

HOUSE FINANCE COMMITTEE  
April 29, 2006  
9:18 A.M.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [9:18:02 AM](#).

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Jim Holm

ALSO PRESENT

Representative Kurt Olson; Representative Paul Seaton;  
Representative Ethan Berkowitz; Representative John Coghill;  
Senator Gene Therriault; Dr. Pedro Van Meurs, Consultant,  
Office of the Governor

SUMMARY

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 & HELD in Committee for further consideration.

#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.

[9:20:06 AM](#)

DR. PEDRO VAN MEURS, CONSULTANT, OFFICE OF THE GOVERNOR, provided a handout to the Committee, "Petroleum Production Tax (PPT) Issues". (Copy on File).

Dr. Van Meurs noted concern the Senate Finance Committee (SFC) had adopted the 25/20 tax rate. Prior to PPT discussions, extensive analysis on the heavy oil had been undertaken. He encouraged a focus on heavy oil and that the Administration has provided extensive research on it. Two distinct forms of oil exist, heavy & light. The concern with the North Slope is the huge gradation of oil. The value of oil diminishes with a decreased Alaska Petroleum Institute (API) and the cost of production increases depending upon it. Cost becomes greater with weight. Alaska has oil with many qualities; heavy is not just one type of crude. Gradation starts from 25 to 10 API.

Dr. Van Meurs spoke to the 25% tax credit, pointing out that it is important to Alaska to stimulate heavy oil production. The economic future of the State is linked to heavy oil production.

[9:26:07 AM](#)

Dr. Van Meurs noted that he had counseled the Governor not to support a 25% tax credit because:

- High cost/low value crude oil and the likelihood that the crude could be economic would rapidly diminish and the probability of a loss in carry-forward increased.
- Higher costs and then credits become proportionately higher. Page 3 indicates the 22.5%, 25% & the 20% system and how that applies. The revenues on the 22.5% and the 25%, @ \$40/bbl becomes less because of high tax credits; lower prices provide a tax loss with carry forward of capital costs.

Dr. Van Meurs emphasized that Alaska cannot afford such high tax credits; he urged that the 20% tax credit be adopted.

[9:29:28 AM](#)

Dr. Van Meurs noted the importance of the tax credit consideration, faced with the fact that crude @ \$10-\$15/bbl, there would be capital investment.

[9:30:12 AM](#)

Dr. Van Meurs discussed the progressive feature as listed on Slide 4. The starting oil price for that feature nominally would erode in real value over time. It could affect seriously heavy oil development towards lower API gravities if prices are established too low. The price indicates also that it could be useful to determine the actual gross value at the point of production rather than using West Texas Instrument (WTI) or Alaska North Slope (ANS).

[9:35:15 AM](#)

Dr. Van Meurs referenced Slide 5, showing the level of activity and tax rate. There is some relationship between competitiveness in Alaska and the rest of the world. It indicates that the higher the tax rate, the less Alaska is attractive to the industry. As long as oil prices remain high @ the \$40-\$50/bbl range, it does not matter; however, when prices decline to \$35/bbl, it becomes very important. He added that the net back received from Alaskan oil is \$5 dollars less per gallon.

[9:38:03 AM](#)

Dr. Van Meurs pointed out that Alaska oil production is in decline and urged consideration to bring forward oil deposits. He reiterated differences between heavy and light oils. Higher tax rates mean less activity. A \$1 billion dollar investment is not enough to stop the decline; Alaska needs to double that investment. Dr. Van Meurs urged caution be taken in consideration of the tax rates.

[9:40:30 AM](#)

Dr. Van Meurs referenced Slide 6 - the 22.5-25 strategy. A general strategy of increasing tax rates to 22.5% with a 25% tax credit, to maintain activity at the same level as a 20-20 system, increases the State's risk. Under the downside situation, tax loss carry forward + investment credits equal 47.5% rather than 40%.

[9:42:02 AM](#)

Dr. Van Meurs spoke to Slide 7 - the gas gross revenue exclusion. Generally, governments that face long distance gas transport to market, fix government takes for gas at 5%-30% below oil. [Indonesia, Malaysia, Qatar, Oman, Libya, Trinidad, Venezuela]. There is good reason for establishing a GRE as proposed. Dr. Van Meurs concluded his testimony.

[9:45:41 AM](#)

Representative Joule asked if there were models showing long-term effects to the State. Dr. Van Meurs advised that there is a comprehensive model of the gas project and that there are concerns regarding Alaska relative to gas projects in other parts of the world. He reminded members that it is a large capital expenditure & is an unusual risk profile that could be unprofitable. Dr. Van Meurs urged that it be considered. He mentioned the stranded gas contract, pointing out there are producers not part of that arrangement.

[9:50:35 AM](#)

Representative Joule recalled the decision made to treat gas differently from oil and requested to see the model that lead to that decision. Dr. Van Meurs said the analysis could be provided.

[9:52:24 AM](#)

Representative Kerttula voiced concern regarding a distinction between the North Slope and Cook Inlet with lower tax and the same gas credit. She warned that over the long run, the State could loose a lot of revenue. She requested the numbers separating Cook Inlet from the North Slope.

Dr. Van Meurs responded that to judge the PPT on its own merits, all possible credits related to gas development, would be upstream credits and related to production. In the gas projects, the credits relate primarily to Pt. Thompson and some new fields. The amount of credits associated with bringing the gas line forward are limited and included in the oil information. He acknowledged the importance of those concerns, indicating that the credit section of the gas contract had already been presented and that gross revenue exclusion does not have to be compared to the credits.

[9:56:10 AM](#)

Representative Kerttula explained that was a large misunderstanding and thought there would be credits against the gas. Dr. Van Meurs clarified that Point Thompson would be subject to full credits. Oil and gas would be a 20% credit and would total about \$400 million dollars, which was included in the oil revenue presentation to the Legislature. During that presentation Mr. Marks advised that the full credits were deducted and that the gas revenue would not subtract any further credits.

[9:57:45 AM](#)

Representative Kerttula requested a comparison to the current system. Dr. Van Meurs said he would provide that.

[9:58:24 AM](#)

Representative Kerttula heard comments regarding the lack of fiscal certainty on the note being written by the oil section and asked why the State was waiting for that. Dr. Van Meurs explained that once the Legislature passes the law of general application on oil and gas, it is then incorporated as fiscal stability to the contract. The contract can not be finalized unless the PPT piece is complete and once that is ready, there will be connecting language element in the contract.

[10:01:14 AM](#)

Representative Kerttula advised that such comments make the concern regarding the credit on oil more important. Dr. Van Meurs stated that the credits for Point Thompson would be the main gas project field & assuming \$2 billion dollars @ the 20% credit, equals \$400 million dollars. Point Thompson applies to gas and the investment credit would be allocated to oil & gas. It is too complex to separate the investment between oil and gas; it is an important issue and is not wise to complicate the PPT breakdown.

[10:04:40 AM](#)

Representative Weyhrauch inquired why a distinction between profit tax dollars three times greater for oil than gas. Dr. Van Meurs understood that the Senate Finance Committee (SFC) did not recommend a different tax rate; it would be the same for oil and gas. Given an exclusion, since gas is a less economic source than oil, excluding only part of the gross revenue from gas to calculate gas profit, which creates a lower government take for the gas. That could make getting the gas difficult.

[10:08:43 AM](#)

Representative Kerttula thought it was confusing from the Senate version that gas is taxed at 7.5% rather than the 22.5% on oil. Dr. Van Meurs pointed out the tight deadline; he recommended working in parallel. In designing the PPT, it was not appropriate to outline the details to protect the State and then the Governor introduced the 20% gas. That is a modest effect. The Senate version assumes that if a gas contract moves forward, there will be producers not part of it and the PPT law will need to include that group.

[10:12:18 AM](#)

Dr. Van Meurs responded to Representative Kelly's concern regarding a \$100 run as indicated on Page 3. There will be a positive difference at \$60 dollars, where a higher tax rate becomes beneficial.

[10:13:53 AM](#)

Representative Kelly observed that when tax credits are weighed, it is higher at a 25% credit than 25% tax. Dr. Van Meurs emphasized that Alaska cannot afford 25% tax. Studies indicate less activity at 25% as it is less competitive. Heavy oil can cost up to \$20 to \$30 dollars a barrel to develop. A high cost of development can make heavy oil difficult to bring up. He foresaw a negative affect to heavy oils, but less on the light; those differences are not immaterial. He cautioned against raising the tax rate as tax credits carry a negative risk to the State.

[10:20:37 AM](#)

Representative Kelly referenced safety net risks at higher prices. Dr. Van Meurs replied there is a down side to tax credit & background analysis has modeled minimum amounts. He would not recommend such an approach because minimum taxes around the world must be comparable if the price increases. A typical minimum tax could be recovered, an effect not important for the State. An additional consideration is that Alaska has been well protected on the down side. Royalty & property taxes already exist and Alaska also carries a State corporate income tax. If prices go down, corporate taxes stay in place.

[10:26:43 AM](#)

Representative Kelly mentioned the issue of profit/taxation and why the State should let go of a system already in place. Dr. Van Meurs did not comment on the "correct" numbers, noting that the PPT was not determined by international standards. An international experience indicates that there is more investment in a profit-based system than a gross value system. A net profit share is more difficult to administer than a gross profit share.

Representative Kelly spoke against the math in the current GRE. He pointed out the effective date in the claw-back & the impact on the long-term investment strategy of the oil companies. Dr. Van Meurs recommended a 2 for 1 system. He felt that companies should be rewarded for their willingness to move forward. The effective date is only a matter of money, impacting the cash flow this year. He maintained that there will be significant impact this year either way and urged the Committee to get organized. Dr. Van Meurs

advised that is why the Administration's bill does not include retroactivity.

[10:34:24 AM](#)

Representative Kelly inquired about a severe worldwide retroactive indication. Dr. Van Meurs responded that Algeria just passed a PPT-style profit based tax, waiting more than a year to implement. The real international practice is passing a new fiscal system and making it applicable after the law is passed.

[10:36:07 AM](#)

Co-Chair Chenault believed there were countries structuring their gas taxation in order to get into the U.S. market; he asked why that market is different. Dr. Van Meurs corrected that other nations are structuring their taxation system to reach the world market, including the U.S. market and referenced the Tobago design system. The value of gas has been studied, becoming the base for a fiscal design for long distance transportation of gas.

[10:38:33 AM](#)

Co-Chair Chenault referenced the tax rate activity. He noted the exclusion of the 22.5/25 comparison and asked if that would be regressive, progressive or neutral.

Dr. Van Meurs offered to provide such an analysis. The available chart provides a competitiveness rating, a more attractive fiscal system on Slide 5. It demonstrates current activity in Alaska and the proposed PPT system, which is the reason to move toward a profit based system. The figures mean nothing more than general competitiveness among the fiscal systems.

[10:43:09 AM](#)

Representative Kerttula asked about the U-Shape on Slide 5. Dr. Van Meurs replied that represents regressive fiscal systems & low prices, where the government take becomes less, while at higher prices, the take becomes more progressive.

[10:43:57 AM](#)

Co-Chair Meyer asked what the anticipated price for oil was for the next five years. Dr. Van Meurs replied forecasting is difficult and that it is important to study the projects, comparing price. Projects must be acceptable to a whole range of ideas because the world is complex. Most oil companies use several forecasts. Dr. Van Meurs estimated a

price of \$35 dollars per barrel for long term, a consensus number among many companies.

Co-Chair Meyer inquired if current prices were sustainable. Dr. Van Meurs replied "action creates reaction". If prices increase, activities react to the high prices that result in counter-force and that brings prices back down.

Co-Chair Meyer thought events in the Middle East could cause prices to continue to increase and felt that warrants the progressivity factor. Dr. Van Meurs contributed to the Stranded Gas Development Act (SGDA), in which progressivity was an important feature; however, he emphasized that PPT is already a progressive system by including tax credits. He reiterated caution about the heavy oil condition in Alaska.

[10:52:38 AM](#)

Representative Weyhrauch asked about the original concern regarding a threshold oil/gas tax policy rate. He asked if a tax rate model had been prepared by the Administration. Dr. Van Meurs advised that the State has prepared two broad models, a revenue system prepared by the Department of Revenue and the investment style model. The PPT bill applies to both oil and gas; it was never intended to be separated.

[10:55:09 AM](#)

Dr. Van Meurs said his recommendation is to have a \$73 million allowance, given that most Cook Inlet producers are smaller. He explained that the gas regime could be changed in the beginning. The purpose is to be able to present both a gas and oil bill, not negatively impacting Cook Inlet. Models were well established, running the gas line economics. He offered to provide the impact of that GRE information to the Legislature.

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

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[10:57:14 AM](#)

ADJOURNMENT

The meeting was adjourned at 10:57 A.M.