THE STATE of ALASKA
GOVERNOR SEAN PARNELL

Department of Natural Resources
Joe Balash, Commissioner
Department of Revenue
Angela Rodell, Commissioner

CS FOR SB 138 (RES): Commercial Production of North Slope Gas
SECTIONAL ANALYSIS: 28-GS2806\O

Senate Finance Committee – February 25, 2014

Section 1 sets out the legislative findings that the commercial production of gas deposits from the North Slope is of vital public interest that will provide benefits to the state; therefore it is the intent of the legislature that further progress towards this goal incorporate consideration of the provisions as set out in this section.

Section 2 amends AS 31.25.005, related to the purpose of the Alaska Gasline Development Corporation (AGDC), to add new subsections (4) and (5) for the advancement of a large-diameter natural gas pipeline project through acquiring an equity interest in the large-diameter pipeline project and developing treatment and liquefaction facilities through the subsidiary created in new AS 31.25.122.

Section 3 conforms AS 31.25.010, the structure of AGDC related to dissolution, to include reference to a large-diameter natural gas pipeline project.

Section 4 amends AS 31.25.080(f) to allow the AGDC in-state gas pipeline project developers to continue to coordinate with the developers of large-diameter natural gas pipeline to the maximum extent practicable without delaying the progress of developing the in-state natural gas pipeline. In coordinating with the developers of a large-diameter natural gas pipeline, AGDC may use money appropriated for that purpose under AS 31.25.110 but may not use money appropriated for the in-state gas pipeline fund in AS31.25.100. This section removes the description of a large diameter natural gas pipeline, the 'common' status of pipeline facilities, and portions of the area description related to a gas pipeline from the North Slope.

Section 5 amends AS 31.25.100 to direct that money appropriated to the in-state natural gas pipeline fund may not be used for the large-diameter natural gas pipeline project under new AS 31.25.005(4) and (5) and AS 31.25.080(f).

Section 6 establishes AS 31.25.110, the Large-Diameter Natural Gas Pipeline Project fund in order to fund the purposes of the subsidiary established in AS 31.25.122. Money appropriated to the Large-

Diameter Natural Gas Pipeline Project fund may not be used for the purposes of the in-state natural gas pipeline under AS 31.25.005(1). Money appropriated to the Large-Diameter Natural Gas Pipeline Project fund for the purpose of AS 31.25.005(4) and (5), the large-diameter natural gas pipeline project, is to be held in an account created within the fund for that purpose.

Section 7, related to subsidiaries created under AS 31.25.120 to specify that a subsidiary corporation under this section may only use money appropriated for the in-state natural gas pipeline under AS 31.25.100.

Section 8 adds new section AS 31.25.122 to establish a subsidiary for a large-diameter natural gas pipeline project as a public corporation and a government instrumentality for administrative purposes but with a legal existence independent from the state and the AGDC. The purpose of the subsidiary is to acquire state equity interests in components of a large-diameter natural gas pipeline project, including pipelines, treatment, liquefaction and marine terminal facilities. The subsidiary may use money appropriated under AS 31.25.110 and may not to use money appropriated to the in-state natural gas pipeline project fund in AS 31.25.100. Subsection (b) creates a seven member board of directors of the subsidiary. Subsection (d) sets out purposes, (e) allows the AGDC to transfer assets, except for revenues as restricted by AS 31.25.100 to the subsidiary created under this section. Some of the statutory provisions applicable to the AGDC are incorporated to aid in the operation of the subsidiary. Subsection (f) relates to employees of the subsidiary while (g) describes the conditions of termination of the subsidiary.

Section 9 amends AS 31.25.390(5), the definition of “in-state natural gas pipeline”, by adding a reference to AS 31.25.005(1).

Section 10 adds new definitions in AS 31.25.390. New subsection (7) defines a “large-diameter natural gas pipeline project” and (8) defines a “subsidiary board” as meaning a subsidiary under AS 31 25.122.

Section 11 amends the authority of the commissioner of the Department of Natural Resources (DNR) by adding new paragraphs (10) – (13) to AS 38.05.020(b). Effective immediately, the DNR commissioner may enter into commercial agreements of not more than two years duration for project services related to the North Slope natural gas project. In consultation with the Commissioner of Revenue, the DNR commissioner may participate in negotiations associated with a North Slope natural gas project. A contract negotiated in which the state is a party would not be effective against the state without legislative authorization for the governor to execute the contract. Paragraph (12) permits the DNR commissioner to enter into confidentiality agreements to maintain confidentiality throughout contract negotiations and contract implementation. Confidential information obtained under paragraph (12) shall be shared with the legislature only in committees held in executive session or under confidentiality agreements. Final contracts subject to approval by the legislature would not be confidential.

Section 12 adds new paragraph (13) to allow the DNR commissioner, in consultation with the commissioner of revenue, to take custody of gas delivered to the state under new AS 43.55.014(b), to manage project services and the disposition of gas delivered to the state under new AS 43.55.014(b).

Section 13 clarifies AS 38.05.180(i) with a conforming amendment that the exploration incentive credit may be applied against the oil and gas production tax levied under AS 43.55.011.

Sections 14 and 15 adds a new subsection (hh) to the Alaska Land Act, AS 38.05.180, which deals with oil and gas leasing, to permit the DNR commissioner to propose modifications to existing oil and gas leases relating to the state's ability to take royalty gas in kind or in value, the establishment of values for the state's royalty gas and deductions for transportation costs, and the fixation of royalty rates of not less than 12.5 percent and modifications to net profit share terms in oil and gas leases. Modifications to existing oil and gas leases would require a written determination by the DNR commissioner that a North Slope natural gas project has sufficient financial commitment and commitment of gas from the leases to be modified, in addition to concurrence of the lessees to the modification.

Sections 16 through 19 amend AS 38.05.183, related to sales of royalty oil or gas, by adding references to gas delivered to the state under AS 43.55.014(b), the levy of production tax on gas to be paid in gas for certain North Slope leases.

Section 20 adds two new subsections (26) and (27) in AS 38.05.965. Subsection (26) defines "North Slope natural gas project;" subsection (27) defines "project services."

Sections 21 and 22 amend AS 40.25.100 related to the confidentiality of tax information to clearly establish as confidential information related to contract negotiations for a North Slope natural gas project. Section 21 references new subsection (k) in AS 43.05.230 to except from taxpayer confidentiality provisions the name of each person that makes an election to pay the gas production tax from modified North Slope leases in gas and the amount of gas subject to that election.

Section 23 amends AS 40.25.120(a) to establish an exception in public records for information confidential under the new provisions of AS 38.05.020(b) (related to contract negotiations for a North Slope natural gas project).

Sections 24 and 25 amend the authority of the commissioner of the Department of Revenue (DOR) by adding new paragraphs (16) and (17) in AS 43.05.010. Effective immediately, paragraph (16) provides that the DOR commissioner may consult with the DNR commissioner on negotiations associated with a North Slope natural gas project. Section 24 amends AS 43.05.010 by adding paragraph (17) to provide that the DOR commissioner direct the disposition of revenues received from gas delivered to the state under AS 43.55.014(b) by entering into agreements with the DNR commissioner.

Section 26 adds new subsection (k) to AS 43.05.230 to except from taxpayer confidentiality provisions the name of each person that makes an election to pay, after 2022, the gas production tax in gas and the amount of gas subject to that election.

Section 27 amends AS 43.20.144(f) to clarify that gas subject to an election to pay the oil and gas production tax on gas as gas under AS 43.55.014 is included the extraction factor in the Alaska Net Income Tax Act.

Section 28 amends AS 43.55.011(e), the levy of the oil and gas production tax, to add reference to the separate levy under AS 43.55.014 for certain North Slope gas. For oil and gas produced after January 1, 2014 and before January 1, 2022, AS 43.55.011(e)(2) would levy on producers of oil and gas produced each calendar year a flat rate tax of 35 percent of the production tax value of taxable oil and gas produced from each lease or property in the state. No change is made to current tax ceilings that apply to Cook Inlet oil and gas, gas produced outside the Cook Inlet basin and used in the state, and oil and gas produced from new fields outside the Cook Inlet basin and south of the North Slope.

For oil and gas produced on or after January 1, 2022 (after expiration of the tax ceilings for Cook Inlet oil and gas, and gas produced outside the Cook Inlet basin and used in the state), AS 43.55.011(e)(3) would levy on producers of oil produced each calendar year a flat tax rate of 35 percent of the production tax value of taxable oil produced from each lease or property in the state and on producers of gas, and a flat tax rate of 10.5 percent of the gross value at the point of production of gas produced from each lease or property in the state. (Oil and gas subject to AS 43.55.011(p) continue to be taxed at no more than four percent of gross value at the point of production until 2027.) The tax on gas for which the DOR commissioner has approved an election to pay in gas would be levied under AS 43.55.014.

Section 29 amends AS 43.55.011(f), the alternate minimum tax on North Slope oil and gas, to retain the current minimum tax until January 1, 2022. After that date, the minimum tax would apply to oil produced on the North Slope. A minor amendment adds the reference to the tax applying to leases or properties "that include land" to ensure that property that straddles 68 degrees North latitude will be considered north of 68 degrees North latitude for purpose of the alternate minimum tax.

Section 30 adds AS 43.55.014 which allows producers to make an irrevocable election, under regulations adopted by DOR, to pay the oil and gas production tax in gas for gas produced from oil and gas leases whose terms have been modified under proposed AS 38.05.180(hh). The levy would be 10.5 percent of the taxable gas when and as the gas is produced. The producer would pay the tax by delivering the gas to the state at the point of production. The DNR would manage the custody and disposition of gas delivered to the state. Gas subject to this provision would not include gas flared, released, or allowed to escape upstream of the point of production, or to gas used in lease operations or for repressuring. Tax deficiencies and interest and penalties on any tax deficiency would be accounted for as if the tax was levied for money under AS 43.55.011(e). This section would take effect on January 1, 2015 to be applied to gas produced from certain North Slope leases on and after January 1, 2022.

Sections 31 and 32 are conforming amendments to the oil and gas producer education credit, AS 43.55.019, to clarify that the credit can be applied to tax liability under AS 43.55.011(e) only.

Section 33 amends AS 43.55.020(a), monthly installment payments of estimated tax, to add provisions for payment of tax after January 1, 2022 and to clarify the tax rates that apply to oil and gas produced after a certain date. Monthly installment payments for oil and gas produced on or after January 1, 2022 are in new subsection (a)(7).

Sections 34 and 35 are conforming changes to AS 43.55.020, monthly installment payments. Subsection (g) is amended to account for new tax provisions for oil and gas produced after January 1, 2022. A similar conforming change is made in AS 43.55.020(h) to account for interest on overpayments of installment payments.

Sections 36 and 37 amends AS 43.55.020(*l*) and adds subsection (m), related to making settlements by a producer with private landowner royalty owner, to account for making a settlement with the royalty owner for gas taxable before January 1, 2022 and under new AS 43.55.014.

Section 38 amends AS 43.55.030, annual statements by producers and explorers, to require reporting of the amount of gas produced from a lease or property for which tax is levied under AS 43.55.014 and the amount of gas delivered to the state under AS 43.55.014.

Section 39 amends AS 43.55.160(a), calculation of annual production tax values, to clarify and conform to the levy of tax under AS 43.55.011(e)(2) for oil and gas produced before January 1, 2022.

Section 40 amends AS 43.55.160(e), related to determination of excess lease expenditures for the purpose of calculating a carried-forward loss credit, to account for annual production tax values for oil produced on and after January 1, 2022.

Section 41 amends AS 43.55.160(f), a 20 percent gross value reduction for certain oil and gas produced north of 68 degrees North latitude, so that gas produced on and after January 1, 2022 would not qualify for the gross value reduction in this section.

Section 42 amends AS 43.55.160(g), a 10 percent gross value reduction for certain oil and gas produced from a unit north of 68 degrees North latitude made up solely of leases that have a royalty share of more than 12.5 percent in amount or value of the production removed or sold from the lease so that gas produced on and after January 1, 2022 would not qualify for the gross value reduction in this section.

Section 43 amends AS 43.55.160, calculation of annual production tax values, to add a new subsection (h) for calculation of annual production tax values for oil produced on and after January 1, 2022. On and after January 1, 2022, gas would be taxed at a percentage of gross value. Accordingly, there would be no need to calculate a production tax value (gross value at point of production less lease expenditures) for gas. Producers would still calculate a production tax value of oil taxable under AS 43.55.011(e) for the segments set out in AS 43.55.160(h).

Section 44 makes a conforming amendment to AS 43.55.165, lease expenditures, to exclude as a deduction from lease expenditures the tax levied under AS 43.55.014.

Sections 45 through 47 amend, for purposes of the oil and gas production tax, the definitions of "gas processing plants" and "point of production" for gas to be upstream of either the first point where accurately measured, the inlet of a pipeline transporting the gas to a gas treatment plant, or the inlet of any gas pipeline system transporting gas to market. Section 46 adds a definition of "gas treatment plant".

Section 48 makes conforming amendments to AS 43.98.030, the film production tax credit, to limit the applicability of the credit to the tax levied by AS 43.55.011.

Section 49 amends uncodified law to add a new section related to direction that at the time the commissioner of natural resources submits the first contract to the legislature for approval, the commissioner of revenue shall present a plan and suggested legislation to allow a resident of the state to participate as a co-owner in a North Slope natural gas pipeline, and sets out factors that must be in the plan.

Section 50 allows the DNR and the DOR to adopt regulations to implement this Act.

Section 51 instructs the revisor of statutes to make a title change to AS 38.05.183 to include AS 43.55.014(b).

Sections 52 and 53 set effective dates for different sections of the bill. Sections 1 -10, 12, 13 19, 20, 22, 23, 30, 31, 47 and 48 would be effective immediately. The other sections would be effective January 1, 2015.