

March 14, 2005

Notes re: Substantive Changes to HB488 by the House Resources Committee

1. Make tax rate progressive-

Reasoning- The State should make more money at higher prices, and a larger percentage of the whole pie at extremely high prices. The Committee has increased the Governor's 20% tax rate to a progressive system. The 20% number will be in effect until the price of oil (West Texas Intermediate, WTI) reaches \$50/barrel. After \$50/barrel, the tax rate increases by .30% per \$1.00 increase in the oil price (WTI). The rate caps at 50% at about \$150.00/barrel, in case of a global oil shock. This makes the tax rate at \$60.00/barrel 23.5%, and \$70.00/barrel 26.5% and continues to escalate from there.

We feel that this keeps investment opportunity in Alaska very strong, but balances it out by taking advantage of windfalls in high spikes of oil prices.

2. Reduce Transitional Money as deductible allowance- The Governor allowed five years of past investments to be deducted as costs. The rationale behind the transition provision was that investments made for the previous five years directly led to the production of oil that is now being taxed at a higher rate. The Committee feels that this rationale is partly true, but that a full five years of looking back is not appropriate. The cost recovery of the five years of investments has already been enhanced by extremely high oil prices. The Committee has replaced the 100% cost recovery of the previous five years with a

greatly scaled back program. The CS will allow 75% of 2005 expenditures, 50% of 2004 expenditures, and 25% of 2003 expenditures to be deducted as costs. The payback period of six years that was in the original legislation has been increased to seven years. The same caveat of oil prices being at least \$40/barrel (ANS) before cost recovery is allowed remains the same. Additionally, the Committee has determined that the inflation indexing mechanism on the \$40 price shall be in statute, not left up to regulators. This change reduces the amount of deduction allowed by industry from 5 billion to 2 billion and reduces the amount of the credit from approximately \$1 billion to \$300 million. Therefore, instead of the State absorbing \$167 million annually in scheduled credits, the amount will be reduced to approximately \$43 million per year.

3. Exploration enhancement- The SB185 exploration tax credits of 40% will be extended 10 years. The Governor's credit rate of 20% remains intact. The Committee feels that this will significantly enhance explorers and independents. Department of Revenue has testified that exploration investment in new fields represents less than ten percent of all development and exploration investment dollars. The Committee wishes to emphasize exploration. As they do currently, the company will choose between which credit is most beneficial to them.
4. No credit for abandonment costs- The CS contains specific language that abandonment costs will not be eligible for tax credits.

5. Private Royalties- The CS sets private royalty oil severance tax rates at 5%.

6. AOGA technical changes- AOGA worked in conjunction with the Governor's office to suggest several technical changes and clarifications to the bill. Some of these changes are incorporated into the CS.

7. Contingency sur-charges- The CS will leave current statute in place, which makes a 5 cent/barrel sur-charge non-deductible and non-creditable. Currently, of the 5-cent/barrel charge, 2 cent/barrel is deposited into the Response Mitigation Account until the account reaches \$50 million. After this, the 2-cent/barrel charge is suspended. The CS lowers this amount to one cent/barrel. The remaining 3-cent/barrel charge is deposited into Prevention Mitigation Account. The CS increases this to 4 cents/barrel, while dropping the Mitigation money to 1 cent/barrel, leaving the total sur-charge at 5 cents/barrel.

8. Effective date- CS changes the effective date of the bill from 1 July to 1 April, the start of the second calendar quarter. This will result in an almost immediate effective date and will gain the State over 200 million dollars in the current fiscal year.

9. Issues surrounding the \$73 million allowance- The CS eliminates the 73 million annual dollar allowance, which resulted in a \$14.6 million credit. Instead, the Committee implemented an annual direct tax credit, dollar for dollar, for the first \$10 million worth of expenditures. The credit is annual, non-transferable, non salable and not eligible for carry forward. The credit can only be applied to the current year's severance tax. If there is no tax, the credit cannot be claimed. If a company has income but spends less than 10 million dollars, they can only claim credit up to amount that was spent.

10. Tax Credit Repurchase Program- To help protect explorers and new entrants to Alaska, the State will buy up to \$10 million per year per company for credits at 100% of face value. Companies must show that an equivalent amount to the credit is being reinvested for exploration or lease purchases in Alaska.

11. Penalties on underpayment of less than 90% of monthly tax liability- The CS puts in place a 5% penalty for underpayment of the monthly severance tax bill for any amount below the 90% threshold. In addition, interest will be charged on any payment shortfall less than the full liability.