

HOUSE / SENATE FINANCE COMMITTEE MINUTES - 1967-1982 2669

Representative Cowper asked if the "cash in lieu" provision was an integral part of the negotiations. Mr. Smith said it was for some communities who thought they would not have enough land to fulfill their entitlement. HB 133 (continued)

Representative Meekins said he would like to refer the bill back to the original subcommittee chaired by Representative Schaeffer. He said he would like to look over the distribution method.

Representative Cowper made the observation that when the law was passed 14 years ago it created some rights at that time--whether they were right or wrong--they exist in terms of political realities. He wondered in this bill might not be the best solution they can come up with in view of what was created before. He said it would be very hard to tell the Mat-Su Borough that they don't get the land now.

Mr. Smith remarked that if there is not some resolution of this matter, any meaningful type of land management is not going to move, particularly in Kenai, where it will cause some severe problems.

Mr. Smith said as far as the North Slope goes, their Department has been approached by the Borough about the possibility of talking to the Borough's attorney. He said there is some possibility that a compromise might be worked out with the Borough.

Representative Freeman ran down a list of the various entitlements, questioning how they were arrived at and if any of the entitlements were over 10%. Fairbanks North Star Borough was over 10%. Mr. Freeman said he did not think the State is very concerned about providing any of the 400,000 acres they might get to the municipalities in Southeast. He pointed out that the total entitlement for all of Southeast Alaska is 32,000 acres, and that 50% of the State's population is getting only 20,000 acres, and the remaining 37-1/2% is getting 670,000 acres, with the North Slope Borough excluded.

Robert Dupere told the committee that the State has not made any effort to develop the land in the North Slope Borough on a comprehensive basis. That is one of the reasons the Borough selected the land--so they could provide sewer and water facilities and areas for industrial development. He remarked that you cannot solve all the land use planning problems from the State level.

Representative Cowper asked Mr. Dupere if the Community & Regional Affairs bill were passed, what it does to the North Slope Borough. Mr. Dupere replied that "it screws them." He said they either must accept the 645 acres or go to court.

Representative Cowper said he was led to believe that the North Slope Borough would be satisfied with getting whatever was decided by the Court. Mr. Dupere replied that that was not correct.

HB 133
(continued)

Mr. Dupere said he felt that the North Slope Borough should be given the 197,000 acres as of the date of the application and receive 10% just like everyone else. He pointed out that an acre of land up there is not worth a lot of money. What the North Slope Borough wants is to plan and program in accordance with any needs existing in the arctic.

Representative Cowper asked if Mr. Dupere would propose that the Legislature pick the land that is to go to the North Slope Borough. Mr. Dupere replied that he felt that the discretion should be taken away from the Division of Lands.

Representative Freeman asked how much land is available to Southeast communities without the 400,000 acres. Mr. Smith replied about 10,000 acres.

Representative Freeman stated that if this bill goes to the floor, he would propose an amendment to increase the allotment to Southeast communities, for a total of 140,000 acres (Juneau 50,000; Sitka 40,000; Ketchikan 8,000 acres, etc.)

The Chairman asked how many members would sign "do pass" if the Community & Regional Affairs committee substitute were reported out today. Only one member (Leo Rhode) indicated he was in favor of that. He said he would recommend that a committee substitute with the amendments mentioned by Representative Freeman be reported out.

Representative Duncan asked if Lee Sharp, City of Juneau Attorney, would care to testify on his view of this as it relates to Southeast communities.

Mr. Sharp said the breakdown on Southeast came about during negotiations between his office, the State, and the Cities of Ketchikan and Sitka. When it appeared that the State would make additional land available, three communities got together to decide how it should be apportioned and agreed that whatever would be available should be divided with 3 units for Juneau, 2 for Ketchikan and 2 for Sitka. The figure they were given was 32,000 acres, as what the State said they would support. He said what Representative Freeman said is correct--Southeast wants more land but is forced to accept what is offered by the State.

Representative Duncan asked Mr. Sharp what the effect on Southeast would be if that part of the entitlement were delayed until next session. Mr. Sharp said that there are many unknowns as to the effect. He pointed out that there is now some legislation before Congress that could affect the national forests and the state selection.

He said if there was some indication from the State as to what lands they intend to select in the national forests, it would put the municipalities in a better position. He felt that if the State made their own selections in the national forests at this time, then they might be working more towards lands they want to use for their own (State) purposes. He said he would rather have a bill adopted setting forth how many acres the cities are entitled to, so when the State selects federal land they will be aware that so many acres must be set aside for municipalities.

HB 133
(continued)

Representative Cowper commented that he appreciates the Division of Lands' efforts to comply with what was a legislative mandate, even though that mandate was confusing. He said he intends to refer the bill to Mr. Schaeffer's subcommittee, and the bill can be addressed next year.

Representative Guy wanted to know what happens to organized municipalities in unorganized boroughs. Does it mean that these communities will be left without options to select lands? Mr. Smith said it did mean that. He said in 90% of those cases there is no State land in the areas and the State would not select much in those areas.

Representative Meekins moved and asked unanimous consent that HB 133 be referred to Representative Schaeffer's Subcommittee. No objection, so ordered.

HB 133
Referred to
Subcommittee

Next bill to be considered was:

CSSB 355: AN ACT MAKING A SUPPLEMENTAL APPROPRIATION TO THE LEGISLATIVE AFFAIRS AGENCY AND THE LEGISLATIVE FINANCE DIVISION.

CSSB 355

Alison Farnan, Fiscal Analyst for the Legislative Finance Division, testified that a proposed House Finance Committee substitute would change the appropriation of the Legislative Affairs Agency from \$194,000 to \$423,500, and would change the appropriation to Legislative Finance from \$3800 to \$7600. The breakdown of the additional costs is explained in a memo dated May 20 from Alison Farnan to Steve Cowper (see bill file). Basically, the changed appropriation is the additional amount needed to keep the session going through close of business May 29, 1977.

Representative Duncan asked if this committee substitute would include the legislative salary increase. Ms. Farnan replied that it does not include any pay increase for legislators; however, it does include legislative per diem at the rate recommended by the salary commission. The amount included for per diem in this bill would not make it retroactive.

Representative Cowper moved and asked unanimous consent that HCS CSSB 355 be reported out of committee. The bill would incorporate the following additions:

Committee
Substitute
Reported
Out

Capital 77 through May 19	\$ 11,000
Legislative Session expenses through May 29	193,500
Temporary session employees, Legislative Finance Div.	3,800
Tanzer Contract	<u>25,000</u>

Total Additions:\$233,300

No objection, the committee substitute was reported out "do pass".

There being no further business to come before the Committee Adjournment
at this time, the Chairman adjourned the meeting at 5:00 p.m.

5/23/77

Background

The 10% land grant to boroughs was initially one of those incentives deemed necessary to encourage formation of boroughs. The land would provide these boroughs with that resource to provide for its assumed responsibilities for schools, roads, subdivisions, industrial sites, etc. In some cases, it would provide a source of revenue which, in turn, would help provide revenues for the public services required of an increasing school or resident population.

Problem

The basic problem is that the law utilized federal terms -- "vacant, unappropriated, unreserved" -- which were very handy for the Bureau of Land Management to arbitrarily and capriciously deny any land for public use. This was reinforced when in 1972 the Municipal Code added "consistently with the best interests of the State."

The cities of Anchorage, Fairbanks and other urban areas had high value Federal land in their areas of concern. The Division of Lands selected these high value lands under the Mental Health grants (and other restrictive categories), thus depriving those general land selections of any value for community use or public disposition. They, in fact, conspired to frustrate the basic legislative intent.

The subsequent Division of Lands Directors have done a less than adequate job in administering this program in getting land into the hands of the municipalities who, in turn, are in the best position to get it into public use.

A solution offered by the present Director of the Division of Lands, whose actions are now beset with lawsuits by various political subdivisions concerning his arbitrary and capricious administrative actions, is in reality -- no solution.

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The best interest of the local population and the local determination in land use would be best solved by pulling those legislative prerogatives that led to the problem.

In this regard, the following are suggested in rough form:

Specific Recommendations

Sec. 29.18.190: State land is repealed and reenacted to read:

(a) A borough or city is entitled to select an amount equal to 10% of the State land located within its boundaries regardless of classification of said land.

(b) The land selected may not be denied for transfer by the Director except when said land is being specially utilized by a State agency. However, if the best interest of the State is jeopardized in the view of the Director, the Governor shall introduce a resolution denying the transfer to be approved within 60 days of the Legislature or said transfer shall be made.

(c) Mental health, school, university lands if selected by a municipality will be replaced by the Director with an equal value of general lands.

(d) Each selection must be approved or disapproved within 90 days of its selection by the Director.

Section 2. The lands previously applied for by a borough or city shall be transferred to that borough or city with all rights, leases or other contracts entered into and remuneration received therefrom as of the date of the application. The Director may recommend that the Governor submit a resolution before the next Legislature concerning those lands which are not in the best interest to transfer which must be acted upon within 60 days to deny such transfer.

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Assume Acceptance of the Above

The enclosed table must now be updated to gain the "total number of acres of all State lands within the Borough."

Then the policy makers and their planning staff should assess the situation concerning whether or not they desire dollars in preference to land and if so, how much.

The necessary data and information is not available for an intelligent decision assuming step number one is acceptable. This could take place between sessions and implemented in a subsequent bill.

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HOUSE FINANCE COMMITTEE
Friday, May 27, 1977
9:20 a.m.

All Committee members were present with the exception of Representatives Duncan, Gruening, Schaeffer and Guy. Also present were Bob Grogan, Fiscal Analyst, Legislative Finance Division, and John Crandall, Administrative Assistant to Representatives Meekins and Duncan.

Discussion of SB 148

*Discussion
of SB 148*

Chmn. Cowper asked Rep. Meekins if Phil Nash is satisfied with this committee substitute. Meekins replied that he is. These are changes recommended by Susan Burke. There is one more change to be made in my opinion - delete Lines 21, 22 and 23 on Page 11. Mr. Nash says it's federally mandated, but it's my opinion that it should be deleted.

Amendments

Changes proposed by Meekins adopted by the Committee with no objections. Motion to report out Finance CS for SB 148 carried unanimously.

*Report Out
Finance CS
for SB 148*

Discussion of SCR 1

Motion to report out with unanimous consent carried.

*Report Out
SCR 1*

Discussion of SB 184

*Discussion
of SB 184*

Cowper made a motion to report out SB 184 with unanimous consent. There was objection and Cowper withdrew his motion. Haugen made a motion to add in \$50,000, bringing the total up to \$200,000. Motion carried with no objections.

Add In

Motion to report out Finance CS for 184am carried.

*Report Out
Finance CS
for SB184*

Discussion of SB 338

*Discussion
of SB 338*

Cowper said this bill relates to trust loans. SB 338 not in Committee yet.

Meekins said that it raises the limit on tourism from \$1 million to \$3 million. Supposed to have a -0- fiscal note.

Freeman suggested discussing it now and making a decision on it and then "bicycling" it.
like

Cowper said he would/to hold off on it.

Hold

Discussion of SB 118

*Discussion
of SB 118*

Cowper said this is money that has to be paid. Move to

amend by changing the title of the bill to "An Act making supplemental appropriations to the Department of Administration, the Alaska Court System, and the University of Alaska; and providing for an effective date." Sec. 1 would remain the same; Sec. 2 change to "The sum of \$49,800 is appropriated from the General Fund to the Alaska Court System to fund the costs of Chapter 193, SLA 1976, increasing the number of Superior Court judges." Change Sec. 3 to "The sum of \$150,000 is appropriated from the General Fund to the University of Alaska to fund the costs of professional managers and consultants retained by the University of Alaska during fiscal year 1977."

Amendments

Cowper explained that this is the text of a bill that was passed in the Finance Committee last year, but that was left out of the budget.

The Senate refused to agree with the detailed Letter of Intent. The committee looked at the supplemental they came in with and knocked out several things, but they do have a number of bills for FY 77 to pay. Since we told them to go ahead with this program, we will have to go ahead and take care of it.

Section 4 would be the same as Sec. 3.

There being no objection to the proposed amendments, the motion carried.

Rhode made a motion to report out Finance CS for SB 118. Motion carried unanimously.

*Report Out
Finance CS
for SB 118*

Discussion of SB 306

*Discussion
of SB 306*

Cowper commented that this is a bill being taken up by request of Senator Croft. The fiscal note is for 146.4. Letter of Intent adopted by the Senate would have the state build cabins at state parks around the state, primarily near Anchorage. The Department has "adopted a position of cautious neutrality". Senate Finance reported out with recommendations by Sackett, Butrovich, Croft, and Hohman for and Tillion and Orsini against.

Meland

Rep. Freeman commented on the Forest Service cabins in his district.

Rep. Swanson made a motion to report out SB 306 with unanimous consent. There was objection. Motion to amend original motion and report out SB 306 with individual recommendations carried.

*Report Out
SB 306 -
Indiv. Recs.*

Discussion of HB 24

*Discussion
of HB 24 -*

Rep. Swanson made a motion to report out HB 24 with a "do pass" recommendation. There being no objection, the motion carried.

Report Out

Rep. Cowper commented that this would effectively raise the compensation of election board members about 50¢ per hour.

Discussion of SB 198

Motion to report out Finance CS for SB 198 carried with no objection.

Report Out
Finance CS
for SB 198

Meeting adjourned at 9:50 a.m.

Adjourned

Tape H77-80, Log 1699
to Log 2191

HOUSE FINANCE COMMITTEE
Friday, May 27, 1977
2:35 p.m.

Committee members present were Representatives Freeman, Rhode, Guy, Schaeffer and Meekins. Also present was Roy Dunn, Lobbyist, Alaska Public Employees Association. Rep. Freeman chaired the meeting in Rep. Cowper's absence.

Discussion of HB 384

*Discussion
of HB 384*

"An Act re severance pay and retirement for state employees whose jobs are abolished as a result of the creation of the Department of Transportation and Public Facilities; date."

Rep. Duncan gave a brief explanation of the proposed committee substitute which he had presented copies of to the members previously. The Administration says there will not be any persons laid off as a result of the change; however, a lot of people within the departments affected are concerned and this is to dissell their fears.

*Report Out
Finance CS
for HB 84*

Motion to report out Finance CS for HB 84 carried unanimously.

Discussion of SB 338 and HB 283

*Discussion
of SB 338
and HB 283-
Finance CS for
SB 338 Report
Out with HB283
Incorporated*

Rep. Meekins gave a brief explanation of the bills.

Motion to report out House Finance CS for SB 338 incorporating HB 283 into it carried with no objection.

Discussion of CSSB 198

Jim Rhode presented Committee members with copies of the proposed Finance Committee Substitute and gave a brief explanation.

*Report Out
Finance CS
for CSSB198*

Motion to report out House Finance CS for CSSB 198 carried with no objection.

Meeting adjourned at 2:45 p.m.

Adjourned

Tape H77-80, Log 2191
to Log 2305

HOUSE FINANCE COMMITTEE
Saturday, May 28, 1977
10:55 a.m.

All Committee members were present with the exception of Representative Freeman. Also present was Milt Barker, Fiscal Analyst, Legislative Finance Division.

Discussion of CSSB 337(Res)

*Discussion
of CSSB 337*

Rep. Swanson made a brief explanation of the bill and his feelings on it. Would like to see a Letter of Intent that not more than 10% be used for the baseline studies and to keep them from duplicating the same studies previously done.

Cowper asked how much the Administration proposes to use in studies of the appropriation? Swanson replied that they would they would have used \$200,000 for it.

Cowper said he would oppose the letter of intent because he would like to see if they are going to do what they say they are going to do. They claim they are going to go ahead with this project, and it would be a good thing, if they do. If we make them do it another way, they may not do it at all.

Swanson replied that if they would do what it says they are supposed to do in the bill, he would totally support it.

Cowper commented that if the bill is accompanied by such a letter of intent, it may hold it up until next year.

Haugen made a motion to report out CSSB 337(Res). There was objection by Meekins, which he withdrew after brief discussion. The motion carried unanimously.

*Report Out
CSSB 337(Res)*

(Changed Tape H77-81)

Buchholdt asked if the Committee is going to entertain any more appropriations. In answer, Cowper said that CSSB 337 should be the last one.

Buchholdt made comments regarding lack of attention to some of her bills, particularly the "toilet bill".

*Buchholdt's
"Toilet Bill"*

Cowper replied that he thinks the Committee is already on record as being in favor of the bill and so is the House and that, perhaps, she could do something on the "floor".

Cowper asked if there was anything else to come before the Committee. Rhode asked how soon the Legislature would be able to get the Governor's budget for next year. Cowper replied that up until this year the Governor didn't give that information until he gave his message to the Legislature.

This year, however, that has been changed so that the Legislature will get those figures as soon as they are available.

Cowper suggested that the Committee come in a week to ten days before the start of the session next year and asked how many of the Committee members would be willing and able to do that. The members responded that they would all be willing and able and fully supported the idea.

*"Early Start"
Plans for Finance
Committee
Next Session*

Meeting adjourned at 11:15 a.m.

Adjourned

Tape H77-80, Log 2305
to H77-81, Log 0469

HOUSE FINANCE COMMITTEE
Tuesday, April 12, 1977
8:40 a.m.

Tape #1

Log:
0000

All Committee members were present. Also present on the panel was Representative Snider. Other members of the Legislature and interested parties were present in the Gallery.

Chairman Cowper opened the meeting at 8:40 a.m. by stating the purpose - Consideration of four tax bills - HB 321, HB 322, HB 323 and HB 328. Requested the witnesses who would be speaking to restrict their testimony, as much as possible, to matters not covered by the Resources Committee, since the Finance Committee would be receiving copies of the testimony given before the Resources Committee. The Agenda for the day was announced (copy attached) and Chairman Cowper stated that it is his intention to refer the bills to the Ways and Means Subcommittee chaired by Representative Gruening for their recommendation at the conclusion of these hearings.

0059

Presentation of Niall Trimble, Economist, Division of Community Planning, Department of Community & Regional Affairs:

Mr. Trimble gave a brief report of his background, with his most recent employment being involved in the North Sea oil development.

Presentation will cover three major concerns: (1) The traditional oil industry response to proposed increased taxation, (2) the availability of success for the oil industry in Alaska, (3) the effect on consumer prices, and (4) the effect on oil companies' activities in Alaska.

Similar proposals have been made (and carried out) in many other countries around the world and the reaction by the oil industry is always the same - intensive lobbying campaign, representations made to the Executive Branch, threats of oil industry moving out, will enable the oil industry to continue exploration for new fields, not good for the general economy of the state.

Mr. Trimble contends that the state or local government rarely ever know what the profits really are to the industry in an area. The industry rarely produces for the general public a comparison schedule of taxation effect in different countries, and their testimony tends to be the same regardless of the return on capital.

The demand for oil has been rising and the Data Resources Incorporated forecast shows demand will be 3 1/2 million

4/12/77

barrels per day. Imported oil amounted to 7 million barrels per day and is expected to reach 9-11 million barrels per day in the future. The U.S. was 41% dependent on imported oil last year and is expected to be 45% or more dependent by 1980. It is projected that by 1980 twenty percent of U.S. oil will be produced in Alaska - 9 1/2 million barrels per day.

Regarding prospects of finding oil in the future in the U.S. - studies conclude that 20-25% land discoveries will be in Alaska. Believed that 10-49 billion barrels could be discovered in the U.S. with almost 2/3 of that found in Alaska according to the U.S. Geological Survey.

Consumer prices are determined by demand and costs are irrelevant to the price the consumer pays. The proposed increased taxation will affect the profit of the oil companies, not what the consumer pays.

Mr. Trimble contends that the oil industry's reaction to an increased taxation should not be a basis of decision since the availability of the oil is really the deciding factor and it is not as available as it used to be. They are going to go where the oil is in spite of the working conditions and what the tariff is. If they feel they can get a good DCF rate that's where they will go. Fields such as Prudhoe Bay are very profitable. In phase 3 at Prudhoe Bay the costs are going to be relatively modest. In a profits comparison study it was found that the traditional rate of return is 10-12%. Between 1970-1973 the rate of return to the "Big 7" averaged 11 1/2%. The accepted figure now is a 15% return.

The oil industry only paid 1.8% of their income to the federal government last year in the U.S., 60-70% to the government in Great Britain, 95% to the government in Eastern countries.

Alaska provides a good secure place to do business since there is no risk of war here, government takeover, or serious political disturbances, such as in Lybia.

0463 In summary, Alaska offers outstanding profits to the oil industry. They are very unlikely to move out because Alaska offers: high profits, low taxes comparatively, outstanding geological prospects and security of supply.

0495 Rep. Rhode asked what effect President Carter's energy policies would have on oil production in Alaska. Mr. Trimble replied that there will probably be a slow down in the rate of increased production, but that there will probably be no reduc-

tion in the rate of consumption and the price of natural gas will probably rise.

0634

Rep. Haugen asked if the figure of 10-12% profit Mr. Trimble had mentioned is the net after taxes and asked what his source of information is. Mr. Trimble replied that these are Standard Oil Company figures and Rep. Haugen stated that he knows that some of the companies don't show those kinds of profits and that he is inclined to think that Mr. Trimble's statements are prejudiced against the oil industries. Mr. Trimble replied that he can only assure Rep. Haugen that his statements are not prejudiced.

0566

Rep. Gruening commented regarding the interests of oil companies in other areas other than oil and inquired as to the reason for it. Mr. Trimble replied that it offers them a diversification of their activities since oil is not a renewable resource.

0578

Rep. Cowper stated that it is commonly known that the figures the oil companies give do not go in line with the actual production and asked what is the reason for that. Mr. Trimble explained that they use reserve appreciation since it is very difficult to work out what can be produced due to the large number of unknown factors. The figures are based on test wells and they tend to make cautious projection figures. Louisiana turned out to be 2.13 times the projected figure. It is not because they are trying to cheat the public.

0617

Rep. Cowper asked to what extent the recoverability of reserve has been affected. Mr. Trimble answered that it has been affected a lot. The dramatic price increases have allowed the industry to use some of the technology that they could not afford to use before. Rep. Rhode asked Mr. Trimble what background he has in the private oil industry and Mr. Trimble replied that he has not worked for private industry, but that he has no prejudice against it and thinks it would be interesting to do.

0734

Chairman Cowper called a recess at 10:00 a.m.

HOUSE FINANCE COMMITTEE
Tuesday, April 12, 1977
1:37 p.m.

Tape #1

Log:

All members of the Committee were present. Rep. Snider and James B. Rhode, Assistant to Rep. Cowper, were also present.

0739

The Chairman, Rep. Cowper, stated that this was a continuation of hearings on HB 321, HB 322, HB 323, and HB 328. He then introduced Professor Jerome Zeifman, a professor of law at University of Santa Clara. Rep. Cowper explained that Professor Zeifman is an attorney and tax counsel, and he has been retained by the administration to address some of the problems with these measures. Rep. Cowper asked Professor Zeifman to comment on his history.

Professor Zeifman explained that his involvement goes back to 1959 when the Supreme Court decided the Northwestern Portland Cement Company case. He was hired by the Judiciary Committee of the U.S. Congress to investigate the tax structure of all 50 states. He was the chairman of the subcommittee on the outer continental shelf. He then became Chief Counsel for the House Judiciary Committee. Professor Zeifman continued that when he left the Committee he began teaching courses in law and one in legislative law.

Professor Zeifman said that in order to dispel any confusion he would like to first outline the simple mechanics that the administration's bill and the income tax area is addressed to.

There are two inter-related aspects of the problem of taxing the income of multi-national companies. Under the decisions of the U.S. Supreme Court it is necessary for the states to impose apportioned taxes on the income of companies that engage in business in more than one state. It is first necessary for a taxing state to make a determination of entire income from all sources. That will be referred to as the "size of the whole pie". The first step is to determine the unapportioned tax base. The next step is to make an assessment of what percentage will be attributable to one area. In Alaska they have delegated to the U.S. Congress the responsibility for making the determination of what is the whole pie. Alaska uses the corporation's federal taxable income. The next step is for the state to make an apportionment.

Professor Zeifman continued that Alaska has adopted a tax act which considers three things: 1) Alaska to total payroll, 2) Alaska to total property, 3) Alaska to total sales. When we looked at corporate income taxes in Alaska we looked at both the size of the pie and the method of apportionment. Professor Zeifman summarized the findings and conclusions as follows.

Professor Zeifman said we should first start with the idea of the whole pie and the use of federal taxable income. We looked at the tax returns of the 13 oil companies doing business in Alaska with the amount of income that each of them have been reporting to their stockholders. We were impressed with the disparity in the amount of income reported as earnings and profits to the stockholders and the amount of income reported to the federal government for federal tax purposes. The oil industry reports three times as much earnings to stockholders as they do to tax authorities. The companies' own books show that their whole pie is three times larger than that which is reported to the federal government.

Professor Zeifman said a question to ask is what had caused the pie to shrink in the federal tax area. Congress has granted subsidies to the petroleum industry. When you consider that fact you come out, looking at it in Alaskan terms, it seems bizarre for the state of Alaska to be doing some of the things it now does under federal law. For example: Alaska is granting a tax subsidy to a company that wants to drill in Texas or Iran. Alaska is subsidizing the development of mines in states outside Alaska. If a multi-national oil company gets afflicted with a loss in the Middle East, Alaska is providing some sort of tax cushion and subsidy for that.

Professor Zeifman said that in addition to increasing the size of the pie, the use of book income has another advantage. It eliminates all of the out-of-state subsidies. The use of book income has a dual advantage. It increases the size of the pie by eliminating the loopholes. Professor Zeifman said he knew of no better way to do this than to say that the company shall assess itself the book income or federal taxable income, whichever is higher.

Professor Zeifman continued that Alaska uses a formula based on property, purchases, and sales. There is a feature of the sales factor which is also grotesque in terms of its effect on Alaska. The sales factor has a distance orientation. There is included in the present law in the numerator of the sales factor only a small percentage of the companies' oil. The present sales factor is in effect also a kind of tax subsidy. It subsidizes exports and exporting companies. Alaska doesn't need to do that with respect to the petroleum industry. The more oil a company extracts from Alaska and ships out of Alaska, the more the tax liability. To correct that we recommend the use of an extraction factor as a substitute for the sales factor, but only with respect to the petroleum industry.

Professor Zeifman summarized that the two proposals were for the use of book income to assess the size of the oil pie, and the use of the extraction factor instead of the sales factor. This would increase four-fold the benefits to the state of Alaska.

Professor Zeifman then outlined some of the objections to the Administration's bill.

1) We are going to move out -- it will drive us away. Professor Zeifman said in the six years of study we determined that lowest of their priorities was the matter of state and local taxation. Perhaps there's no greater priority than the location of the natural resources. Professor Zeifman said that in the 20 years he had worked in this area he knew of no case where a company has been driven away from a resource by any state's taxing power. The experience we have had about multi-national companies is that although lobbyists often had the ears of members of our committee, we discovered that they had little to do with the decision-making in their own companies. When they send the Chairman of the Board, that may mean we are doing something effective. The move out argument is something that you will continuously hear. Moving out is the kind of a threat that only a multi-national company can make, and you should assess it very carefully.

2) Under our proposal the possibility exists of a multi-national company being subjected to duplicate taxation on more than 100% of their income. Professor Zeifman said he would agree that the tax structure of Alaska is different than those of another state. In 20 years no multi-national company has been able to testify that it's paying taxes on over 100% of its income. The fact is that they pay taxes on nowhere near 100% of their income. Mobile Oil paid 1.8% when you get all done with loopholes. Professor Zeifman said he would not be too concerned over the dangers of subjecting a multi-national company to duplicate taxation. If you are concerned about that you could write into the law that, "If any company is in fact subject to a taxation of more than 100% of its income and can demonstrate that, you could provide that some procedure would be worked out to negate the double taxing effect."

Professor said that in closing he would make an observation. He could not recommend the corporate income tax as a major means of taxing multi-national companies. If you want to look at the taxation of the state of Alaska in the analogy of a Navy ship, the income tax is a secondary gun at best. The best way to go is a severance tax. The problems of making definitions for an income tax can be enormous. No matter how much money Alaska puts into the area of tax administration, you can never develop the audit capability to make income taxing an effective means of taxation. The severance tax is a better way to go.

Rep. Cowper asked why the book value was limited to multi-national companies. Professor Zeifman said the idea of confining the use of book income at this point to multi-national companies has several bases. We have only studied the oil industry. The greatest erosions of the tax base have occurred in the petroleum industry. It's the petroleum industry in many estimates that is the most multi-national. It would not bother me as an Alaskan to remove activities of these companies by the use of book income. It would bother me to take away the special tax subsidies from the state of Alaska. I would eliminate them for the petroleum industry because they relate to the granting of subsidies for the development of non-Alaskan oil.

Rep. Freeman asked what would be wrong with a simple fair severance tax without regard to a company being a national or multi-national company. Professor Zeifman said that he saw nothing wrong with that in terms of tax structure, but he would not suggest that the choice be either/or. The income is measured to some extent by profitability. The severance tax is off the top and not measured by profitability. It's also easier to administer.

Rep. Freeman said it seems that what the people should do is determine how Alaska can get a fair payment for the severance of its natural resources. Rep. Freeman said he didn't care about their income. Professor Zeifman said that to the extent that you have an income tax on your other Alaskan industries, it seems that in the interest of equity there should be an income tax on the oil industry.

Rep. Cowper asked how long Professor Zeifman had worked for the U.S. Congress. Professor Zeifman responded that he had worked from '61-'75. Rep. Cowper asked him to comment on the likelihood that the congress might take a look at a substantial deviation of a means of levying income tax. Would the Congress make a decision for all the states. Professor Zeifman said they had tried. The problems of the need for federal legislation have not come from the areas you are concerned with in this committee. They have come from the kinds of problems faced by small companies. If there was to be federal legislation it would be limited to the problems that are faced by very small companies which are faced with insurmountable compliance problems. In terms of multi-national companies, that's not a realistic possibility.

1182

Rep. Cowper said there's been a suggestion that these proposals might destroy the uniformity of state taxation and they could lead to federal legislation or a court decision. Professor Zeifman said on the subject of uniformity, it would be interesting if some of this committee were to go and meet with some of the legislative committees in Indiana right now. Some of the same groups that are lobbying for uniformity here are lobbying against uniformity in Indiana. If the multi-national companies would take a uniform position on uniformity throughout the U.S., you might want to listen to their comments more seriously.

Rep. Gruening asked if other states had heard the argument that they shouldn't tax now because they don't need the money. Professor Zeifman said in consideration of a boom town economy we should look to Louisiana. When their forests were being denuded the state did not tax those industries because there was an economic boom. But, when the last trees were cut down there were serious economic problems. This is a problem you are bound to be faced with in terms of the non-renewable nature of the petroleum industry.

Rep. Snider asked a question about OCS development in relation to the franchise tax. Professor Zeifman said that one of the advantages of the franchise tax approach is it affords a fighting chance in the courts of being able to impose an income tax that can be measured by the impact of the off-shore development. You will probably be faced with litigation in this area. If you are unsuccessful, I would hope that Alaska would urge Congress to take a look at it.

Professor Zeiman said that under the Buck Act Congress has made it clear that the state can impose severance taxes on the lessee of the mineral interest. It would seem unreasonable and unfair to impose a limit on a similar kind of tax on petroleum. The off-coast production of petroleum poses as much a threat as the in-land development.

Rep. Haugen said on the differences of taxable income and income reported to stockholders, why hasn't IRS looked into it. Professor Zeifman said they have tax credits and normal write-offs, plus depreciation allowances. A company keeps two sets of books--one for its stockholders and one for the IRS. Rep. Haugen asked if they didn't have to pay a stock dividend on the profit. Professor Zeifman said they do. That's why you have a company paying a big dividend and having a negative income tax statement. The disparity between book income and taxable income for 10 of the companies was some \$3-billion total. There was \$3-billion more in earnings and profits reported to the stockholders than to IRS. Professor Zeifman said that documentation of that was in the report.

Rep. Freeman said he thought it would be much simpler if the state of Alaska would decide how many dollars per barrel they will charge for the oil instead of getting into the income tax business. Professor Zeifman said he liked the severance tax, but nevertheless the income tax has some advantages because it is measured by profitability. Not everyone in Alaska is extracting oil; some are fishermen. Those people pay an income tax, so a multi-national company should also pay its share of income tax if there's to be an income tax.

Rep. Rhode said that on oil lease sales he thinks we are sandbagging companies with a tax before they get a cent out of the ground. Would the royalty approach before they start be desirable. Professor Zeifman said consideration was not given to that in the study. As a general principle, my reaction is that you should consider the "farmers' share" as a separate kind of revenue from tax revenues. It's not necessarily a good policy to mix the leasing notion with the tax revenue notion.

Rep. Rhode asked if Professor Zeifman thought there should be both. Professor Zeifman responded that the "farmers' share" should be considered by Alaska in the same way it is in other states. When we look at how Alaska is taxing oil industry we see that mineral leases are lumped with revenues. They are not in other states because of the "farmers' share" so to speak. Such a large share of Alaska is owned either by the state or the federal government and therefore is not on the tax rolls. That's another reason for not considering the royalties from the leases in the same ways you would consider the revenues from proposed taxes.

Rep. Rhode asked if it is desirable and health for a state government to have a surplus. Professor Zeifman said he would defer that question to the Committee. If you are anticipating some lean years ahead, it's desirable. With the petroleum industry, "The time to prune is when the blade is sharp." When the last barrel is gone your possibility of having a surplus in revenues then is not very good. It would seem to make sense to prepare for the future.

Rep. Guy asked how the three-part formula works. Professor Zeifman answered that under the present system a company will develop a system based on the average of: 1) Alaska payroll to total payroll, 2) The percentage of Alaska property to total property, 3) Alaska sales to total sales. You take the average of those three fractions. That gives you the percentage of the total attributable to Alaska.

1401

Rep. Cowper thanked Professor Zeifman for appearing before the Committee. He then called a brief recess at 2:40 p.m.

(This portion of the meeting was recorded on the Sony recorder, tape #1, #284 - #708)

Rep. Cowper called the meeting back to order at 2:58 p.m. Senator Rader was present.

1401

Rep. Cowper introduced Dr. Edward Shaffer, Associate Professor of Economy, University of Alberta, and asked him to briefly explain his background.

Dr. Schaffer said he was originally from Pennsylvania. After World War II he went to the University of Michigan, where he got his bachelor's and master's degrees in economics. He then moved to New York City and worked as a consultant. He got his doctorate at Columbia, and his doctoral thesis was published as a book. He has written several books on Canadian oil and its impact on Alberta.

Dr. Schaffer said his first comment would touch on the effect of the petroleum industry on the state of Alaska. He said the most important point of all is that oil in Alaska should be viewed as a capital asset. That is, a stream of income to its owners, the people of Alaska. Every time a barrel of oil leaves the ground Alaska gains current income, but loses future income. Unless carefully watched the sale of oil may provide only temporary benefits to the state of Alaska. These temporary benefits may result in permanent headaches. If Alaska decides they have too much capital in the form of oil and want to sell part of it, Alaska is faced with a problem of how they can convert their oil into other capital.

Dr. Schaffer continued that there's a theory of economic development that argues that the export of a raw material will in and of itself start a process of economic development. The export of a raw material will initially create jobs in the export factor. They will also need supplies. This process is called backward linkage. The industries created by backward and forward linkage cut the cord and become independent. They become more important than the export industry. Thus, when the industry fades away the economy can continue to grow. This theory is an example of how raw capital can be changed to other capital.

1492

Dr. Schaffer continued that if the export of oil in Alaska would bring about such a result, then perhaps Alaska would be justified in encouraging the development and exploitation of its oil. However, this process is not likely to occur in Alaska. The free market mechanism will not convert Alaskan oil capital into other capital. This is according to Dr. Innes. In studies it was shown that oil development in the Middle East and Venezuela did not create backward and forward linkage. More relevant to Alaska is that Professor Hershman of Harvard has shown that oil development itself has very little linkage. There are many reasons for this.

Dr. Schaffer said that oil employs very few people. After development has set in there are few people employed in oil. Many of the supplying industries are subject to economies of scale. This means that the larger the production, the cheaper the unit of cost becomes. It often pays to expand production where they are rather than building a plant with a limited market. Oil companies don't like to talk about the existence of reciprocal relationships. But, some oil companies deal only with certain supply companies. There are also interlocking directorships and various stockholders that would dictate that supplies come from one area and not another. This would discourage new business from setting up to supply the oil industry; that is, backward linkage.

1553

Dr. Schaffer commented that on forward linkage, the general tendency on the oil industry is to locate things near the centers of consumption instead of near resource extraction. Dr. Schaffer said there's one exception to the rule that oil does not bring lasting benefits. In Alberta, which is more like Alaska than other places, oil has brought gains to Alberta. The question is whether the changes are permanent and life will continue to thrive. The key link is the link to manufacturing. In the period from '61-'70 in Alberta 161,000 new jobs were created. An estimated 86,000 jobs were created as a result of the oil industry. Only 9,000 jobs were in manufacturing. What's interesting about this is that of these jobs in manufacturing, they have been created in satellite industries. These industries have failed to grow independently. If the oil business goes, they go. This does not represent permanent capital. In what the Canadian government calls non-commercial services, 25,000 jobs were created. This essentially means the expansion of the public sector. In the years '61-70 there came about a large expansion in the school system from the public school level to the university level. Also, there's been a big expansion in health care. This expansion did not come about through direct oil company activity. It came about because the government took royalties. The government didn't know what to do with them at first. This is discretionary linkage. It was not automatic, but the government got this money and spent it. By spending on education and health they improved the quality of the population and improved its capability. It substituted human capital for oil capital. Because of the enlargement of the University of Alberta they have traded specialists in oil. The export of the expertise does bring some income to Alberta.

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Dr. Schaffer continued that the Alberta experience shows that the market mechanism will not by itself bring about the substitution of other capital for oil capital. Dr. Schaffer then read a quotation from Professor Mike Sell, University of Oregon.

1625 Dr. Schaffer said the indirect impact on the rate and pattern of social and economic change may be enormous. This depends on government resourcefulness in allocating revenue. The only way Alaska can maximize its gains from oil is to make sure its current income is not earned at the expense of its future income by collecting economic rents and disbursing them in a responsible manner.

1663 Dr. Schaffer continued that the industry claims that the state does not need the oil revenues. This is based on the Department of Revenue's report showing large revenues. This is not true. The Department has underestimated population growth. In Alberta the population grew after the discovery of oil. If that's relevant, Alaska has underestimated by 1/2 the increase in population growth. The Department has underestimated the necessary expenditures per capita. With a greater population, you will need new schools, roads, etc. The surplus may be much less than the estimate. The real point is the government must have a surplus if it is ever going to convert oil capital to other capital. In this area Alaska has made a wise move by setting up the Permanent Fund. This is the only way to keep Alaska from becoming one big ghost state after the oil depletion. If the Alaskan government doesn't need the money, who does? The oil and gas companies? They won't spend it in Alaska. There is no reason the government should forego income in order to allow income for the oil companies to be allowed income.

Dr. Schaffer continued that the oil industry threatened to leave Alberta. In the same year when rigs were moved from Alberta the bonus bids reached an all-time high. Dr. Schaffer said he was quite sure that the industry anticipated that Alaska would ask some rents on lands off shore. Oil men are good businessmen, and being so they did anticipate Alaska's tax claims. Even if the industry slows down or stops development, this is not necessarily undesirable. There are bad things that go with development. A slowing down of development may actually be desirable. If the state wants to it can use its own revenues to hire drilling contractors to do exploration.

Dr. Schaffer said there was another argument and that is the threat of low oil prices so taxes cannot be increased. Alaska must not underprice its oil capital. If the price drops Alaska would be better off to decrease production and keep its oil in the ground. There's a possibility that there may be a temporary drop. A permanent drop is not likely. Until a substitute for oil is found a permanent drop in oil prices will not happen.

1757 Dr. Schaffer said there was another issue, and that's the moral issue. Alaska made an agreement in 1969 and is now changing the conditions. When extreme changes arise it's normal business practice to renegotiate the deal. The oil companies raise this issue of morality only when the state suggests a change.

1798

Rep. Gruening said there had been discussion earlier on the rate of return from petroleum investment. He called attention to Exhibit 1 and said it had come from a periodical. He asked if this was an adequate reflection of industry profitability. Dr. Schaffer said this was an average, so some may be much higher and some much lower. It would be helpful to know what the spread is around the average. Generally, the multi-national companies do better than this. Rep. Meekins commented that if we want renewable resource industry enhanced we will have to take the money from the oil companies and put it into renewable resources.

Rep. Rhode said that if the proposed taxes were passed 80% of the state's income would be from oil. He asked if that was a healthy situation for a state to be in. Dr. Schaffer said that if the money was used entirely for current spending it would not be healthy. It's a wise policy that the bulk of the current expenditures will be funded from normal taxation. The bulk should be put away in the Permanent Fund so oil capital is replaced with other capital..

Rep. Rhode said that Canada is socialistic as compared to Alaska. He asked Dr. Schaffer if he would advocate our going into business with our surpluses. Dr. Schaffer responded that some of the most devout free enterprisers are in the Alberta government. It's not a socialistic government. They are going into joint ventures with businesses. This is not to advocate buying out any company. What has to happen is that you go all around Alaska and find out what the priorities of the people are.

1900

Rep. Cowper said he had read a report written by Dr. Schaffer that related to whether the oil industries created jobs. He asked for a brief sketch of the findings. Dr. Schaffer said that jobs are created in two categories: 1) Some came about just through the market. There were 80,000 jobs. 70% were created just through the market. Only 10% of those jobs were in manufacturing. In terms of lasting benefits, these do not represent lasting benefits. 2) The other 28-30% of jobs were an expansion of the public sector. That's the only permanent benefit that oil has brought to the people of Alberta.

Rep. Guy asked for an example of a reciprocal relationship. Dr. Schaffer gave a hypothetical example: An oil company comes to a steel company and says you buy all our oil and we will buy all your steel pipe. That means that a small industry who makes steel pipe will not get the deal.

1953

Senator Rader asked for an interpretation of some statements by Senator Stephens. Dr. Schaffer replied that the comment about "we are Albertans too" could have two meanings. The Alberta government has given a number of concessions for drilling in Alberta. One of the conflicts in '76-'76 was that the federal government decided to eliminate royalties paid as a deduction from income tax. Alberta told the oil companies that they would pay back the deductions lost because of the clause. Alberta gave too many incentives. This was an example of a government panicking to the pressure.

1961

Dr. Schaffer commented that none of the proposals he had read were outlandish. The proposals are very moderate. You should collect the maximum price possible for your oil. What's the maximum price. It's everything over what's required to induce them to take the oil out of the ground. There's a great economic rent at Prudhoe Bay because the cost of getting the oil out is so small.

Dr. Schaffer continued that in comparing Alaska to Texas, a high number of wells in Texas are strip wells which pump less than 10 barrels a day. The royalties that are paid in Texas and Louisiana go to private people. In Alaska the state gets the royalties because they own the land. The economic rent will vary from one area to another.

Senator Rader asked to the extent that the state is an entrepreneur, if a lease was sold five years ago and then we found out that it's worth more, is that a contract or not. Dr. Schaffer replied that it is a contract, but oil companies break contracts.

(Sony recorder tape was changed at this point to #2)

2052

Senator Rader said that the oil companies being willing to break a contract is no argument to say that the State of Alaska can do it. Dr. Schaffer wondered why Alaska should be the only place that sits back and says they will forego profit because of a former contract.

Rep. Gruening said there seemed to be an inference that by changing our taxes we are going back on our agreements. There's no clause that says we cannot raise taxes.

Senator Rader asked what the state had sold and what the oil companies had bought. Dr. Schaffer replied that they bought the rights to explore for, produce, and sell the oil. They never bought the right to say that the income from this should not be taxed. Sen. Rader asked if that meant the state had unlimited right to tax. Dr. Schaffer said you can tax them as much as you like. You have to ask if it's better to tax or not to tax.

Senator Rader said the higher the tax the more marginal a field becomes. When we start talking about using our sovereign right to taxation, how about the private owners of land who come under the same tax regimen as the multi-nationals. Dr. Schaffer said that could always be arranged in the tax law.

2160

On the concept of economic rent, Rep. Meekins said if you tax all the economic rent, that would leave normal profits. Dr. Schaffer agreed with this. Rep. Meekins continued that oil has gone up \$10 a barrel. If it was profitable at \$3.25 then the change to \$10 would be the economic rent. The definition of economic rent is the point at which they are making a good profit and they won't leave. It's hard to determine what the level is for economic rent.

Rep. Gruening said that on the oil lease sales the \$900,000,000 was paid by and large by the losers. How can we give the losers a benefit on their loss. Dr. Schaffer replied that a lot of loss is written off the federal return. The oil companies know they will lose in a certain number of cases. The state shouldn't pay them a cent.

Rep. Guy asked if the fair share of the state was synonymous to the losses mentioned in speaking of economic rent. Dr. Schaffer said the rate of return that's necessary to induce further exploration has to include payment for those losses.

2258

Rep. Cowper called a recess at 4:45 p.m.

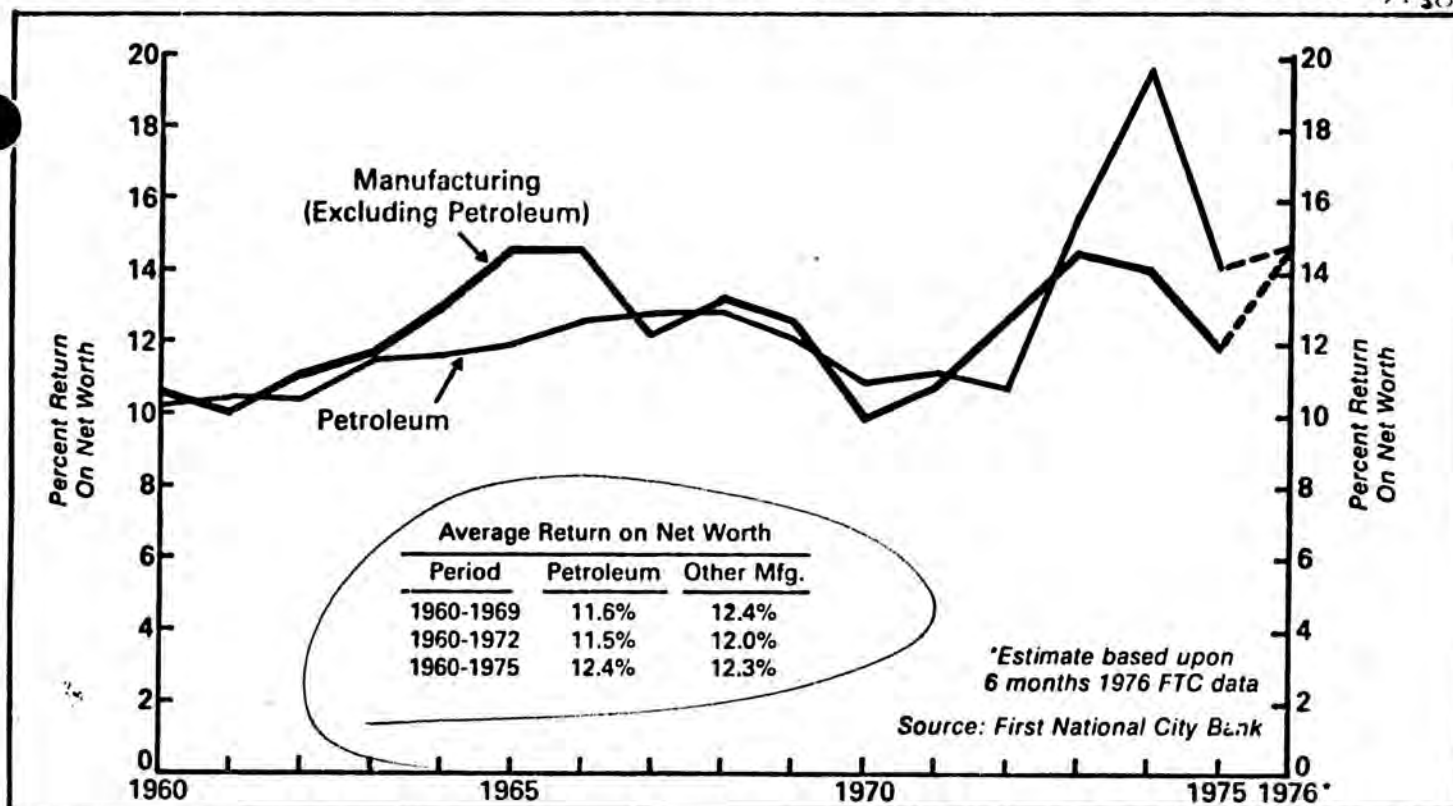
Sony Tape #1 log 284 - tape #2 log 159

Akai Tape #1 log 739 - 2258

How Profitable is the Petroleum Industry

Petroleum returns historically about equal to all other manufacturing

Attachment to
minutes of
Meeting 4/12/77
1:30 P.M.



Taxes may backfire...

(Continued from page three.)

eventually, less tax return to the state."

"The study, 'Alaska's Oil and Gas Tax Structure', prepared by the Department of Revenue and submitted to the Governor on February 11, reveals that Alaska now has and will have for the foreseeable future ample revenues to meet its public needs without changes to its present tax structure," Wiles said.

"The projections in this study show that, under the existing tax structure, by Fiscal Year 1985 the new permanent

fund will approximate \$1.8 billion and the general fund balance will approximate \$6.8 billion for a total of \$8.6 billion over and above projected expenditures."

Wiles goes on:

"The projections in this study further reveal that under the present tax structure, that by FY 1980 revenue from the oil industry will exceed the total projected general fund expenditures and that by FY 1984 the revenue from the oil industry will be over double the projected general fund expenditures."

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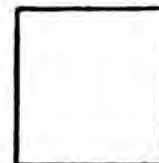


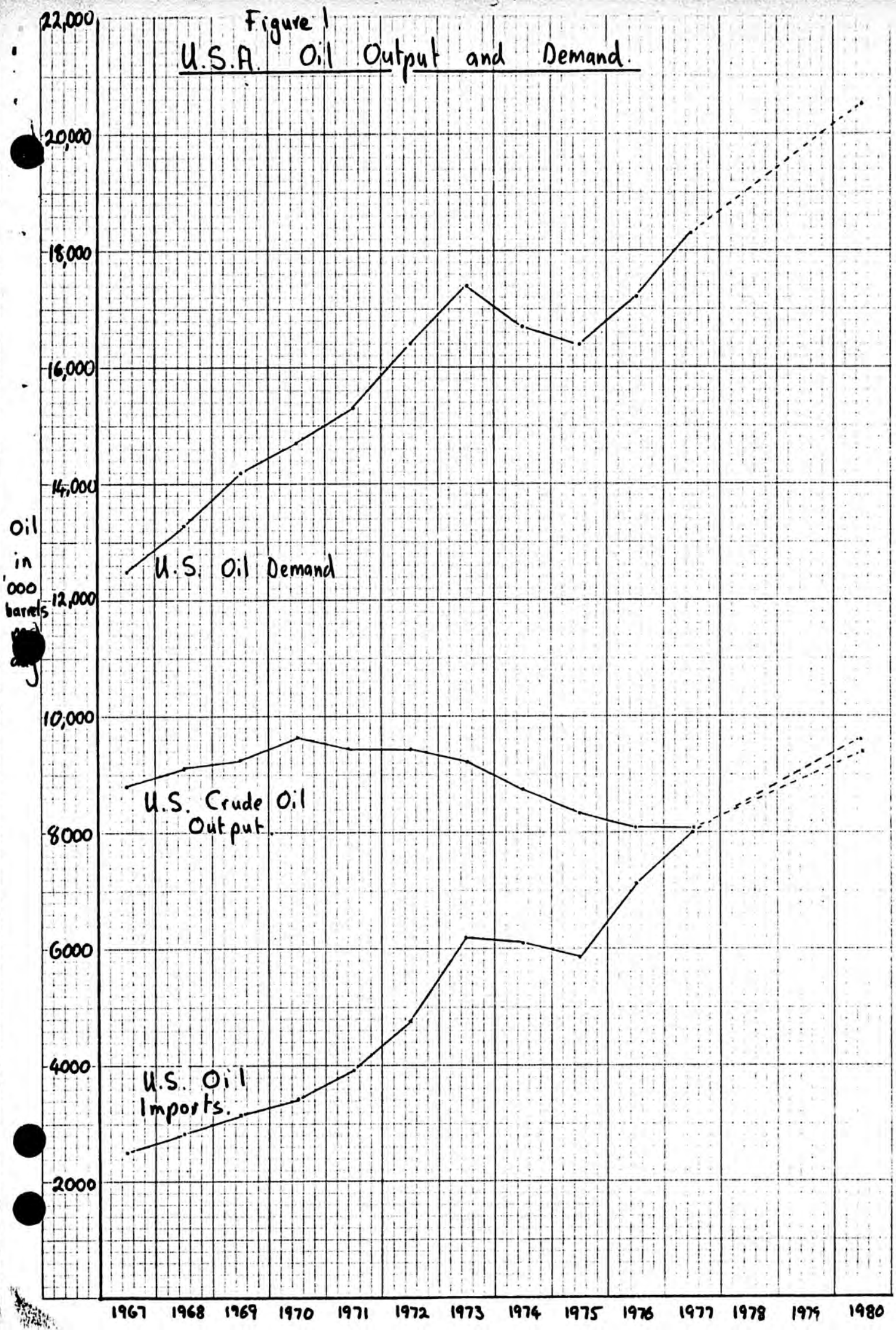
Table 1

U.S. OIL SUPPLY AND DEMAND (all figures in thousand barrels/day)

	1967	1971	1972	1973	1974	1975	1976	1977	1980
U.S. Oil Output	8,810	9,463	9,477	9,208	8,764	8,362	8,125	8,148	9,400
U.S. Oil Demand	12,500	15,300	16,400	17,400	16,700	16,400	17,200	18,300	20,520
U.S. Oil Imports (Crude & Products)	2,537	3,926	4,754	6,201	6,088	5,825	7,131	8,031	9,600
Imports as % of Demand	20.3%	25.7%	29.0%	35.6%	36.5%	35.5%	41.5%	44.0%	46.8%

Sources 1967-1977 Oil & Gas Journal, January 31, 1977
1980 D.R.I. Energy Bulletin, February, 1977

Figure 1
U.S.A. Oil Output and Demand.



HOUSE FINANCE COMMITTEE
Wednesday, April 13, 1977
8:40 a.m.

Chairman Cowper opened the meeting at 8:40 a.m. All the Committee members were present.

Rep. Cowper introduced Dr. Joseph Kemp, Senior Lecturer in Economics, University of Aberdeen, Scotland, and commented that Dr. Kemp's experience in an area where economic development with the oil industry has been under similar circumstances as Alaska is now experiencing will be very useful and helpful to the Committee in their consideration of the subject bills.

Dr. Kemp's presentation: Background - spent a number of years in work in the area of oil and natural petroleum, worked on problems of project appraisals, taxing natural resources, and published a number of papers on taxation of North Sea oil.

History and parallels of the oil industry in the North Sea and Alaska: Fundamental exploitation has changed considerably. Additional taxation may be levied upon oil industry without damaging the industry. Increased taxes in North Sea have lead to a more efficient structure.

History of oil in the North Sea starts in 1969 with discovery of commercial oil. The objectives of the British government gave priority to early exploration. A considerable number of commercial fields were discovered - 19 commercial at present, others still under review, and others are not commercial.

Price increases were quite unanticipated by everyone. There were large increases in exploration and development costs for the companies involved in North Seas exploration.

Expected profitability of North Seas operations: Must qualify the likely position in 1973 and 1974. When considering what the rates of return to be obtained are likely to be, must take into account that profits will not be earned until some time after the expenditure has been incurred. Returns expected under the taxation system before 1975 consisted of two parts - royalty 12 1/2% and corporation tax 52%. If the real price of oil were to hold up, we would have a considerable range in expected returns - the top being 50% and the bottom being 20%. If the real price of oil did not maintain, we would still have figures ranging from 40% top, down to 15-16% for the bottom.

Question: Are returns such as these excessive? Should the taxation be levied? In 1972, Sir Frank McFadden,

Chairman, Royal Dutch Shell Groups, said a rate of return around 15% would be necessary in the North Seas exploration; necessary, due to the great risks involved. Since then, companies have generally been unwilling to say what kinds of returns are necessary to compensate for the risks involved. The Chairman of Gulf said as much as 25% might be necessary to compensate for the risks.

Rate of return for petroleum companies in America has been 11-12%. Excess profits, in the sense of profits more than are necessary to continue exploration, can be made with an increased taxation.

1974 was a year of negotiations and decision-making in the North Seas. There was considerable propaganda by the oil industry emphasizing the size of investments to exploit North Seas oil; always an emphasis on the cost and very little about the revenues received. Some of the propaganda used made comments that the companies would have to leave if the taxation were increased. Another argument that was used was that it was unethical to raise taxation after the licenses had been issued. Taxation is a matter of capacity, not of morality. Changes in taxation are the fundamental right and duty in dealing with changing economic circumstances of the government. There was a good deal of controversy and confusion regarding the types of taxation that were appropriate. A Public Accounts Committee was selected to study the matter and found that the oil companies operating in the North Seas did not, in effect, pay profits for operating in the North Seas for a period of ten years, due to the fact that major companies operating in Britain had accumulated very large tax allowances. A number of companies had purchased their main equipment from the Middle East. Shell and British Petroleum had paid no taxes since beginning operation. They had large capital allowances not directly connected with the profits derived. Royalty remained unchanged at 12 1/2% and petroleum revenue taxes were 45%. There were a large number of special allowances and provisions (meaning that the effective rate was much lower than the normal) particularly instituted to help the smaller marginal fields. Government took discretionary powers to remit royalties on marginal fields where convinced that additional help was necessary.

Real price of oil is maintained. Still have large range of rates of return on that basis -- highest - 40%, some a little under 20%. Price of oil increases at a slower rate than the rate of inflation. Usually find that the expected rates of return are 40% for the top field and 13-14% for the bottom fields. The criticism was that it left the very profitable fields doing very well over the lifetime of the fields, between 60-70% of total profits are accrued to the government.

Effects of legislation: Investment in operations in the North Seas has not been adversely affected by the taxation package introduced in 1975. Exploration of new fields has continued. One indicator of this can be obtained by looking at the results of recent licensing growth. There were far more applications than anticipated. The DOE had to allocate the licenses and choose between applicants. Some of the applicants were not given the fields that they wanted. However, there has not been a case of a major company already operating in the North Seas choosing to re-apply. The British Government was requiring compulsory participation; all licensees had to participate in the British Petroleum Company. The licensees disliked this participation more than they disliked the increased taxation.

Location of the oil in the North Seas is off the Scottish coast. In regards to the distribution of the income generated by oil development, 80% will accrue in the form of profit and taxes; only a small part will actually accrue to workers who are directly concerned. The linkage will be very small. The main industrial activities in this area are the services provided to the oil rigs and the construction of the platforms.

Amount of employment generated in Scotland as a result of oil exploitation - 26,000 jobs which are wholly connected, 18,000 jobs partially connected, and 9,000 construction jobs, some additional jobs will be the result of incomes being spent. Total of 67,000 jobs created.

Shetland, Scotland is vitally involved in the landing of North Seas oil. There is a very large terminal construction there. In 1973 the Executives of the Shetland Council were able to get a bill passed that Shetland would be able to bargain for compensation for the disruptive effects. Fishing and knitwear industries lost labor to the oil industry. Some firms actually had to close down. The County Council was concerned about the effect of the transient nature of the oil industry activities. They decided the best way to reconcile this, was to demand compensation for the local communities. The oil companies did not want to agree, saying that it had never been done before. Eventually they did agree. It was decided that established oil companies will pay into this fund throughout the lifetime of the fields related to the flow rates. The compensation will be used to construct facilities for the local communities affected. A system of royalties ranging between 16-18% emerged.

The orthodox corporation tax in Norway is at the rate of 58%. An increase in taxation will result in around 65-72% of the total profits of the life time of the fields will

be taken by local taxation policy. Norway introduced a very strict depletion policy and very careful development of fields. Some development will even be held back by the government.

The rates of return expected in the Prudhoe Bay fields compared to those expected in the North Seas are broadly similar. Assuming the price goes from 4.5 per the rate of return should be just over 19%.

Although it is appreciated that exploiting oil in Prudhoe Bay has its risks, those risks are probably not as high as they are in the North Sea. The oil industry has been operating in the forefront of technology in the North Seas and a number of accidents and deaths have been directly resultant of development of oil. The risks in Prudhoe Bay should be somewhat less.

Another factor which should encourage development in Alaska is that there is no threat of nationalization. The Department of Revenue's proposals are very sensible. In the North Sea it has become clear that reliance on one type of tax would cause very serious problems. The economic limit concept is a "most enlightened one."

Rep. Cowper asked what the reason for the strong dislike of the industry of the compulsory participation in the North Seas with British Petroleum is. Answer: Companies have to surrender a full disclosure of information and they feel it limits their development flexibility.

Rep. Buchholdt: What is your government doing to get more people employed in the oil industry? Answer: Established Offshore Supplies Office which enables the companies to get as much of the goods and supplies necessary to run the rigs from local suppliers. With regard to the licensing policy, the main objective is to insure that a competitive program is conducted. In consideration of the licenses, the United Kingdom favors companies that provide opportunities to supply goods and services to the oil companies.

Chairman Cowper invited other Legislators present in the gallery to join the Committee in discussion regarding the testimony of Dr. Kemp.

Rep. Gruening: Have you had an opportunity to examine the Tanzer report? Answer: I have read both of those reports. There are a number of returns that vary with the prices. I would say that adopting the price, as he suggests, of \$13.00 flat figure, is extremely conservative.

Rep. Gruening: You mentioned arguments made in the United Kingdom against the taxation policies introduced there, have you heard any arguments on the Alaska scene regarding this? Answer: I have heard that Alaska doesn't need the money.

That, of course, is extremely novel since the United Kingdom needs as much as they can get. Another argument that I have heard is that of the tax incentives. Oil is very much a depleting resource. A government will be interested in how the community will look after that resource has been depleted and will want to insure that the standard of living does not decline once the oil production stops. Will want to insure compensation for the disruption that will result and will need to reserve a fund to build up the communities that have been changed by the oil development.

(Reference made to Tanzer report, Exhibit 2, "Impact of Increased Taxation and Development in Alaska")

Rep. Meekins: In the past the question has been what is the fair share. Economics rents is really the big question - whether this is an incentive killer. Answer: In the concept of economic rents, monies that are really a surplus are considered economic rents. This will not inhibit the oil companies. Should emphasize the point that the oil companies get their share first and the government gets their's next. Economic rent is best described as a surplus.

Rep. Meekins: Question regarding discounted cash flow. Answer: If what we call the rate of discount is 10% today, what we get for \$110.00 will only be \$100 in ten years. Within two and one quarter years of production, the company will get back in profits what they have put in.

Rep. Rhode: What does the United Kingdom use its oil revenues for? Answer: Primarily used right now for collateral to decrease the public deficit. At this time there is no direct use of the funds to build up other industries, to create employment that will remain once the oil is gone, etc.

Rep. Rhode: Presently, Alaska's revenue consists of 61% from the oil revenues. If the taxation proposals are adopted, that figure will go up to 80% from oil revenues. Is this a healthy situation? Answer: The revenues should be used very wisely over the lifetime of the fields. In general, it would mean that the revenues should be invested and not consumed.

Chmn. Cowper asked if there were any further questions of Dr. Kemp. There being none, a recess was called at 9:50 a.m.

HOUSE FINANCE COMMITTEE
Wednesday, April 13, 1977
1:40 p.m.

All Committee members were present. Also present on the panel was Representative Snider. Other members of the Legislature and interested parties were present in the gallery.

Chairman Cowper called the meeting to order at 1:40 p.m. by stating that this was a continuation of the oil and gas policy meeting. He explained that tomorrow's meeting at 1:30 would be held in the Senate Resources Committee room for the purpose of providing live radio coverage and providing a place where the public can call in with testimony. Chairman Cowper then introduced Mr. Richard M. Donaldson, Vice President for Government and Public Affairs, Standard Oil of Ohio. Mr. Donaldson introduced, for the record, the testimony that was made in the Resources Committee.

Mr. Donaldson pointed out five areas of interest that should be addressed by his company: 1) The revenue needs of the state's government. This is the public sector and the principal area of concern of a government. 2) The needs of the private sector of Alaska. 3) The pricing of Alaska North Slope crude oil by Washington, D.C., and where that stands now. 4) An attempt to respond to questions raised yesterday and today. 5) An attempt to identify where we are now and where we are going.

Mr. Donaldson continued: While there's a great deal of money that will flow to the state, we wanted to know from a fair share standpoint what percentage of the oil revenue would come to Alaska. Since Prudhoe Bay field is located on state lands, Alaska will receive 100% of all royalty payments, 100% of severance tax payments, and 100% of ad-valorem. The state will receive state income tax payments amounting to 22% of the total income paid to all states as a result of oil. Alaska will receive 75% of all revenues to be received by all 50 states for this development here. The state is looking forward to some very substantial revenue surpluses.

About 75% of all Alaskans live and work in the private sector. Many of them are largely dependent on the work we are doing. It's very important to them to have a continuing program of economic growth throughout the state. They like the kind of prosperity that they have enjoyed. Alaska is moving into the post pipeline plateau, but Alaska's future remains bright because of its other potentials.

Mr. Donaldson continued: There are two things which affect cost and the private sector. The imminent cost of developing oil. It costs 2-3 times as much to drill a well in Alaska as it would in the lower 48. Productivity is many times 1/3 - 1/2 that of

the lower 48 based on the conditions. The Federal Energy Administration published a report last August in which some points were clear. Costs are so high and risks so great in the arctic that it would be uneconomic to develop MPR 4 unless a field was known. The companies and individuals interested in pursuing Alaska oil may not like the costs of doing business in Alaska.

The second category of costs that affect people of Alaska is taxes. One study shows that Alaska has a tax burden that is 176% of Texas, 99% of Louisiana. When the Administration's tax package was run through the same study the percentages increase to 240% of Texas, 135% of Louisiana, and 151% of California. With the legislative package it would be 291% of Texas, 163% of Louisiana, and 183% of California. This confirms the point that Alaska's present overall structure already equals and exceeds other oil producing states. Significant increases will render Alaska less able to do business. The passage of either of these two packages would affect the revenue surpluses as follows: The surplus in both the general and permanent fund at the end of FY 85 jumps from the \$8.5 billion surplus level under present law to \$11.5 billion under the administration package and \$15.3 billion under the legislative package. Mr. Donaldson said he wanted the state to think about what measures of that sort will do to an industry like the oil industry and the private sector of Alaska. These tax measures should be given a good deal of study and whatever tax measures that may be appropriate should be taken up in the next session.

Mr. Donaldson raised the question of where Alaska stands with the FEA now: Our office has been following this on a daily basis for three months. Some people in Washington have little interest in what happens in Alaska. The vibrations seem to be favorable, but the decision of President Carter is not yet in the book. When this happens a number of committees in Washington will start their activities. There is drafted legislation on Alaska oil pricing. Sometime in mid-summer we should know.

Mr. Donaldson anticipated some of the questions that might be asked: The legality of some of the tax measures before the legislature? There has only been time for a preliminary review of the legality of the bills. Further legal questions will have to be answered by the state and by the oil companies. For seven years or longer the state has made increasing efforts to increase revenues from oil in Alaska. The focus has been narrow. 99% of the market for this oil is out of state. There have been no specific revenue needs presented.

Mr. Donaldson commented on the proposed substitution of the extraction factor for the sales factor: The extraction factor is narrowly based and seems inappropriate as a means of apportioning. In Sohio's case it would apportion to Alaska things that are unrelated to the activities in Alaska. The extraction factor will ultimately come out with the multiple taxation of companies. This does not represent fair treatment of interstate commerce. Why should a company that's come to Alaska to do some of its business not pay 9.4% of that part of its business? Answer: When you have a company in Alaska that has all its activity here in the state, all its other activity is also here. When only some business is in Alaska if you can determine what is attributable to Alaska, there's no argument in paying 9.4% for that.

On the subject of Economic Rent: If there's a windfall, who gets it? Most of the government's witnesses look at only the oil field. On that basis, they use some pretty impressive numbers. That's only part. Any of the companies involved had to face the case and risks of the pipeline, the tankers, etc. Those taking the plunge at Prudhoe Bay took the whole plunge. World oil prices went up 400%. The cost of the total project also went up about 400%. What that meant is investing four times as much with a 15% return on the dollars invested. If there's been a windfall, it's been to Uncle Sam and secondly it's been to the state. The state's royalty oil will be worth four times as much as it was. It's severance taxes will reflect this 400%. It's ad valorem tax will reflect the same thing. The state is a four-time winner with no investment. In terms of economic rent--15% was at the low end of our preferred range going in. The participants were committed to complete the pipeline project no matter what the cost was. Compliance with stipulations has doubled the cost. Oil companies will not undertake a project for an expected return of less than 15%. A 12% return is not equitable for a project as big and risky as the North Slope.

Mr. Donaldson talked a great deal about what's "fair". One question he raised was: Would you invest your money in the companies given this new tax structure? When you put your own dollars into it, you must make a decision as to the fair rate of return.

Mr. Donaldson then discussed Dr. Tanzer's report (copy with minutes): Dr. Tanzer is not listening to responsive concerns of the industry. He is ducking the hard questions that these tax proposals raise. He states that as an outside observer it's difficult to see how the company feels. In Tanzer's opinion the state should take over the oil business for itself. He bases his analyses on only part of the investment and risk.

He ignores the U.S. and Alaskan constitution. He disregards the hopes and desires and concerns of the people in Alaska. Dr. Tanzer's second report was not that different.

Mr. Donaldson respectfully suggested that since the state's revenue needs are well covered and we all have price questions in Washington, the bills before the Committee should be deferred and incorporated into a policy study. A proper balance should be struck. It's not too late to do so.

Chairman Cowper called a recess at 2:55, meeting to reconvene around 3:05.

Sony tape #2 (612 ~ 1274)

Can the Oil and Gas Corporate Franchise Tax Proposal by the
Administration of the State of Alaska result in duplicative taxation?

*Attachment to Minutes
Gas & Oil Tax Policies Hearings
4-13-77 (1:30 p.m.)*

A. Proposed Law

The law would define net income as the higher of (1) taxable income for federal income tax purposes or (2) net income reported to a company's shareholders without regard to any tax on net income.

B. Illustrative Case

Assume a company invests \$2,000 in a project having a life of 5 years. The company elects to write off the \$2,000 for federal income tax purposes using the so called sum-of-the-years-digits (SOYD)* method of rapid depreciation. For its financial reporting purposes the company writes off the investment in equal amounts each year of its life.

Results would be as follows using the indicated revenues and expenses:

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Total</u>
1. Revenue	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$5,000
2. Expenses	200	200	200	200	200	1,000
3. Net	<u>800</u>	<u>800</u>	<u>800</u>	<u>800</u>	<u>800</u>	<u>4,000</u>
4. Tax Depreciation	666	534	400	266	134	2,000
5. Federal Taxable	<u>134</u>	<u>266</u>	<u>400</u>	<u>534</u>	<u>666</u>	<u>2,000</u>
6. Financial Depreciation	400	400	400	400	400	2,000
7. Financial Income, Before Tax	400	400	400	400	400	2,000
8. Taxable by Alaska	400	400	400	534	666	2,400

C. Results

The amount subject to federal taxes over the life of the project is \$2,000, and the financial net income before tax is also \$2,000. However, the amount subject to Alaskan taxes would be \$2,400, or 20% more than the amount subject to federal taxes. Effectively then the 9.4% tax rate would be 11.28%.

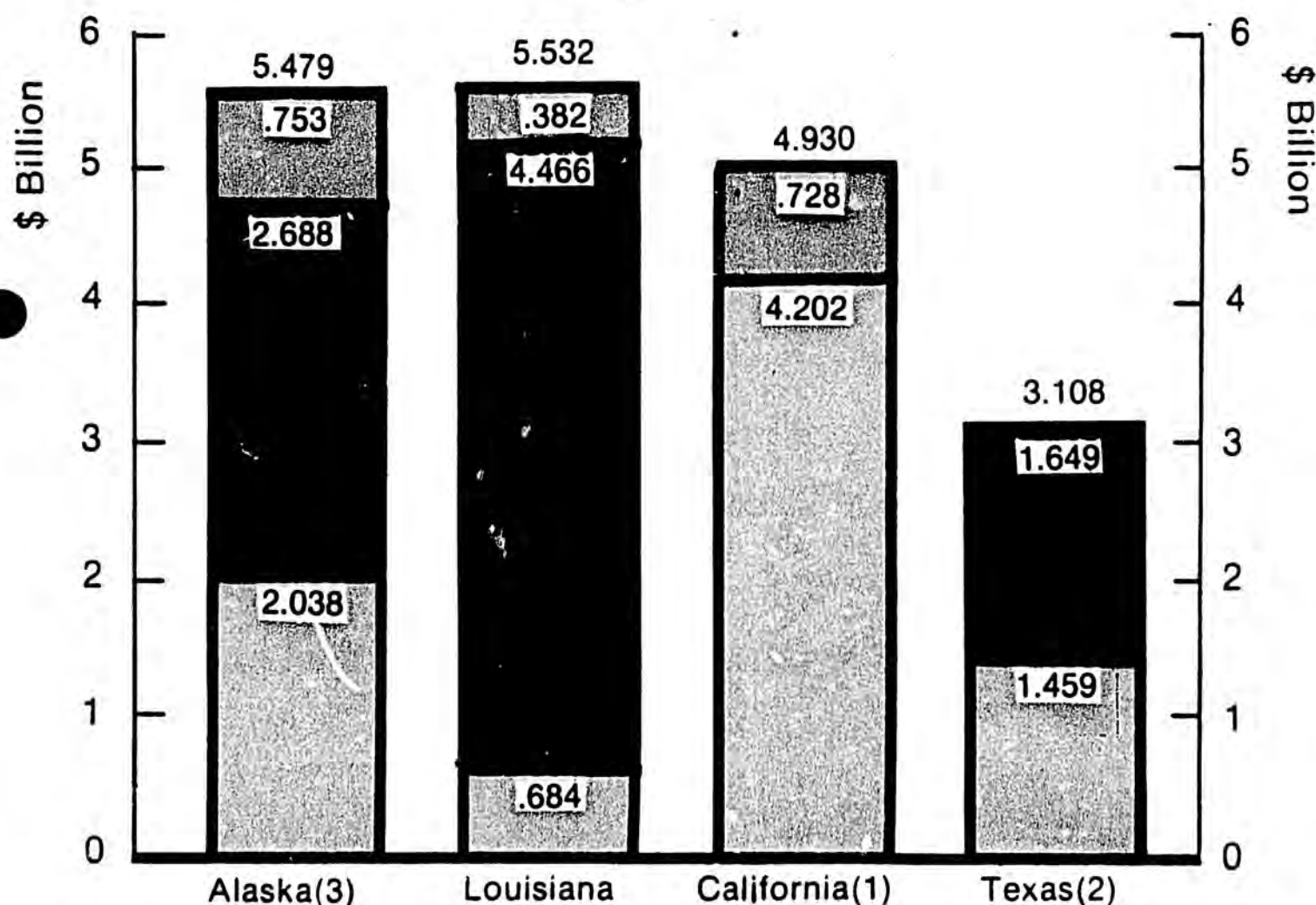
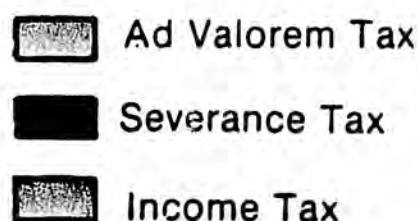
*/ Under the SOYD method a project with a 5 year life would have depreciation equal to the following percents of the total investment for each year, respectively: 33.3%, 26.7%, 20.0%, 13.3% and 6.7%.

Attachment to
Minutes - Gas & Oil
Tax Policies, Args.
4-13-77 (1:30 pm)

TOTAL TAX BURDEN OF ALASKA
COMPARED WITH THE TAX BURDEN OF
LOUISIANA, CALIFORNIA AND TEXAS

- Chart 1 - Existing Laws
- Chart 2 - Administration's Tax Package
- Chart 3 - Legislature's Tax Package

TOTAL TAX BURDEN*



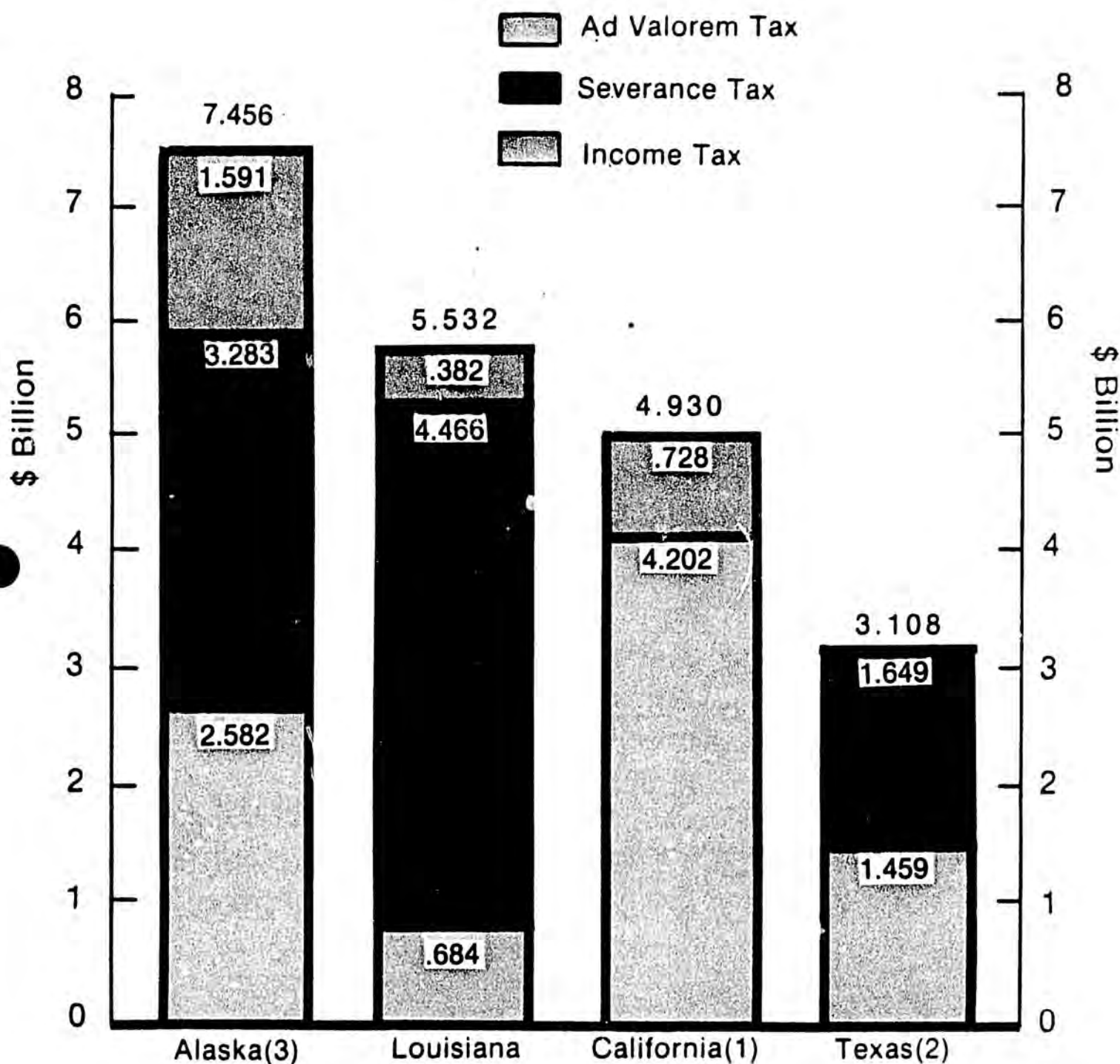
(1) California does not have severance tax

(2) Texas does not have income tax

Sohio Hypothetical Three Company Ownership of Prudhoe Bay and Taps comparison of tax burden under the laws of Alaska, Louisiana and California - 1977 through 1986 assumes constant \$13.00/Bbl. price in California - constant 1976 dollars

(3) Alaska Existing Tax Laws

TOTAL TAX BURDEN*



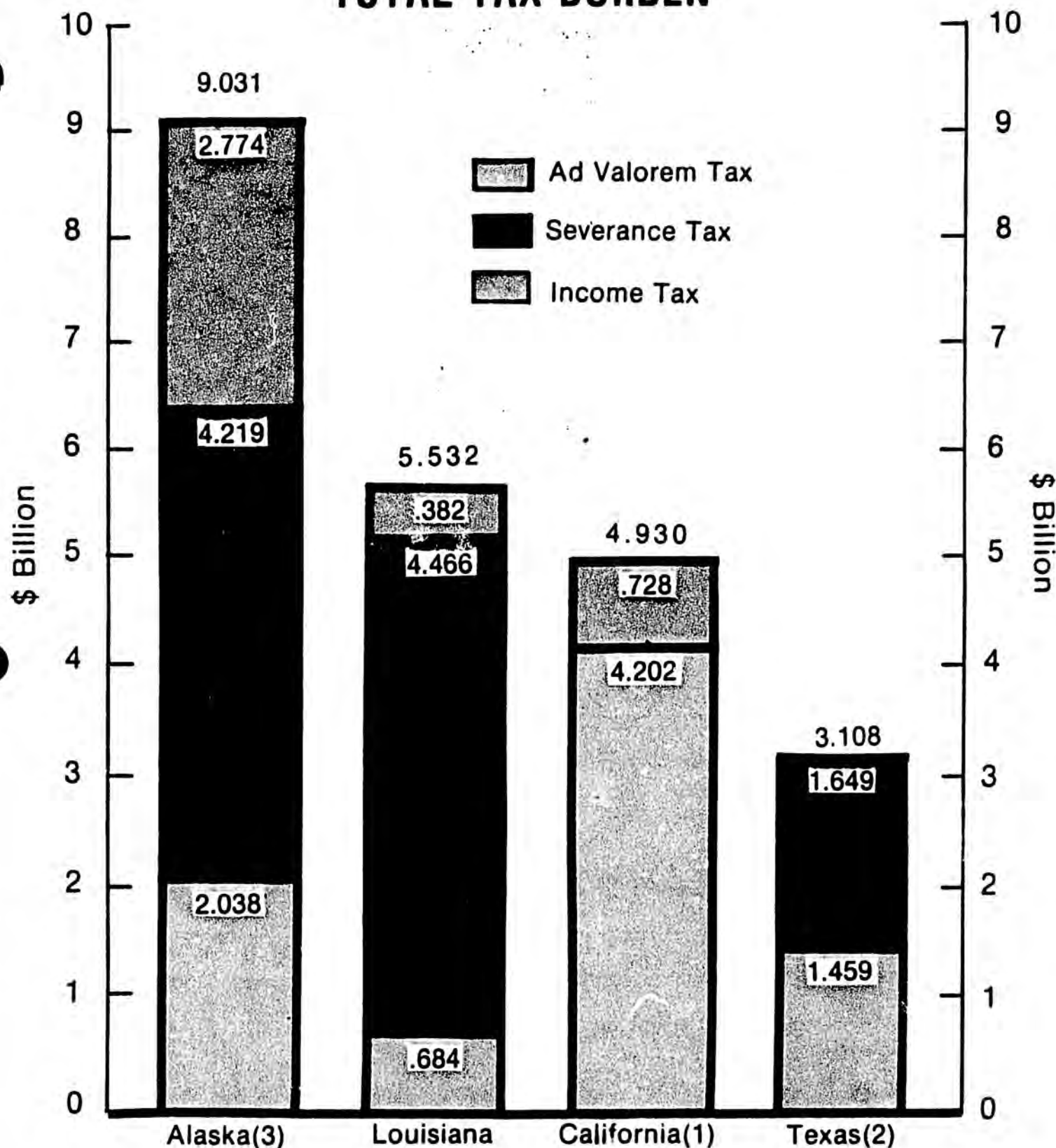
(1) California does not have severance tax

(2) Texas does not have income tax

Sohio Hypothetical Three Company Ownership of Prudhoe Bay and Taps comparison of tax burden under the laws of Alaska, Louisiana and California - 1977 through 1986 assumes constant \$13.00/Bbl. price in California - constant 1976 dollars

(3) Proposed Alaska Tax Laws embodying the Administration tax package

TOTAL TAX BURDEN*



(1) California does not have severance tax

(2) Texas does not have income tax

*Sohio Hypothetical Three Company Ownership of Prudhoe Bay and Taps comparison of tax burden under the laws of Alaska, Louisiana and California - 1977 through 1986 assumes constant \$13.00/Bbl. price in California - constant 1976 dollars

(3) Proposed Alaska Tax Laws embodying the Legislature's tax package

HOUSE FINANCE COMMITTEE
Wednesday, April 13, 1977
3:15 p.m.

Chairman Cowper reopened the meeting stating that Mr. Donaldson would entertain questions by the Committee:

Rep. Cowper: What effect will the proposals being considered now have on your company here in Alaska?

Answer: In the next few years, after production starts up, a large part of our cashflow has to go to working off our debt which was incurred for us to be here. At present there will be a substantial cashflow, part of which will be paid out to the stockholders, a large degree in further development.

The proposed taxes will simply reduce the amount that will be reinvested here.

Rep. Cowper: Most of your debts will be repaid to you through the pipeline tariffs, isn't that correct?

Answer: Over the long pull, yes.

Rep. Buchholdt: What are you looking for in terms of revenue justifications? Answer: Many states, when facing up to their revenue needs, have decided to raise their taxation levels to meet those needs. Here in Alaska it would make a large surplus. If gone beyond a proper balance, it can endanger a lot of other areas of income development in the state.

Exchange between Rep. Gruening and Mr. Donaldson regarding the Permanent Fund and definition of revenue surpluses.

Rep. Freeman commented that, in his opinion, it is not any of his business whether or not the oil company is making a profit, and that, likewise, whether or not Alaska is making a surplus is not any business of the oil company. What is important, in his opinion, is whether or not the oil companies in Alaska are going to be paying a fair share of the taxes as compared to the other states in the U.S. Reply: Studies show that they will be pay more even under the present tax structure.

Rep. Freeman asked how much money will be invested in the oil development by the oil companies. Answer: \$15 Billion, approximately.

Rep. Cowper: Are the local taxes included in your Submission #3 presented to the Committee? Answer: Yes, the taxes that would change the picture at all are included.

Mr. Charles W. Carcher, Director of Policy and Planning, Standard Oil of Ohio, commented that some changes have been made in California, but they did not change the figures substantially.

Exchange between Rep. Meekins and Mr. Donaldson regarding Submissions #2 and #3.

Rep. Meekins commented that everything in the oil world has changed so drastically in the last ten years, even the last two years, and expressed concern that the studies regarding the whole matter may be so far behind that they don't present a very realistic picture. Reply: Multiplicity of taxes spread the burden, but it is still an overall burden. Incomes have gone up all over the nation. This has added to the types of taxes in some places where they are trying to broaden the base. Alaska's proposals that are before the Committee almost represent a giant leap forward out of the picture. My question is that if you take that leap, your state treasury may be bursting, but if you have caused substantial slowdown to the rest of the development of the state, how valuable has this advance been?

Rep. Meekins: The original concepts of many states may have kept their tax rates very low as tax incentives. It would seem that perhaps in the next five years the other states may change their taxing policies. I am concerned about the kind of data we are using to determine the advantage or disadvantage of doing this now.

Further discussion regarding the definition of profit from marginal fields and comparisons with other states' tax policies. Meekins: There are a great many other factors.

Donaldson: Let's assume that the FEA or the President set the world market price. That market price is the figure for California, or wherever, not the market price for Valdez. The margin between the costs and the world market is much less in Valdez than any place else. The question is really the margin due to the fact that the companies are doing business in Alaska. The profitability, and not its comparability to the other states, is what we should look at.

Rep. Buchholdt: In testimony by Mr. Trimble, he indicated that the profits in Alaska are very high; that the rate of return should not be below 15%. Would the rate of return be below 15% if these bills are enacted? Answer: It could be. It will depend on the barrel price and tariffs decided in Washington, D.C. One of the scenarios by the FEA is that, if they should make a mistake, the result could be that the wellhead oil could be equal or less than the old wellhead oil in the Gulf of Mexico.

Rep. Cowper: We all know that the recent construction boom helped the state and its private sector. What kinds of businesses will develop here now? Answer: Hotels, transportation, food service, skills, what is known as the

ripple effect. Rep. Cowper: What businesses would depend on oil and gas development per se? Answer: There are a number of projects that would come - goods and materials going into further development and the pipeline itself. As you get some of the sustained economy going, everything will grow. Rep. Cowper: Exploration and development activities themselves are not really labor intensive industries are they? Answer: The fact that the industry itself does not bring in a lot of labor is something that is desirable to a lot of Alaskans. Rep. Cowper: Suppliers for oil exploration and developers -- who are they in Alaska? Answer: A lot comes from outside Alaska and a lot comes from inside. Rep. Cowper: In view of the wage scare, do you foresee manufacturers of supplies and equipment for the industry moving into Alaska? Answer: Not very much.

Rep. Gruening: You mentioned that the U. S. government takes over one-half of your profits. What has been your rate of effectiveness in the recent years? Answer: Very low. Many companies are in different businesses at the same time. For tax purposes you pay taxes on the overall. You have to make the money before you can pay it. If you have a real good year, the profit for one year can be carried back over the losses of the last three previous years.

Rep. Gruening: What was the rate of taxation? Mr. Carcher: One thing that has cut down the taxable income is well drilling on Prudhoe Bay. I think it's very low, about 7 or 8%. Rep. Gruening: Would the rate ever be as high as 50%? For what policy reason should the State of Alaska grant tax credits for oil going out of the State? Mr. Donaldson: Probably a drop in the bucket. All this money has come from outside of Alaska, not generated here.

Rep. Meekins: I agree that private enterprise ought to take the risk. Shouldn't the State consider a longer term and take the surplus and put it into a broader base just in case the development plays out? Answer: I expect that under the present law, you will have these surpluses. What is in jeopardy is the timing. What I am suggesting is that today, in terms of this tax burden, you are equal or ahead of the rest of the states. What I am really suggesting is putting off the decision on this. Rep. Meekins: My question really is whether or not you are becoming close to the point at which exploration will be discouraged. Answer: I think that could be a possibility in the future under the proposed taxation.

Rep. Cowper announced that he had hoped it would not be necessary to have an evening session, but that it was taking longer to hear the witnesses than he had anticipated, and the meeting would, accordingly, be recessed at 4:30 and reconvened at 7:00 p.m. He thanked Mr. Donaldson and asked him to attend the evening meeting.

Recessed at 4:00 p.m., to reconvene at 4:10 p.m.

Rep. Cowper called the meeting back to order at 4:10 p.m. and introduced Mr. F. Harlan Flint, Manager, Corporate Relations, British Petroleum Company. Mr. Cowper requested that Mr. Flint present a copy of his presentation to the Committee if he had it in written form.

Mr. Flint replied that he would gladly submit his testimony in writing after it is retyped. Mr. Flint told the members that he intended to direct most of his comments to the 1977 Tanzer report although they hadn't had time to do a complete study and rebuttal. He said he does agree that the oil industry is "far worse off" almost every place in the world than in the United States. Tanzer has predicated increased Alaska tax levels on speculative DCF analysis. We think he erred in some of his foreign examples and that it is a mistake to base analyses on comparisons of Alaska's experiences with those of other countries. Tanzer invites the State of Alaska to consider potential advantages in developing exploration itself. We question the appropriateness of using the DCF in Tanzer's report as a basis for analysis. Tanzer's figure for operating costs of 25¢ per barrel and transporting costs are too low. He applied a 25% discount level without any evidentiary basis.

The fact that the Tanzer report is in fact a comparison of Prudhoe Bay to the rest of the world, makes it difficult to reconcile the differences. Tanzer sounds as though he suggests reducing the company take in Prudhoe Bay to the extent that only companies already in Prudhoe Bay would be left with the incentive to search for another Prudhoe Bay.

In a 1975 report, chances of finding a field the size of Prudhoe Bay were 1 to 55 and chances of finding a 50-million barrel field were much less. With reference to Mr. Walter Lipton's testimony of March 23 last year, such studies are not germane. All studies of DCF are prospective in nature and all critical factors are unknown. DCF rate is very sensitive to factual deviations.

Regarding OPEC comparisons around the world: Some of the OPEC countries are very mature companies and will not be doing more exploration in the future. We think we are on the verge of exploration opportunities in Alaska.

Much of the recent pace in Canada was to make up for a backlog. Industry cashflow was reduced to well over \$500 million. These things are open to interpretation. The per-acre price paid for land went up during that period of disincentive. While the price per acre went up, there was a 58% reduction in the amount of acreage that was taken up at that time. In spite of that, there were some people still taking up land; British Petroleum was one of them. The situation now is that B.P. still believes that additional incentives are necessary. Recent information shows that significant reserves of oil

and gas will be found in the Northwest, but cost incentives will be necessary to attract development of them.

Regarding the United Kingdom in Norway, it is interesting to note that Mr. Tanzer finds the tax analysis exactly the same as in Alaska. If Mr. Tanzer's figure of \$18 Billion is accepted, the investment costs for Prudhoe Bay would be approximately \$1.50 per barrel. Alaska offshore exploration is in its infancy. There is no reason to know that the costs will be less for the offshore development in Alaska than it is in the North Sea. Received today a telecopy of a brief summary (by Wood McKenzie) of the United Kingdom and Norwegian tax regimes. A copy will be presented to the Committee upon completion.

The OPEC countries have banded together and control a good deal of the price setting of the world's oil. When Alaska sets a price rate it must consider the effect on the national supply. The security of supply was not a consideration in the Tanzer report. (Read letter from an article by John Turner, Canadian Finance Minister who referred to oil as a provincial resource.) It is our opinion that Mr. Tanzer misreads the Alaska public mood and need and ignores the interests of Alaska Native Regional Corporations. This could adversely affect the state's interest by adding to the burden of costs on those fields. Well-head values of Lisbon and other areas might have to reach more per barrel.

Reference made to Dr. Kemp's testimony and to statement of Rep. Gruening's regarding the Permanent Fund Plan.

Rep. Cowper commented that Dr. Tanzer does not make tax proposals to the Legislature and that he was retained to make a study. The tax proposals being considered are by the Administration.

Question: Cowper - What would be the extent of the effect on your company here in Alaska? Answer: It will raise our taxes. Have never heard the oil industry say that they are going to leave Alaska. If the State took 98% compared to 100% of Prudhoe Bay, we would stay. We are not going to abandon our land position; too much invested in it already.

Question: Cowper - Do you think that these proposals are unfair or unrealistic? Answer: I think so, yes. One effect could be that two different companies of the same impact on Alaska would be paying different taxes because of the "book" tax.

Question: Meekins - The Tanzer study and other witnesses have made estimates as to the profitability of development of Prudhoe Bay leaving out the cost of the pipeline. We understand that Alyeska is claiming that because they are separate they are not covered by the same law - that they

are regulated as a separate entity. Don't you think it's proper to calculate pipeline costs, since they really are separate? Don't you think that you should look at the field separately? Answer: We feel that in an analysis from the standpoint of the investor and the cost he was faced with it is reasonable to include the pipeline as well as the field facilities in the investment required in order to move that product to market. Reply by Meekins: It seems to me that when you put the pipeline in there, that is what you are doing - when you consider the pipeline return and the risk involved in the operation on the basis of preliminary geological studies. Response by Mr. Flint: They would have to have considered costs of the pipeline when they considered developing here as a part of the costs of the facility that they serve. Further exchange between Mr. Meekins and Mr. Flint.

Question: Swanson - What would the cost for the discovery well you put up be? Answer: Was probably a leased rig from one of the neighboring leasing companies. Today's prices would probably be about \$10-15 million. Question: How many rigs are drilling on the Slope now? Answer: Probably about twenty. Comments by Mr. Swanson regarding the usage of rigs for television commercials.

Exchange between Representative Gruening and Mr. Flint.

Chairman Cowper thanked Mr. Flint for his presentation and testimony and called a recess at 5:10 p.m., to reconvene at 7:00 p.m.

HOUSE FINANCE COMMITTEE
Wednesday, April 13, 1977
7:10 p.m.

All members of the Committee were present. Chairman Cowper reopened the meeting at 7:10 p.m. Chairman Cowper introduced Jim Howell, tax attorney, EXXON.

Mr. Howell commented on the profitability of the oil industry in Alaska and the profitability of Prudhoe Bay. Prior testimony in Senate and House Resources included data on the comparative tax burden on the states, historical comparisons of oil industry, and studies of the profitability of Prudhoe Bay. This was submitted to each of the members of the Committee for review.

In reference to the Tanzer Report: Dr. Tanzer seems to make the same answers as he did in 1976. He made some corrections to the 1976 report, but Tanzer continues to exclude tankers and to greatly understate field investment and operating costs. Tanzer's rates of return are unrealistically high. While his ideas may appeal to a few, we feel it is contrary to most citizens. His examination of foreign government activities is at best useless and highly misleading. Tanzer completely overlooks Alaska's 20 mil hardware tax which decreases the rate of return and adds to the state's share of the oil "pie". In conclusion, there is little information in the analytical sections of the report that are valid.

Monte Taylor, Alaska Operations Manager for EXXON, was introduced and asked to testify. Mr. Taylor explained his handouts (copies with minutes). Portions of testimony: Because it has become an issue we did calculate the rate of return on the field portion only and it's 17.6%. Tanzer did not include the right numbers. A 14.5% rate of return on the total cannot be considered excessive for the largest field discovered in the state. Even Wainwright Securities said, "A rate of return of just under 16% for the largest oil field discovered shows an interesting question for economic rents." It is not good to formulate policy based on just one field, Prudhoe Bay. Mr. Taylor urged the Committee to start from a factual basis rather than from a wordy economic analysis as in the Tanzer report.

On the question of low federal income tax rates: In 1975 EXXON paid 42.1% on domestic income. That's about the rate that all manufacturing companies pay. EXXON is making a lot of profit on Prudhoe Bay, but there will only be a 15% return; but we will stay and operate Prudhoe Bay no matter what the tax rate.

Chairman Cowper asked what rate of return was expected on the pipeline investment. Mr. Taylor replied that EXXON had figured a 12% return on that. Chairman Cowper asked if that was on the entire investment. Mr. Taylor said it was and that it is not proper to add interest back. Your rate of return on capital investment is 12%. Chairman Cowper asked about the debt equity

ratio on the pipeline. Mr. Taylor replied that the borrowed funds are 85-90%. Chairman Cowper said that EXXON has put up 15% and you have borrowed 85%. Your 12% is based on the entire figure, so what EXXON has actually put up is 15% of the figure, but you are getting 12% back of the entire amount. Mr. Taylor said EXXON's share of the pipeline had been for sale all along. We are in the pipeline business to get a crude oil from a point of production to a market. Chairman Cowper asked if the EXXON Corporation would want to sell its share of the pipeline to the state of Alaska. Mr. Taylor replied "sure", but he would have to talk to the President.

Representative Gruening noted that in spite of the high level of taxation in the North Sea EXXON has a high rate of return. Mr. Taylor agreed. Representative Gruening asked if it wasn't true that the North Sea pipeline is not regulated as a utility. Mr. Taylor said it was. It is not guaranteeing that it will work. We are going to make an investment decision to invest in the North Sea or Prudhoe Bay and we have to have a transportation system. Anyone making that kind of investment has to consider getting his product to market. It's impossible to see the relevance of the profitability of the pipeline coming off the top. Representative Gruening pointed out that in the North Sea the pipeline is lumped in with the other investment. In Alaska it is not part of that investment.

Representative Gruening asked if for any given year in this decade, has there been evidence to show that where taxes are lowest in the 50 states the investment is greater. Mr. Taylor said he was not trying to say that the tax rate would completely control the investment. About 30% of the future undiscovered oil in the United States is in on-shore and off-shore Alaska. EXXON is trying to find some of that oil. It's necessary to look at comparative economics of projects.

Representative Meekins on the cash flow analysis: It makes a great deal of difference what percentage you use. Do you use the rate of interest that's average in the market or what do you use. Mr. Taylor said what we are calculating here is the rate of return. That's the discount rate at which the total cash value figure equals 0. That's 17.6, if you look at the field only. Most exploration companies use 20-25% risk adjustment on their ventures. The reason for that is the unsuccessful ventures. In any case, we do use the rate of return for our investment criteria.

Chairman Cowper asked Mr. Taylor for his reaction to the tax bills being taken up in this hearing. Mr. Taylor responded that he thinks they are unreasonable because they add substantial tax burden to a tax burden that is already too high.

A conversation then followed between James Rhode, Assistant to Chairman Cowper, and Mr. Taylor regarding return on equity. COPY OF EXCHANGE FOLLOWS THIS PAGE.

Chairman Cowper then asked Mr. Howell to proceed. Mr. Howell commented on the income tax bill: Alaska's share of the income would be determined by using an extraction factor. The objective of HB 322 is to increase income to an amount properly attributable to the state under apportionment rules. This could result in an overlap of taxing. Both the property and payroll factors tend to give too much of the income pie to Alaska. If Alaska oil and gas producers are taxed on the higher, book or taxable income, it appears that those producers will be taxed on phantom income. Mr. Howell then explained the handout that was prepared on the extraction factor (copy in minutes).

Representative Meekins asked if on the book income vs. taxable income there had ever been a case when the company's book income was more than the taxable income. Mr. Taylor said he wasn't sure. In EXXON's case the taxable income and book income are near the same number within 5 and 10%.

(A new tape was put on at this point.)

Mr. Howell said he felt the state was currently receiving tax revenues from off-shore development. We are spending \$750,000 a month on shore in support of our off shore activities. We are buying huge amounts of gasoline and paying 8¢ a gallon motor fuel tax.

At 8:35 Chairman Cowper thanked Mr. Howell and Mr. Taylor and called a recess; the meeting to reconvene at 8:45.

Hearing on Oil and Gas Policy
House Finance Committee
portion of meeting April 13, 1977, 7:10 p.m.

exchange between James B. Rhode, Assistant to Rep. Cowper, and
Mr. Monte Taylor of EXXON

Rhode: You mentioned a moment ago that you have a full detailed study of the assumptions and calculations.

Taylor: Yes, sir.

Rhode: Would you be willing to make that available to the Committee?

Taylor: We already did. We didn't put it in a fancy cover, but it's a detailed study; it has the computer runs in there.

Rhode: You spoke about the 12% simple accounting profit on your 15% equity in the pipeline.

Taylor: We spoke about a 12% discount cash flow rate of return on the total capital employed on the pipeline.

Rhode: Right, but 12% over 15% is 80% return on equity.

Taylor: I don't . . . can you do that? That doesn't make sense.

Howell: You can do that if you assume that the borrowed money is risk-free, but EXXON and other corporations in this pipeline put their full corporate assets behind that venture say that it doesn't matter where it came from -- the companies will eventually have to pay it if that pipeline doesn't pan out. So, the risk on that equity, that's borrowed money that we could be borrowing for some other project if we didn't put it in the pipeline. We don't consider it that way.

Rhode: But isn't 12 over 15 an 80% return on equity?

Taylor: 12 over 15 is 80; I'll agree to 12 over 15 is 80 or .8

Rhode: But your argument is that the return is warranted by the risk on the pipeline.

Taylor: Right.

Rhode: Isn't it true that in many parts of the world pipelines are owned and operated by separate companies?

Taylor: True.

Rhode: And, in that case, you would exclude the investment for

such a pipeline from calculations on the profitability of the given field?

Taylor: If we found a field now in the middle of Texas or someplace and there's a pipeline going right beside it and we are going to sell our oil to ourselves or anybody else that has that pipeline, then in considering whether to make that investment to develop that field we will not consider that pipeline because it is not a part of the investment decision. It's only a part of the investment decision if it's a required investment that you make.

If we would have thought that someone else would build a pipeline up there to Prudhoe Bay, if we had known, we couldn't have just thought, if we had known that someone would build a pipeline to Prudhoe Bay and operate it, we wouldn't have considered it as a part of that investment decision. Just like, if you build a restaurant and you know there's a road outside then, they you don't have to worry about that. But, if there isn't a road outside, you had darn sure better worry about it.

Rhode: Isn't it a fact that, in this case, the producers had to build the line because of the large sums of borrowing required and guarantees from the parent companies ... and also the financial resources, but it did because a company with those resources did not exist.

Taylor: Yeah.

Rhode: Under U.S. law, isn't the pipeline a separate profit center with a limit on profits imposed by the ICC?

Taylor: I think the answer to that is yes.

Rhode: When you lump the field with the pipeline debt, aren't you lumping investments with very different risks? I think that's partially established now.

Taylor: Yes -- you're talking about hindsight now, not foresight, and you don't make investments on hindsight. At least I haven't found any I could make. If I could find one I could make on hindsight, I wish I could so I would know if I was going to make money on it. All investments are made on what you think is going to happen in the future, and that's what we're talking about. There are different risks on a hindsight basis. On a foresight basis, I don't agree that they're different risks.

Rhode: Am I not correct that the banks roughly only asked you to put up 10¢ on the dollar for the pipeline and that amount in equity on the line, as opposed to 45-50¢ on the dollar for the field? Does that suggest some difference, by the estimate of the bankers on the relative risks?

Taylor: Yeah, but knowing you've got the field developed, and

that's what I'm talking about. You are now able to look at the existence of Prudhoe Bay field even though it's not producing in hindsight. You know it is an oil field. You've drilled a whole bunch of wells, and you've done a whole lot of things to prove all that. And now, you can get

Carcher: Had we pledged just the income off that pipeline to back up that loan, we wouldn't have gotten any loan. We pledged our full corporate assets.

Rhode: But aren't you asking, in fact, for the same return for the pipeline as for the field, despite U.S. law and the fact that there's a limit on the return? You are asking us to hold down on taxes, or actually to reduce them in order to give you an overall return, which seems to me to be the same as saying you want the same return on the pipeline . . . as you want on the field.

Taylor: What we are looking for, you know, is we have made all the investment whether it's on the pipeline or the field or the tankers, and what we are looking for is a reasonable return on our total investment, and we really don't care whether that investment is in the pipeline or the tankers or the field. The overall, we think it's important, not only to us, but to the state that that be a reasonable rate of return.

Rhode: When you made your investment decision, you knew that U.S. law was that you would be held to a limit on your earnings on the pipeline.

Taylor: Sure.

Rhode: Mr. Chairman, just one other point. Do you know of any professional economist who agrees that your lumping of the pipeline and the field . . ., all these studies are done by financial houses, and as a matter of fact, both Burnham and Wainwright did separate analysis of the field itself. Now I am not aware of any professional published economist

Taylor: Is the Drexall, . . . 17%?

Carcher: No.

Taylor: I did one for the field itself, too, but that doesn't mean I support that theory. I did that because everybody keeps asking for it. But just the fact they did one for the field doesn't necessarily say to me that they think they agree with it. I haven't checked with all the economists

I don't know of any economist except Tanzer that has calculated any rates of return on the Prudhoe Bay field. The rest of them have been by people who were putting some money into it.

Rhode: Do you know of any published economist who agrees with you?

Taylor: I haven't tried to find one, so no, I don't know of any. I bet you I could find several though, if I started looking.

Cowper: If you find any, Mr. Taylor, I would like you to let the Committee know. That would be economists that don't work for EXXON.

ALASKA H.B. 322
USING EXTRACTION FACTOR ATTRIBUTES ONE-THIRD
OF NON-PRODUCING INCOME TO PRODUCING OPERATION

Alaska House Bill No. 322 proposed to substitute an extraction factor for the sales factor in the Alaska apportionment formula. This substitution can result in an attribution of as much as one-third of all "downstream" income (i.e., income from transportation, refining, marketing, etc.) or non-producing income to Alaska, and can cause this one-third "overlap" of downstream income to be taxed twice. Consider the following simplified example:

Assume that a producer of oil and gas in Alaska with upstream operations wants to expand into California with downstream operations. Sales, payroll, and property would be as shown below. Further assume that all production is in Alaska.

	Alaska	California	Existing Law Apportionment Factors	
			Alaska	California
Sales	\$50,000	\$50,000	50/100 = .5	50/100 = .5
Payroll	\$20,000	\$20,000	20/40 = .5	20/40 = .5
Property	\$30,000	\$30,000	30/60 = .5	30/60 = .5
			1.5 ÷ 3 = .5	1.5 ÷ 3 = .5

Assuming taxable income of \$40,000, each state would have taxable income attributed to it of \$20,000 (\$40,000 x .5 apportionment factor) under the uniform formula and there is no overlapping taxation.

Now assume that an extraction factor is substituted for the sales factor in Alaska, while all other amounts remain the same:

<u>Alaska</u>		
	<u>Data</u>	<u>Apportionment Factors</u>
Extraction	10,000 Units	$10/10 = 1.0$
Payroll	\$20,000	$20/40 = .5$
Property	\$30,000	$30/60 = .5$
		$2.0 \div 3 = .66667$

This will have no effect on the California apportionment factor which remains at .5 since California still abides by the uniform rules. Since total taxable income is still \$40,000, Alaska has attributed income of \$26,667 ($\$40,000 \times .66667$), while California's attributed income remains at \$20,000. Thus, substitution of an extraction factor results in the attribution of one-third of the California downstream income to Alaska, and a \$6,667 "overlap" of income which is taxed twice. In effect, the Alaska producer would be paying one-third more income tax on his California operations than would his competitors in that state. This added burden could even block his expansion plans completely.

EXAMPLE II

ALASKA H.B. 322 USING HIGHER OF BOOK OR TAXABLE INCOME TAXES RECOVERY OF CAPITAL

Alaska House Bill No. 322 proposes to base Alaska taxable income on the higher of taxable income as defined in AS 43.20.011(e) (adjusted federal taxable income), or book net income determined without regard to any taxes on, or measured by, net income.

Since the tax is based on the higher of taxable income or book net income before income taxes, it appears that all Alaska oil and gas producers (including native corporations) will effectively be prevented from fully recovering their capital investment for Alaska income tax purposes and will therefore be taxed on phantom income. Consider the attached simplified example which clearly shows that only \$76,000 of a \$100,000 capital expenditure would be recovered through the depreciation deduction allowed by the proposed law. The taxpayer would lose as a tax deduction 24% of the cost of a capital expenditure necessary to produce income and would be taxed on \$24,000 of non-existent income.

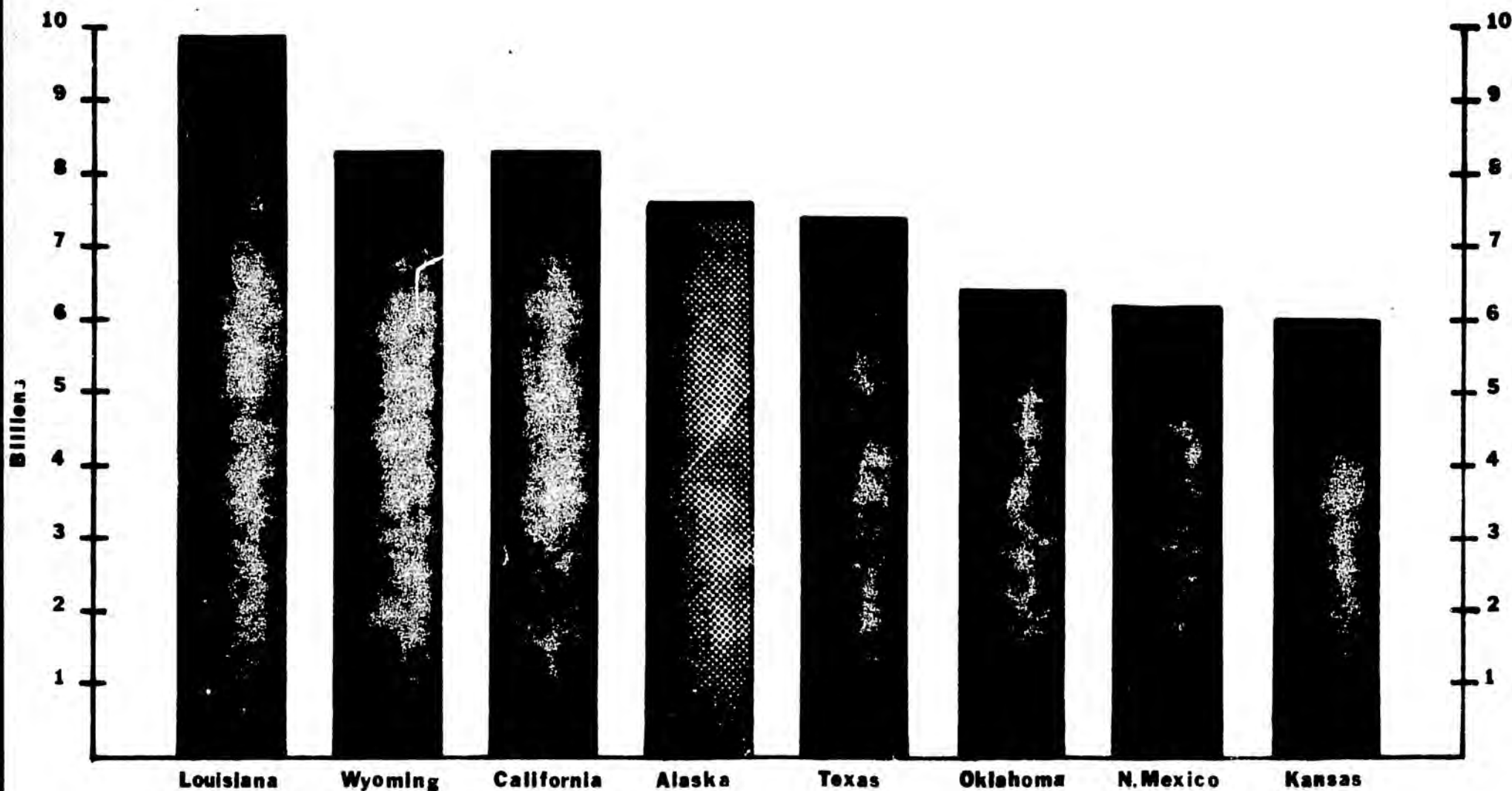
EXAMPLE: Company X is in the business of producing oil and gas. It owns machinery which it purchased for \$100,000 on January 1, 19A, for use in its producing operations. Production income is \$50,000 per year and the machinery has an expected useful life of five years. Depreciation and income using tax and book methods are as follows:

<u>Tax</u>				<u>Books</u>		
<u>Year</u>	<u>Revenue</u>	<u>Depreciation (DDB/SYD)</u>	<u>Taxable Income</u>	<u>Revenue</u>	<u>Depreciation (S/L)</u>	<u>Net Income</u>
19A	\$50,000	\$40,000	\$10,000	\$50,000	\$20,000	\$30,000
19B	50,000	24,000	26,000	50,000	20,000	30,000
19C	50,000	18,000	32,000	50,000	20,000	30,000
19D	50,000	12,000	38,000	50,000	20,000	30,000
19E	50,000	6,000	44,000	50,000	20,000	30,000
Total		<u>\$100,000</u>	<u>\$150,000</u>		<u>\$100,000</u>	<u>\$150,000</u>

Since the Alaska bill requires that the higher of taxable income or book income before taxes be used as the tax base, the Alaska income and related depreciation for each year are as follows:

<u>Year</u>	<u>Tax/Books</u>	<u>Depreciation</u>	<u>Alaska Taxable Income</u>
19A	Books	\$20,000	\$30,000
19B	Books	20,000	30,000
19C	Tax	18,000	32,000
19D	Tax	12,000	38,000
19E	Tax	6,000	44,000
Total		\$76,000	\$174,000
Real Net Income			<u>150,000</u>
Phantom Net Income subject to 9.4% tax			<u>\$ 24,000</u>

Tax Comparison



SOURCE: ALASKA DEPARTMENT OF REVENUE (April 14, 1977)

HOUSE FINANCE COMMITTEE
Wednesday, April 13, 1977
8:50 p.m.

Chairman Cowper reopened the meeting at 8:50 p.m. All Committee members were present.

Rep. Cowper introduced Mark Singletary of Atlantic Richfield Company. Mr. Singletary told the Committee members that he would submit a copy of his presentation in written form at a later time.

Background - Regional Attorney, Legislative Counsel for ARCO since 1971. With ARCO for 16 - 17 years now. Staff Attorney with the Sinclair Oil and Gas Company for six years.

Would like to examine some of the reasons given for these proposals. Not here to plead a hard case. ARCO is pleased to be a part of the activity in Alaska. These tax proposals, even though I consider them unwarranted, would not create any unnecessary tax burdens without undue stress on the overall corporate structure. It should be self-evident, however, to the Legislature that if the company is deprived of those profits (assuming in the range of \$200-400 million per year) that is money it will not have to use in Alaska or elsewhere. It is clear that the flexibility of the industry would be affected in terms of ARCO's involvement within the state.

The Prudhoe Bay field holds a great deal of promise, not only for ARCO and others who own an interest in that field, but also for security in the State of Alaska. If it is true that ARCO does help to provide for an improved economic condition in the State, it is not necessary or desirable for the company or for the State to have these proposals enacted.

The fair share concept is a hard one to define. Will take it from the view of what it meant to our industry when it first came to Alaska twenty years ago. We expected to find a place that was not only cold, but where the odds for finding oil were not better than other places in the country. We realized that as corporate citizens, we would be asked to pay our fair share of taxes.

When the State sold the Prudhoe Bay leases in the early 1960's they contracted for those leases on a royalty basis of 1/8 off the top with no deductions. Furthermore, if some day there was a demand for crude oil that the State would benefit proportionately by a provision made for sharing of 1/8 of the value of the wellhead.

We have heard that the taxing power of the State should be exercised with caution and with the viewpoint of equally spreading the tax load. Also that our industry is paying more than its fair share. We hear comments that our fair share should be X or Y and in a tax context. And, that since the State is not in a position to revise the contracts, they

have merely elected to utilize their taxing power to modify their original agreement.

There is a suggestion that, in light of the needs in this country, the contracts should be modified. Our industry, by and large, has tried to meet these needs in concession agreements and it was generally felt that that was not what we bargained for and the political power was used and we had to deal with it on the best terms available. It was not voluntary action. As corporate citizens, we fully expect to pay our share of taxes as they are needed, when they are needed, in the State of Alaska, and other states of this country. ARCO's record is indicative that we are prepared to be, and will remain, good corporate citizens in Alaska.

Prudhoe Bay field offers profits which go beyond profits offered by any other property if you consider only the number of barrels produced. If you are talking about the rate of return for one company, a field in Barrow will produce more. If you could turn back the clock, there are quite a few fields that we would have drilled before Prudhoe Bay, because they would have provided a better rate of return. But, we didn't know that then.

Regarding the matter of need of the State, the State will some day have need of the revenues from the industry and perhaps it should be taken now since one day those fields won't be there. Is that really an equitable tax load and justified means of doing that?

Windfall benefits - the State is calculated to benefit proportionately higher than the industry by the increase in the price of crude oil. Our business is trying to find windfalls. We must find fields which generate in excess of what Prudhoe Bay returns. Currently operating a well in Cook Inlet that is not a profitable operation. When there is an energy crisis in the country, how can we close a well that is not making us money?

Have heard the comment that big oil is not paying the same tax rate as other tax rates in the state. There is no indication that that is true. Some of the taxes are very selective and discriminatory. Our tax load (when you consider the bottom line) is higher than any other business in the state. In the traditional concept of a fair tax load, the record demonstrates that we are and will continue to pay more than our share of the taxes needed.

Regarding the non-renewable resources concept, in the leases covering the Prudhoe Bay field the provision was made for the state to receive 1/8 of the royalties of everything produced from that field.

The Prudhoe Bay field is going to be very profitable and we will be able to pay these taxes. We feel, however, that the

tax monies are not needed by the state and are unequitable. We suggest that we can use those dollars to explore more oil here and create investment opportunities and more jobs.

Chairman Cowper complimented Mr. Singletary on the quality of his presentation.

Partially in answer to a question by Rep. Cowper, Mr. Singletary commented that it is unprecedented in the United States that a state government would move to increase a tax structure that is already set at such a rate that will supply a considerable surplus. Taxation has never been based on any other bases than to support services.

Rep. Cowper responded that he believes the majority of the Committee would disagree with that viewpoint. Making reference to Louisiana raising its severance tax, it is not unusual to expect a taxing authority to take a look at possible changes and make provision for them.

Rep. Gruening asked if these specific tax proposals abrogate the lease agreements. Mr. Singletary answered that he thinks the intent of some is to do just that. The rationale of some is that the state is unable to revise the lease agreements and the exercising of the taxing power is another way of doing it.

Rep. Gruening asked if that would be the effect. Mr. Singletary replied that if the state elected to pay a royalty at 16 1/2% and ARCO objected and the state took the position that it would raise the taxes the amount of the difference, in terms of the bottom line, the effect would be the same.

Comment by Rep. Meekins to Mr. Singletary that if ARCO is willing to pay only taxes according to the needs of the state, the state will have money for operating expenses, but won't have the money for leasing in the future. It must have some surplus in order to make these types of investments.

In response, Mr. Singletary said that if the projections are correct, the state will accumulate surplus revenues from the royalties and existing taxation policies.

Question by Rep. Rhode as to the wisdom of heavy reliance by the state from the oil producing revenues. Mr. Singletary replied that if it is a secure source he wouldn't think that the State would want to turn it down, but that undue reliance on any one industry eventually is going to lead to trouble. The attempt should be made to diversify and broaden the base of the tax load.

Chairman Cowper thanked Mr. Singletary for his presentation and informed those present that the remaining witnesses would have to limit their testimony to ten minutes.

Dan Teel, Chief Executive of Anchorage Natural Gas commented regarding HB 321 "on behalf of all users of natural gas and electricity made from natural gas." HB 321 provides for an increase. There are provisions for an automatic increase based upon specified rate of inflation. The new tax would represent 5¢ increase on the tax in this area. Unless the plight of consumers is considered here, we fear this bill will be passed. Last year we had to pay more than \$600,000 to our suppliers as tax reserves and we will have to pass part of that increase on this year to our customers, as much as \$50 per year per customer.

Further brief discussion.

Meeting adjourned at 10:45 p.m.

HOUSE FINANCE COMMITTEE
Thursday, April 14, 1977
8:40 a.m.

All Committee members were present. Also present on the panel was Representative Snider. Other members of the Legislature and interested parties were present in the gallery.

Chairman Cowper opened the meeting at 8:40 a.m. and stated that the purpose was the consideration of the administration's oil and gas package. Sterling Gallagher, Commissioner, Department of Revenue; John Messenger, Deputy Commissioner of Taxation; and Tom Williams, Director of Petroleum Revenue were present to give the administration's presentation.

Commissioner Gallagher said in part: The oil industry has made various claims and we feel that three are worth responding to. We don't agree that Alaska has the highest tax burden of the various states in the union. We surveyed eight oil producing states and found that Alaska is number four out of eight. After the new tax proposal is evaluated we change from fourth to second. We don't agree that these tax proposals will affect future exploration for oil and gas in Alaska. We don't agree with the claims that the effect on the Alaska consumer of the gas severance tax are those claimed to be \$2,000,000 a year.

Commissioner Gallagher continued: Last year the legislature requested that we make a comprehensive review of oil all taxes. We did an in-depth analysis. It took two man years to produce. It's a comprehensive review of our tax statute. We came up with some comprehensive recommendations. We think all those taxes should be reviewed. We think the tax package should be passed that includes all three of these bills. You should pass this year the income tax to put it back on the basis of putting into the tax something that reflects the scarcity value of minerals. That's one of the reasons we include the exclusion factor. There have been loopholes in the federal law and they should also be investigated this year. Our revenue should be protected from federal taxing actions. We don't think the state should pay for moving the oil to the east coast. We must provide revenues to meet the on-going need of the government, but also to provide for future needs. Oil is a non-renewable resource, but 25 years is a short time in a state's history. We think the money derived from Prudhoe Bay should be put in the permanent fund and saved for the future. We propose the severance tax and raising the price per barrel. We think the problems should be addressed this year and recommend you raise the cents per barrel tax. We recommend you attach to the severance tax an economic limit factor. In the Cook Inlet area, the economic limit is around 180 barrels a day. In the Prudhoe Bay it is around 750-800 barrels a day. Our tax system should be modified to take into account these realities. We believe that the gas severance tax should be raised so it's on a par with oil. We propose a gas flaring tax to help conserve our resources.

Commissioner Gallagher continued: We propose an income tax based on the higher of book income or taxable income. The reason for that is that in the past years taxable income may be 1/4 to 1/2 of book income. It does not reflect the scarcity value of minerals. We propose an extraction factor. We think our proposal has the ability to tax on the outer continental shelf. We originally introduced a comprehensive review of the property tax that included adding to our present tax base marine transportation refineries and LNG. We think you should review that again and decide if it should pass. We want to be sure we get the full value on the pipeline. We introduced a bill that lowered the millage on the reserve tax this year. One of my highest priorities is to make sure the date is extended another year in case there's an unforeseen delay.

Commissioner Gallagher asked Mr. Messenger to talk about our taxes in comparison to other states.

Mr. Messenger said in part: In the past several weeks the Committee has received substantial comments from members of the oil industry as to the ranking of Alaska tax structure with those in the other states. The claims have been that Alaska's tax burden is one of the highest of the oil producing states. We think those claims are not true. Alaska is actually in the mid-range in the oil and gas producing states. We have been able to compare Alaska's tax structure with the other eight major gas producing states including Texas, Louisiana, California, Wyoming, Oklahoma, New Mexico, and Kansas. In making the comparison, each state's tax structure was applied against Alaska's oil and gas property, production, and income. The department found that Alaska ranked fourth behind Louisiana, Wyoming, and California under existing law. The total taxes from '77 - '86 total \$7.6 billion which was \$2.2 billion below Louisiana, the highest state. Very close to Alaska is Texas, which has a severance tax of 4.6% on oil and 7.5% on gas and property tax, also on hardware, and oil and gas reserves it an average millage rate of approximately 16 mils.

Mr. Messenger continued: We have also made a comparison of how Alaska would rank after the administration's proposals were passed. With the inclusion of the changes, Alaska's tax structure would be raised to 9.6 or just under Louisiana.

In summary: Alaska should set its tax rates and its structure based on the state's needs and not necessarily follow the lead of other states. With production at Prudhoe Bay, Alaska will become the largest oil and gas producing state in the nation. We must provide tax revenue to cover not only our on-going expenses, but to provide oil and gas revenues for future Alaskans.

Mr. Williams presentation in part: I would like to make an observation about a feeling that is being expressed by members of the legislature on why we have to act now. The fact is that the problems and uncertainties regarding pricing will not go away. The FEA is not charged with the responsibility of setting the Alaska pipeline tariff. The ICC is reviewing its procedures which date from the 1940s as to how to set rates on interstate oil pipelines. We have our own Alaska Pipeline Commission which is exploring the rates for moving gas throughout Alaska.

Mr. Williams then ran through the handout entitled "Tax Comparison", (copy with minutes).

Mr. Williams continued: You have also heard that the tax proposals will discourage development. The impact on the decision making to invest or not will be slightly affected by this. Our analysis of the cash flow developed by Wainwright Securities indicates that the increase in tax burden will affect the rate of return by .9%. On field productivity -- there's a great degree of uncertainty, and the impact of a slight change in productivity will be far greater than .9%. The delay between discovery and when the field can come on stream is another factor. The whole purpose of the discounted cash flow analysis is to recognize this factor. The longer it is deferred the smaller the profit will be. Another factor is the wellhead price. This will have a far greater influence on the rate of return analysis. A .9% influence on the rate of return is too small to have an impact.

Commissioner Gallagher interjected: On the gas severance tax, the Anchorage consumer will be paying a small share of it. Most of that money will be paid by the Japanese consumers.

Chairman Cowper explained that there's a companion bill that would more than make up for the severance tax to the consumer by means of a tax credit.

There were various questions by the Committee regarding statements made in the previous presentations. Chairman Cowper displayed a present from the Staff Economist. He then adjourned the meeting at approximately 9:50 a.m.

HOUSE
JOURNAL SUPPLEMENT

May 1, 1938

Finance Committee Chairman's Report
on HCS CS SF 205,
The Oil and Gas Properties Production Tax

HCS
SF
205

PART I. SUMMARY OF TESTIMONY

Hearings were held from April 12 to April 14 by the House Finance Committee to take testimony on bills dealing with state taxation of the oil industry. Testimony was presented by consultants for the committee, representative of the state Department of Revenue, the oil industry and by other individuals.

The first witness, Mr. Will Grubbs, financial director for the Alaska Department of Commerce and Development, testified that the oil industry in Alaska is a very important factor in the state's economy. He stated that the oil industry is the largest source of revenue for the state and that it is the only industry that is growing rapidly. He also stated that the oil industry is the only industry that is providing employment for a large number of people.

Mr. Grubbs also testified that the oil industry is the only industry that is providing a large amount of revenue for the state. He stated that the oil industry is the only industry that is providing a large amount of revenue for the state and that it is the only industry that is growing rapidly.

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CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

HOUSE
JOURNAL SUPPLEMENT

May 7, 1977

No. 60

Finance Committee Chairman's Report
on HCS CS SB 238,
the Oil and Gas Properties Production Tax

HCSCS
SB
238

PART I. SUMMARY OF TESTIMONY

Hearings were held from April 12 to April 14 by the House Finance Committee to take testimony on bills dealing with state taxation of the oil industry. Testimony was presented by consultants for the committee, representatives of the state Department of Revenue, the oil industry and by other individuals.

The first witness, Mr. Niall Trimble, Principal Economist for the Alaska Department of Community and Regional Affairs, testified that Alaska continues to be a most attractive prospect for oil development. Alaska still offers the oil industry high profits, low taxation relative to other areas of the world, outstanding geological prospects, and security of supply.

Mr. Trimble concluded that the oil industry will remain and continue to expand its activities in Alaska whether or not the modest tax increase proposed by the administration is adopted.

Professor Jerome Zeifman, Professor of Law at the University of Santa Clara and formerly Senior Counsel to the United States House Judiciary Committee, specializing in state-federal tax relations, testified that current state tax policy (i.e. the multi-state tax compact), with its use of federal taxable income, substantially erodes the State's tax base. He observed that changes in state and local taxation have never caused companies to change the location of their exploration and development efforts. In response to industry arguments that no tax increases ought to be considered when state budget surpluses are anticipated, Mr. Zeifman reminded the committee of the Biblical injunction to store grain in the seven fat years to avoid famine in the seven lean years.

Professor Edward Shaffer of the Department of Economics at the University of Alberta pointed out that oil will provide Alaska's major source of capital for the next several decades. This capital can be turned into human capital by way of education and health, or into direct business capital, which provides a stream of employment and income for a rising standard of living for Alaska's residents.

HCSCS
SB
238

Adequate transformation of capital can only take place, Dr. Shaffer noted, by effective state government tax policy and, in part, by the use of the Alaska Permanent Fund. An increase in state tax revenues from the oil industry was necessary, in his view, to sufficiently finance the diversification of the Alaska economy, since the oil industry would otherwise use a substantial part of its profits for investment in other parts of the world. Diversification of Alaska's economy could take place through long-term loans from the Alaska Permanent Fund, or through capital budgets for transportation, communication, and the like.

Professor Schaffer pointed to the experience of oil production in Alberta and Nigeria and copper mining in Zambia and Chile, where these industries have not, in-and-of themselves, fostered economic diversification. Dr. Shaffer believes that local processing, business expansion or new businesses spurred by the oil industry in Alaska would likewise not be large-scale, and will decline as oil production declines.

Mr. Joseph Kemp, a noted specialist in the field of oil taxation, and Senior Lecturer in Economics at the University of Aberdeen, Scotland, commented on the many parallels between oil development in Scotland and in Alaska. He noted that the discoveries near Scotland came in the late 1960's, after payment of relatively modest lease fees for exploration rights. Following the fourfold rise in oil prices in 1973, North Sea oil fields were, like the Prudhoe field, suddenly capable of large returns (up to 50% on a discounted cash flow basis.)

Mr. Kemp explained that much of these windfall profits were surplus to amounts needed by the companies to develop the North Sea fields and to search for additional fields. Despite tax raises in 1975 of 60 to 70 percent of total profits, there was no slowing of oil industry activity in the North Sea.

Mr. Kemp described the unusual action taken by the people of the Shetland Islands, who secured compensation from the oil industry to provide for the social and economic disruption caused by oil development activities. This compensation, he said, is being used to rebuild and diversify local industries and to pay the costs of providing additional public facilities, a function possibly similar to that of the Alaska Permanent Fund.

The Department of Revenue offered data gathered from the tax commissioners of eight states which show that Alaska ranks fourth among the states in total oil and gas taxation.

Alaska would rank second, following Louisiana, if the tax measures proposed by the Administration are passed.

Moreover, the proposed tax increases will not, according to the administration, have a major impact upon the rate of profitability. Using the assumptions and data of the report by Wainwright Securities, the changes reduced discounted cash flow returns on the field by less than 1% (in nominal terms).

The Administration strongly urged raising the well-head value at which the cents-per-barrel severance tax goes into effect (from the present \$6.33 to \$7.50). In addition, the Administration recommended that the wellhead value floor (at which the cents-per-barrel tax would go into effect) should rise with inflation relative to the Gross National Product deflator (instead of the Wholesale Price Index, which for some years has been going up more rapidly than the cost of living). These provisions would give the State an "insurance policy" against Federal or corporate manipulations of wellhead values and would help protect the State's revenues.

HCSC3
SB
238

Numerous witnesses from the oil companies appeared before the committee and there was a certain amount of repetition in this testimony. The following is a summary of each of the arguments directed against the bills:

Several of the companies pointed out that the State of Alaska had signed contracts with them in 1964, 1966 and 1969 to lease the land at Prudhoe Bay. They felt that the state was trying to "change the rules of the game" by the unfair use of the state's taxing power.

Even though taxation increases will probably not affect industry willingness to remain at Prudhoe Bay, it could reduce the incentives for further oil exploration and development, the witness said.

Oil company witnesses stressed the need for tax rates in Alaska to stay in line with other states, and since they alleged that tax rates on oil in Alaska were already the highest in America no further increases should be allowed.

Oil company witnesses, while avowing the readiness of the industry to pay its share of taxation actually required by the state, expressed reluctance to pay higher taxes when the Department of Revenue was predicting budgetary surpluses.

Producers in the Kenai-Cook Inlet area warned that higher taxes would compound the problems they face as a result of Federal price controls and the greater costs in the later stages of field recovery.

Most of the testimony from oil company witnesses was largely philosophical in nature, without specific attacks on the provisions of the bills before the committee or the research reports that lay behind them. However, the testimony from one company-Exxon-differed sharply from the others. Exxon submitted to the committee its own economic analysis of the profitability of the Prudhoe Bay field. This study was the first detailed industry comment on the profitability report prepared for the Legislature by consultant Dr. Michael Tanzer over 15 months ago.

A number of errors of fact in the Exxon testimony are already apparent:

HCSCS
SB
238

1. In questioning the accuracy of the probable rate of profitability of the Prudhoe Bay Field established by the Tanzer reports, Exxon witness Monte Taylor stated that no allowance was made for payment of reserves tax by the companies. Payment of reserves tax was in fact included in the calculations presented on pages 42-43, 49 and 94 of Tanzer's first report to the Legislature.

2. Mr. Taylor also stated that Tanzer did not deal with payments in respect to property tax. In fact, Tanzer covered this on pages 44, 47 and 49 of the first report.

3. Mr. Taylor also criticized the Tanzer report for not including \$900 million in bonus bids paid in the 1969 lease sale. He neglected to mention that 90% of these payments were for areas outside the boundaries of the oilfield under consideration. These payments were not made by the principal leaseholders in Prudhoe Bay.

4. The Exxon study asserted that the return on the field and the pipeline should be considered together. However, since pipeline tariffs have first claim on any return from Prudhoe Bay, it is clear that the risks involved on the two investments are of different orders of magnitude. These differences are reflected in the willingness of banks to finance 85-90% of the pipeline costs, compared with only 45-55% of field development costs. Dr. Milton Lipton of Walter Levy & Associates and Dr. Walter Mead of the University of California both concur in the validity of treating the pipeline as a separate profit center.

Likewise, Messrs. Lipton and Mead agreed that Exxon's inclusion of \$1.8 billion for construction of new tankers in the capital cost of field development is improper.

Mr. Taylor contrasted the DCF rate of return produced by Exxon (18%) with that contained in the latest report from Tanzer (29%). He did not inform the committee that Exxon's figure was a constant dollar rate of return, which took out the effects of inflation. If it were done on the same basis as Tanzer's, the Exxon rate would be around 25%.

The Exxon representative attacked Dr. Tanzer's approach in excluding the cost of the pipeline from field investment, describing it as "faulty economic analysis... naive and illogical" and "completely unrealistic". Mr. Taylor admitted that he did not know of any independent, published economist who agreed with his views, and "had not tried to find one."

One individual witness, Mr. Eben Hobson, Mayor of the North Slope Borough, focused on the need for the industry to become "good corporate citizens" and to pay the taxes they can well afford to bear. Mr. Roger Lang, appearing for the Bristol Bay Native Corporation, expressed fears that some Native regional corporations might be adversely impacted in their search for, and development of, medium and marginal prospects under their lands.

Mr. Duane Carlson testifying for the AFL-CIO, Alaska, advanced the view that oil taxes in other states were "their own business" and that Alaska's goal must be a consensus on the "price we want for our resources". Until that occurs, he said, the industry had a legitimate complaint about unstable tax policy in Alaska. However, he said the price Alaska chooses to set should not depend on whether or not Alaska has predicted budgetary surpluses.

HCSCS
SB
238

Mr. Vic Fisher, a senior member of the Institute of Social and Economic Research, University of Alaska, set out a "one-time" theory of taxation, arguing that oil, primarily Prudhoe Bay, is the only known source of large revenues for Alaska for decades to come. He challenged industry claims that such revenues are "surplus" to Alaska's real needs, noting the great cost of needed capital improvements in most of rural Alaska, using the North Slope Borough's plans as an example.

PART II. NEW INFORMATION

The new facts that emerged from the House Finance hearings include:

- a) Industry acknowledgement that Alaska's taxation on oil is much lower than that found in the vast majority of oil producing areas in the world.
- b) According to the administration's calculations, based on information from tax commissioners of eight oil producing states, Alaska does not have the highest oil taxes in the U.S. Alaska now ranks fourth and will, after the passage of these bills, rank second.
- c) The discounted cash flow (DCF) analysis of returns appears to be the main technique used by the oil companies in estimating the profitability of an oil field.
- d) The risks for the pipeline are in a lower category than for the field itself and that returns on the pipeline investment are limited by U.S. law to 7%.
- e) The Administration and Drexel-Burnham studies of DCF returns on Prudhoe Bay were 26% and 27% (at today's dollars and setting aside pipeline and tanker investment). Both studies used medium estimates for oil production and both made the conservative assumption that the companies will pay an effective 48% Federal income tax rate. Several companies admitted, however, that they paid far less than the full Federal rate.
- f) The Administration offered data showing that the proposed taxes would lower DCF returns on Prudhoe Bay by less than 1%. Witnesses appearing in behalf of the oil companies conceded this point.
- g) BP and SONIO stated that passage of the tax bills would make no difference to their future operations. They will continue their investment in Prudhoe Bay and will continue their exploration program in Alaska.

PART III. CONCLUSIONS

HCSCS

SB

238

The industry spoke of the "unfairness" of changing the tax rules after they had made substantial investments in Prudhoe Bay. Since 1973, though, the price of oil has more than quadrupled, dramatically increasing the value of this field without any effort on the part of the companies. While inflation and environmental constraints have pushed up total costs, total profits have risen even further. There must be a balance of the "loss" of profits which the companies could not, and did not, expect against the responsibility to protect the long-run interests of Alaskans.

Certainly the oil companies would have been expected to come to the state if the costs of the pipeline or mistaken estimates of recoverable reserves had trapped them under the previous, depressed prices. No contract prevents the industry from asking for, and receiving, lower severance and other taxes. Dr. Shaffer reported that companies in Alberta broke a joint venture agreement with the province for extracting oil from tar sands (the Syncrude project) until new terms were obtained, including higher government aid.

No oil company has ever had an agreement with the state of Alaska that taxes would not be raised in the future.* To the contrary, the oil companies holding the major leases on the North Slope fully expected that taxes would in fact be raised even before the oil flowed.

The industry emphasized that higher taxation could discourage further oil activity in the state. They did not, however, explain why this might occur when Alaska does offer exceptional discovery prospects, higher profits and lower taxes as compared to many parts of the world, and security of supply, (i.e. no risks of revolution, war, expropriation and, in Prudhoe Bay, the absence of the disruptions associated with off-shore operations.)

It appears on the hearing record that oil prices, the size of reserves and the costs of extraction will be far more critical in determining the magnitude of future oil exploration and development than the modest tax proposals before this committee.

In particular, weight should be given to the Administration's study (which used industry-based data), which shows that the severance tax proposal reduces DCF profits by less than 1%, a reduction which BP and SOHIO witnesses frankly stated would not cause them to halt investment in Prudhoe Bay or reduce present plans for exploration.

The claim by the industry that Alaska's oil and gas taxes are the highest in the nation, thereby lessening Alaska's competitive position, is contradicted by the Administration's claim that Alaska now ranks fourth among the states and would move to second with the passage of their bills.

* No such agreement could exist, since Article IX, Section 1, of the Constitution of the State of Alaska prohibits the surrendering of the power of taxation.

In making its comparison, the Department of Revenue superimposed tax structures of other states on the production, income and property in Alaska. To be conservative, the Department excluded sales and use taxes, special pipeline taxes, and other taxes unique to other jurisdictions. The analysis of eight state tax commissioners appears to be more credible, but regardless of the past decisions of other states, Alaska is not and should not be bound by those past decisions alone.

HCSCS
SB
238

First, the oil fields found in other states are now in large part in the later years of their life--smaller, and less profitable (often only stripper wells are involved).

Secondly, virtually all leases in the lower 48 states are on private rather than public lands and therefore do not involve the extraction of non-renewable resources belonging to all the people. The primary concern here is that the people of Alaska receive a satisfactory return for the extraction of non-renewable resources.

The industry contended that Alaska has all the revenues it needs, as proven by the prediction that a major "surplus" will accumulate in the Alaska Permanent Fund and the general fund.

Moreover, in recent statewide media presentations, the oil industry praises the Permanent Fund but makes much of the assertion that no legitimate purpose is given for the predicted surpluses.

Nevertheless, one of the major objectives of the Permanent Fund is to develop an economic base for Alaska beyond the monolithic oil industry. Viewed in this light, the use of oil revenues to diversify the Alaska economy is certainly as worthy a purpose as is, for example, Mobile Oil's recent takeover of Montgomery Ward's.

The final shape of the Alaska Permanent Fund is open, but there is wide consensus that it can be used both to provide savings and income for the years after oil declines and to build a diversified, private economy and a new tax base. The capital projects from the general fund or bonding will hopefully compliment those broad goals. No one knows whether Alaska will, in fact, have a surplus; since no one knows, today, what will be the needs as oil production inevitably declines.

As for the problems of the Kenai-Cook Inlet operators, the Administration has pointed out that Federal price relief is available and that Federal controls may go on a stand-by basis in 1979 under the Energy Act. Yet there are delays in obtaining price relief, and the future of controls is uncertain. Moreover, as most of these fields are declining, it is sound policy to provide, in advance, that oil recovery and revenues be stretched out as long as possible.

Accordingly, a formula has been adopted that will immediately reduce severance taxes in the Kenai-Cook Inlet area and will, in future years, reduce the rates there more sharply than in other, more profitable areas.

May 7, 1977

HCSCS It was argued by the industry that they were suf-
SB ferer an undue burden from taxation at existing rates.
238 Specifically, the data in SOHIO Submission One reveals,
according to Walter Levy & Associates, that the effective
income tax on the oil industry under the current law will
not exceed about 2.5%, as opposed to the 9.4% in the
statute. The oil industry never denied that most Alaskan
businesses pay a higher effective rate. This arises from
the large subsidies in the Federal taxable income figure
on which our tax is based today* and because the actual
value of North Slope production is not reflected in oil
property, sales, and payrolls in the state (the factors
now used to divide income).

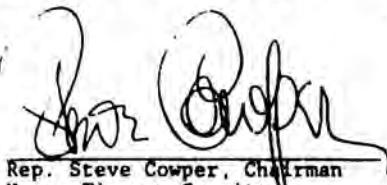
In the course of the hearings, one major conflict
kept emerging - the state's need for incentives versus the
desires of Alaskans to turn oil capital, which can never
be replaced, into uses that will provide benefits for the
present and future generations.

It is the task of the Legislature to balance these
desires, and the uncertainties that go with each of them.

Given the tax relief that the administration's sever-
ance tax 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.

HB 322, the corporate franchise tax, as well as HB 145,
the direct accounting approach recommended by the Sub-
committee on Oil and Gas Taxing and Leasing Policy, merely
represent a mechanism to produce an effective rate equal
to that which the present income tax law is supposed to
recover for Alaska.

In light of the testimony and a thorough review
of the analysis and study of tax proposals over the past
three years, a majority of the members of the House Finance
Committee recommends passage of HCS for CS for SB 238.



Rep. Steve Cowper, Chairman
House Finance Committee

* Last year, the largest oil companies in Alaska reported
\$3 billion more income to stockholders than they were re-
quired to report to the I.R.S.

* House Finance Committee Substitute for CS for SB 238
is essentially the Governor's bill.

MAJOR PROVISIONS OF THE OIL AND GAS
PROPERTIES PRODUCTION TAXHCS
SB
238

The severance tax for oil is set at 12.5 percent of the wellhead value, or \$.9375 per barrel, whichever is higher. The cents-per-barrel "trigger" is set at a wellhead value floor of \$7.50, a floor which escalates at the rate of the GNP deflator. The floor, combined with the escalator, gives the state "downside protection" from the risks of changes in Federal pricing policy or attempts by the oil companies to shift costs from the fields to the pipeline and tankers (thus lowering well-head values) or to move profits to the refinery, marketing, and distribution phases of their operations (thus lowering the profits exposed to taxes in Alaska). The \$7.50 floor was not criticized by the industry as unreasonable, and the escalator is seen as being essential to insure that Alaska's revenues keep pace with the rising value of Alaska's oil and to protect the purchasing power of the state's dollars.

By raising the minimum economic limit factor (ELF) from 100 to 300 barrels, the special problems of marginal producers, such as those on the Kenai-Cook Inlet fields, are recognized. The ELF formula has been altered with an exponent that speeds the fall in severance tax for marginal fields.

The definitions of "gross value at the point of production" in Section 7 avoid the instability that came from the six years of litigation over the pricing of Cook Inlet oil.

The severance tax rate for gas is set at 10 percent of value, or \$.064 per thousand cubic feet, whichever is greater. Again, there is a floor under revenues, guarded by the GNP deflator. Again, because of the ELF formula, the less profitable a field, the more rapidly the severance tax ends. The former tax on all flared gas (a drafting error in the original bill) has been replaced by a penalty on gas use exceeding that allowed by the State Conservation Committee for safety flaring and for operating purposes on a lease.

OUTLINE OF HCS CSSB 238

The House Finance Committee Substitute for Committee Substitute for Senate Bill No. 238 provides for a production tax on oil and gas which has the following characteristics:

FOR OIL,

1. A 12.5% of value tax; or,
2. A \$.9375 per barrel tax (\$7.50 floor price), whichever is higher;
3. An escalator for the cents per barrel tax based on the GNP deflator;

HOUSE JOURNAL
SUPPLEMENT

May 7, 1977

No. 60

HCSCS
SB
238

4. An economic limit factor (ELF) which reduces the effective tax rate as production approaches the economic limit; and
 - (a) which presumes 300 barrels per day as the economic limit subject to the taxpayer demonstrating otherwise; and
 - (b) which contains an exponent that further reduces the effective rate for leases with an economic limit of less than 300 BPD; and
 - (c) which relies on the free market price of imported oil for determining the economic limit;
5. A definition of the point of production.

FOR GAS,

1. A 10% of value tax; or
2. A \$.064 per thousand cubic feet tax, whichever is higher;
3. An escalator for the cents per MCF tax based on the GNP deflator;
4. An economic limit factor which reduces the effective tax rate as production approaches the economic limit; and
 - (a) which requires a hearing to determine the economic limit; and
 - (b) which relies on the highest field price within 100 miles for such determination;
5. A penalty on gas flared in excess of that authorized for safety equal to the production tax on gas;
6. A definition of the point of production.

Prepared by:

Legislative Affairs Agency
Research Division 6 May 77

OUTLINE OF CSSB 238 am

The Senate Resources Committee Substitute for Senate Bill No. 238 as amended in the Senate provides for a production tax on oil and gas which has the following characteristics:

FOR OIL,

1. A 11.5% of value tax; or
2. A \$.75 per barrel tax (\$6.52 floor price), whichever is higher;
3. No escalator for the cents per barrel tax;

4. An economic limit factor (ELF) which reduces the effective tax rate as production approaches the economic limit; and
- (a) which presumes 100 barrels per day as the economic limit subject to the taxpayer demonstrating otherwise; and
- (b) which contains an exponent that further reduces the effective tax rate for leases with an economic limit of less than 750 BPD; and
- (c) which relies on the free market price of imported oil for determining the economic limit;
5. No definition of the point of production.

HSCS
SB
238

FOR GAS,

1. A 10% of value tax; or
2. A \$.064 per thousand cubic feet tax, whichever is higher;
3. No escalator for the cents per MCF tax;
4. An economic limit factor which reduces the effective tax rate as production approaches the economic limit; and
- (a) which requires a hearing to determine the economic limit; and
- (b) which relies on the highest field price within 100 miles for such determination;
5. No penalty on gas flared in excess of that authorized for safety.
6. No definition of the point of production.

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HOUSE JOURNAL
SUPPLEMENT

May 7, 1977

HCS
CSSB
238

EFFECTIVE SEVERANCE TAX RATES IN PERCENT FOR PRESENT LAW,
HOUSE FINANCE COMMITTEE SUBSTITUTE FOR
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238,
AND
SENATE RESOURCES COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238 am

<u>Field Units</u>	<u>Present Law</u>	<u>House Finance CS CSSB 238</u>	<u>Senate Resources CSSB 238am</u>
Beaver Creek	8.3	0	1.1
Granite Point			
280001	7.7	5.5	2.3
280002	7.5	1.0	0.8
280012	7.0	0	0
280022	8.0	4.2	1.5
McArthur River			
520001	10.5	14.7	8.6
520002	9.0	5.6	2.3
520003	8.8	7.7	3.7
Middle Ground Shoal			
524001	5.6	1.8	1.0
524002	6.0	4.4	1.9
524003	5.8	5.0	2.5
524013	5.6	3.8	1.7
Swanson River			
772001	10.4	1.0	0.6
772002	0	0	0
Trading Bay			
800001	7.6	0	0.6
800002	7.2	0	0
800003	0	0	0
800004	8.5	0	0.1
800005	7.1	0	0
Production Weighted Kenai- Cook Inlet Composite	8.9	8.4	4.9
Prudhoe Bay	7.7	12.2*	10.4*

*Assuming an economic limit of 750 bbl/day.

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Legislative Affairs Agency
Research Division
6 May 1977

COMPARISON OF TOTAL* SEVERANCE TAX REVENUES GENERATED BY PRESENT LAW,

HOUSE COMMITTEE SUBSTITUTE FOR
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238
AND
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238 AMENDED

Field	Millions of Dollars*		
	Present Law	House Finance CS CSSB 238	Senate Resources CSSB 238am
FY 1978:			
Kenai-			
Cook Inlet	23.5	22.3	13.1
Prudhoe Bay**	<u>171.4</u>	<u>270.8</u>	<u>227.8</u>
TOTAL	192.7	293.1	242.9
FY 1979:			
Kenai-			
Cook Inlet	19.6	19.0	11.1
Prudhoe Bay**	<u>255.8</u>	<u>397.6</u>	<u>349.4</u>
TOTAL	275.4	416.6	360.5
FY 1980:			
Kenai-			
Cook Inlet	18.2	16.3	9.3
Prudhoe Bay**	<u>303.7</u>	<u>471.9</u>	<u>413.6</u>
TOTAL	321.9	488.2	422.9

* All figures are gross, EDIC has NOT been credited.

** Assume wellhead value at Prudhoe Bay Oil is \$7.38/bbl in FY78 with 5% inflation thereafter.
Assume economic limit at Prudhoe Bay is 750 bbl/day.

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