

HOUSE FINANCE COMMITTEE
April 26, 2006
1:50 P.M.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at 1:50:30 PM.

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Richard Foster
Representative Mike Hawker
Representative Jim Holm
Representative Reggie Joule
Representative Mike Kelly
Representative Carl Moses
Representative Bruce Weyhrauch

MEMBERS ABSENT

Representative Beth Kerttula

ALSO PRESENT

Representative Ethan Berkowitz; Representative Norm Rokeberg; Susan Parks, Deputy Attorney General, Criminal Division, Department of Law; Chris Christensen, Staff Counsel, Alaska Court System; Robynn Wilson, Director, Division of Tax, Department of Revenue; William Corbus, Commissioner, Department of Revenue; Dan Dickinson, Consultant, Tax Division, Department of Revenue

PRESENT VIA TELECONFERENCE

Larry Cohn, Executive Director, Alaska Judicial Council, Alaska Court System

SUMMARY

CS SB 237(FIN)

An Act relating to the compensation of justices and judges, and to increasing the number of superior court judges designated for the third and fourth judicial districts; and providing for an effective date.

CS SB 237(FIN) was REPORTED out of Committee with a "no recommendation" and with fiscal note #2 by the Alaska Judicial Council, fiscal note #4 by the Office of the Governor, and with new fiscal notes

by the Alaska Court System, the Department of Law, the Department of Public Safety, the Department of Administration, and the Department of Corrections.

HB 29 An Act relating to health care insurance and to the Comprehensive Health Insurance Association; and providing for an effective date.

CSHB 29 (L&C) was REPORTED out of Committee with a "no recommendation" and with zero fiscal note #1 by the Department of Commerce and Economic Development.

HB 375 "An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of certain income earned on money received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

CSHB 375 (FIN) was REPORTED out of Committee with a "do pass" recommendation and with a new zero fiscal note by the Department of Revenue, and with a new zero fiscal note by the Department of Administration.

CS SB 305(FIN) am

An Act repealing the oil production tax and the gas production tax and providing for a production tax on oil and gas; relating to the calculation of the gross value at the point of production of oil and gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the production tax on oil and gas; relating to the relationship of the production tax on oil and gas to other taxes, to the dates those tax payments and surcharges are due, to interest on overpayments of the tax, and to the treatment of the tax in a producer's settlement with the royalty owners; relating to flared gas, and to oil and gas used in the operation of a lease or property under the production tax; relating to the prevailing value of oil and gas under the production tax; relating to surcharges on oil; relating to statements or other information required to be filed with or furnished to the Department of Revenue, to the penalty for failure to file certain reports for the tax, to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue as applicable to the administration of the tax;

relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the tax, and to the deposit of tax money collected by the Department of Revenue; amending the definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and adding further definitions; making conforming amendments; and providing for an effective date.

CS SB 305(FIN) am was HEARD and HELD in Committee for further consideration.

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CS FOR SENATE BILL NO. 237(FIN)

An Act relating to the compensation of justices and judges, and to increasing the number of superior court judges designated for the third and fourth judicial districts; and providing for an effective date.

CHRIS CHRISTENSEN, STAFF COUNSEL, ALASKA COURT SYSTEM, addressed the pay raise for judges. Over the last 15 years, judges' salaries have been reduced by 42 percent. The problem is made worse by the way judicial salaries are set in statute. Salaries have not kept up with inflation. In rural Alaska the situation is even worse due to geographic differentials in salaries. Judges are often not the highest paid state employees in the community. Bethel's position has been vacant for 11 months.

Mr. Christensen spoke about the published list of state salaries. Superior Court Judges' salaries have dropped to 185th. Salaries have dropped relative to other judiciaries and relative to state employees. He spoke about the high number of citizens that come before the court. A judge has the power to destroy someone's life and must make major decisions. He argued for employing the best lawyers possible as judges.

Mr. Christensen related qualifications for being a judge and common attributes. He addressed income and salary decline, which may cause lawyers not to apply to be judges. He mentioned judicial positions that remain vacant. It is important to have judges with private sector experience.

Mr. Christensen noted that the bill would provide for a new salary structure, but would remain below the previous salary structure. Under the new salary structure, Alaska judges would rank approximately 20th among the states. He opined

that standards may need to be lowered to fill judge positions. He urged support of the bill.

Mr. Christensen addressed the perception that the increased pay raise in the bill is 50 percent. It seems that high because existing law depicts judges' salaries ten years ago. He stated that the increase is actually less than 30 percent.

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Vice Chair Stoltze asked if there is any component of public service with value, such as a retirement system for judges. He also wondered if the state is losing judges to federal judgeships. Mr. Christensen replied that there is a strong component of public service to being a judge. He spoke of social restrictions experienced by judges. The Bureau of Labor Standards publishes a survey that has determined, nationwide, the public service discount is 20 percent less than a lawyer of similar experience in the private sector. In Alaska, judges are working for a 40 percent public service discount. Before Judges receive a paycheck they have to sign a sworn affidavit that says nothing has been on their desk for longer than 6 months. He gave an example of a case that lasted 6 months and a judge's paycheck was withheld because cases were backlogged. There is a strong public service component to being a judge. He stated that several state judges have taken federal jobs.

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SUSAN PARKS, DEPUTY ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF LAW, offered to address the Department of Law fiscal notes.

Representative Hawker inquired about the Alaska Court System fiscal note, which addresses a capital expenditure for improvements in the Kenai facility. He did not debate that improvements were needed, but wondered why the expense was not included in the capital budget. Co-Chair Chenault agreed that was odd.

Mr. Christensen said they were advised to put all costs into the fiscal note, including capital costs. He commented that the costs in Kenai are the same as the cost for the facility in Palmer and are accurate.

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Co-Chair Chenault asked how many judgeship vacancies there are. He wondered if the judicial council has ever made a recommendation to not accept a judicial candidate.

LARRY COHN, EXECUTIVE DIRECTOR, ALASKA JUDICIAL COUNCIL, ALASKA COURT SYSTEM, replied that in the 80's several applications for retention were rejected.

Co-Chair Chenault listed all of the fiscal notes that accompany SB 237: fiscal note #2 by the Alaska Judicial Council, fiscal note #4 by the Office of the Governor, and with new fiscal notes by the Alaska Court System, the Department of Law, the Department of Public Safety, the Department of Administration, and the Department of Corrections.

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Representative Hawker MOVED to REPORT CSSB 237 (FIN) out of Committee with individual recommendations and the accompanying fiscal notes. Vice Chair Stoltze OBJECTED.

Vice Chair Stoltze said he has a concern with all of the issues being tied together. He wished that the Judicial Council was more receptive to some of the ideas put forth by the legislature and by the public regarding enhancing the recruitment process for judges. Vice Chair Stoltze WITHDREW his OBJECTION.

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Representative Joule noted that a number of crime bills were passed this session. This bill is the connecting piece to hold people accountable for appropriate behavior. He spoke in support of SB 237.

Representative Kelly OBJECTED to the motion to adopt SB 237. He questioned whether there is actually more crime today. He admitted to having difficulty passing the bill out of Committee.

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Representative Hawker noted that this is a significant policy decision and financial commitment. He said he has no reservations about passing SB 237. He spoke to the "deferred maintenance" issue in the judicial system, where the community has grown and crime has increased. He called it the number one priority legislation in his district. He spoke strongly in support of the bill.

Representative Kelly REMOVED his OBJECTION.

Vice Chair Stoltze agreed with Representative Hawker's comments.

There being NO further OBJECTION, it was so ordered.

CS SB 237(FIN) was REPORTED out of Committee with a "no recommendation" and with fiscal note #2 by the Alaska Judicial Council, fiscal note #4 by the Office of the Governor, and with new fiscal notes by the Alaska Court System, the Department of Law, the Department of Public Safety, the Department of Administration, and the Department of Corrections.

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HOUSE BILL NO. 29

An Act relating to health care insurance and to the Comprehensive Health Insurance Association; and providing for an effective date.

REPRESENTATIVE NORM ROKEBERG, commented that in the last hearing a graph was submitted regarding what would have happened if the state had not become self-insured and had remained in the high-risk pool. The bill authorizes the state to grant a tax credit from the \$46 million income received from insurance company premium taxes annually. It grants a 50 percent annual assessment to pick up the cost of insuring the high-risk pool premiums. This will help the health insurance crisis in the state.

Co-Chair Chenault noted a zero fiscal note from the Department of Commerce and Economic Development. He inquired what "all funding sources" means. He asked about the date, "2005 legislative session".

Representative Rokeberg explained that the Administration's fiscal note was for a prior version of the bill. Co-Chair Chenault was referring to old fiscal notes. Fiscal note #1 by Department of Commerce, Community and Economic Development is a zero note for FY 07 and \$1,750,000 credit for FY 08.

Representative Foster MOVED to REPORT HB 29 (L&C) out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CSHB 29 (L&C) was REPORTED out of Committee with a "no recommendation" and with zero fiscal note #1 by the Department of Commerce and Economic Development.

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HOUSE BILL NO. 375

"An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of certain income earned on money received

as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

Representative Holm reported that he spoke to people in Fairbanks and they are in agreement with Amendment 2, which was adopted at a previous meeting.

Co-Chair Chenault noted a new zero fiscal note from the Department of Administration. He stated that the Department of Revenue needs to revise the fiscal note analysis, which currently lists Amerada Hess as the source of funding for the account.

Representative Hawker voiced concern about the attempt to create a universal mechanism, when each community has a unique need. He said he would not oppose the bill today, but would when it is read across the floor.

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Representative Joule also shared reservations about the bill because it does not address concerns in all communities. All communities should be treated fairly. He spoke about the needs in his district.

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Representative Foster MOVED to REPORT CSHB 375 (FIN) out of committee, as amended, with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSHB 375 (FIN) was REPORTED out of Committee with a "do pass" recommendation and with a new zero fiscal note by the Department of Revenue, and with a new zero fiscal note by the Department of Administration.

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#sb305

CS FOR SENATE BILL NO. 305(FIN) am

An Act repealing the oil production tax and the gas production tax and providing for a production tax on oil and gas; relating to the calculation of the gross value at the point of production of oil and gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the production tax on oil and gas; relating to the relationship of the production tax on oil and gas to other taxes, to the dates those tax payments and surcharges are due, to interest on overpayments of the tax, and to the

treatment of the tax in a producer's settlement with the royalty owners; relating to flared gas, and to oil and gas used in the operation of a lease or property under the production tax; relating to the prevailing value of oil and gas under the production tax; relating to surcharges on oil; relating to statements or other information required to be filed with or furnished to the Department of Revenue, to the penalty for failure to file certain reports for the tax, to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue as applicable to the administration of the tax; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the tax, and to the deposit of tax money collected by the Department of Revenue; amending the definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and adding further definitions; making conforming amendments; and providing for an effective date.

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WILLIAM CORBUS, COMMISSIONER, DEPARTMENT OF REVENUE, stated that HB 488/SB 305 is historic legislation. It will:

- Replace a broken Economic Limit Factor (ELF) based production tax system
- Provide incentives for badly needed investment
- Provide special incentives for small sized companies to explore Alaska
- Provide higher State revenues, particularly at higher prices

Commissioner Corbus pointed out that the Governor strongly supports the Petroleum Profit Tax (PPT) as originally proposed as it provides a:

- 20% tax/20% investment tax credit
- Includes no add-on progressivity factor

Commissioner Corbus noted that the House Resource Committee (HRC) version includes the Governor's proposed 20% tax rate combined with a progressive factor. The Department of Revenue does not support the progressive factor. He commented that high taxes discourage investment. Alaska should not be mesmerized by the current high prices of oil, as it is important to encourage oil production that has dropped, overtime.

Commissioner Corbus pointed out that the Trans-Alaska Pipeline System (TAPS) is now operating at less than 50% capacity. He stated that recent investment in development and production has been inadequate and that higher tax rates would further discourage new investments. The State should not emphasize short-term revenues, but instead maximize wealth over the long run. He urged that:

- The 20/20 is the appropriate tax and tax credit rate to arrest the trend. It is important to keep an eye on the prize, the gas pipeline.

Although PPT includes investment incentives, a stronger link for effecting investment would be the tax rate. As tax rates go up, investment goes down.

Commissioner Corbus stated that the Senate version (SFC) made several changes from the Governor's proposal. He recommended that any alternative be carefully scrutinized.

- 22.5% tax rate
- 25% tax credit rate
- Progressivity factor
- The effective date

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Commissioner Corbus addressed the 25% tax credit noting that the SFC version includes a 25% tax credit rate. The higher a tax credit rate, the more risk for the State. Most of the new oil development on the North Slope relates to heavy oil, which can involve an investment of billions for new facilities and wells and take many years to plan and execute.

Commissioner Corbus continued, considerable investment in heavy oil development during years of low oil prices can result in low Petroleum Production Tax (PPT) for the State during such years until the tax credits are absorbed. The State must be careful with high tax credits, as they are high-risk strategy; adopting high tax credit rates of 25% to justify high tax rates of 22.5%, is the wrong strategy. It is a strategy that gambles too much on oil prices being high for too many years into the future. It could be a great detriment to the State, which is why the Governor limited in his proposal to a 20% maximum incentive, which the State could safely provide.

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The Administration strongly supports the original HB 488/SB 305. He commended the House for all their hard work on such a complex issue; however, the Administration does not

support the 22.5% tax/25% credit as passed by the Senate. The Administration believes that the 20/20 recommendation, not including the progressive factor, is an appropriate level to:

- Attract investment,
- Bring the gas line on, and
- Maximize the State's wealth over the long term.

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ROBYNN WILSON, DIRECTOR, DIVISION OF TAX, DEPARTMENT OF REVENUE, provided a handout to Committee members: "Comparing CS HB 488(RES) to SB 305 (CSSB 305 (FIN) am)". (Copy on File).

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Ms. Wilson referenced Page 2, noting that the bottom line for the State, the cumulative severance tax (\$B) 2006-2030 low volume scenario. She pointed out that the Governor's bill is highlighted in red and indicates "a middle of the road" approach and provides a balanced package that brings in adequate new revenues but does not place the State at risk with credits too high.

The green line indicates the House Resource Committee (HRC) version; the graphed black line indicates the Senate Finance Committee (SFC) version. The chart highlights the different oil prices and default scenarios. A crossover happens at about \$60 dollars per barrel.

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Representative Hawker asked the parameters in the low volume scenario database used. Ms. Wilson responded that low volume does not assume a gas line.

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DAN DICKINSON, CONSULTANT, TAX DIVISION, DEPARTMENT OF REVENUE, added, that the low volume does not include the development of Pt. Thompson. He emphasized that the low volume scenario is based on a rate of decline and assumes a significant amount of reinvesting. The assumptions are that there is sufficient investment being made to generate the volumes. They are volumes based on a historic rate of decline. Representative Hawker asked if the low volume scenario excluded the differentiation of adding an alpine size field every few years. Mr. Dickinson affirmed.

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Ms. Wilson referenced Page 3, the tax rate. Under the SFC version, the general rate offered was 22.5% compared to the HRC version at 20%, the same as the Governor's original bill. That rate was based on net value production.

The private royalty lease rates under the SFC version offer the rates, 5% for oil and 1.67% for gas. In the HRC version, the private royalty rate is 5% on oil & gas. The amount of magnitude on the private royalty leases is less than 1% of the total production.

Under the SFC version, there is a separate rate for Cook Inlet oil @ 5%, based on the net value. In the HRC version, there is no special provision for Cook Inlet.

The SFC version treats gas differently. There has been discussion for a lower rate for gas. When dealing with tax on the net, questions on allocation costs arise. There is no special gas treatment in the HRC version of the bill.

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Ms. Wilson referenced Page 4, gas revenue (value) exclusion (GRE) found in the SFC version on Page 19. The gross value excludes 2/3 of the value of gas:

- Yields an effective rate (before deductions) of 7.5%
- On a net value basis, yields an effective tax rate of nearly 5%
- Obviates the need to allocate expenses

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Ms. Wilson referenced Page 5, indicating the effect of the tax rate, the cumulative severance tax revenues under SB 305 with a 20%, 22.5% and 25% tax rate. She pointed out the large differences.

Co-Chair Chenault inquired why no 20/20 rate had been indicated. Ms. Wilson explained it indicates a change to the tax rate based on the SFC version.

Representative Weyhrauch questioned if the representation of the bar was correct. Ms. Wilson apologized that it had been mislabeled.

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Ms. Wilson referenced Page 6, which provides the same information offered on Page 5, on year-by-year bases. The graph indicates the effect of the tax rate and the annual severance tax under the SFC version, using various percentages into 2030.

In response to a query by Representative Kelly, Ms. Wilson explained that the graph isolates only the tax effect.

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Ms. Wilson addressed the progressivity listed on Page 7. The chart shows a separate progressivity for oil and gas. For oil, it is triggered at \$50 West Texas Intermediate (WTI) with a slope factor of .3%. In the HRC version, the rate is triggered to 37.5% at \$110 dollars.

Ms. Wilson compared the SFC version, referencing Page 8, oil only, triggered at \$50 dollars Alaska North Slope (ANS) West Coast with a slope factor of .00155. She viewed WTI as a better marker; it is used as the standard.

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Ms. Wilson referenced Page 9, providing the SFC version progressivity formula. She explained the three combined standard numbers. She suggested that if the SFC version were adopted, the formula would be condensed to .00155, which is actually the same result.

Representative Holm asked what "wh" meant. Ms. Wilson replied that would be the wellhead price. Mr. Dickinson added that in statute, it is defined that the wellhead is the prevailing value; in regulations, the prevailing value is that which prevails when the oil is sold.

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Ms. Wilson referenced Page 10, which graphs the effects of progressivity. The HRC version moves at a steeper slope than the SFC version and jumps up at \$110 dollars.

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Ms. Wilson referenced Page 11, the capital investment credit rate of 20% (HRC) versus 25% (SFC).

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Ms. Wilson continued Page 12, highlights the effect of the credit rate, cumulative severance tax revenues under SB 305 with the various proposed credit rates. The inherent risk is not reflected. The Administration opposes the 25% credit rate as it poses too much risk to the State.

Representative Joule inquired who would benefit the most. Mr. Dickinson replied that generally, it would be the investors. Presently, on the North Slope, the three largest

companies are making about 80% of the investment, which gives them 80% of the benefit.

Representative Joule said there would be no difference for credits for new exploration. Mr. Dickinson responded that in the base credit, there would be no difference. There are other provisions, which would be different, and would be addressed later during testimony.

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Ms. Wilson continued, Page 13, the capital investment credit under both versions, applies to the PPT general tax only and not against the progressivity tax or spill surcharges. Under both bills, the credits are transferable.

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Ms. Wilson referenced Page 14, refundable credits. Under the HRC version, up to \$10 million credit dollars could be refundable depending on the current investments; there is no such provision in the Senate version.

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Ms. Wilson referenced Page 15, the carry forward of loss. In the event of net calculation, with a producer loss, that loss could be carried forward to the next month. At the end of that calendar year, any remaining loss is converted to credit at that rate of tax. In the HRC version, the conversion rate is 20%; in the SFC version, 22.5% of the loss is carried forward into the credit.

Co-Chair Chenault asked about the exploration graph credits and if there were models for exploration versus development versus credit. Mr. Dickinson responded that there has been modeling provided: an investment credit in the exploration stage provides more leveraging as it covers dry holes. The bill does extend the credit for rank exploration. There is no modeling regarding the change of rates, changing behaviors.

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Ms. Wilson referenced Page 16, the handling of the progressivity tax. In the HRC version, the tax is deductible like lease expenditures; in the SFC version, the progressivity tax is not deductible. The progressivity is calculated on the gross in both versions.

Mr. Dickinson observed the complexity of the formula.

Ms. Wilson pointed out that the Governor's bill does not have a progressivity element in it. If the House Finance

Committee chooses to include that element, the language in the HRC version is "cleaner".

Representative Hawker remembered that the Senate's first draft version provided a very different option than the end product. He concluded that there were more benefits to a net structure versus a gross structure. Ms. Wilson observed that there are both advantages and disadvantages to both approaches. In the net, progressivity does recognize costs, which is beneficial. On the other hand, looking at the progressivity on gas, making it on net could be problematic. She thought that the SFC version was the equivalent.

Mr. Dickinson added, the SFC version returned to the gross as it reflects the math of combining the oil and the gas. To do it on the net creates problems, as there should be a constructing to make the impact of the oil and gas the same. Six to one is a figure used because of BCU equivalents. The danger is the unexpected effects for producers that have oil and gas and that combination.

Representative Hawker believed such complexity could be handled.

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Ms. Wilson referenced Page 17, the transition provisions. In the Governor's bill, there is a 5-year look back and the expenses are allowed over a 6-year period. Under the HRC version, the 5-year look back was changed to a 3-month period. Under the Governor's version, the only expenses dealt with are capital investments, but the HRC version looks at capital and operating expenditures, deductible over 9 months. Under the HRC version, there is no sunset.

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Ms. Wilson referenced Page 18 of the Senate version, where the look back is 5 years and applied to capitalized investments only. It could be a benefit up to 7 years, moving forward. There was a sunset of March 31st, 2013, pointing out the credit of 20%.

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Ms. Wilson referenced Page 19, which provides two recouping scenarios for 5 years and 7 years. The graph indicates the total possible credits that could be recouped and that must be recouped with the 7-year limit. Mr. Dickinson added that if a producer was investing at the same level they did during the look back period, they would not be able to claim the full amount of the transition investments. To claim the full amount, they would have to increase the amount of the investment during the recouping period.

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Ms. Wilson referenced Page 20, which illustrates the effect of the transition.

Representative Hawker discussed the rate of recovery for the individual beneficiary that would depend on their own investment. He asked if it would all be in the assumptions. Mr. Dickinson acknowledged it is in the assumptions and is shown the differences between the two bills. Under the Governor's bill, the Industry would be able to recoup if they had expenditures and revenue. Ms. Wilson added, that under the Governor's bill, there is a provision that it could be taken only if oil was over \$40 dollars a barrel; that provision was not included in either of the other two versions.

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Ms. Wilson referenced Page 21, the base allowance in the two proposed versions from the House and Senate. The credit of \$12 million dollars per year per company, sunsetting 3/31/2016.

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Ms. Wilson referenced Page 22, the base allowance. Under the Governor's bill, there is a \$73 million dollar deduction; the HRC version changed that from a deduction to a credit and the effective amount was pared down. A \$12 million dollar credit per company would be worth about \$60 million dollars compared to that proposed in the Governor's.

Ms. Wilson explained how the base allowance works on Page 23. If it were less than 5000 barrel per day (bpd), the credit would be equal to 100% of the tax being offset. If production were over 5000 bpd, there would be a percentage of tax offset, provided by formula. All producers will have some amount of tax offset. Mr. Dickinson added that everyone receives the 5000 bpd exclusion at average value.

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Ms. Wilson referenced the new Page 24, which indicates the allowance difference from 2006 to 2030, highlighting three different price scenarios from the three bill versions.

Mr. Dickinson observed that the Governor's version did not sunset. Both the HRC and the SFC elected to have a sunset. The Department believes that if the State is attempting to affect investment behavior, there should be no sunset. When prices are low, the price allowance does not account for much but as prices rise, the effect of the allowance

increases under the SFC version. In the HRC and Governor's version, the effect is small.

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Ms. Wilson referenced Page 25, the safe harbor provisions. Those provisions were brought forward with the idea that many of the calculations would be done using estimates of annual expenditures. In the spirit of fairness, there was a provision established that determined as long as 90% of the due tax was paid each month, there would be no interest. The annual "true-up" would be due in March of the following year, at which time, the remainder of the tax would be collected. That is called the "safe harbor". Under the HRC version, the safe harbor is 90% and if it is not met on time, there is an interest & a penalty charge of 5%. The penalty was not in the Governor's version. In the SFC version, the safe harbor amount was increased to 95% & requires more accurate estimating on the part of the producer; if not met, there would be interest placed on the amount up to 95%.

Representative Joule asked if there was a similar function under the current Economic Limit Factor (ELF). Ms. Wilson explained that under the ELF, 100% of the tax is due monthly and if it is not paid, there is a charge of 5% per month. Mr. Dickinson interjected that falls within the general interest provision @ 11% interest annually. The penalty provision under current law is not automatic.

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Ms. Wilson referenced Page 26 - safe harbors, pointing out the differences in drafting language. In the HRC version, the language indicates what is due would be 100% with a safe harbor of 90%. In the SFC version, the amount is due at the 95% level. The difference in the language indicates a change between the SFC and HRC version.

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Ms. Wilson referenced Page 27, the effective date. In the Governor's version that date is July 1st, 2006; in both the SFC and the HRC versions, it would be retroactive to April 1st, 2006. Ms. Wilson advised it is not a good policy to make taxes retroactive.

Both bills provide for a transition rule that payments could be made under the old ELF system for 6 months with pay-up in the 7th month.

Representative Hawker asked for assurance that the Department would have time during the six months to promulgate all the regulations necessary to implement the

tax with adequate time for the Industry to respond and prepare their accounting system. Ms. Wilson said she could not guarantee that. There is an accompanying fiscal note to cover costs for contracting for additional legal help to draft regulations during those six months. She added, it is not an unreasonable time to do that but is a consideration.

Mr. Dickinson pointed out that the proposed versions have not made the task simpler; they are very complex & the fiscal note reflects that complexity.

In response to Representative Kelly, Mr. Dickinson commented that it is not a common practice to charge taxes retroactively. Representative Kelly thought that harm could be mitigated by not addressing the penalties. Mr. Dickinson advised that the current bill gives 6 months from the date it was enacted. The general principles are understanding what the obligations are for tax planning.

Ms. Wilson was not looking forward to the first audit, including the seven-month tax return.

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Ms. Wilson referenced Page 28, addressing the spill surcharges (split nickel). Currently, there is a 5 cents surcharge. The amount suspended is based on the balance of the spill fund. In the HRC version, there is no change to the surcharge @ 5 cents but the amount collected increases from 3 cents to 4 cents with no credit & no deduction for that tax. In the SFC version, the total was increased 1 cent for a total of 6 cents; the amount collected increased 2 cents from 3 cents to 5 cents; there is no credit or deduction for that tax.

Representative Hawker asked for more information about the proposed surcharge. Mr. Dickinson observed that the SFC version offered intent language on Page 2, Section 1, item #B. Representative Hawker noted that the intent language was what raised his question.

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Ms. Wilson referred to Page 29, the use of Department of Natural Resources (DNR) royalty values. In the Governor's bill, it was thought that some of the royalty values could be used in calculating real value. They thought it could simplify the tax and audit process. The SFC version removed that provision by an amendment.

Mr. Dickinson related that Page 30 depicts the use of the Department's values in the SFC version.

Representative Holm did not understand the Department of Revenue's position regarding the applications.

[4:05:47 PM](#)

Mr. Dickinson replied that the Commissioner would be balancing the efficiency of the Tax Division, determining if the calculations reflect value and reasonable costs of transportation in an unbiased way.

Representative Hawker pointed out that is a "large issue". He opined that some of the House Finance Committee (HFC) members do not agree with the allowance. He mentioned the RSA agreements submitted by the three large oil companies. The RSA's from ConocoPhillips and BP contain small differences; however, the Exxon RSA agreement has a huge difference. Mr. Dickinson said given the data, it would be inappropriate to identify the information. Representative Hawker advised that he had taken his information from the Department of Revenue's web site, which is public information.

In response to a query by Representative Hawker, Mr. Dickinson said the Department's analysis indicates that there are different values between the tax and royalty. Representative Hawker suggested that the Department should provide a convincing argument regarding that, as it is vital it become public discussion.

[4:11:08 PM](#)

Ms. Wilson pointed to a couple of differences indicated on Page 31 regarding abandonment. The HRC version has no credit for abandonment; in the SFC version, there is no credit or deduction for abandonment of old production. It requires the allocation of expense based on production be allowed.

Co-Chair Chenault asked if abandonment refers only to wells. Mr. Dickinson referenced a list including well, unit, right of way and/or platform, listed on Page 22, Line 17, SFC version.

[4:13:53 PM](#)

Ms. Wilson addressed other provisions included in SFC version listed on Page 32, not included in the HRC version. For any credits taken under that provision, the exploration date must be provided to the Department of Natural Resources if claimed. That language mimics current language in statute. Co-Chair Chenault asked if language applied only to existing fields or new exploration. Mr. Dickinson stated that it is automatic on State land and that new drilling on a private lease would not meet the requirement.

Ms. Wilson continued, Page 32 addresses transfer of goods and services from a foreign to a domestic market. She noted discussion in the Senate about having tools for the future, pointing out that IRC Sec. 482 for transfer pricing in the federal arena between a domestic company and a foreign-sister company. There has been discussion regarding the need for that provision. The Department does not believe it is necessary and that "ordinary & necessary" is standard to the bill; she heard discussion it could be useful in the future.

[4:18:10 PM](#)

Representative Hawker asked about the permissiveness of the IRC 482 language. He questioned if the Department felt "mandated" to incorporate those provisions. Mr. Dickinson referred to language elsewhere in the bill, which clarifies transactions such as an internal transfer, not allowed. The Department's concern rests with such internal transfers.

Ms. Wilson pointed out, that language was taken from the SFC version and was not included in the HRC version. She noted that the Department would like to see it included in the final bill.

[4:20:49 PM](#)

Ms. Wilson noted clarifying language added in 160©(1)(B). Mr. Dickinson said that language develops cost standards and places the ranks in order. A balance could be sought. The SFC version amended support of credit for any preferred facility. He urged support for the Governor's version.

Co-Chair Chenault asked about credits on anything regulated or dealing with tariffs. Mr. Dickinson stated that the types of facilities listed in the bill are not currently being regulated; if they were, the credits would be taken into account.

[4:23:43 PM](#)

Ms. Wilson referenced Page 33, the catastrophic oil spill expenditures for clean-up are not deductible. In the SFC version, they would not be deductible; in the SFC version, they could be deductible if leased, but not specifically addressed.

Ms. Wilson advised that catastrophic oil spills have specific meaning in Alaska's history to the environment in spills in excess of 100,000 barrels. The most recent oil spill was approximately 6,000 barrels and clearly, not within the meaning of "catastrophic oil spill".

Co-Chair Chenault asked if there had ever been an oil spill in Alaska, where fault was not determined. Mr. Dickinson said that he would look to see if that was standard practice or not. Co-Chair Chenault believed most likely, it would never come into effect, as fault is always found.

Representative Joule pointed out that with that language, a spill ½ the size of the Exxon Valdez would not be considered catastrophic. Ms. Wilson acknowledged that the Valdez spill was "a lot of oil". Representative Joule stressed that it was much less than 5 million gallons and that the damage was "horrific". Mr. Dickinson interjected that "catastrophic" should be considered a quantum qualification that presents a grave and economic threat to the environment and economy. A smaller spill, in a sensitive area, could qualify under that language.

Representative Hawker questioned an oil discharge in excess of 100,000 barrels. He asked how that could be interpreted from wells producing that much water & oil mixture. Ms. Wilson stated that given the limited statutory site, it would meet the second criteria, which is "any other discharge, which the Governor determines presents a grave and substantial threat to the economy or environment".

Co-Chair Chenault asked about a situation for a gas station crack and if clean-up expenses would be deductible on any tax the State issues. Mr. Dickinson advised that there are diesel filling stations on the North Slope and in those facilities, catastrophic would be deductible.

[4:32:52 PM](#)

Ms. Wilson referenced the language in the HRC version regarding catastrophic oil discharge into marine or inland waters of the State. That language is specific to water and also covers incremental expenses of transportation. It focuses on oil spills affecting water. Mr. Dickinson added that the language appears in statute and deals with the downstream, reference tankers. The language was moved and crafted to deal with tankers and lease expenditures.

Vice Chair Stoltze asked if the delivery system was part of Trans-Alaska Pipeline System (TAPS). Mr. Dickinson explained that the end of TAPS is where the tankers responsibility begins. There is nothing between TAPS and the ship.

[4:35:33 PM](#)

Ms. Wilson referenced Page 34, the effective severance tax rate compared to the wellhead (less royalty), low volume scenario. She urged the Committee to consider a moderate approach.

4:36:59 PM

Representative Kelly asked about the credit listed on Page 12. Ms. Wilson explained the comparison difference between the three credit rates, noting that the \$20 dollar level moves and could have a net increase of 100%. The intent was to isolate the credit rate. Mr. Dickinson voiced concern when prices are high, with large investments and then a severe price correction occurs. That could make a large difference, creating a situation of long recovery time.

SB 305 was HELD in Committee for further consideration.

#

ADJOURNMENT

The meeting was adjourned at 4:38 P.M.