# off the record

a bi-weekly legislative update from **Senator Kim Elton**

Room 504, State Capitol, Juneau, AK 99801 • 465-4947 • 465-2108 FAX • October 29, 1999


# Tax Facts

**Fact:** Alaska-owned corporations pay 9.4% corporate income taxes.

**Fact:** non-Alaska oil corporations operating on the North Slope pay corporate income taxes at the average effective rate of about 6%.

**Fact:** the proposed nuptials between BP and ARCO will, according to BP, result in $1 billion annual savings for BP.

**Fact:** not $1 of that $1 billion in savings will accrue to the state under existing state tax structures.

**Fact:** BP could control more than 70% of North Slope oil, more than 70% of North Slope oil production facilities, 72% of the trans-Alaska oil pipeline, and 80% of the marine tanker capacity if the merger with ARCO goes through.

**Fact:** a merged BP and ARCO has the potential to reduce competition on the North Slope and pit BP's foreign board of directors against Alaska interests.

***BP/ARCO merger review***

# Getting our share or getting the shaft?

Alaska politicians frustrated with the outcome of the September 14th ballot initiative have gone back to the balanced-budget drawing board. 'Where,' they ask themselves, 'do we find more than half-a-billion dollars?' The search for big bucks has policy makers turning over every stone, including the one under which the BP-ARCO merger is hiding. My colleagues are now asking: "Should state review of the anti-trust implications of the merging BP and ARCO economic fiefdoms also include a review of Alaska oil tax policies?

I think it's obvious. Of course the anti-trust review should include a review of oil taxes. We ought to review the fairness of oil taxes periodically regardless, so why not now as BP attempts to consolidate its economic power in Alaska?

Right now, Alaska makes money from North Slope production in two ways: taxes and royalty oil. The royalty oil side of the state's North Slope income is pretty straightforward. The state grants private companies access to state-owned oil but reserves a certain percentage of the oil for itself—that percentage is Alaska's royalty oil. The value of our royalty oil will continue to rise and fall with the markets and transportation costs, unaffected by the merger.

Alaska's oil tax recipes, on the other hand, are fairly complex. There are production (severance) taxes and income (corporate) taxes. And, while BP estimates the company will add $1 billion annually to it's bottom line because of merger efficiencies, neither of Alaska's oil taxes captures a dollar of those additional billion dollars.

### State severance taxes

The production (severance) taxes are set at 15 percent of production. But severance taxes start at Pump Station #1 of the pipeline, so none of the oil field efficiencies on the other side of the pump station will affect severance tax collections. In other words, Alaska gains nothing from BP's savings.

In reality, none of the North Slope oil pays at the 15 percent severance tax rate. That's because of a state tax break called the economic limit factor (ELF). The complicated ELF formulas try to account for purported inefficiencies in the different North Slope oil fields. When the ELF is applied to the flat 15 percent severance tax, North Slope fields actually pay severance taxes that range between .54 percent for Milne Point and 12.47 percent for Prudhoe Bay oil.

For Alaska to benefit from the increased field efficiencies cited by BP, the ELF needs to be changed to reflect those new oil field efficiencies. If the ELF were repealed, and the straight 15 percent severance tax applied, North Slope tax revenues would go up $145 million next year and balloon to an additional $250 million in 2004. Removing the ELF only from the large Prudhoe and Kuparuk oil fields (hardly marginal North Slope fields needing a tax break) brings $57 million more in 2000 and an additional $78 million in 2004.

If the merger brings new North Slope efficiencies for BP, than the state should study changes to the ELF to reflect those new efficiencies. Why give tax breaks for inefficiences that may no longer exist?

### State corporate taxes

The state's corporate income tax on the oil industry is structured so that outside oil companies pay less than two-thirds what Alaska corporations pay. The corporate income tax in Alaska is 9.4 percent, yet the behemoth oil companies on the North Slope pay an effective rate of only 6 percent.

How could this happen?

Until 1978, the corporate income tax levied on giant North Slope oil companies was a formula apportionment 'recipe'. But that corporate income tax did not account for all the Alaska profits of the North Slope oil companies. So, in 1978, the legislature adopted a separate accounting approach that reflected delivered oil prices less refining, marketing, Outside transportation costs, and various exploration and other in-state costs. The separate accounting approach allowed the state to tax actual Alaska production profits.

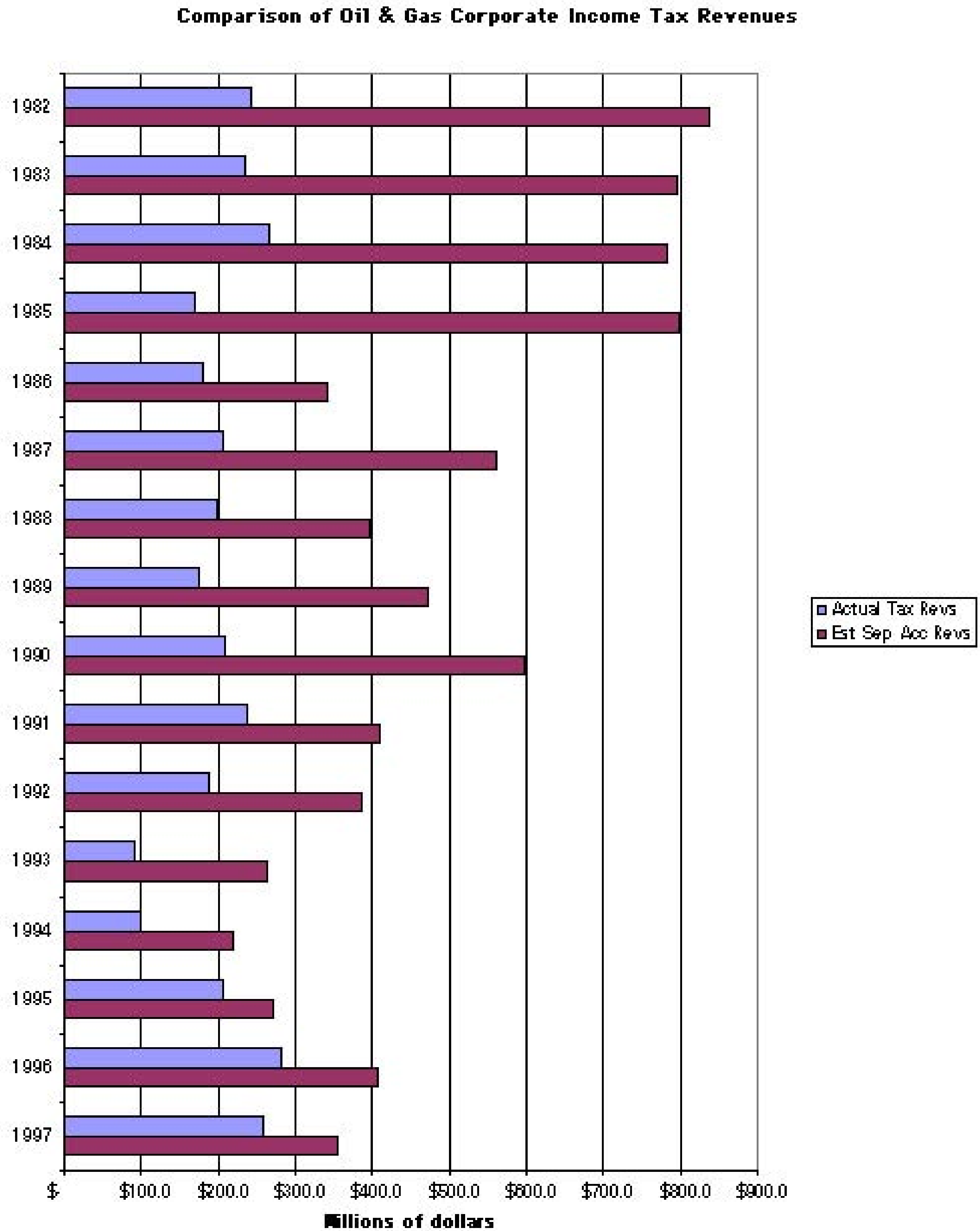
By substituting separate accounting for the old formula apportionment method, state oil revenues shot up and major oil companies finally began paying about what other Alaska corporations were paying, approximately 9.4 percent on profits. Sohio (later acquired by BP) and ARCO sued—with alacrity. In 1981, unsure whether the state would win the suit filed by big oil, the legislature dumped separate accounting and went to a back to a "modified" formula approach that then Revenue Commissioner Tom Williams (who now works for BP) said would be "revenue neutral". In other words, we'd replace separate accounting with a new tax but, don't worry, state oil tax revenues would not drop.

Well that "revenue neutral" tax wasn't exactly neutral. In fact, between 1981 and 1997, **the state lost more than $4.6 billion** in taxes by dumping separate accounting and substituting a tax that wasn't close to being revenue neutral as Mr. Williams promised (*see accompanying chart*). The irony here is that the state won the lawsuit in 1985 and the Alaska Supreme Court upheld the legitimacy of the separate accounting approach. As the final word, the U.S. Supreme Court refused to overturn the Alaska decision in 1986.

Despite winning in court, the legislature did not reinstate separate accounting—the one tax method that had major oil companies paying the same percent of their profits in taxes that all other Alaska corporations pay. Some suggest that, if Alaska went back to a separate accounting system, revenues from this tax source would jump from about $150 million annually to about $225 million annually if oil was $13 a barrel—more if oil markets stay strong and the price of oil is higher.

### It's time for a tax review

Given our oil tax history, Alaskans should review our oil tax regimes as the Brits and ARCO tie the knot, literally and figuratively, on the North Slope. If the legislature can spend an entire year preparing a ballot question on using permanent fund earnings to help pay for government, we ought to spend at least a little time to see if oil taxes can help fill the gap. Determining whether our old oil taxes fit the coming reality of merged oil superpowers on the North Slope would simply be an act of commonsense by state policy makers. It would be a shame if Alaska's elected officials treated Alaskans with less consideration than BP treats its shareholders on profit and loss issues.





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