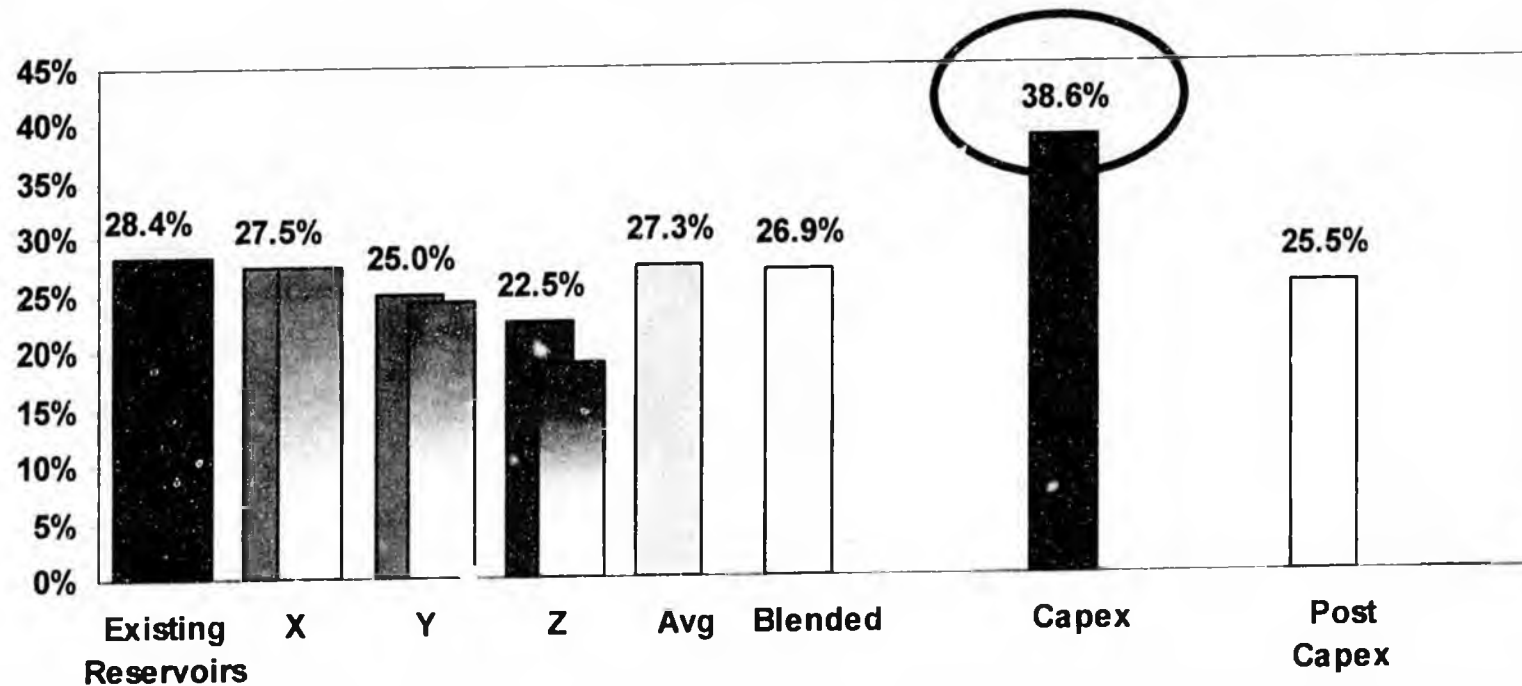


**Tax Rate
25.5%**

There Is Another Way To Look At This, Though



Tax Rate By Field Within A Company - As Affected By Portfolio Blending, Capex And Tax Credit



It is the same as still paying the blended rate of 26.9% on the portfolio production (or having an effective rate of 28.4% on Existing Reservoirs .. down to 18.9% on Field Z) and Alaska paying* 38.6% of that \$800 million capital

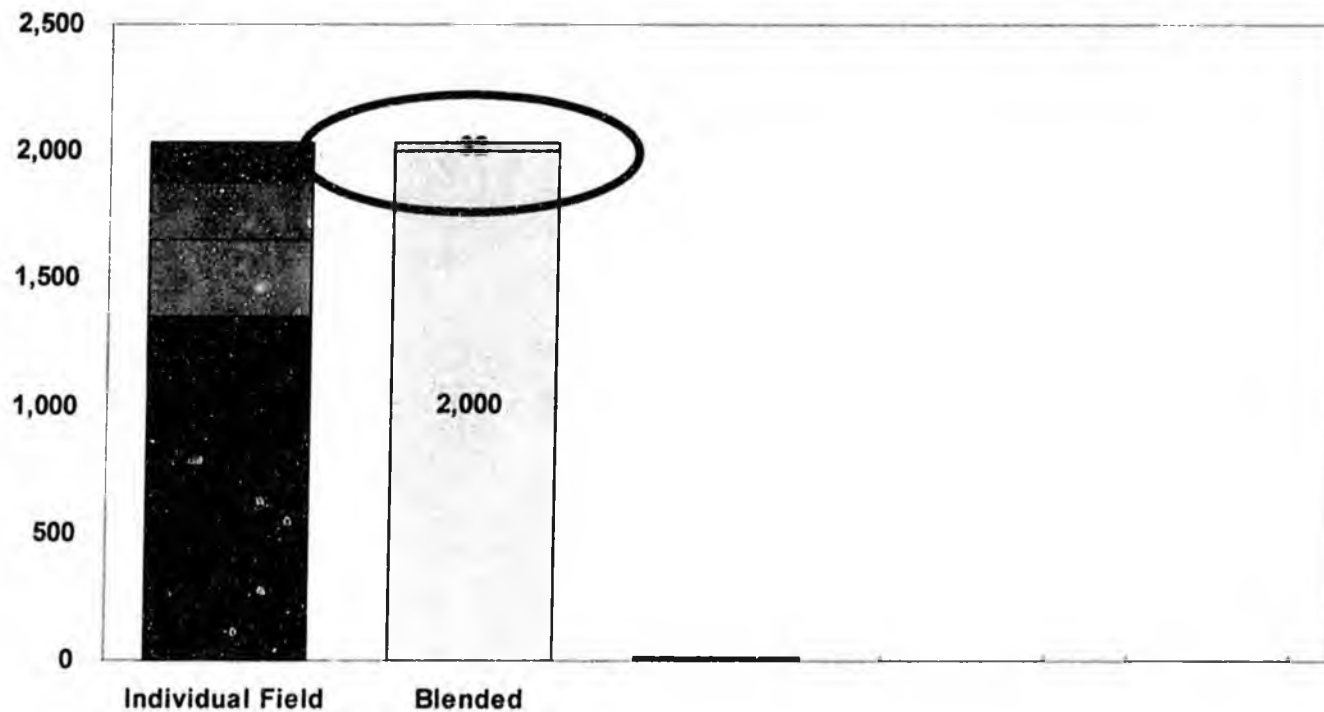
This 38.6% is higher than the Blended tax rate ... and is a function of the capex per barrel and the overall portfolio cost and margin structure

* from PPT only - does not include State and Federal tax effect.



Portfolio Effects Lower Total Tax

Tax Allocable By Field Within Portfolio

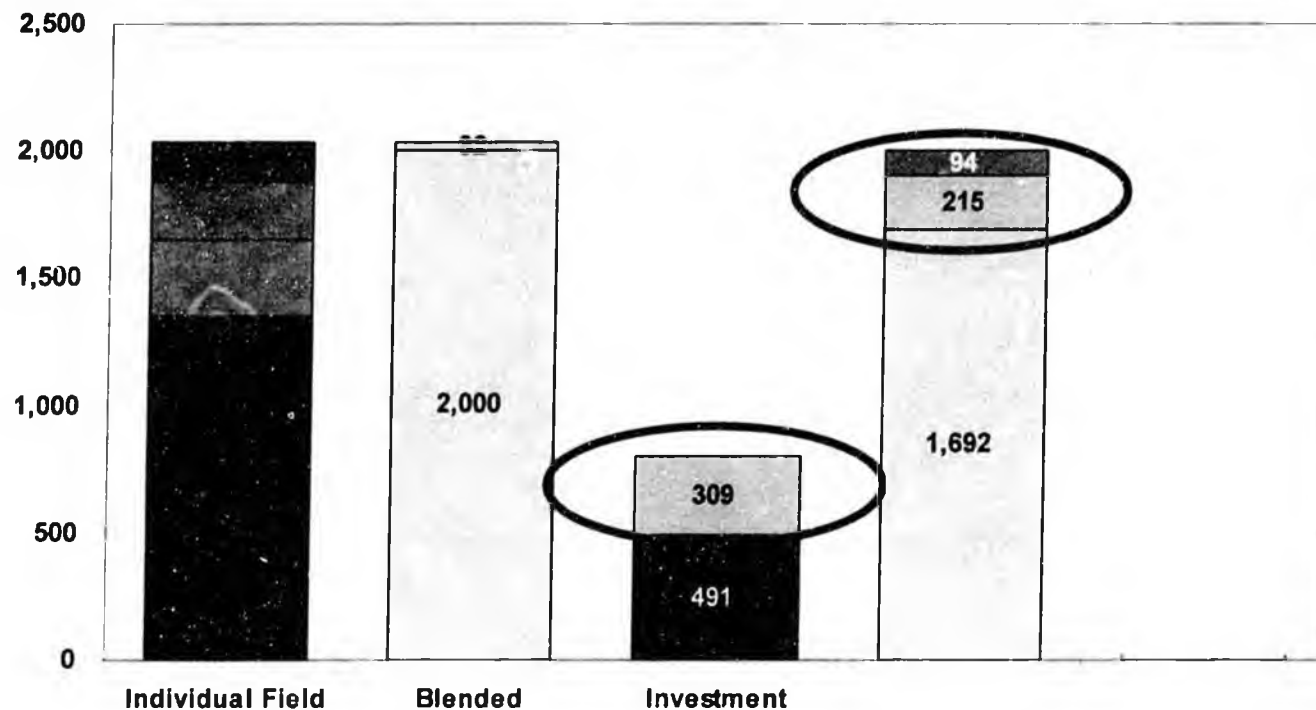


Putting all fields in one portfolio (company) lowers this to \$2Bn ...
... a saving of \$ 32 million



The Big Winner Though Is Capex

Tax Allocable By Field Within Portfolio

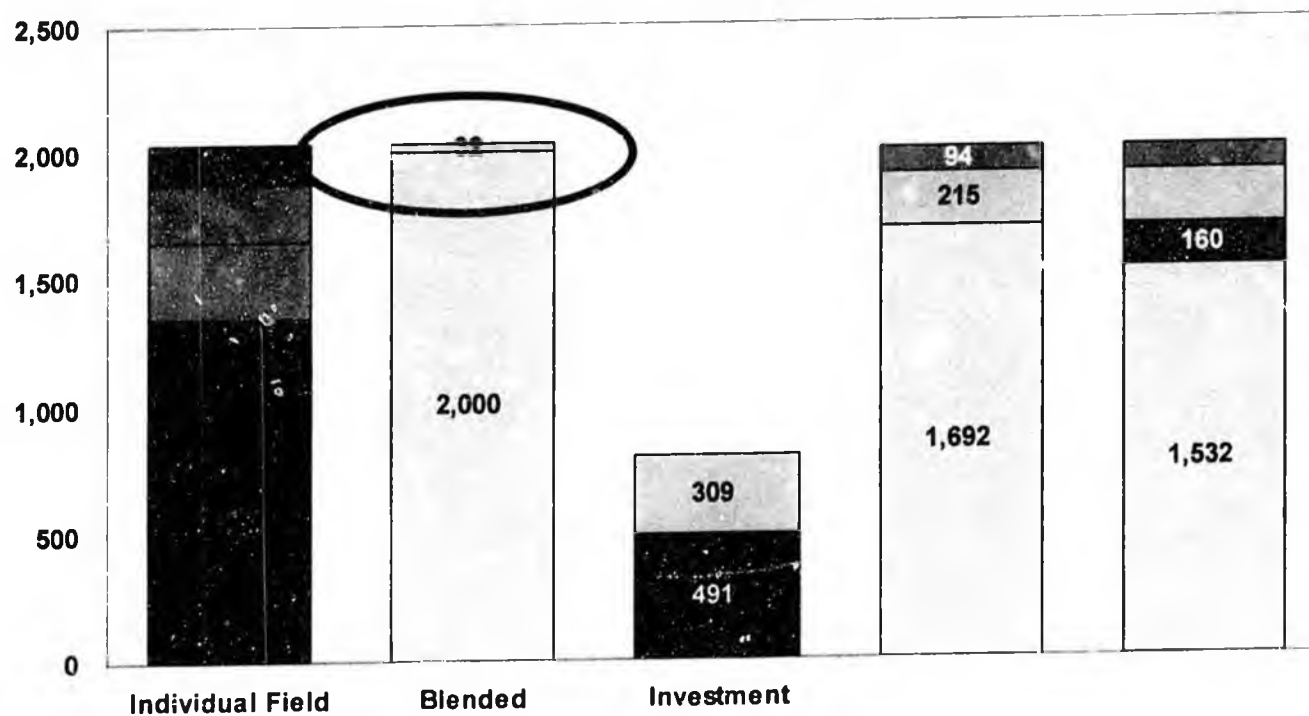


In this example the State pays \$309 million (38.6%) of the capital (the percentage will vary based on overall portfolio net margin per barrel)
The \$309 million can be allocated as \$215 million from reducing taxable income at 26.9% and \$94 million from lowering the rate from 26.9% to 25.5%



But Wait ! That Is Not All

Tax Allocable By Field Within Portfolio

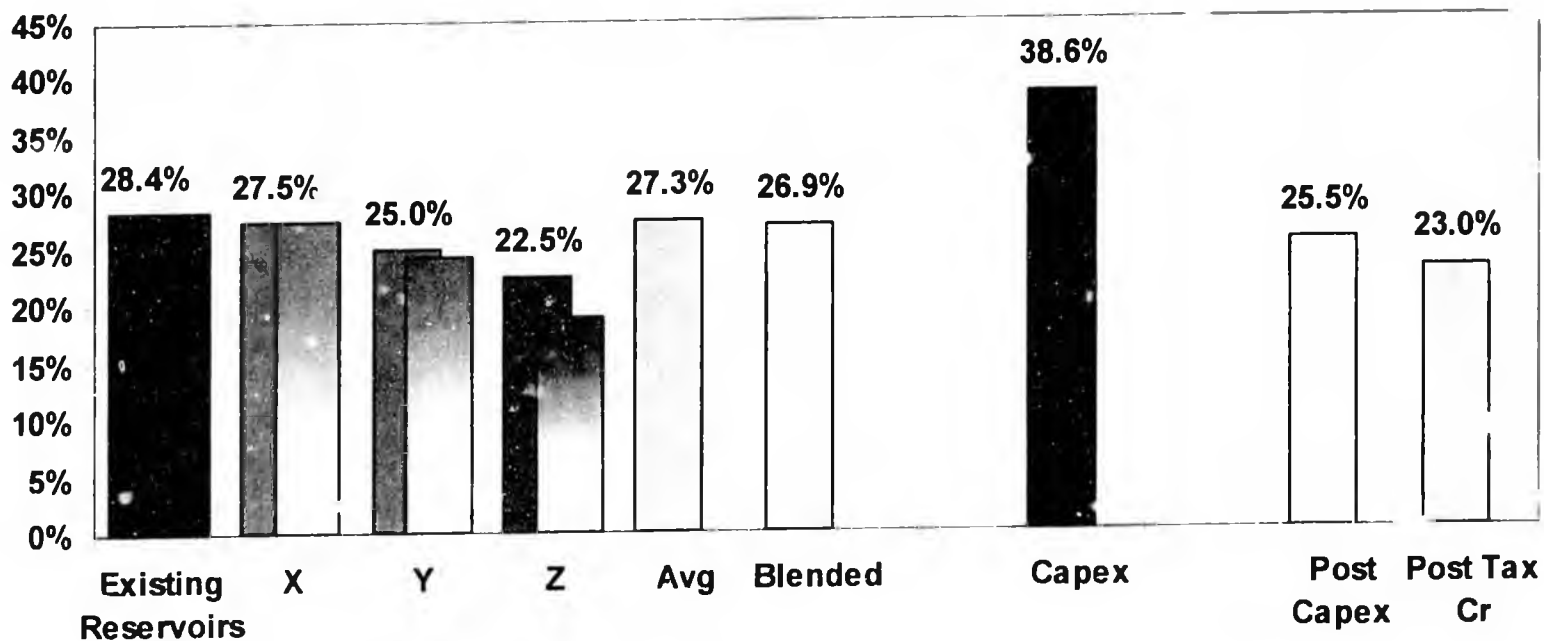


Investment Credits Take a further \$160 million (20% of \$800 million)
from the tax payable



After Investment Credits ...

Tax Rate By Field Within A Company - As Affected By Portfolio Blending,
Capex And Tax Credit



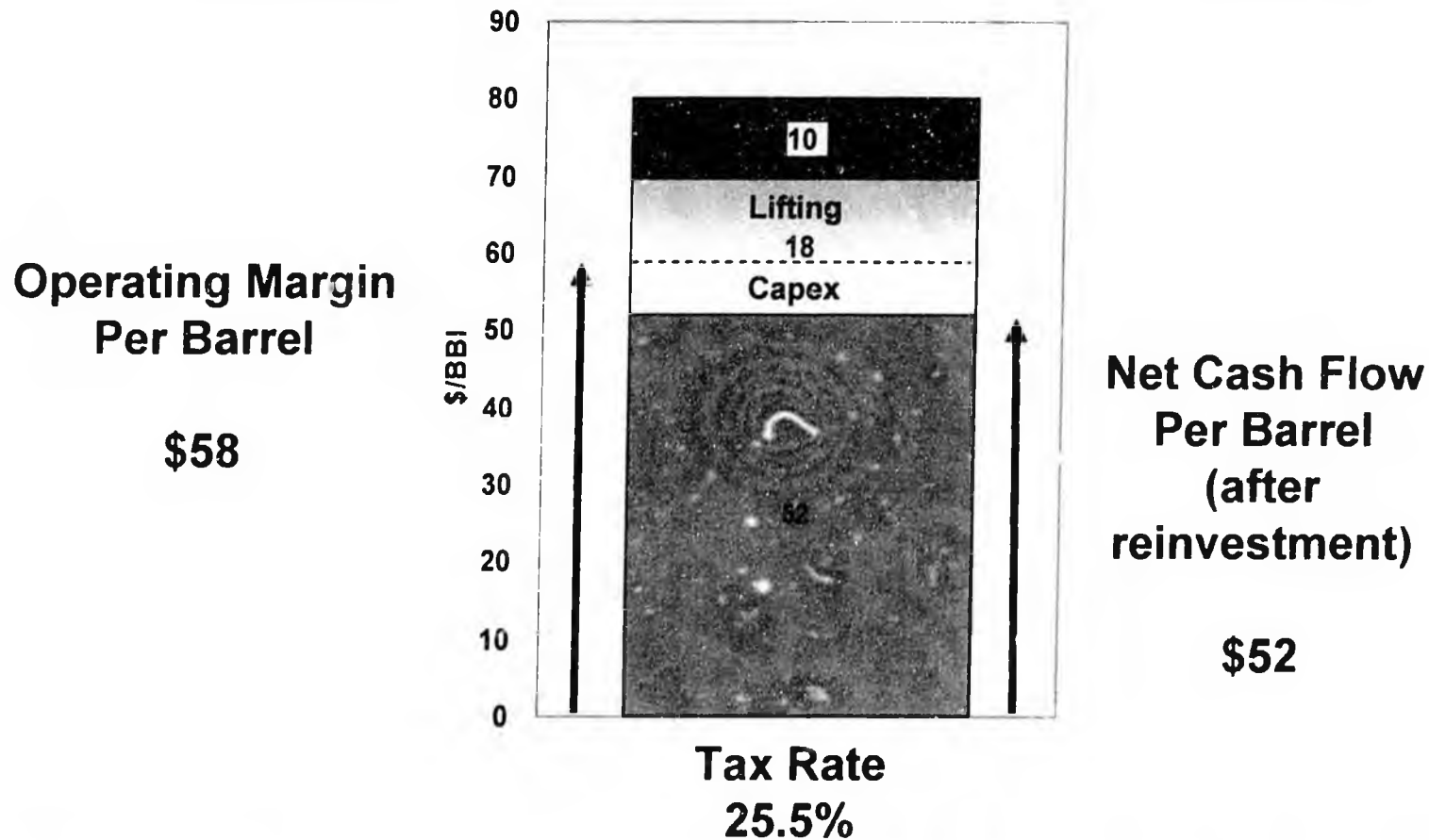
... the effective tax rate is lowered further to 23%*

* In this example

PPT Is Really A Tax On Net Cash Flow Per Barrel



... or, a tax on net revenues that are not reinvested ...



House Oil & Gas Committee

Gross Progressivity Amendment



Progressivity

- **PPT**

- Tax rate increases 0.25% for every dollar that net cash flow per barrel exceeds \$40

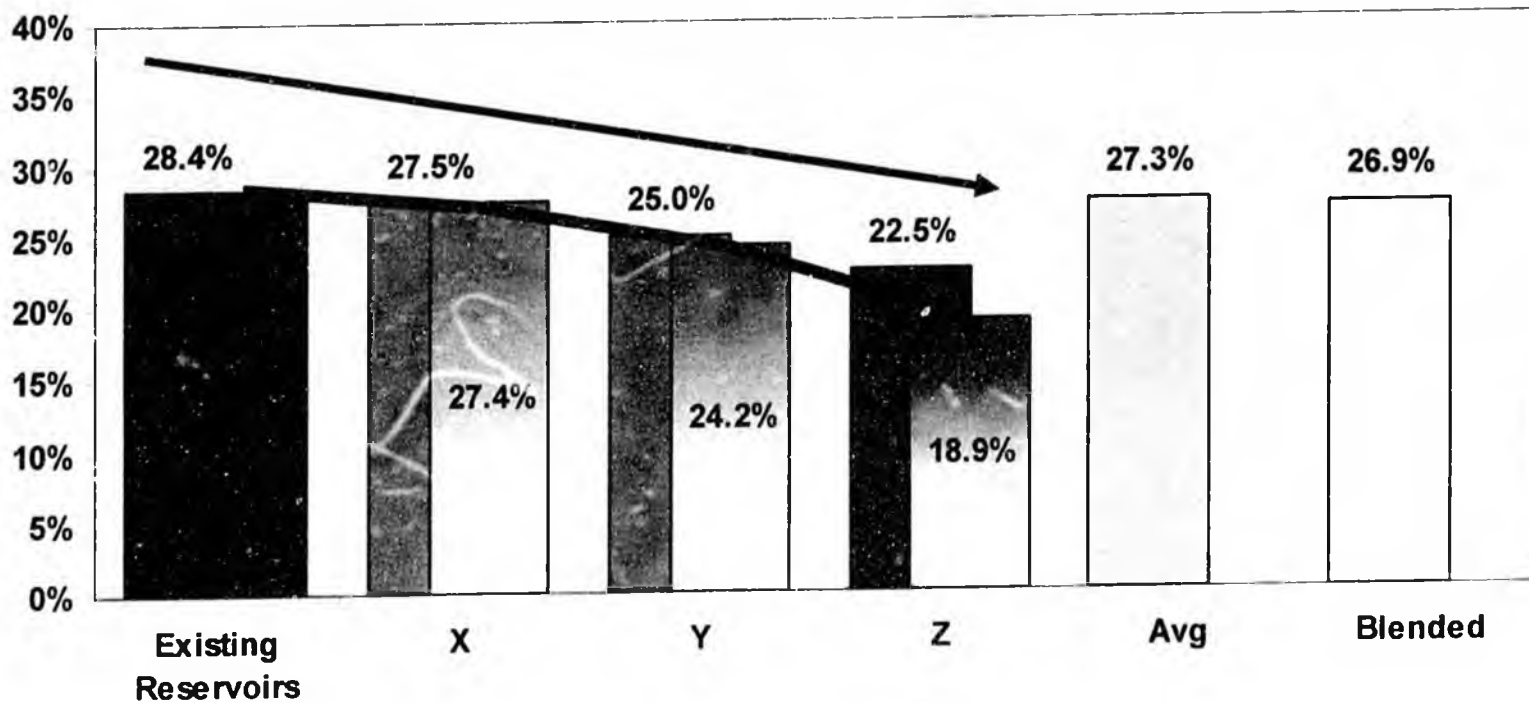
- **House O&G Amendment**

- Maintains the PPT basic rate of 22.5%
- Adds a tax of 0.225% for every dollar that the gross value at the point of production exceeds \$50
- Applied to the gross value at the point of production



PPT Progressivity

Tax Rate By Field Within A Company - As Affected By Portfolio Blending

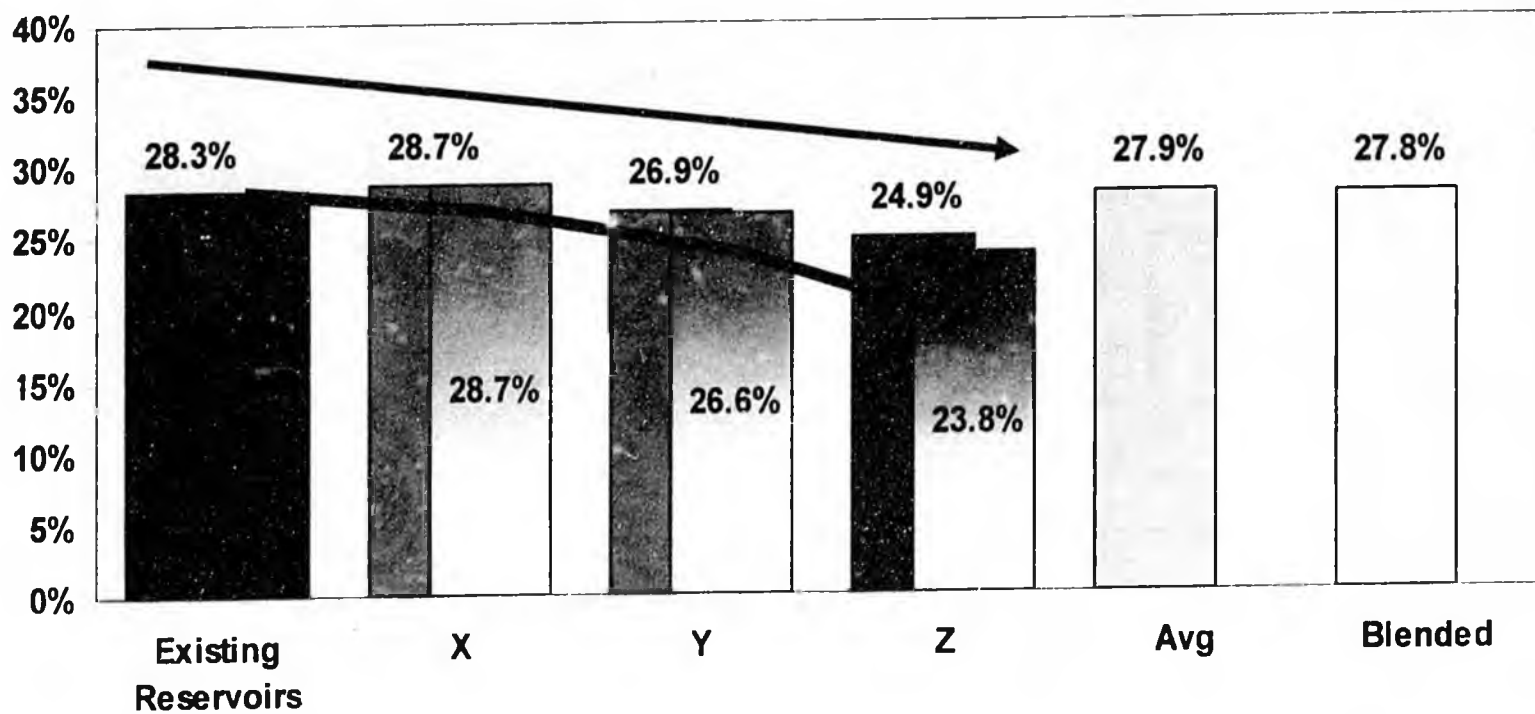


The progressivity can be seen through the lower effective tax rate on lower margin fields



House Oil & Gas Progressivity

Tax Rate By Field Within A Company - As Affected By Portfolio Blending

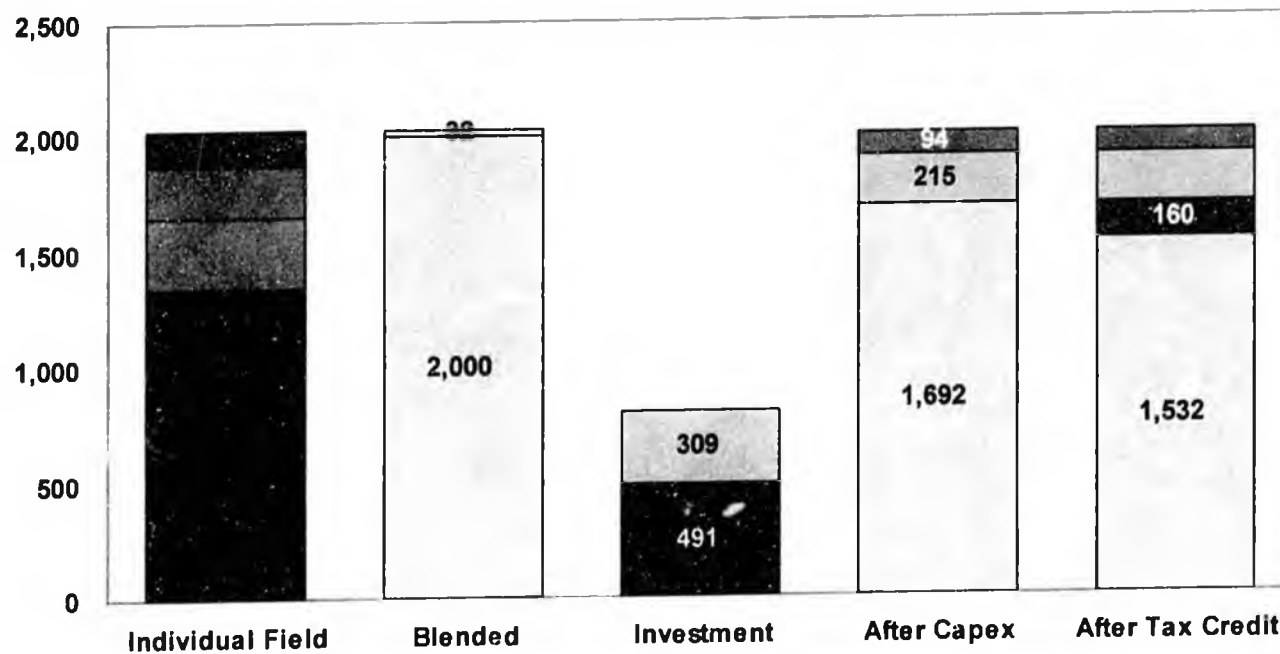


The bulk of the increased burden in this case is being borne by the lower margin fields ...



PPT Progressivity

Tax Allocable By Field Within Portfolio

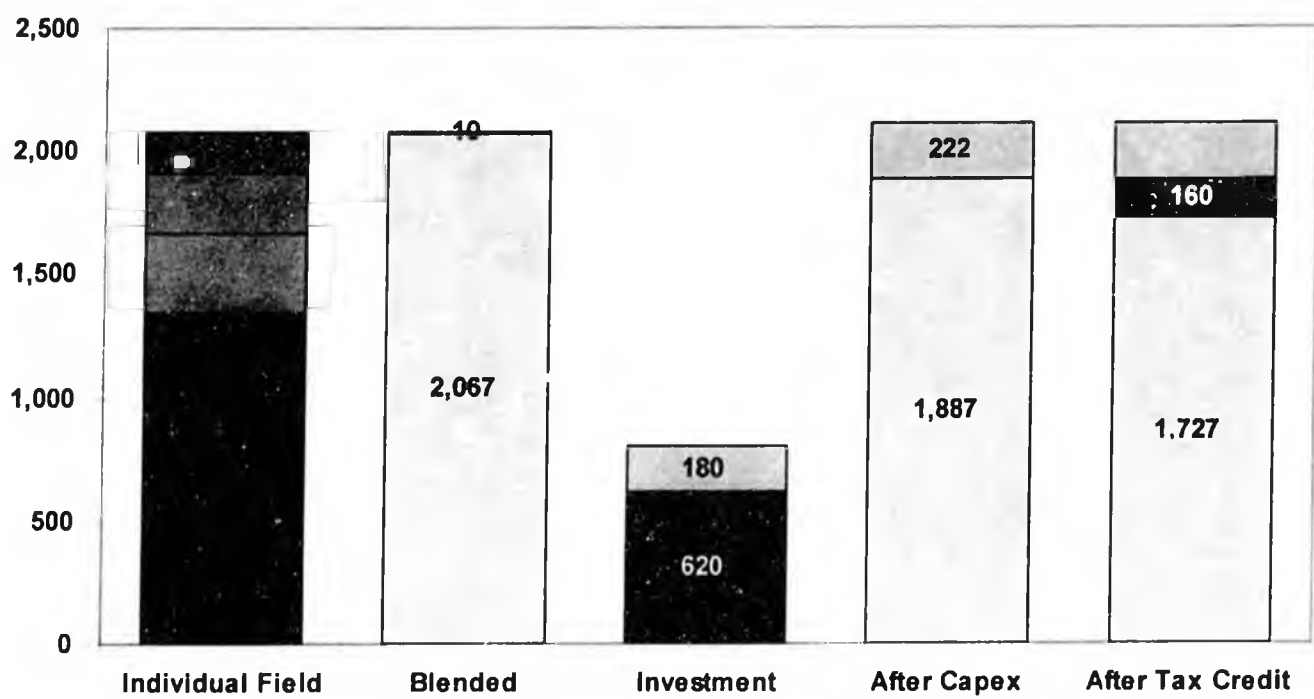


Under PPT progressivity this portfolio would pay \$1,532 million at \$80 ANS West Coast \$2 Bn before the capital investment



House Oil & Gas Progressivity

Tax Allocable By Field Within Portfolio



**Under House O&G progressivity this portfolio would pay \$1,727 million
-only \$67 million before the capital investment
The net cost of the investment rises from \$331 million to \$460 million***

* Before State and Federal tax impacts



Conclusions

- **A net tax on the margin is a tax on the retained cash flow and not just a tax on simple profitability**
- **Corporate ring fence for production tax allows the effective rate to vary between more, and less, profitable fields**
- **More aggressive net progressivity provides a greater differentiation on the effective rate than simple gross progressivity**
 - **Less/lower taxes at low margins**
 - **More/higher taxes at high margins**

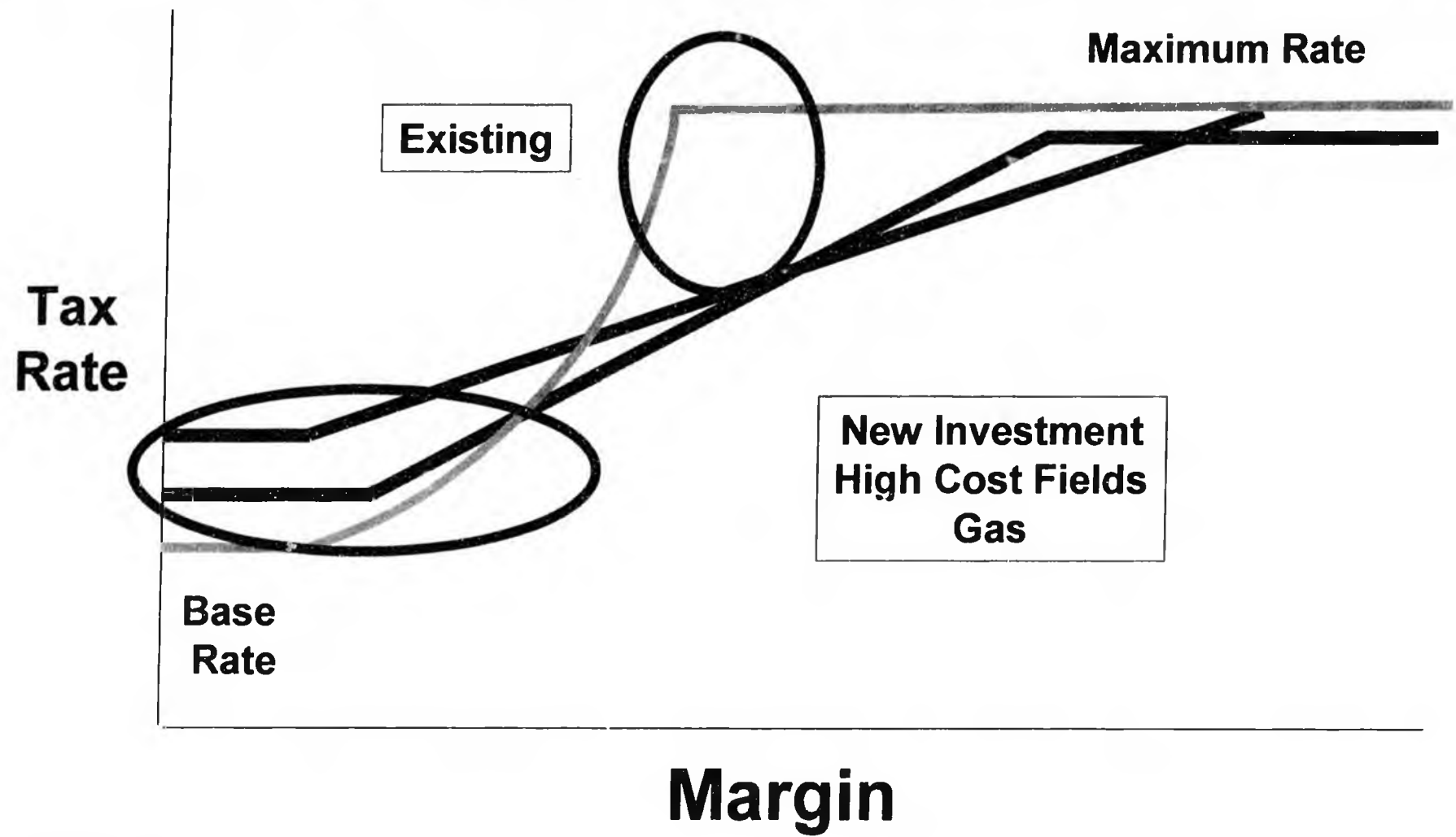


Progressivity

- **Progressivity, based on “net”, as manifested in the PPT/ACES structure is more responsive to individual field profitability than that in a “gross” structure**
- **Greater progressivity (raising the maximum rate and / or slope) can achieve even greater differentiation**
 - More tax on legacy investments benefits from current higher prices – that will drop back if prices drop back
 - Lower tax rates on higher cost / lower margin new investments



Aggressive Progressivity



Not The End But a New Beginning

30 October 2007

Progressivity in CS HB 2001 (O&G)

Dan E. Dickinson
October 30, 2007
House Resources

The tax is equal to
[.225 percent]
of the [monthly gross value at
the point of production of
the taxable oil and gas]
multiplied by [the number that represents the difference

0.00225

19,520

[(1) the quotient of the
total monthly gross
value at the point of
production of the
taxable oil and gas
produced by the
producer in BTU
equivalent barrels]
[and (2) \$50]]

\$ 80.00

\$ 50.00

\$30

The tax is equal to
 [the number that represents the difference between

[(1) the quotient of the
 total monthly gross
 value at the point of
 production of the
 taxable oil and gas
 produced by the
 producer in BTU
 equivalent barrels]
 [and (2) \$50]]

\$ 80.00

\$ 50.00

\$30

0.00225

6.75%

multiplied by [.225 percent]

multiplied by [monthly gross value at
 the point of production of
 the taxable oil and gas]

19,520

1,317.60

Progressivity Taxes

	PPT	ACES	HO&G
<u>BASE</u>			
Taxable bbls	244	244	244
ANS Market	87.00	87.00	87.00
Trans	7.00	7.00	7.00
GVPP	80.00	80.00	80.00
Lifting	20.00	20.00	-
PTV	60.00	60.00	80.00
bbls time \$/bbl	14,640	14,640	19,520
Base	14,640	14,640	19,520
<u>RATE (factor/dollar * dollars over starting point)</u>			
Starting place	40.00	30.00	50.00
Price index	20.00	30.00	30.00
Factor/dollar	0.2500%	0.2000%	0.2250%
Prog Factor	5.00%	6.00%	6.75%
<u>Tax = Rate * Base</u>			
Tax	732.00	878.40	1,317.60

AS 43.55.011(g) & (h)

(g) the tax levied under this subsection is equal to ...

[.25 percent]

of the

[monthly production tax value of the taxable oil and gas ...]

multiplied by the

[the price index determined under (h) of this section.]

[For purposes of (g) of this section, the price index for a

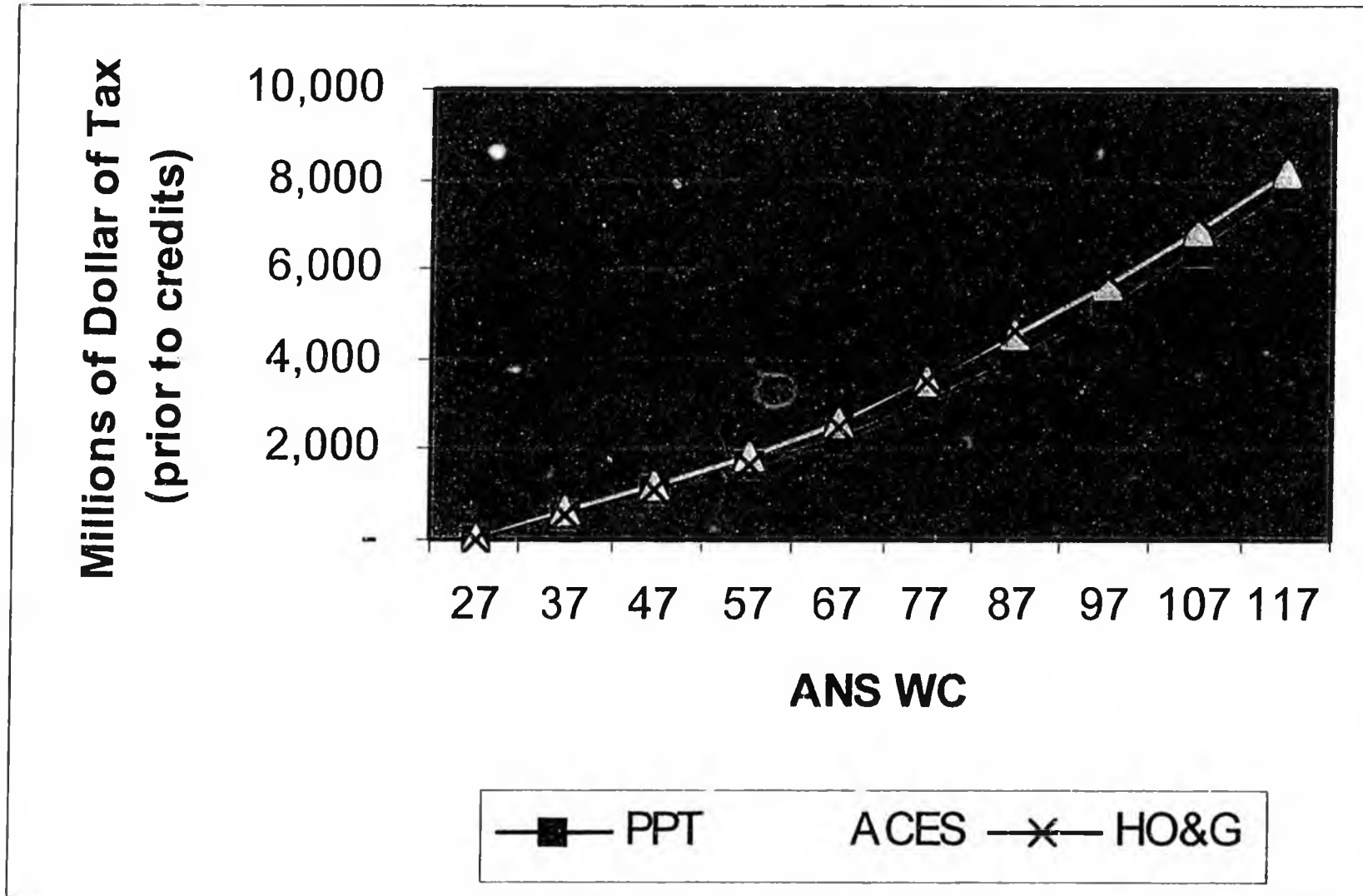
(h) month is calculated by subtracting

[40]

from

[the number that is equal to the quotient of the total monthly production tax value of the taxable oil and gas produced by the producer during that month...divided by the total amount of the taxable oil and gas produced by the produce during that month, in BTU equivalent barrels]]

Progressivity Studies 10/28/07 (\$7 downstream costs, \$20 upstream)



ALASKA STATE LEGISLATURE



Official Business

HOUSE SPECIAL COMMITTEE ON OIL AND GAS

Representative Kurt Olson, Chair
State Capitol, Room 408
Juneau, AK 99801-1182
Phone 907-465-2693 Fax 907-465-3835

Representative Ralph Samuels
Representative Nancy Dahlstrom
Representative Scott Kawasaki

Representative Jay Ramras
Representative Mark Neuman
Representative Mike Doogan

Sectional for HB2001(O&G)\K

Section 1. Amends AS 38.05.035(a) by adding a new paragraph that requires the director of the Division of Lands to furnish information to the Department of Revenue for the purpose of forecasting state revenue and the administration of AS 43.55 (oil and gas production tax and surcharges). The information to be shared includes confidential information relating to sale, lease, or other disposal of land; geological, geophysical and engineering data; financial information; and other information held by the director. Requires the Department of Revenue to maintain the same confidentiality of the information received under the paragraph as is required of the director of the Division of Lands with regard to that information.

Section 2. Amends AS 38.05.036(b) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because the amendment of AS 38.05.035(a) in Section 1 renumbered some paragraphs in the subsection and added a new paragraph

Section 3. Amends AS 38.05.036(f) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 4. Amends AS 38.05.036(g) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 5. Amends AS 38.05.123(f) by changing a cross-reference to a paragraph in

AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 6. Amends AS 38.05.133(e) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 7. Amends AS 38.05.180(j)(6)(B) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 8. Amends AS 38.05.275(c) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.35(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 9. Adds a new paragraph (42) to AS 39.25.110 that makes oil and gas production tax auditors and their immediate supervisors in Department of Revenue and oil and gas royalty auditors, including net profits share auditors, and their immediate supervisors in Department of Natural Resource exempt employees.

Section 10. Amends 41.09.010(d) by changing a cross-reference to a paragraph in AS 38.05.035(a); the change is required because of the amendment of AS 35.05.035(a) in sec. 1 renumbered some paragraphs in the subsection and added a new paragraph.

Section 11. Amends AS 43.05.230(a) to include AS 43.55.890 (added by sec 33 of the bill), that provides disclosure of tax information, as an exception to the prohibition against divulging the amount of income or the particulars set out or disclosed in a report or return made under AS 43.

Section 12. Amends AS 43.05.230(h) by adding tax returns, reports, and documents filed under AS 43.55, and the Department of Revenue's determinations and work papers under HB 2001 O&G CS \K Sectional 10.28.07

AS 43.55 and AS 43.65 to the information that the Department of Revenue is required to furnish to the Department of Natural Revenue.

Section 13. Amends AS 43.55.260 (a) to include AS 43.55.075 (added by sec. 27 of the bill) as an exception to the general three-year statute of limitations on assessment. Details are discussed in s. c. 27.

Section 14. Amends AS 43.55.011(j) (relating to Cook Inlet gas) to add AS 43.55.011(o) to delete reference to AS 43.55.011(g), under sec. 42 of the bill, this section takes effect January 1, 2008.

Section 15. Amends AS 43.55.011(k) (relating to Cook Inlet oil) to add AS 43.55.011(o) to delete reference to AS 43.55.011(g), under sec. 42 of the bill, this section takes effect January 1, 2008.

Section 16. Amends AS 43.55.011(m) by adding reference to AS 43.55.011(o) and makes technical changes.

Section 17. Adds new sections to AS 43.55.011

(o) Amends AS 43.55.011 by adding a new subsection (o) that adds a gross element to the progressivity tax, which is triggered when oil reaches \$50 a barrel at the rate of .225% of the gross value at the point of production calculated monthly.

(p) Prior to 2022 (p) providing that gas produced outside of Cook Inlet, after December 31, 2007, and south of 68 degrees North Latitude, be taxed at the similarly to the Cook Inlet Basin.

Section 18. Amends AS 43.55.020(a) by changing a cross-reference to a paragraph in AS 45.55.011; required by the addition of AS 45.55.011(o) in sec. 17. Deletes reference to subsection AS 43.55.011(g).

Section 19. Amends AS 43.55.020(d) by changing a cross-reference to a paragraph in HB 2001 O&G CS \K Sectional 10.28.07
3 of 7

AS 45.55.011; the change is required because of the addition of AS 45.55.011(o) in sec. 17.

Section 20. Amends AS 43.55.020(g) Clarifies the period during which interest accrues under 26 U.S.C. 6621 on the underpayment of an installment.

Section 21. Amends AS 43.55.020(h) Clarifies the period during which the interest accrues under 26 U.S.C. 6621 on the overpayment of an installment.

Section 22. Amends AS 43.55.023(d). Applying current statutory language to the use of tax credits for losses and expenditures and makes conforming amendments to AS 43.55.030(a) or (e).

Section 23. Amends AS 43.55.023(i) by reducing the TIE credits to expenditures incurred after March 31, 2003 (previously 2001).

Section 24. Amends AS 43.55.030(a) to make the statement filing requirement apply to all producers rather than only those producers with a tax liability. Adds additional information requirements to those already in current law. Under sec. 39 of the bill, this section applies to statements and reports required to be filed after December 31, 2007. Under sec. 42 of the bill, this section takes effect January 1, 2008.

Section 25. Amends AS 43.55.030 by adding subsections (e) and (f). Requires explorers or producers to file an annual statement on expenditures (or adjustments) even if no oil or gas is produced during the year. Makes clear that the Department may also require monthly reports from producers, explorers, and operators.

Section 26. Amends AS 43.55.040 by adding paragraph (5) that authorizes the Department of Revenue to require a producer, explorer, or operator to file reports and records that the department considers necessary to forecast state revenue under AS 43.55.

Section 27. Adds a new section AS 43.55.075. This section recognizes that historically most production tax audits take longer than 3 years. The proposal requires the amount of tax imposed by this chapter to be assessed within 6 years after the latest return is filed. The section also details various filing time period obligations.

Section 28. Adds new subsections to AS 43.55.110

(e) Allows the department to require that returns, statements, reports, notifications, and applications be filed electronically in a form required by the department.

(f) Allows the department to require electronic payments.

(g) Allows the department to issue advisory bulletins.

Section 29. Amends 43.55.160(a) makes conforming amendments.

Section 30. Amends AS 43.55.165(a) Conforming statutory language to reflect prohibited lease expenditures under AS 43.55.165(e).

Section 31. Amends AS 43.55.165(e) (relating to excluded lease expenditures) by deleting language in AS 43.55.165(e)(15) that relates to dismantlement, removal, surrender, or abandonment costs attributable to production before April 1, 2006, and adding additional categories of excluded costs. AS 43.55.165(e)(6) is amended to exclude costs that arise from a violation of law or the failure to comply with an obligation under the lease, permit, or license issued by the state or federal government.

AS 43.55.165(e)(19) is added to exclude costs for repair, replacement, or deferred maintenance undertaken in response to an ^{unanticipated} unscheduled interruption ^{leading to a} or reduction in the rate of production or undertaken in response to an unpermitted release of gas or other hazardous substances.

(AS 43.55.165(e)(19) appears to address concerns similar to those addressed in HB 128 and SB 80, but uses different criteria than those in the existing legislation for determining excluded costs.) AS 43.55.165(e)(20) is added to exclude costs related to a refinery or crude oil topping plant, but allows the value of certain products produced from such a facility to be lease expenditures. Under sec. 39 of the bill, this section applies to oil and gas produced after March 31, 2006. Under sec.41 of the bill, this section is retroactive to April 1, 2006.

Section 32. Amends AS 43.55.170(a) by delineating an exception relating to the subtraction of a payment or credit in calculating billable or billed costs. Under sec 39 of the bill, this section applies to oil and gas produced after March 31, 2006. Under sec.41 of the bill, this section is retroactive to April 1, 2006.

Section 33. Adds a new section to AS 43.55 – AS 43.55.890. The new section provides for the publication of information, if aggregated among three or more producers or explorers, that includes the amount of oil or gas production, the amount of taxes levied and paid under AS 43.55, and other information related to credits, expenditures, and the value of oil and gas produced.

Section 34. AS 43.55.900 Definitions.
Adds definitions for producer, and unit.

Section 35. Repeals AS 43.55.165(c) and 43.55.165(d)

Section 36. Repeals AS 43.55.011(g), AS 43.55.011(h), AS 43.55. 011(l) and AS 43.55.160(c).

Section 37. APPLICABILITY Makes identified bill sections applicable to oil and gas produced after March 31, 2006, and before December 31, 2007, to expenditures incurred after December 31, 2007, to tax credit certificates that have not been refunded, and statement and reports required to be filed after December 31, 2007.

Section 38. Provides for the assignment of current oil and gas auditors in the department of Revenue and the Department of Natural Resources and their immediate supervisors to the exempt service, but allows those individuals hired before the effective date of sec. 9 of the bill (adding these position classifications to the exempt service) to choose to continue in the classified service.

Section 39. Allows regulations adopted by the Department of Revenue and the Department of Natural Resources to be retroactively applied to April 1, 2006.

Section 40. Transitional language. Permits the Department of Natural Resources and the Department of Revenue to adopt regulations under the Administrative Procedure Act to implement the Act but provides that adopted regulations may not take effect before the effective date of the law being implemented.

Section 41. Provides for the retroactivity of certain provisions of the Act to April 1, 2006.

Section 42. Makes certain provisions in the Act effective January 1, 2006.

Section 43. Accept as provided in sec. 42, makes the Act take effect immediately.

HB

2001

(10/30/07)

PUBLIC

TESTIMONY

CVT
Blue

Thank you for allowing me ^{an} opportunity to testify on our flawed oil tax ~~system~~.

While I often times have reservation about referring to the sale of our states resources as a tax, it seems to ~~be~~ the word that has been given us and most easily communicates fiscal policy debate.

It is ~~is~~ my understanding that this committee is responsible for assessing the value of our oil resources and determining a fiscal policy that allows the state to place our oil into the market so as to "maximize the benefit" to the state.

It appears to me that this committee and indeed the legislature as a whole has abdicated ~~these~~ ^{gated} these responsibilities.

~~Why don't we take a look back~~

It's pretty clear that the Oil Industry wrote the PPT and submitted it through Gov. Murkowski.

~~It seems to me~~

This leaves the state in the unfortunate position of having to stumble into traps the industry has inserted into this complex piece of legislation. It condemns the state to a future of litigation.

The Big 3 have some of the best lawyers in the world and they love Monkeewrench law.

Just throw a monkeewrench into the already slow moving gears of justice and ~~the~~ the result is dozens of courtrooms jammed with cases similar to the Exxon Valdez damage case, now stretching into it's 30th year.

One of the reasons the Big 3 love this scenario is because the state pays the legal bill for our lawyers and theirs.

Thanks to a net profits based tax structure.

These goons write off the cost of their hired guns against ~~the~~ taxes owed the state. Or is it a direct credit? Who knows! The PPT is so flawed and complicated even our lawyers can't agree.

The legislative abdication of its responsibilities has not only led to a giveaway of our greatest resource it has put the state in a perpetual state of litigation.

Thank for that one!

Keep it simple we said. Citizens and oil experts alike warned of the perils of this type

~~at net based tax~~ at net based tax

Keep it simple we
~~had~~ said.

Gross tax ^{Point of} Production
~~based~~ tax.

For reasons that defy logic
you folks in Juneau ~~along~~
~~Republican party lines~~ decided
The cries of impoverishment
oozing from the Big 3 should
be rewarded ~~sweeteners~~, layered
with ~~credits~~ and ~~topped~~
with ~~clawbacks~~.

And reward these admitted
crooks you did.

Sweetener's layered with deductions, wrapped with credits, and topped with clawbacks.

Clawbacks! I see even our representatives are too embarrassed to defend this bit of creative accounting.

5 years of rebate, at state expense, for investment in infrastructure, a retroactive giveaway of state funds to perhaps the most profitable industry in the history of the world.

How do you explain this. The fact is it's indefensible

Please Give us a break.

If this special session ends with these "kickbacks" still intact even the least observant of us will know the fix is in.

Clawbacks

I thought it ~~was~~ some sort of joke at first. ~~Some say~~ OR maybe ~~some say~~ a ~~mistake~~ red herring to distract us while the rest of the bill was jammed down our throat.

I'd like to ask
this committee to
add a gross production
tax facet to this
piece of legislation.
I'd like to see
the state reap it's fair
share of the oil run-up.
Increasing from 2.5%
of every dollar starting
at \$50 per barrell
5% from \$40 per barrell

7.5% from \$70 per barrel
and topping out at
10% for every dollar
~~per barrel above~~
~~\$70~~ when the price
of oil bests \$80
per barrel.

These numbers
certainly could be
fine tuned by finance
or the Revenue Dept.
But you get the idea

Keep it Simple
The state deserves
it's fair share of
\$100+ a barrell oil
and it's your
constitutional obligation
to see that she gets
it -

Thank you
and good luck

Mark Sharp
907 479 5657

GREATER * FAIRBANKS CHAMBER OF COMMERCE

100 Cushman St., Suite 102, Fairbanks, AK 99701
phone: (907) 452-1105, fax: (907) 456-6968

e-mail: info@fairbankschamber.org
website: www.fairbankschamber.org

October 29, 2007

The Honorable Sarah Palin, Governor
and
The Alaska State Legislature
Alaska State Capitol
Juneau, Alaska 99801

Dear Governor and Legislators:

The mission of the Greater Fairbanks Chamber of Commerce is to advocate for, and support, a strong investment and economic development climate in our community and our state. With this commitment in mind, the Chamber was a close observer of last year's PPT discussion. So it follows that this year's debate on a proposed replacement is being monitored just as carefully.

When all tax policy is concerned, the Chamber recognizes the delicate balance that must be struck. The State's petroleum assets are non-renewable. As such there is only one opportunity to receive fair value from the severed resource. On the other side of the fulcrum lies the responsibility to implement a tax structure conducive to enhancing future revenue opportunities through creation of a positive investment climate for businesses large and small.

Last year the Chamber supported replacing the obsolete ELF system with PPT, a plan designed to star revenues to the State that would satisfy a contemporary notion of "fair share". Of equal importance to Chamber members was PPT's tax credit program designed to kick-start an investment cycle that would help sustain the State until commercial quantities of North Slope natural gas could be delivered to market. The Chamber remains a strong advocate for both of these vital development objectives.

The Administration's ACES proposal has raised much concern among Chamber membership regarding the prudence of completely revamping a tax system that has been on the books only a short time. As proposed, ACES would change every single one of the PPT variables. These include:

- Net Rate
- Floor Rate
- Progressivity Rate
- Progressivity Starting Point
- Investment Tax Credit Structure

The Department of Revenue, in its August 2007 PPT Implementation Status Report, acknowledges that it is too early to tell if the PPT system will have the desired effect. So while it might be entirely possible that PPT will need some minor modifications to achieve the intended purpose, how do we know what these might be absent a sufficient assessment period?

PPT has returned a level of revenue to the State which is substantially higher than the ELF system it replaced. Yet, the Status Report complains that industry capital and operating costs have exceeded projections and as a result anticipated tax revenues

Benefactors

DIAMOND

Alaska Pipeline Service Co.
BP Exploration
Cotton Petroleum
Fairbanks Daily News Miner
Fairbanks Memorial Hospital
& Donnell Center
Hill Hills Resources Alaska
GCI
Suhner's Flowers & Gifts
Wells Fargo

PLATINUM

Alaska Airlines
AT&T Alaska
Golden Heart Utilities
Mt. McKinley Bank
Phone Directorate Company
The Carbon Center

GOLD

Alaska Railroad
Alaska USA
Denali State Bank
Design Alaska
Dorson, LTD
First National Bank Alaska
Laborers Union Local 042
Military & Civilian KCU
Northern Bank
The Docking Co.
Unibell Coal Mine

SILVER

AFC
A/S Merrill
Blue Wire Technologies
Enron/Mobil
Fairbanks Building &
Construction Trades
Fairbanks Natural Gas
Flowing Alaska
Fred Meyer
DVA
Key Bank of Alaska
Personal Plus
Sethna Ford, Lincoln, Mercury
Tanana Valley Clinic
YQTE
UAF

GREATER * FAIRBANKS CHAMBER OF COMMERCE

100 Cushman St., Suite 102, Fairbanks, AK 99701
phone: (907) 452-1103, fax: (907) 456-6968

e-mail: info@fairbankschamber.org
website: www.fairbankschamber.org

have not met expectations. The Report goes on to acknowledge the recent spate of extraordinary price increases for labor and materials that have beset the industry.

Upward spiraling cost trends defy accurate projections. Anybody in business during the 1970s or early 80s can attest to this. Revamping PPT to take a larger tax cut serves only to exacerbate this cost pressure. And it certainly does not work to achieve the investments the State needs on the North Slope. A final word on costs, the Department of Revenue Spring 2007 Revenue Source Book was prescient in its closing statement regarding PPT. "The PPT system is designed to encourage additional investment. If PPT is successful, costs will increase in the near term and production will increase shortly thereafter."

Of concern to all State residents is the implication that PPT deliberations were subject to undue influence. Much of the discussion on PPT centered on whether the tax rate should be 20% or 25%. Strong personalities on both sides argued the relative merits of each alternative. Yet, it's important to note that ultimately the Legislature did what legislatures do -- it compromised. In this case at a very predictable rate of 22.5%. While this was not the level the Chamber supported, membership understands the value in compromise and reconciliation in the interest of achieving a greater goal.

The Chamber membership applauds the Administration's efforts to enhance the quality of information flowing to and from State agencies as well as improving the structural flow of information among its various departments. Furthermore, the Chamber supports the Administration's desire to improve the level of expertise applied to complex tasks necessary to validate compliance with State law. These are prudent managerial objectives which could likely be accomplished in a non-statutory manner.

In summary, the Greater Fairbanks Chamber of Commerce supports the Administration's efforts relating to the gathering and sharing of information as well as the need to attract higher levels of expertise in certain tax accounting fields. With respect to the Administration's tax proposal, it is clear that ACES cannot possibly serve the State's interest in fostering a stable investment climate necessary to secure sustainable levels of North Slope oil production. Therefore, the Chamber cannot support the Administration's desire to completely overhaul the PPT tax system after just one year of experience.

Sincerely,

Charlie Bockley
GCCC Board Chair

Brian E. Hove
GCCC Government Relations Committee Chair

Benefactors

DIAMOND

- Alaska Pipeline Service Co.
- BP Exploration
- ConocoPhillips
- Fairbanks Daily News Mirror
- Fairbanks Memorial Hospital & Medical Center
- Front Hills Resources Alaska LLC
- Santitas Flowers & Gifts
- Wells Fargo

PLATINUM

- Alaska Airlines
- AT&T Alaska
- Golden Heart Utilities
- MC McKinley Bank
- Phone Directories Company
- The Carlson Center

GOLD

- Alaska Railroad
- Alaska USA
- Bank of Alaska
- Design Alaska
- Dayco, LTD
- Frost National Bank Alaska
- Laborers Union Local 012
- Military & Civilian FCL
- Northstar Bank
- The Bowling Co.
- United Coal Mine

SILVER

- ACS
- ACS Media
- Blue Wire Technologies
- Canon Mobile
- Fairbanks Building & Construction Trades
- Fairbanks Natural Gas
- Flowline Alaska
- Fred Meyer
- GVEA
- Key Bank of Alaska
- Personnel Plus
- Shelburne Ford, Lincoln, Mercury
- Tanana Valley Clinic
- TORE
- UAF

TOM LAKOSH P.O. BOX 100648 ANCHORAGE, AK 99510 Ph/Fax (907) 563-7380
October 30, 2007

TESTIMONY ON HB 2001, ACES

My alternative to ACES is called **TRIPS**, Taxes, Royalties and Infrastructure for the Petroleum Sector. There are some, albeit few, sections of ACES that would be useful but the basic principles at work that require a wholesale reworking of the Bill are:

- Virtually all oil bearing structures on state lands have been explored so there's little reason to provide incentives to the industry to explore where they have already exploited everything they could. BP made this clear in their statement that 70% of their future investment would be in the greater Prudhoe area where they are obligated to wisely extract the hydrocarbons pursuant to the applicable leases and AOGCC guidelines. If producers don't provide full and efficient extraction in the operation plans submitted to the Division of Oil and Gas, leases may be subject to revocation and "there's always other fish in the sea". We should not give existing producers kickbacks where they're obligated to do the job properly and within technological feasibility and economic limits under their existing lease contracts and applicable law. With the price of oil above \$80 there should be little left to recover in our legacy fields and we must demand that the ADOG conduct the mandated evaluations of the economic feasibility of heavy oil extraction now while we still have light oil to mix into TAPS shipments and the price is still high enough to warrant extraction without subsidy.
- Where extraction of heavy or viscous oils is necessarily tied to the availability of lighter oils, the ADNR and AOGCC must conduct the proper technology and economic analyses to insure the optimization of revenues from regulation of the rates heavy and light oils are extracted. The ADNR and AOGCC must thereafter issue the necessary directives to lessees to insure that lessees are producing each type of hydrocarbon on their leases in manner that optimizes the total revenues to the state. There is no quantifiable correlation between the oil production rates or total state revenues and the tax rates so the proper oversight of our regulatory agencies, ADNR/ADOG must be conducted to insure that they regulate lessees to the optimal benefit of the state in conformance with Article VIII Section 2 and the applicable statute, regulations and lease provisions. Only then could the legislature determine if additional tax write-offs and credits would be necessary to ensure maximum benefit to the state and even then it would be preferable to provide ADNR/ADOG additional tools for incentivizing development because they could apply such incentives with surgical accuracy to specific leases and production units where taxes, no matter how specific, would tend to waste considerable revenue to produce the same hydrocarbon production/revenues.
- The fair legislative investigation of this tax matter mandated by Article I Section 7, necessitates that this committee call ADNR/ADOG to testify on its approval of unit and lease operation plans and explain: their best interest findings, the economic feasibility findings for hydrocarbon extraction required by lease provisions as associated with lease/unit plans of operation; and what their projections are for production at specific fields and for specific hydrocarbons in an effort to reach the maximal benefit to the state. Unless and until ADNR/ADOG produces findings that royalty relief is necessary to reach optimal production rates, any subsidy envisioned in tax write-offs and credits could only produce a negative fiscal note. Moreover, any fiscal note produced absent this detailed investigation would be arbitrary and capricious where there would be no basis for relating what production/revenue was already required of

producers in comparison to what the tax legislation was predicted to create. The sad fact of the matter is that ADNR/ADOR has never performed any independent economic feasibility analyses of the operation plans proffered by producers to evaluate whether the state was receiving, or would receive in the future, maximum benefit from the producers' plans of operation. This administrative dereliction of duty must be rectified before the legislature can move forward with any additional incentives to industry beyond what is already provided for in AS 38.05.180. The producers have not utilized the current royalty reduction incentives and should not be allowed to "buffalo" an ill informed legislature into granting an "end run around" the ADNR/ADOR regulations that were specifically designed to prevent such relief without a thorough economic assessment that shows a clear justification for relief. The applicable statutes and regulations actually envision that operational plans required to generate optimal production over the life of the field may in fact demand that lessees operate at a net loss near the end of the field life. Where the legislature imposes write-offs and credits over this regulatory scheme, tax revenues could be eliminated and we might even have to pay producers 20% of costs where they generated no tax revenue at all due to write-offs. This situation would clearly require posting of a negative fiscal note that would violate the constitutional mandate to maximize public benefit. The legislature must first require ADNR/ADOG to exhaust their administrative duties and lessees must also first exhaust their administrative remedies before any additional incentives such as write-offs or credits are offered.

- If absolutely necessary, we can subsidize production of hydrocarbons that are difficult to develop by adjusting royalty rates instead of taxes. This would allow for lease by lease evaluation that is clearly more sensible than the broad subsidies to all operations. The royalty rates apply to gross production so the 19% range I've suggested has more than enough value available to provide incentive for development of heavy oils and remote gas should existing lessees submit, or new lessees sign on, to the new adjusted royalty rates that express the relative accessibility and marketability of specific lease types at specific distances from established infrastructure.
- The testimony clearly enforced the principle that "if you build it they will come". Angola got a \$1 billion for its leases and rabid global competition because the oil co's knew there was oil to develop. If there's oil/gas to be found, the state should find it and define the field before it puts out leases so it can garner the highest bids among many competitors. The state would also be better able to predict development, classify fields to establish proper royalty rates and determine appropriate deadlines for relinquishment. The more we improve information on prospective fields and insure access, the less we need speculators that demand high rates of return. When we eliminate the discovery and access impediments we essentially only need contractors to build the production facilities and pump the oil as regulated by ADNR and AOGCC.
- If we have to subsidize the industry we should do it in a way that benefits other businesses and public interests. Taking money from royalties to improve transportation to the fields/pipelines floats everybody's boat. The heavy lift helicopters and low impact transport would also reduce tundra impacts, allow a longer exploration season and year round deliveries to isolated drilling/production pads. They would also be extremely effective tools for getting spill response equipment to remote sites and help repair global warming damage in remote areas that is directly caused by the oil we peddle.
- Our economic future through 40 - 60 years depends on our ability to market gas and the gas will not be marketable until the relative BTU value of gas approaches the price of oil BTUs, (PVM said it was at 40% of oil because Northern Tier coal companies successfully marketed their coal to power plants). The relative BTU value of gas can only be increased by de-valuing coal as a