

# ALASKA STATE LEGISLATURE HOUSE RESOURCES COMMITTEE

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## **SPONSOR STATEMENT CSHB 488 (RES)**

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(version 24-GH2052/L)

COMMITTEE REPORT: 6 "Do Pass" / 1 "Do Not Pass" / 1 "Amend"

CSHB 488 (RES) would convert Alaska's oil severance tax structure from the Economic Limit Factor (ELF) method, to a petroleum profits tax (PPT) method. The governor's version would increase revenue by about \$705 million per year, on average, over the next five years. The House Resources Committee (HRC) version would increase revenue by about \$816 million per year, on average, over the same five years.

The severance tax is one of four levies paid by the oil industry in Alaska, the others being royalties, property taxes, and income taxes. Tax deductions and tax credits continue to be used to motivate industry for exploration, production, and development activities. The objectives of the bill remain as follows: Increase the state's share or "government take," under conditions of high oil market prices; provide industry with new or expanded incentives to explore and produce from marginal and frontier fields; and to ensure motivation for continued activity in the Cook Inlet fields.

The HRC proposed several changes to the governor's bill, most notably, installing a two-pronged progressivity feature on the PPT tax rate. In the governor's version, the PPT rate is a flat 20% regardless of the market price of oil. The HRC version also uses the 20% rate, but only at market prices up to \$50 per barrel (WTI benchmark). At market prices between \$50 and \$110 per barrel, the progressivity feature adds 3/10% of the wellhead value for every dollar the market price is over \$50. A single year of additional revenue in times of high market prices can offset many years of lower revenues when prices are close to their historical average.

If there is a dramatic price shock or the value of oil continues to rise at market prices over \$110 per barrel, the tax generates an additional 37.5% of wellhead value for the state. We would get a greater share at very high market prices. As prices climb, the combined effect of the 20% PPT base rate and the 37.5% progressivity factor (which is deductible in calculating the amount payable under the PPT rate) approaches 50% of the oil's value in Alaska. The committee felt this two-pronged progressivity feature would keep investment opportunity in Alaska strong, while allowing the state to share in windfalls at high spikes of market prices.

Another policy change from the governor's bill to the HRC version was the elimination of transition costs as deductions from income tax. The governor provided a deduction for investment costs incurred in the past five-years, feeling that investments made in that period and directly tied to the production of oil which would be taxed at the new rate, should be allowed. After hearing considerable testimony on this component, the HRC deleted it completely.

Exploration tax credits of 40% under SB 185 (Ch. 59, SLA 03) will be extended ten years under the HRC version, and the governor's credit rate of 20% remains intact. This is intended to motivate explorers and independent firms. As is currently done, a company will be able to choose from the two options as they assess which is most beneficial to them.

The House Resources Committee allowed no credit for abandonment costs, but such expenses remain tax-deductible. And, in terms of a private royalty severance tax rate, the HRC version set it at 5%.

As introduced, the governor's version of HB 488 proposes to make the current oil spill contingency surcharge (which is currently 5-cents per barrel) creditable against the PPT. The HRC left the current statute in place, but modified the program. The current 2-cents per barrel which goes into the Response Mitigation Account (RMA), is reduced to 1-cent. This surcharge will continue in suspension as long as the RMA balance holds at \$50 million. The remaining 3-cent per barrel surcharge, which is deposited into the Prevention Mitigation Account (PMA), increases to 4-cents per barrel under the HRC substitute bill.

The governor provided a \$73 million annual allowance for all producers, against which a 20% credit would be applied, resulting in a \$14.6 million tax credit per company, annually. The merits of this allowance and credit incentive eluded committee members, so this provision was changed to a direct tax credit, dollar for dollar, on the first \$12 million worth of capital investment for exploration, production, or development work. This annual credit is non-transferable, non-salable, not eligible for carry-forward, and can only be applied to a current year's severance tax. Should a company spend less than \$12 million, the credit would be applied to whatever amount they did spend.

As protection for explorers and new entrants to Alaska, the HRC devised a tax credit repurchasing program for those credits a company earns on expenditures of up to \$10 million per year for investments in exploration and/or lease purchases in Alaska.

The effective date for HB 488 as introduced by the governor, was July 1, 2006. The HRC version changed that to April 1<sup>st</sup>, also the beginning of a fiscal quarter, but a change which would bring the state another \$200 million this year.