ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SRES 12701

7. Allowable Lease Expenditures AS 43.55.165 (e) (19)

- Compared with SB 80 approach which was built around the concept of "improper maintenance"
- Under current property tax law (AS 43.56), state actually taxes "replacement cost new less depreciation" or "as-if" North Slope facilities generated by cost studies. Millions of state and company dollars and spent on these models.
- Would probably build AS 43.55 "as-if" "well maintained" facilities

7. Allowable Lease Expenditures AS 43.55.165 (e) (19)

- Currently topping plants generate diesel on North slope that is used in production, and costs of plant are allowed.
- Under proposal cost of plant not allowed; instead “fair market value” of diesel less prevailing value of crude.
  - Market may not be broad
  - Specific plant under consideration

8. State Purchase of Credits (AS 43.55.028)

- Currently allowed if
  - Less than 50,000 bbls a day – i.e. not one of the big 3
  - Reinvest in state (including lease bids)
  - Taxpayer has no other delinquent taxes
  - Limited to $25 million a year
- Proposal eliminates $25 million limit
- Proposal establishes fund with percentage of tax revenues
- Removing cap not necessarily tied to separate fund.

9. Information AS 43.55.040 (5) & (6)

- Requires taxpayer "to file reports and copies of records that are considered by the department as necessary to forecast state revenues under AS 43.55"; $1,000 a day penalty
- Regulations will be needed to define
  - "necessary" (as opposed to say useful),
  - how far in advance (one, two, many years?)
  - how often the reports need to be updated (monthly, 1% change, change out three years…?
  - How far does due diligence have to go? Board of directors discussed 5 year plan?
  - Can State audit for information not provided, and assess 2amonthly 2 million penalty starting 6 years from now?

9. Information (general rule AS 43.05.230 – proposed rule AS 43.55.890)

- Currently under AS 43.05.230 (e) DOR can publish statistics with individual data combined so as to "prevent the identification of particular returns or reports"
- Proposal only requires combination of three taxpayers "regardless of whether the information …prevent[s] the identification of particular returns or reports"

9. Information (general rule AS 43.05.230 – proposed rule AS 43.55.890)

- Was described as "same as DOR does for Salmon Pricing Report"

- Alaska Salmon Price Report reporting rules are *not* removed from general AS 43.05.230 (g) – the general reporting tax confidentiality rules.

9. Information
Alaska Salmon Price Report

- Sec. 43.80.065. Confidentiality of reports.

Information in reports submitted under AS 43.80.050 , and price averages calculated by the department from the information in the reports, are public information, except that information that identifies or could be used to identify a particular fish processor is confidential.

9. Information
Alaska Salmon Price Report

- "We use the following guidelines when evaluating confidentiality
  - If there are three or more processors for a given are, the information is reported unless one processor accounts for over 80% of total value, or two processors account for over 95% of total value.
  - If there are only one or two processors for a given are, the information is not reported"
    - From Cover letter - October 15, 2007 Alaska Salmon Price Report

9. Information - (AS 43.05.230(h))

- Proposal will require DOR to share information with DNR obtained under AS 43.55 – including forward looking information required by AS 43.55.040 (5).
- This may have competitive implications if DNR returns to markets as seller of royalty in kind (RIK) oil or gas.

9. Information – AS 43.55.030 (e) and (f)

- Proposes to set forth in statute the actual data required to be filed by taxpayers. Thorough summary of costs, volumes, sales, monthly estimates etc.

10. Statute of Limitations (Old general AS 43.05.260, new AS 43.55.075)

- Proposed extension from 3 years to 6 years
  - Currently frequently extended by mutual agreement of parties
  - Ability to assess$1,000 a day reporting penalties also extended

11. Auditors as Exempt Employees

- Good step to enter a competitive market.
- DOR income auditors also face national corporate income tax staffs. Income tax (both special oil and gas and general) generate over ½ billion dollars a year in tax revenues.

12. Other Admin – Information Management System

- Electronic Information – including information beyond that required for the payment of the tax such as returns, statements, reports, notifications and applications- "in a form or manner approved or prescribed by the department."
- May be great – and the kind of thing you would have seen me pushing for when I was Director of Tax, bringing the Division into the 21st century

12. Other Admin – Information Management System

- It may be information the taxpayer have already – but it may not be in our format. Especially for forward looking information, there may be burden on the taxpayer to restate material
- Do we miss underlying changes because we force financial data into our world view as defined by our forms?

12. Other Admin; Interest (AS 43.55.020 (g))

- Note: Concerns about interest in Dr. van Meurs' 10/18/07 presentation unfounded.
- IRS interest rules only apply to estimated payments through march 31 – then switch to higher state rate found in as 43.05.225 (11%)

13. Cook Inlet Simplicity

- Suggest Cook Inlet Ceilings could be implemented more simply.
  Current statutory language historical product
  - Currently calculations have to be done individually for each lease or property, (twice if produces gas and oil)
  - Could be done Once for Cook Inlet
  - Regulations imported into Statute

13. Cook Inlet Simplicity

- Two rules –
- (1) Ceilings - Cook Inlet oil remain zero and gas taxes preserve 2005-2006 gas prices, tax rates and ELF (volumes are actual) until 2022
- (2) Because Ceilings were meant to benefit consumers, not producers, any pertinent credits and losses that would have been needed to reduce CI taxes to ceilings cannot be applied elsewhere – Taxpayer doesn't get benefits of credits and ceilings.

13. Cook Inlet Simplicity

- CI Tax without ceilings or credits: $10
- Apply "CI Credits" (5)
- Tax after Credits 5

- Ceiling $3

- Taxpayer cannot pay $3 in tax, and then try to sell $5 credit

14. Effective Date

- Generally Effective January 1, 2008
  - Two good tax policies
  - change corresponded to tax year
  - Limited retroactivity
    - Corrosion provisions retroactive.

Senate Resources Committee SB 2001 Context

Presentation by Dan E. Dickinson, CPA
For Legislative Budget & Audit Committee
October 22, 2007

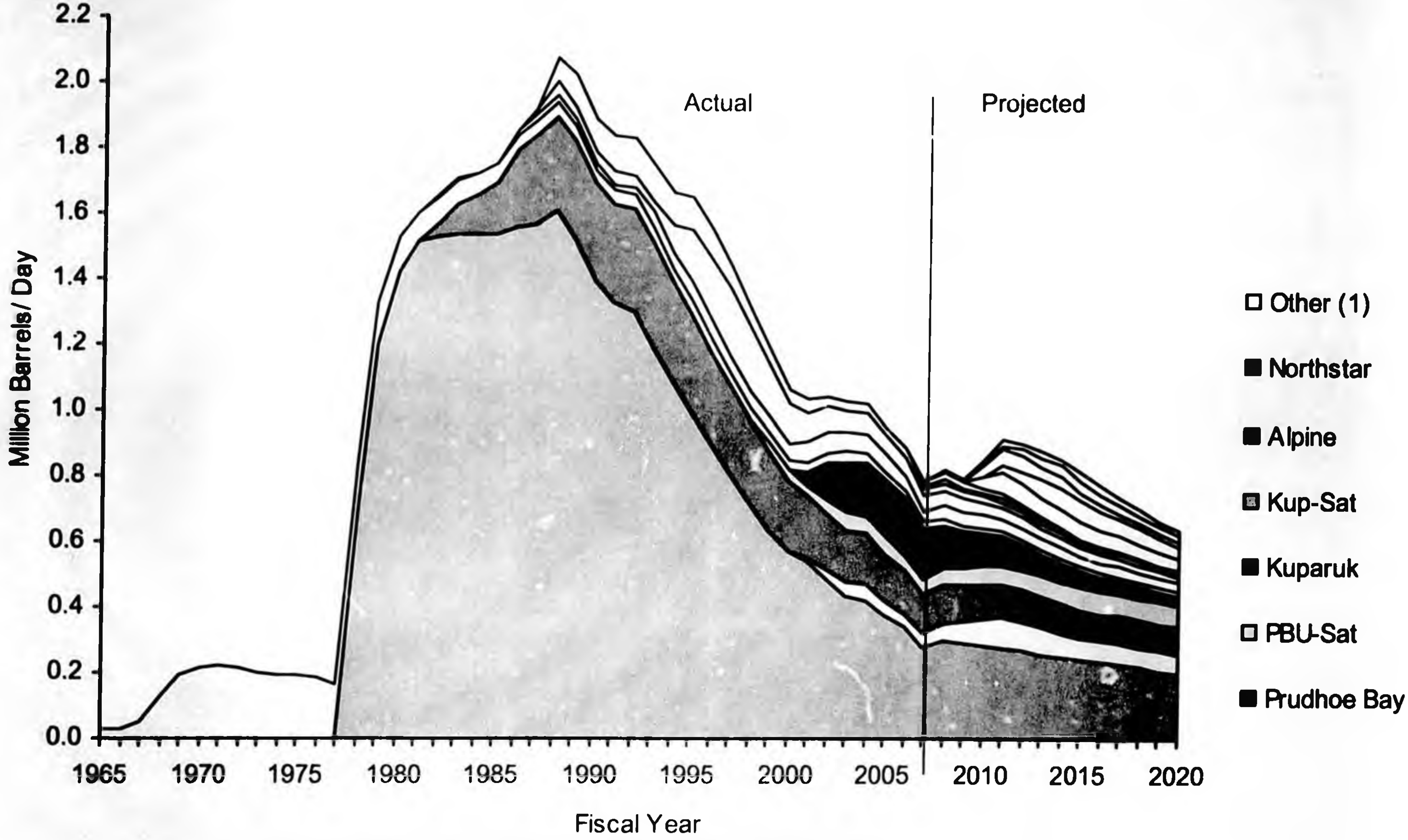
Outline

- Part I: Context - Observations from 30,000 feet
  - Clear tax rules are better than an approval process in front of a government agency
  - Broad and Robust rules applied to everyone better than a narrow rule applied to a single or few (known) taxpayers
  - Windfall Profits can be an effective taxing tool
  - Information informs judgments
- Part II: Detail – applies these conclusions to SB 2001, section by section.

What's going on?

- Is this a discussion of tax – or is trying to "initiate a bidding round."
- Is this a commercial discussion with partners or is it a debate on fiscal policy?

Alaska Oil Production, 1965 - 2020



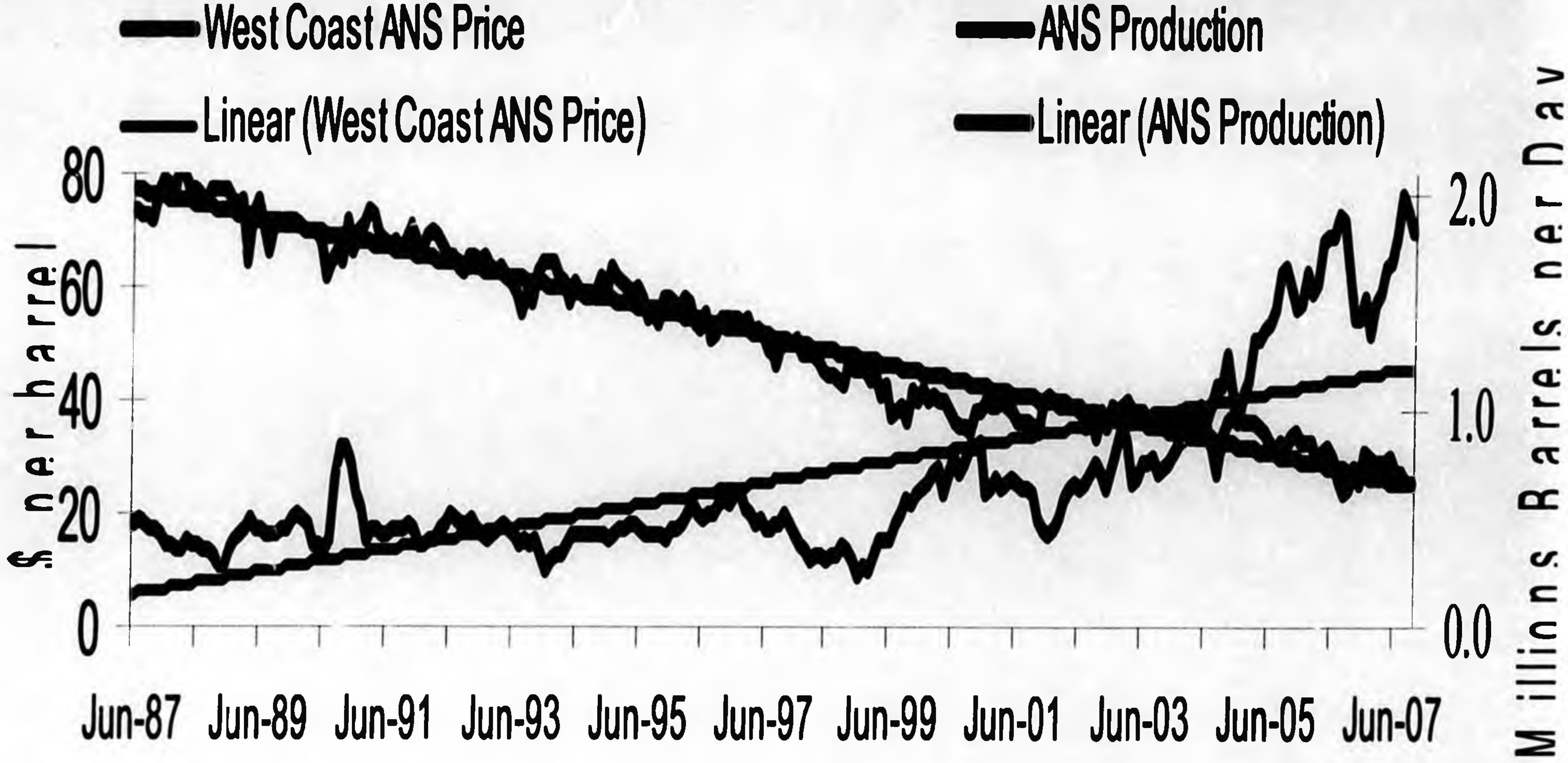
Source: Alaska Department of Revenue, Fall 2006 Revenue Sources Book. extrapolated

(1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.

ANS West Coast Price, July 1977 – Sept 2007

Source: Alaska Department of Revenue, Tax Division

ANS West Coast Price and Oil Production



Source: Alaska Department of Revenue, Tax Division

Production vs. Price

- 2 million barrels a day at $15 = $30 million
- .7 million barrels a day at $80= $56 million

- .7 million barrels a day at $15 = $10 million

Alaska Constitution

- **Article 1 - Declaration of Rights**
- **§ 1. Inherent Rights**
- This constitution is dedicated to the principles that all persons have a natural right to life, liberty, the pursuit of happiness, and the enjoyment of the rewards of their own industry; that all persons are equal and entitled to equal rights, opportunities, and protection under the law; and that <u>all persons have corresponding obligations to the people and to the State.</u>

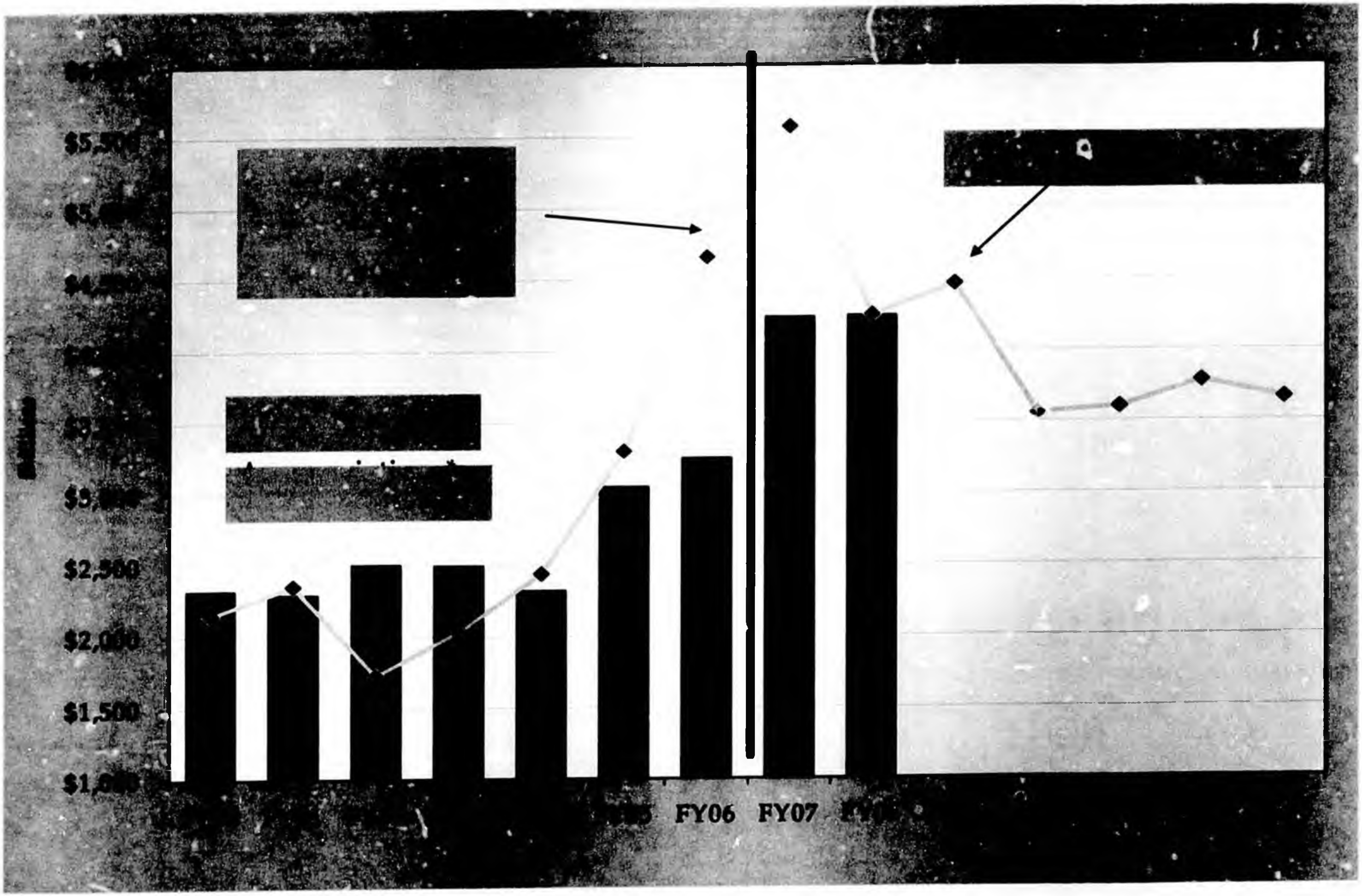
- Moving beyond the idea of taxes as a set of mutual obligations within a society – and focusing on ‘leaving money on the table.’
  - For a tax - rules are better than seeking approvals from regulatory agencies.
  - For a tax - broad and robust rules are better than narrow rules that affect one or a few (known) taxpayers.

- What is the right level of tax?
  - If you believe that there are windfall profits that should be accruing to the government (the people) and not oil companies – then there should be a windfall profits tax.
  - If you believe this is just another commercial arrangement and only chumps take a net, then our piece should be a piece of the gross.

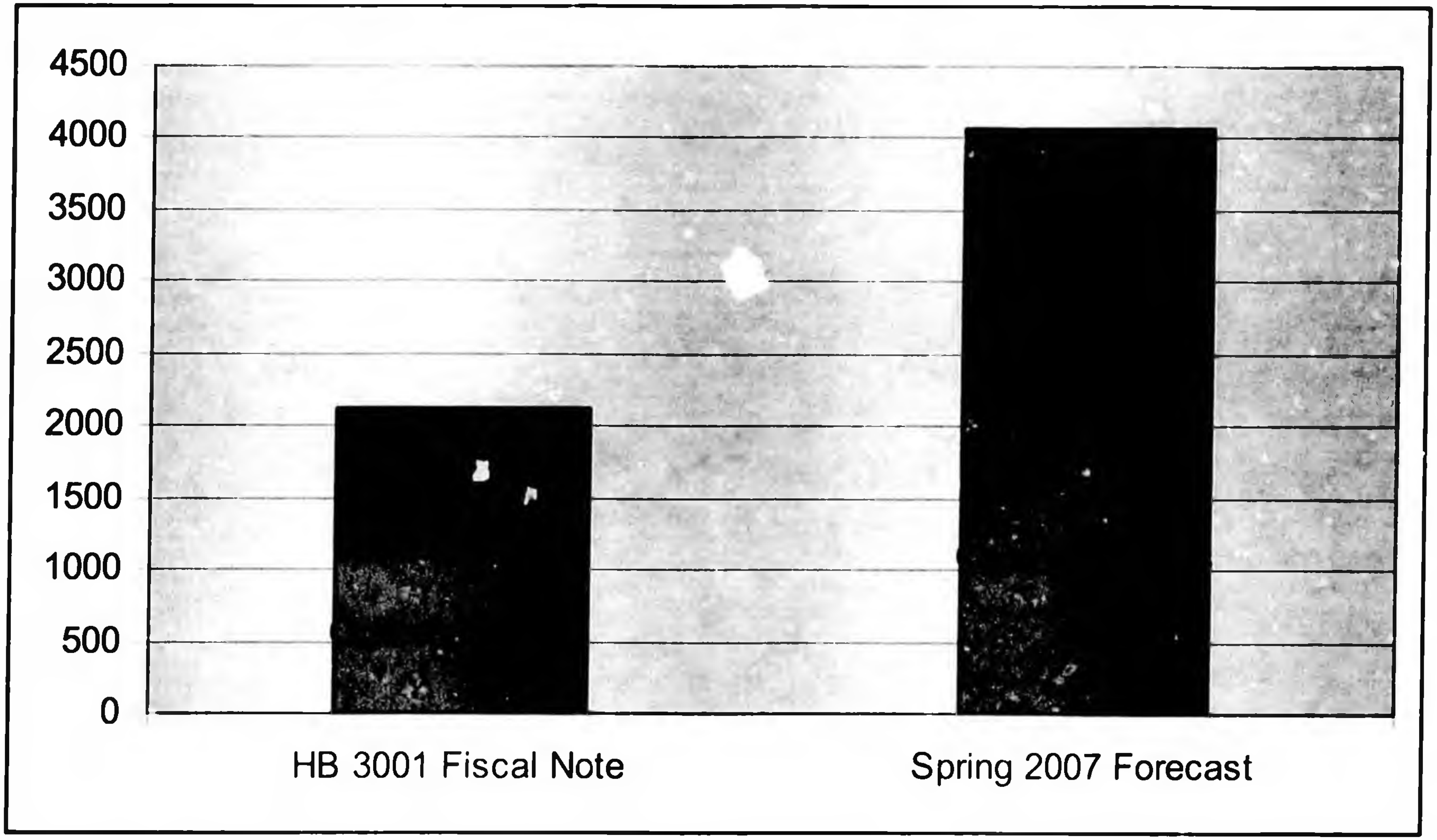
Taxation is said to be an absolute power… and like sovereign power of every other description, is trusted to the discretion of those who use it.

Chief Justice Marshal in McCulloch v Maryland (1819)

Increasing Costs



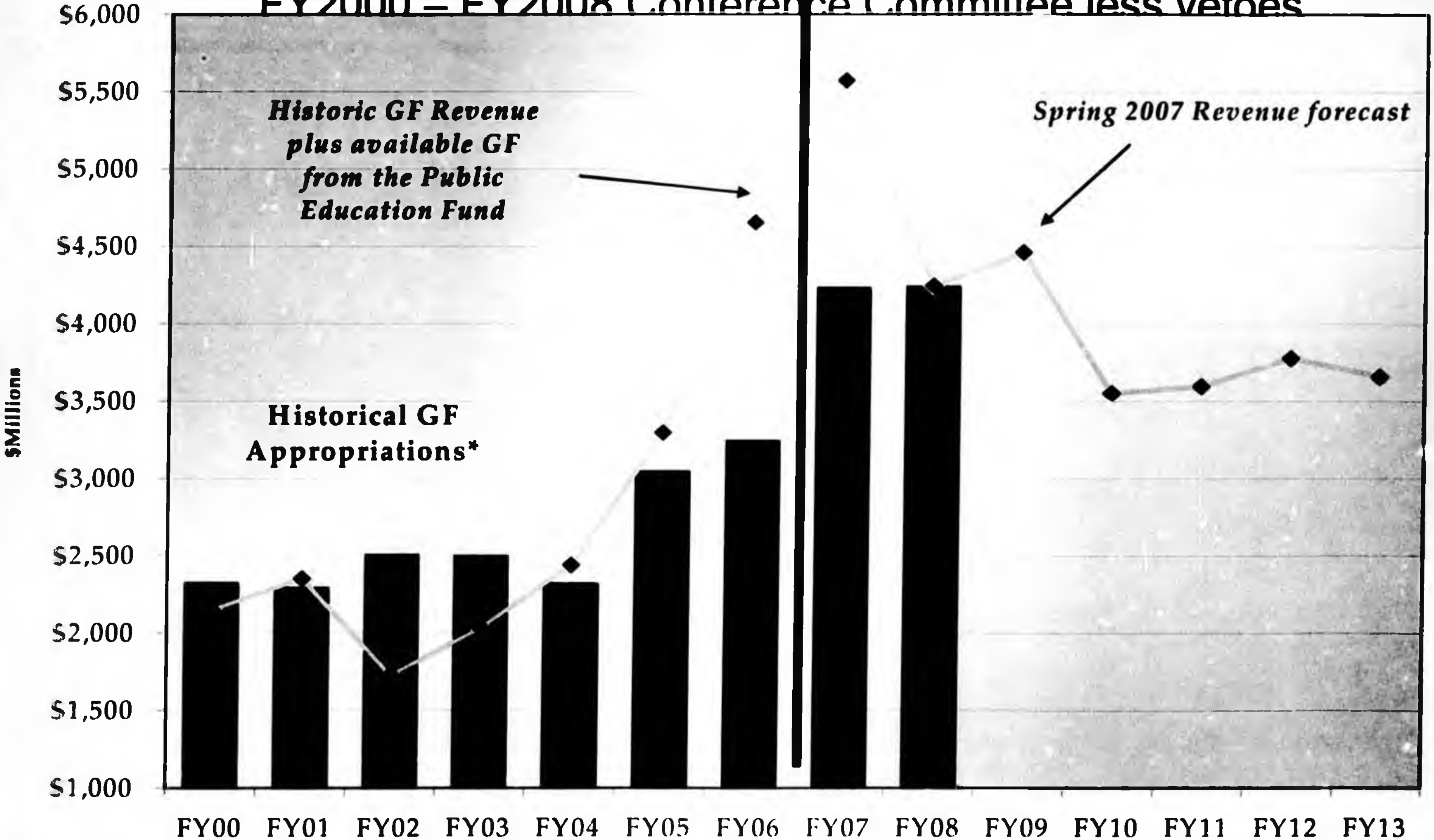
FY 2007 Operating Cost Assumption ($millions)



Source: DOR August 3, 2007 report

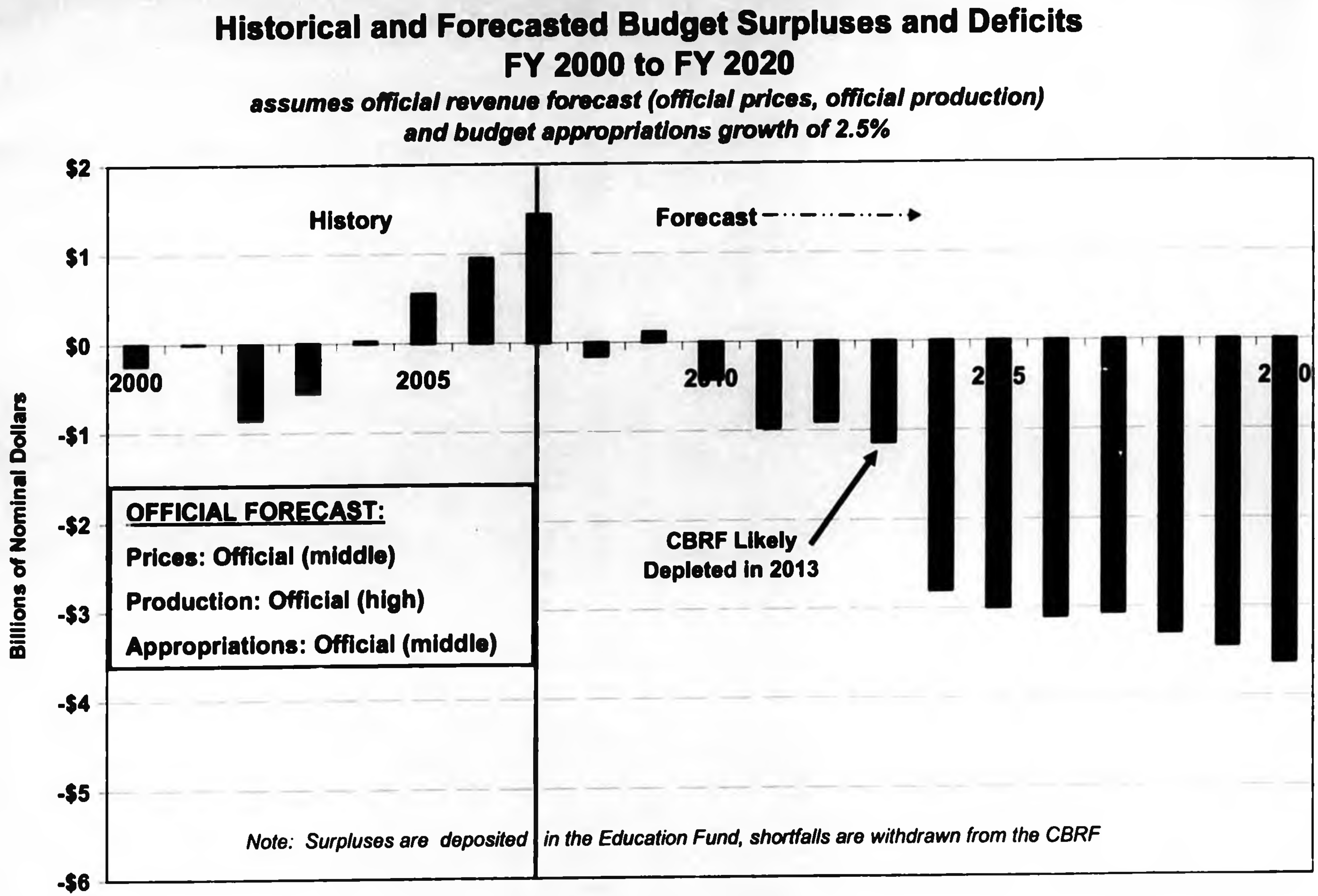
General Fund Revenue including Public Education Fund versus Appropriations*

FY2000 – FY2008 Conference Committee less vetoes



*Excludes appropriations to Public education Fund and some other savings accounts. For example, FY07 excludes $1.000 appropriation to Public Education Fund, $182.7 million appropriation to Power Cost Equalization Endowment, $50.0 million to CBR and estimated $104.7 appropriation to the Alaska Capital Income Fund.

Source: Office of Management and Budget and Alaska Department of Revenue Spring 2007 Revenue Sources Book.


Historical and Forecasted Budget Surpluses and Deficits
FY 2000 to FY 2020
assumes official revenue forecast (official prices, official production)
and budget appropriations growth of 2.5%
History
Forecast
Billions of Nominal Dollars
$2
$1
$0
-$1
-$2
-$3
-$4
-$5
-$6
2000
2005
OFFICIAL FORECAST:
Prices: Official (middle)
Production: Official (high)
Appropriations: Official (middle)
CBRF Likely
Depleted in 2013
Note: Surpluses are deposited in the Education Fund, shortfalls are withdrawn from the CBRF

Information

- Information informs and helps with judgments - But it doesn't usually "speak for itself":
- What would have happened differently in FY 2007 with better information?

FY 2007 first snapshot

FY 2007 - All figures in millions of dollars	Regular Session - May 2006
TOTAL GF REVENUE:	
Oil and Gas Property Tax	36.7
Oil and Gas Income Tax	479.2
Oil and Gas Production Tax	959.8
Oil and Gas Hazadous Release	7.8
Oil and Gas Royalties	1,524.9
Total Oil & Gas	3,008.4
Non oil and gas: All other Taxes, Charges, fines & Forfeitures, Rents, non oil and gas Royalties, Investment Revenues	428.3
Total GF Revenue	3,436.7
Forward funding of Education used in current year:	
TOTAL GF Appropriations/Authorizations:	3,209.1
SURPLUS	227.6

Source: Leg Finance and DOR Spring 2006 RSB; average forecast price$53.60

FY 2007 second snapshot

FY 2007 - All figures in millions of dollars	Regular Session - May 2006	PPT	Special Session Aug 2006
TOTAL GF REVENUE:			
Oil and Gas Property Tax	36.7		36.7
Oil and Gas Income Tax	479.2		479.2
Oil and Gas Production Tax	959.8	1,343.0	2,302.8
Oil and Gas Hazadous Release	7.8		7.8
Oil and Gas Royalties	1,524.9		1,524.9
Total Oil & Gas	3,008.4		4,351.4
Non oil and gas: All other Taxes, Charges, fines & Forfeitures, Rents, non oil and gas Royalties, Investment Revenues	428.3		428.3
Total GF Revenue	3,436.7	1,343.0	4,779.7
Forward funding of Education used in current year:			
TOTAL GF Appropriations/Authorizations:	3,209.1		3,493.6
SURPLUS	227.6		1,286.1
Note: FY 2006 PPT payment in 2007		420.0	
FY 2007 payments in 2006:		923.0	
		1,343.0	

FY 2007 third snapshot

FY 2007 - All figures in millions of dollars	Regular Session - May 2006	Special Session Aug 2006	Spring Forecast 2007	Rec to Leg Fin 2007
TOTAL GF REVENUE:				
Oil and Gas Property Tax	36.7	36.7	52.0	
Oil and Gas Income Tax	479.2	479.2	565.1	
Oil and Gas Production Tax	959.8	2,302.8	2,114.2	
Oil and Gas Hazadous Release	7.8	7.8	10.4	
Oil and Gas Royalties	1,524.9	1,524.9	1,583.0	
Total Oil & Gas	3,008.4	4,351.4	4,324.7	
Non oil and gas: All other Taxes, Charges, fines & Forfeitures, Rents, non oil and gas Royalties, Investment Revenues	428.3	428.3	655.5	
Total GF Revenue	3,436.7	4,779.7	4,980.2	
Forward funding to Public Education Fund used in current year:				572.9
Total:				5,553.1
TOTAL GF Appropriations/Authorizations:	3,209.1	3,493.6	4,980.2	
Forward funding to Public Education Fund used in current year:				572.9
Total:				5,553.10
SURPLUS	227.6	1,286.1	-	
NB: CBRF:	20.0		70.0	

FY 2007 comparisons

FY 2007 - All figures in millions of dollars	Special Session Aug 2006	Spring Forecast 2007	difference	%
TOTAL GF REVENUE:				
Oil and Gas Property Tax	36.7	52.0	15.30	42%
Oil and Gas Income Tax	479.2	565.1	85.90	18%
Oil and Gas Production Tax	2,302.8	2,114.2	(188.60)	-8%
Oil and Gas Hazadous Release	7.8	10.4	2.60	33%
Oil and Gas Royalties	1,524.9	1,583.0	58.10	4%
Total Oil & Gas	4,351.4	4,324.7	(26.70)	-1%
Non oil and gas: All other Taxes, Charges, fines & Forfeitures, Rents, non oil and gas Royalties, Investment Revenues	428.3	655.5	227.20	53%
Total GF Revenue	4,779.7	4,980.2	200.50	4%

Information

- When and how would a 'better' forecast have made a difference?
- When and how would closer monitoring have made a difference?
- Separate debate about regulatory control issues – but that is different from the fiscal debate.
- Separate issue about long term policy

One way to use the information:

Simple Model of FY 2008 Production Tax Revenue to match Administrations Sept 4th Handouts:

Price Scenarios on Sept 4 Handout	Annual Volumes (w/o royalty)	Total Destination Value of non Royalty Barrels	Less Downstream costs from RSB	Less Upstream costs (capex and opex) from RSB	Resulting Production Tax Value	Tax Rate	Base Tax Calculation at 22.5% and 25% and difference	Per Barrel Production Tax Value	Adjustment fc Price Index Calculation	Price Index	Progressivity Rate per Price Index Dollar	Resulting progressivity rate	Progressivity Tax = Rate times value	Total Tax before credits	TIE Credits (Transitional Investment Expenditures)	Capital Costs * 20% or .10%	Tax net of credits	Tax per Price Scenarios on Sept 4 Handout	Unaccounted for in this simple model	Unaccounted f model
						Base Tax		Progressivity							Credits					
$/bbl	MM bbls	MM $	MM $	MM $	MM $	%	MM $	$/bbl	$/bbl	$/bbl	%	%	MM $	MM $	MM $	MM $	MM $	MM $	MM $	%
A	B	C= (A * B)	D	E	F= (C+D+E)	G	H= (F*G)	I= (F/B)	J	K= (I-J)	L	M= (K*L)	N= (M*F)	O= (H+N)	P= (Q/2)	Q=	R= (O+P+Q)	S	T (S-R)	U= (T/S)
Under Current Law																Total Cost:				
		Per bbl:	(7.22)													1,900.0				
30	244	7,320	(1,762)	(4,058)	1,500	22.5%	337.6	6.15	40.00					337.6	(190.0)	(380.0)	-	-		
40	244	9,760	(1,762)	(4,058)	3,940	22.5%	886.6	16.15	40.00					886.6	(190.0)	(380.0)	316.6	200	(116.6)	-58%
50	244	12,200	(1,762)	(4,058)	6,380	22.5%	1,435.6	26.15	40.00					1,435.6	(190.0)	(380.0)	865.6	700	(165.6)	-24%
60	244	14,640	(1,762)	(4,058)	8,820	22.5%	1,984.6	36.15	40.00					1,984.6	(190.0)	(380.0)	1,414.6	1,300	(114.6)	-9%
70	244	17,080	(1,762)	(4,058)	11,260	22.5%	2,533.6	46.15	40.00	6.15	0.25%	1.54%	173.1	2,706.7	(190.0)	(380.0)	2,136.7	2,000	(136.7)	-7%
80	244	19,520	(1,762)	(4,058)	13,701	22.5%	3,082.6	56.15	40.00	16.15	0.25%	4.04%	553.1	3,635.7	(190.0)	(380.0)	3,065.7			
Under Changes indicated in Sept 4th Handouts																				
30						25.0%	375.1	6.15	30.00					375.1		(190.0)	185.1	200	14.9	7%
40						25.0%	985.1	16.15	30.00					985.1		(190.0)	795.1	800	4.9	1%
50						25.0%	1,595.1	26.15	30.00					1,595.1		(190.0)	1,405.1	1,300	(105.1)	-8%
60						25.0%	2,205.1	36.15	30.00	6.15	0.20%	1.23%	108.5	2,313.6		(190.0)	2,123.6	2,000	(123.6)	-6%
70						25.0%	2,815.1	46.15	30.00	16.15	0.20%	3.23%	363.7	3,178.8		(190.0)	2,988.8	2,900	(88.8)	-3%
80						25.0%	3,425.1	56.15	30.00	26.15	0.20%	5.23%	716.5	4,141.6		(190.0)	3,951.6			
Incremental Change: Proposal less Current Law																				
30							37.5							37.5	190.0	190.0	185.1	200	14.9	7%
40							98.5							98.5	190.0	190.0	478.5	600	121.5	20%
50							159.5							159.5	190.0	190.0	539.5	600	60.5	10%
60							220.5		(10.00)	6.15		1.23%	108.5	329.0	190.0	190.0	709.0	700	(9.0)	-1%
70							281.5		(10.00)	10.00		1.69%	190.6	472.1	190.0	190.0	852.1	900	47.9	5%
80							342.5		(10.00)	10.00		1.19%	163.4	505.9	190.0	190.0	885.9			

Work To Date

- **Summary** Comparison between Governor's October 1, 2007 Production Tax Proposal and Current Law (2 pages dated 10/8/07)
- **Detail** Comparison between Governor's October 1, 2007 Production Tax Proposal and Current Law (6 pages dated 10/8/07)
- Preliminary estimate of the FY 2008 revenue effects of four changes proposed by Governor Sarah Palin to the oil and gas production tax as 43.55 ON Sept 4, 2007 and October 1, 2007 (October 3, 2007)
- Sectional Analysis (with Steve Porter) On October 1 work draft, and supplemental analysis on SB/HB 2001

Part II -detail

Looking for places where

- tax rules are replaced by the discretion of an agency (or vice versa)
- Broad and robust rules are replaced with narrow specific approaches.
- might make production tax, or features of it look more or less like a windfall profits tax
- Data might not yield hoped for information

REPORT TO THE ALASKA STATE LEGISLATURE

on the

PRELIMINARY ESTIMATE OF THE FY 2008 REVENUE EFFECTS OF FOUR CHANGES PROPOSED BY GOVERNOR SARAH PALIN TO THE OIL AND GAS PRODUCTION TAX, AS 43.55, ON SEPTEMBER 4, 2007 AND OCTOBER 1, 2007

Dan E. Dickinson, CPA, CMA
October 3, 2007

Executive Summary

On September 4, 2007, the Palin Administration proposed changes to Alaska's oil and gas production tax (AS 43.55). Also handed out at that time was a chart demonstrating estimated FY 2008 production tax revenues under different scenarios. That chart showed that at a price level of $70 dollars a barrel, a revenue estimate under current law and cost and volume assumptions to be roughly:

- a billion dollars higher than revenues had the ELF-based tax still been in place; however,
- a billion dollars lower than under current law and summer of 2006 cost and volume assumptions; and
- 800 million dollars lower than under the Governor's plan also using summer of 2006 cost and volume assumptions.

On October 1, 2007, the Administration made public a work draft of a bill incorporating these and other changes. This paper analyzes four of the proposed changes. If implemented for all of FY 2008, these four changes proposed by the Governor would have large and immediate revenue impacts, and in fact account for the 800 million dollar difference identified above:

> The tax rate would go from 22.5 to 25%. At currently predicted volumes and costs, that would generate a revenue increase of about 37.5 million dollars if oil is at $30 a barrel for the entire year and 342.5 million dollars if oil remains at $80 for the entire year.
>
> Progressivity – a mechanism that imposes an additional tax when net values are very high - is changed so that in most circumstances at prices greater than $55 dollars a barrel it will raise up to roughly 190 million more dollars a year than current law. However, because the Administration has opted for the administratively less complex method of calculating progressivity on an annual rather than monthly basis, in cases of short duration spikes in price the proposal may capture fewer dollars.

The TIE (Transitional Investment Expenditure) credits would be eliminated. Those credits allowed producers that are making both current investments, and had been making investments in the period 2000 through 2005, to "supercharge" their current investment credits from 20% to 30%. In FY 2008, eliminating TIE credits will increase revenue by about $190 million a year.

A fourth proposed change will likely have a large revenue impact in its first year but little impact thereafter. It will require capital credits to be taken over two years instead of in the year of investment. If the change were effective July 1, 2007, the State would receive a revenue boost of about 190 million dollars in FY 2008, but would notice little change thereafter.