State of Alaska
Department of Revenue
Commissioner Bryan Butcher

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The Honorable Joe Paskvan
Alaska State Senator
State Capitol, Room 115
Juneau, AK 99801

March 15, 2011

The Honorable Thomas Wagoner
Alaska State Senator
State Capitol Room 427
Juneau AK, 99801

SUBJECT: Response to Questions from SB 49 Bill Sectional Presentation in Senate Resources on March 9, 2011 and March 11, 2011

Dear Senators Paskvan and Wagoner:

The purpose of this document is to respond to the follow-up questions raised by the Senate Resources Committee meeting during our presentation of the SB 49 bill sectional on March 9, 2011 and March 11, 2011. The requests/questions and responses follow. In addition, several policy issues were raised for future discussion, and we look forward to discussing these issues with the committee as the hearing process continues.

1) **What is the definition of a unit?**

The term "unit" is defined for production tax purposes under AS 43.55.900 (23):

(23) "unit" means a group of tracts of land that is

(A) subject to a cooperative or a unit plan of development or operation that has been certified by the commissioner of natural resources under AS 38.05.180(p);

(B) subject to a cooperative or a unit plan of development or operation that has been certified by the United States Secretary of the Interior under 30 U.S.C. 226(m);

(C) subject to an agreement of the owners of interests in the tracts of land to validly integrate their interests to provide for the unitized management, development, and operation of the tracts of land as a unit, within the meaning of AS 31.05.110(a); or

(D) within the unit area of a unit created by order of the Alaska Oil and Gas Conservation Commission under AS 31.05.110(b)

In addition, if requested, the Department of Natural Resources is prepared to provide the committee with a brief presentation explaining the concepts of leases, units, and participating areas in more detail.

2) Provide slides from a prior presentation by Gaffney, Cline & Associates that show Internal Rate of Return and Return on Investment statistics for infield drilling.

The model developed for BP's infill drilling program, and the Gaffney, Cline & Associates presentation to the House Oil & Gas committee, were released by the previous administration on October 30, 2007. The model and presentation are both available in the "Gasoline & Tax Issues: 2004-2010 – ACES" section of the Legislative Budget & Audit Committee web site at the following address: http://lba.legis.state.ak.us/.

3) What are the "gaps" in data collected by the Department?

15 AAC 55.345 sets out procedures for applying certain tax credits. The regulation is already in place, and requires a producer or explorer filing a claim to set out "the information required by the department on a form prescribed by the department". The department has not yet revised the form to include the types of information that has been requested during the current legislative session. Initial proposals are to include requests for the following types of information:

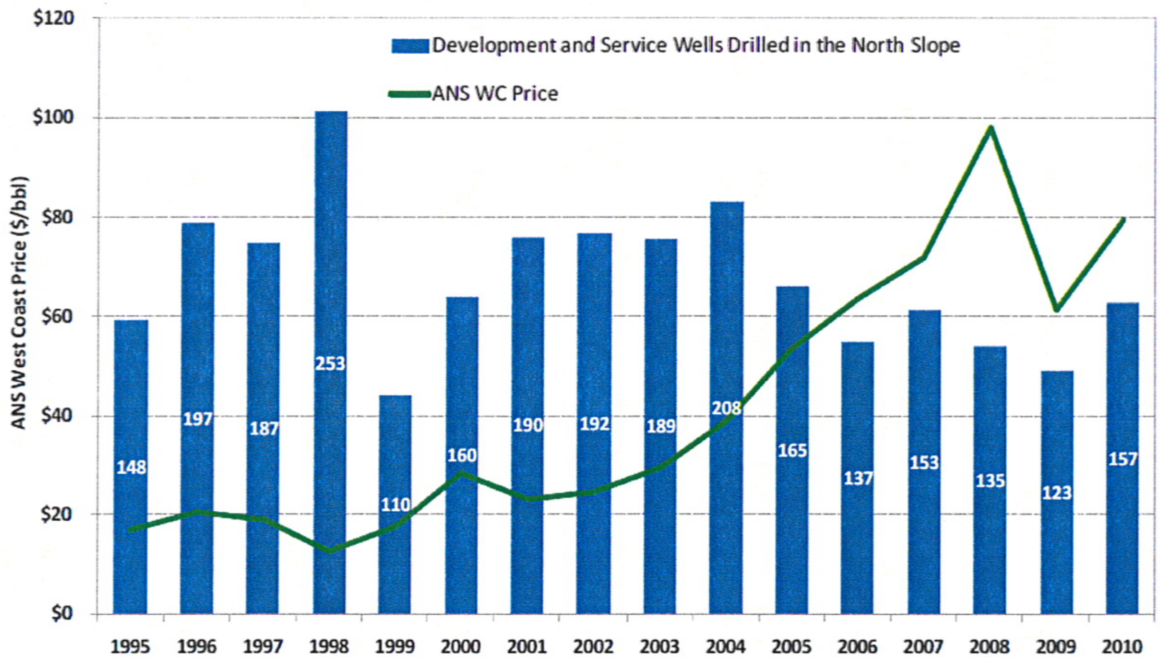
- Exploration costs
    - G&G (geophysics and geology) costs
    - Exploration wells
- Development Wells
    - In-field drilling
    - Workover
    - Operations CapEx
- Facilities
    - Repairs
    - Upgrades
    - New Equipment
    - Operations CapEx

4) How effective has the 40% well lease expenditure credit been in Cook Inlet?

The 40% credit for well lease expenditures in Cook Inlet was created with legislation passed in the 2010 session. Given the short time in which the credit has been in place, it is not yet possible to gauge the effectiveness of the credit other than anecdotally.

5) Provide information about the number of in-field wells drilled last year compared to prior years.

The following chart shows the number of development and service wells drilled on the North Slope annually from 1995 to 2010. This information is part of the Department's presentation to the committee dated March 11, 2011.



Source: Alaska Oil and Gas Conservation Commission

6) Have the minimum tax thresholds ever been triggered?

Under current law, a company's tax liability under ACES is the higher of the tax calculated under AS 43.55.011(e) and the minimum tax, as calculated under AS 43.55.011(f). The minimum tax thresholds are based on the average ANS West Coast crude oil price over the entire calendar year, with the highest tax rate—4%--being applied when the average price of ANS WC crude is greater than $25 per barrel. Therefore, the minimum tax in effect since ACES was implemented in 2007 is 4% of the gross value at the point of production.

Although some companies would calculate a higher value under the minimum tax than under the ACES tax at .011(e), they have been allowed to offset their tax liabilities with credits. To date, we are not aware of any companies that had an annual tax liability under the minimum tax.

7) Provide information about the historical amounts of interest payments for delinquent taxes and refunds under AS 43.05.225 (1).

The following table presents total interest collected under AS 43.05.225 (1) for FY 2008, FY 2009, and FY 2010. These amounts include both interest paid to the state for delinquent taxes, and interest paid by the state for delinquent refunds. All the amounts shown below are positive revenues to the state: typically, the state has collected more in interest than it has paid out.

The Department does not have an estimate of the change in interest due to the lower interest rate provisions in SB 49. Compiling such an estimate would require manually examining and recalculating the interest for hundreds of tax returns or more.

Total Interest by Year (Positive revenue to the state - $ millions)

Fiscal Year	General Fund	CBRF	Total
FY 2008	$7.1	$219.1	$226.2
FY 2009	$5.2	$27.9	$33.1
FY 2010	$78.6	$85.6	$164.3
Total FY 08- FY 10	$90.9	$332.6	$423.5

8) **Provide information about the number of companies available each year for audit (either submitting returns or credit applications).**

The requested information was included in the "Oil and Gas Production Tax Status Report to the Legislature" released on January 18, 2011. On page 11 of that publication, we reported the following:

"In 2006, the first year that filings were made under a net profits tax, there were 19 companies filing annual returns. In 2007, the number of companies filing production tax returns totaled 26, and in 2008, 36 companies filed annual production tax returns. The filing for 2009 increased only slightly from 2008, with 39 companies filing returns."

9) **Provide information about what the oil industry is investing in, in Alaska.**

Department of Revenue Audit Master Lennie Dees will share available information in his presentation to the committee on tax credits, currently planned for Wednesday, March 16.

10) **Provide an analysis where the $3 billion in cumulative production tax credits have been used.**

Department of Revenue Audit Master Lennie Dees will share available information in his presentation to the committee on tax credits, currently planned for Wednesday, March 16.

We hope our responses fully answer your questions.

Sincerely,

Bruce Tangeman
Deputy Commissioner