



COMMONWEALTH
NORTH

Commonwealth North Oil Tax Institutional Background

03/10 - Energy for a Sustainable Alaska, the Railbelt Predicament

Commonwealth North commissioned this study to evaluate solutions and facilitate dialogue relevant to energy policy throughout Alaska and develop guidelines and recommendations for a secure energy future.

RECOMMENDATIONS/CONCLUSIONS (Page 6)

As oil & gas make up the largest sector of the economy, it is important to evaluate all factors to encourage development of oil and natural gas potential.

SUPPORTING TEXT (Page 25)

Encourage Increased, Near Term Exploration and Drilling

The State of Alaska should encourage and support oil and gas development through the implementation of royalty and tax breaks and other incentives... In truth, more aggressive actions need to be taken with regard to all of Alaska's resources to encourage full development and fulfill the mandates of Article VIII of the Alaska Constitution. Commonwealth North has twice published policy papers that advocate the management of Alaska's resources as a business. [Alaska's Asset Portfolio Managing for Maximum Return (1998), Putting Alaska's Assets to Work for Alaskans (2004)] Those policy reports remain relevant for policy makers and government alike.

Overall production shortfalls are predicted in 2013-2030 unless the probable reserves are developed. Gas producers cannot be forced to invest if the opportunity does not meet their investment criteria.

06/97 - Balancing Responsibilities: The Role of State Government

This study group report made recommendations regarding what services state government should provide, and what services it should not, given the growth of the state's private sector and declining state revenue from Prudhoe Bay.

RECOMMENDATIONS/CONCLUSIONS (Page 13 & 14)

The state and oil and gas industry work to adopt consistent interpretation of tax laws and regulations, including a method to determine valuation before making assessments for the future.

A thorough review of current business and individual taxes be done to provide a foundation for future public policy debates. The review should

- *Discuss the tax's structure, how it works, and a profile of current players;*
- *Describe the "public policy basis" for the tax, including the Legislature's intent at the time of its imposition;*
- *Identify taxes that other states impose on individuals and industries that may be applicable to Alaska; and*

- *Identify expenditures of public resources that support certain segments of Alaska's economy, and the corresponding return to the State's treasury and local and state economics.*

SUPPORTING TEXT (Page 13-14)

Taxation: predicatable, stable, and diversified

A state's taxation policies can make-or-break a business' decision to where to locate. They are clear singinals of how "open-for-business" a state really is.

Alaska's history with taxation of the oil industry has been mixed. When revenues got low the appetites of state services were high, Alaskans looking to the oil industry to make up the difference. There have been 16 statutory changes in the induistry taxes between 1973 and 1990. In addition, the interpretation and application of state tax laws and regulations have been inconsistant which results in additional tax assessments. Stability and clear rules are important in all business decisions.

But as will be disscussed throughout this paper, the oil industry has and is the state's primary souce of revenues. While Alaskans in the early 1970's were concerned about seasonal employment, Alaskans today are concerned about the state's reliance on one industry to provide revenues. Because of the oil indurty's "ability to pay," policy makers reduced the tax burden paid by every other sector of the state's economy. The result is the continued decline in state revenues and little public discussion or acceptance of assuming some of the burden to pay for government services.

06/97 - Economic Stability in the 21st Century: Realities and Aspirations

This analysis examines Anchorage's role in the context of the Alaska economy as a whole. It identifies economic engines of Anchorage with potential global competitive edge potential and makes recommendations for the State of Alaska and Municipality of Anchorage.

SUPPORTING TEXT (Page III-6 - III-8)

For FY 1995, 78 percent of the state government's unrestricted revenues in the general fund were derived from petroleum revenues. The state government collects revenue from petroleum by means of a royalty, severance (production) tax, oil and gas corporate tax, and property taxes. Projections for FY 1996 through 1998 show the state's dependence on the petroleum industry will actually increase, ranging from 79 to 81, percent depending on the projected oil prices used in the estimates.

A lack of a personal income tax, and the increased burdens on infrastructure such as schools and roads, lead to a perception that new economic development projects in Alaska create more costs to the state and local government. However, an analysis conducted by local economists Pat Burden and Scott Hawkins suggest that this is untrue of the oil and gas industry. Burden and Hawkins concluded that even if all of the new positions were filled by out-of-state residents that moved to Alaska, there would still be substantial overall net gain for Alaska. This is true even if the state were to offer substantial economic incentives to encourage development and exploration in Alaska.

The petroleum industry in Alaska is without a doubt the single most important industry, yet the resource is no-renewable. With production declining at a rate of approximately 5 percent per year and the state so heavily dependent on the industry's revenue, the future appears gloomy. The good news is that although production is declining, there is still time to adjust for the declining production from the current fields. Following is a list of advantages, disadvantages, and

opportunities in this sector.

Petroleum Industry Strengths

- *Alaska has the most promising new location for exploration in the US*
- *Alaska is the world leader in cold-weather oil-extraction technology*
- *Transportation infrastructure for delivery of oil is in place from the remote northern region*
- *Vast reserves of natural gas exist in Alaska*
- *The export ban on Alaska crude has been lifted, thereby opening new market opportunities*
- *The State has an historical willingness to assist in economic development projects*
- *Alaska has proximity to Russia and China, that hold potential vast reserves*

Petroleum Industry Weaknesses

- *Alaska ranks in the bottom half of all worldwide oil and gas producing areas for capital investment attraction due to the political uncertainties regarding taxes on the industry*
- *Alaska's remoteness and harsh conditions add to the cost of exploration*
- *Stringent environmental concerns in the US (in comparison with developing countries) add additional costs*
- *Developing countries are offering substantial incentives to oil companies making it more difficult to attract capital to Alaska*

Opportunities

In a World Bank study, Alaska's competitiveness for oil and gas investment ranked 148th out of 226 areas and 165th out of 226 areas for onshore and offshore projects, respectively. For high risk and incremental field development projects, Alaska ranked 79th and 87th out of 123 areas for "high risk" exploration and incremental field development respectively.

The state has shown a willingness to offer incentives to encourage further exploration and development by the oil companies... Further efforts could potentially spark activity in several other small to mid-size fields that are currently considered uneconomical to produce. A stable tax environment in the state is necessary to facilitate further exploration...

Increased exploration activity in Alaska has significant impact on the Alaska economy. A study completed for the Alaska Oil and Gas Policy Council by Northern Economics found that for an exploration drilling program, 79 percent of those expenditures are made in-state. For Alaska to continue attracting further capital investment, the state must become more competitive in the world arena. This is a needed policy shift in state government.

06/97 - Agenda 2000: Alaska's Future in a New World

An analysis of the condition of Alaska's economy, quality of life, educational systems and government at a pivotal point in its history.

RECOMMENDATIONS/CONCLUSIONS (Page 5 & 6)

Use Alaska's unique ownership position and geographic location to expand and encourage natural resource development, to add value to the development through in-state processing and to stimulate investment in a broader range of resource activities.

Alaska should;

- *Aggressively inventory its natural resource endowment*
- *Devise “owner” financing for state resource development expenses. For example, invest in and become a part owner of the trans Alaska gas pipeline*
- *Review and streamline rule making and permitting, including a cost/benefit analysis*
- *Use its natural resources as equity to build additional economic capability.*

02/85 - Compass North - Five Challenges for Alaska

Discussion of Alaska as an "owner state" in which the state owns a substantial amount of land and resources. As the owner, Alaska has an obligation to provide its residents with a sustainable economy. To do this, the state must use its land and capital to preserve and enhance the private enterprise system.

RECOMMENDATIONS/CONCLUSIONS (Page 5 & 68)

The legislature, as custodian for state lands, must develop a comprehensive policy that recognizes the state’s reliance on resource development and directs the management of these resources as capital assets.

Resource development is Alaska’s only option for a continued strong economic base in the foreseeable future.

If Alaskans are to maintain their present level of economic well-being, the governor and the legislature must make new resource development a matter of highest priority. The approach must meet the need for development while satisfying concern for the environment.

- *A stable tax policy that includes incentives for new development projects*
- *The legislature should continue its efforts of providing tax incentives to companies that start new development projects*
- *The legislature should review its unitary policy*
- *The legislature should formulate a coordinated state policy for oil and gas exploration and development on state lands*

SUPPORTING TEXT (Page 75-77)

A stable tax policy that includes incentives for new development projects

The goal should be to play fair with project owners while getting a fair share for the state. Essentially it means having coherent state policies in place for taxing various resources and not changing these policies in mid-stream, i.e. when the project begins to show profit.

While tax incentives immediately raise cries of “corporate socialism,” thoughtful analysis will show that they can provide long-term benefits to a state. The petroleum based secondary industries on the Kenai Peninsula are in place, in part, because of tax incentives.

The [unitary] tax, which 12 states including Alaska still have, taxes a portion of the worldwide income of companies, not just income earned in the state. The federal government has called for a repeal of this tax, which many experts believe inhibits development. Japan, for instance, has refused to make new investments in states that have the tax.

Removing Obstacles to Resource Development

- *The fact that Alaska’s dependence on oil is not reflected in public policy;*
- *The belief that one state agency has gained excessive control over development – control far beyond its statutory authority*

- *The danger that small, special interest groups in coastal communities will decide statewide issues through coastal zone management*

12/80 - Alaska's Golden Opportunity: Resource Revenues and State Spending

An analysis of the best ways to invest Alaska's resource revenues for the long-term benefit of the state

RECOMMENDATIONS/CONCLUSIONS (Page 5)

Companies doing business in Alaska should be encouraged to reinvest their profits in the state. Investment tax credits should be established for this purpose.

The windfall profit tax paid by the oil companies should be permitted as an allowable deduction in determining state income taxes to eliminate double taxation.

Reinvestment of corporate profits within the state should be encouraged through tax credits. The windfall profit tax paid by the oil industry should be an allowable deduction.

SUPPORTING TEXT (Pages 19-21)

Oil and Gas Taxes

As tax reform is implemented by the legislature, a thorough review of the taxes levied on the petroleum industry is in order. The following is a list of the FY '82 revenue projected to be derived by the state from oil and gas production, according to the September 1980 estimates of the Alaska Department of Revenue:

Royalties (12.5 - 20% or more) to be paid for the right to produce oil and gas from leases on state lands: \$2,354,900,000

Severance Taxes (12.25%) to be paid for the "severing" of the resource from the ground in the state: \$1,753,300,000

Property Taxes to be paid on industry assets: \$170,000,000

(Industry also pays over \$75,000,000 to municipalities on these assets as part of the 20 miles required by state law)

Income Taxes to be paid in accordance with the Oil and Gas Corporate Income Tax: \$882,900,000

A vital issue of public policy concerns the engagement of additional oil and gas development on state lands and, at the same time, ensuring that a fair share of the benefits go to the citizens of Alaska.

The state must provide an environment of stability in its tax policy and break away from its history of changing the rules of the game after private industry has invested heavily.

One immediate change involves the federal windfall profit tax. No provision in the Alaska tax statutes allows for a deduction for windfall profit tax paid. The legislature should rectify the blatant inequity of double taxation.

For FY '82 this action would reduce the \$883 million to be paid by the oil industry as state income tax to approximately \$485 million, and yet Alaska would still receive approximately \$4.5 billion in petroleum revenue compared with \$3.7 billion in FY '81.

Secondly, as a rule of thumb, corporate income taxation should be administered on a uniform, equitable basis.

Nationally, there is a growing awareness of the detrimental impact high taxes can have on the private sector and thereby, the general economy. Alaska has the opportunity to ease this impact by eliminating or reducing many of the taxes currently being paid. Now is the time to act when there is an opportunity to strengthen and broaden the Alaska economy as a whole.