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 "FLOOR"

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 "Floor" as scheduled for consideration today. We have taken "Floor" as referring to the present "minimum" tax under the PPT, as well as the Administration's proposed tax on so-called "legacy fields" and variations of them.

AS 43.55.011(f) currently provides for a "minimum" tax for production from fields on the North Slope, but nowhere else. Like the basic PPT, this "minimum" tax is determined on an annual basis. But unlike the basic PPT and progressivity, the "minimum" tax is based on the "gross value at the point of production" instead of the net "production tax value" determined under AS 43.55.160. The "minimum" tax rate is 4% when the average ANS West Coast spot price for the year is over \$25, 3% when over \$20 but not over \$25, 2% when over \$17.50 but not over \$20, 1% when over \$15 but not over \$17.50, and zero when \$15 or less.

As introduced, Sec. 16 of SB 2001 would turn the "minimum" tax into a "floor" for fields with over one billion BTU equivalent barrels of cumulative production as of the end of the prior calendar year, and with average daily production of 100,000 BTU equivalent barrels during that prior year. There is no geographic limitation on the applicability of this "legacy" floor as there is with the present "minimum" tax, but statewide only the Prudhoe Bay field and the Kuparuk River field, along with their satellites, would be classified as "legacy." The "floor" would be set at 10% of the "gross value at the point of production" for production from a "legacy field" during the year, and tax credits could not be applied against the regular PPT and progressivity to reduce the tax below this amount.

The Senate Resources CS for SB 2001 has removed Bill Section 16 from the original version of the Bill, and would leave the "minimum" tax as it is.

The very notion of a "minimum" tax or a tax "floor" reflects the same asymmetry that makes us oppose progressivity. The State, in effect, would be saying it wants more and more of the upside opportunity, but less and less of the downside risk. Alaska has the power to do that, but sharing both the upside and the downside more uniformly would be considerably more conducive for making the massive amounts of new investments that this generation of Alaskans and the next will need in order to meet the challenges of declining North Slope production.

More importantly for the future, the Administration's proposed "floor" in the original version of the Bill threatens to turn the production tax for "legacy fields" into a "gross" tax instead of a "net" one. A taxpayer could hit the "floor" in either of two ways. One would be when ANS spot prices are low enough, or expenses are high enough, that a 22.5% on the "net value" is less than 10% of the "gross value." If the basic PPT rate[1] is 22.5%, this would occur when the "gross value" is not more than 1⅔ times the deductible lease expenditures.

The second way a taxpayer could hit the "floor" is by having a lot of tax credits. These could arise from having an exceptionally high proportion of capital expenditures among its deductible expenses for a "legacy field," from having unused non-"legacy" tax credits carrying forward from prior years, or perhaps from buying non-"legacy" tax-credit certificates from others.[2] This may happen more readily than it first appears.

Suppose, for example, the "gross value at the point of production" for a hypothetical "legacy field" producing a lot of viscous oil is $60 a barrel, the deductible expenditures for the field are $30 a barrel, and half of the deductible costs are capital costs that generate a 20% credit. Under the Administration's original version of SB 2001, the taxable "net value" under the basic PPT would be $30,[3] which is just at the threshold where progressivity is still zero. Twenty-five percent of the taxable $30 "net" is $7.50, and a 20% on $15 of capital expenditures would be $3.00, so the basic PPT would be $4.50 after credits. This is less than the "floor" of $6.00,[4] so

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[1] There would be no contribution to the tax rate from progressivity under SB 2001 as introduced, because the net "production tax value" would be less than the $30 level at which progressivity would begin.

[2] Tax credits arising within a "legacy field" may not be used in a non-"legacy" field or give rise to a transferable tax-credit certificate. AS 43.55.023(a)(3) and (d). But there appears to be nothing to prevent credits from going the other direction — that is, from a field that isn't "legacy" to one that is.

AS 43.55.023(a)(3), being enacted in Sec. 26 of SB 2001 as introduced, forbids the use of tax credits from capital expenditures in a "legacy field" against the tax of any non-"legacy field," but we see nothing that would prevent such a credit arising in a non-"legacy field" from being applied to a "legacy field." The prohibition in AS 43.55.023(d), as amended by Sec. 28 of the original version of the Bill, would similarly bar the issuance of tax-credit certificates for credits arising from a "legacy field," but there seems to be no prohibition against applying a tax-credit certificate arising from a non-"legacy field" from being applied against tax for a "legacy field." Finally, AS 43.55.023

[3] This figure equals the $60 "gross value at the point of production" minus the $30 of deductible expenses.

[4] The "floor" is 10% of the $60 "gross value."

the tax for this "legacy field" would be on a "gross value" basis.

In our testimony on "Gross vs. Net" we showed why a tax on "net value" is superior to one on "gross value" in terms of attracting more investment in production to slow the ANS decline, and I will not repeat that analysis now. Rather, the point here is that a "gross" tax is not good for "legacy fields" any more than it is for other ones. The Prudhoe Bay and Kuparuk River units offer a greater opportunity, between them, to slow decline during the short term than the rest of the North Slope put together. For the longer run, the great bulk of the viscous and heavy oil on the North Slope is in shallower formations overlying the main reservoirs of these units. Thus, for two of the three major kinds of investment available to slow decline — in-fill drilling and well workovers, and the development of viscous and heavy oil — the tax under the Administration's proposal would be precisely the wrong kind of tax to facilitate these investments. We respectfully urge the Legislature not to repeat the Administration's mistake.

Thank you for giving AOGA this opportunity to testify.