Alaska Oil and Gas Association

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TESTMONY BY THE

ALASKA OIL AND GAS ASSOCIATION

TO THE SENATE JUDICIARY COMMITTEE

REGARDING SB 2001 & CSSB 2001(RES)

ON THE TOPIC OF "PROGRESSIVITY"

October 31, 2007

Mr. Chairman and Members of the Committee:

For the record, my name is Thomas K. Williams. I am Senior Royalty & Tax Counsel for BP Exploration (Alaska) Inc. and a former tax administrator in the Alaska Department of Revenue ("DOR") I am appearing before you today to testify in my role as chair of the AOGA Tax Committee.

My present testimony pertains to the topic of "Progressivity" as scheduled for consideration today.

"Progressivity" is a feature in the present production tax. It is levied under subsection (g) of AS 43.55.011, and is a separate tax from the basic PPT tax levied by subsection (e) of that statute. It is also in addition to the basic PPT tax. Like the basic PPT tax, the present progressivity tax is based on the "net value" of production. But, unlike the basic tax, progressivity is computed monthly instead of on an annual basis. The tax rate for progressivity is zero when the "net value" per BTU equivalent barrel is $40 or less, and it rises linearly at a 0.25 percentage points per dollar that the "net value" per BTU equivalent barrel rises above $40, up to a maximum rate of 25 percent. The 0.25 figure which sets the rate at which the tax rate rises is known as the "slope."

In SB 2001 as introduced, progressivity would be unified with the basic PPT tax levied by § 011(e), and the rate for this unified tax would be determined under § 011(g). The combined tax would be a tax on the "net value" of production, the two current taxes are. The progressivity component of the rate has slope of 0.20 percentage points per dollar, and it begins when the "net value" per BTU equivalent barrel rises above $30. Progressivity under SB 2001 would be calculated on an annual basis, instead of a monthly one as is the case now.

The Senate Resources CS for the Bill has deleted the changes to progressivity that were proposed in the original Bill.

The rationale for progressivity boils down to little more than "at these prices, the oil industry can afford to pay us more." If "affording to pay" is to be the rationale for setting taxes, then who was arguing, not even nine years ago, to give industry a break when the spot price for a barrel of ANS on the West Coast — after spending some $4.26 a barrel for transportation to get it there[1] — crashed to $8.16 [2] on December 23, 1998? No one.

It is this asymmetry that makes progressivity so objectionable to the industry. We have put up all the capital and taken all the risk in making that investment. Periods of high oil prices are not only an opportunity for industry to catch up after periods of low prices, but they are also the opportunity to make up for expensive investments that proved to be unsuccessful.

Take bonus bids for oil and gas leases as an example. The industry paid $1.013 billion in bonus bids for the Mukluk prospect in the Beaufort Sea in 1982, and then spent another $135.6 million to put in a gravel island and drill an exploration well — it was a dry hole. Even in the State's great $900 million lease sale in 1969, over $525 million of those bonuses was paid for acreage that turned out to be outside the main Prudhoe Bay field. And the acreage that was in the field represented less than 2% of its oil and just over a quarter of a percent of its gas.

AOGA opposed the inclusion of progressivity in the PPT legislation that passed last year, and we do not like it any more now.

Thank you for giving AOGA this opportunity to testify.

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[1] SOURCE: DOR, *Revenue Sources Book Fall 2000*, p. 89, Appendix G "Historical and Projected Crude Oil Prices" ($4.26 figure equals the difference between the "ANS Wellhead Nominal" price and the "ANS West Coast Nominal" price for FY 1999).

[2] SOURCE: *The Wall Street Journal* (December 24, 1998).