

HOUSE FINANCE COMMITTEE  
June 1, 2006  
9:11 a.m.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [9:12:05 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 Jim Holm  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Beth Kerttula  
Representative Bruce Weyhrauch

MEMBERS ABSENT

Representative Carl Moses

ALSO PRESENT

Representative Ethan Berkowitz; Representative Paul Seaton; Representative Less Gara; Representative Norm Rokeberg; Representative David Guttenberg; Representative Ralph Samuels; Representative Woodie Salmon; Dan Dickinson, Consultant, Tax Division, Department of Revenue; Robynn Wilson, Director, Division of Tax, Department of Revenue; Robert Mintz, Assistant Attorney General, Department of Law

PRESENT VIA TELECONFERENCE

There were no teleconference testifiers.

SUMMARY

#sb2001

CSSB 2001 (FIN)

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

HCS CSSB 2001 (FIN)

CS FOR SENATE BILL NO. 2001(FIN)

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

Co-Chair Meyer MOVED to ADOPT committee substitute 24-GS2094\I, Bullock, 5/31/06. There being NO OBJECTION, it was so ordered.

9:12:45 AM

ROBYNN WILSON, DIRECTOR, DIVISION OF TAX, DEPARTMENT OF REVENUE, reviewed changes incorporated into the committee substitute. Members were provided with a matrix to highlight the major difference between CSSB 2001 (FIN), version F (Senate version) and committee substitute GS2094\I (CS) adopted by the House Finance Committee (copy on file). She observed that the tax rate was 20 percent in the CS and 22.5 percent in the Senate version. The next significant difference relates to the treatment of Cook Inlet oil and gas. She observed that previous versions excluded value, which started with the gas revenue exclusion (GRE). The GRE was carried over to Cook Inlet oil. Changes in the CS are intended to simplify the presentation of GRE. Cook Inlet oil would be handled in the same manner as Cook Inlet gas in previous versions. She explained that under the CS the tax would be the lower of: the PPT tax on Cook Inlet or what would have been paid under the ELF (Economic Limit Factor) system. Consequently, Cook Inlet gas remains the same. The credit rate remained at 20 percent in all versions. Private royalty rates also remain the same. The GRE was not included in the CS.

9:18:18 AM

Ms. Wilson observed that, under the CS, progressivity begins at \$45 a barrel net value with a slope of .00175 percent (1.75%) times the net value. The House version [HCS CSSB 305 (FIN) am H) had a trigger of \$35 net per barrel, with a slope of 2.5% percent. The slope is lower, but kicks in higher. In the Senate version, progressivity kicked in at \$35 barrel net, with a slope of .1%, which is a lower slope.

9:19:23 AM

Ms. Wilson further itemized areas that were unchanged:

- 50% progressivity tax cap stays the same.
- There is no gas progressivity because the progressivity calculation is based on net and is not deductible.
- Transition provisions have been maintained: 5 day look back, 2 for 1 on capital expenditures. The 20 % credit remains.

[9:20:37 AM](#)

Ms. Wilson explained that the base allowance has been changed and is based on production. This is not the case in the Senate version. The current CS, with regard to base allowance is the same as HCS CSSB 305 (version B). Unchanged items were:

- The 10 year rolling sunset on the base allowance has not changed.
- Safe harbors have not changed.
- The effective date of April 1, 2006 has not changed.
- The 10 month transition period was retained, however additional languages was added for clarification.
- There has been no change to spill surcharges or the treatment.
- There has been no change to SB 185 version regarding abandonment refundable credits. There is no change with how those credits are used.
- Transferability has not changed.
- Refundable credits have not changed.

Credits for annual loss, the net operating loss that is converted to a credit at the rate of 20%, now matches the tax rate. This differs from the Senate version, which was 22.5%. She further noted that the conversion rate should match the tax rate; that was not the case in the version that passed out of the House.

There is no provision for uses of RSA core values.

Language regarding U.S.C. Sec. 482 Internal Revenue Code was not changed.

Oil spill clean up costs were changed slightly, with an exception for the gravel pad. This will be further highlighted later in presentation.

The Department of Natural Resources (DNR) receives exploration data. The producer must give information to DNR regarding the expiration credits that are claimed. The same language was in the last several versions of the legislation and is contained in SB 185. Provisions remain the same.

Ms. Wilson went on to say that the language regarding NPSL regulations after industry practice (hierarchy of direct costs), in the House version, was fairly general. The Senate version adopted modified language to restrict it to "in Alaska only". This will be highlighted in the walk through of the bill.

The same language regarding credit flow-through re: FERC regulated facility, has been maintained. A high energy fund was established in the House version, but was removed from the Senate version and not included in the current House CS.

[9:25:59 AM](#)

Ms. Wilson reviewed the legislation. She referred to page 3, section 5, line 9, which contains the 20 percent tax rate.

ROBERT MINTZ, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, spoke in regards to section 5. He pointed out that the tax cap for Cook Inlet oil would be the same as the current rate for Cook Inlet gas. The language outlining this is found on page 3, line 8, subsection (j). The new provision, subsection (i), provides for Cook Inlet gas.

[9:27:46 AM](#)

Ms. Wilson observed that progressivity starts on line 3, page 4. The trigger point on net of \$45 is on line 16. She highlighted subsection (h), which requires amortization of the lease expenditures to calculate productivity. She explained that the timing of expenditures is critical, when establishing progressivity on a net basis. This provision would take into account expenditures that vary greatly from month to month on an annual basis. She observed that it was difficult to draft progressivity provisions based on barrels of oil equivalent (BOE) on an energy content. She explained that an amendment would be forthcoming.

[9:29:56 AM](#)

Ms. Wilson provided members with a graph demonstrating progressivity rates for each of the three versions (copy on file).

Mr. Mintz explained that there would be two different methods of calculating BOE (bottom of page 6). The intention is to have two different ways to define BOE depending on what subsection it refers to. One definition is based on cubic feet, the other is based on energy content. He noted that there was an attempt to fix the potential confusion.

[9:30:58 AM](#)

Ms. Wilson explained that the graph demonstrates the progressivity line for each of the three versions discussed. The top line pertained to the House version passed (yellow). The middle line is the current CS (blue). The bottom line pertained to the version passed by the Senate (red). She noted that the current CS represents a moderate option of the three versions with the House version being the highest and the Senate version being the lowest {return}.

Co-Chair Meyer questioned the affect of these rates at the current price of oil, at \$75 with higher progressivity and a 20 percent tax rate. The Senate version has a higher tax rate of 22.5% with a lower progressivity rate. He asked which provided the greater return to the state.

[9:32:58 AM](#)

Ms. Wilson said she would provide that information.

Ms. Wilson continued review of the CS: line 22, page 4, section (i), the Cook Inlet gas, tax cap provision (from pages 4 to page 5, line 8). On the next line is the same language with regards to Cook Inlet oil. On line 27 is a new subsection that explains how Cook Inlet credits apply; PPT taxes are calculated along with progressivity on Cook Inlet. This is then compared to what would have been charged under ELF, and the lower amount is applied. It explains how credits are taken into account and applied. This section explains how the credit carry forward is reduced by that credit amount.

In response to a question from Representative Kertula Ms. Wilson explained that if producers get a break on the tax rate it would not be fair to get the extra credits. The aforementioned language is there to address this.

[9:37:05 AM](#)

Ms. Wilson noted the need for a technical amendment on page 6, lines 7, 9, and 10 to make one word grammatical changes: Replace "are" with "is", replace "of" with "or" replace "under" with "by". She noted an amendment for these changes would be forthcoming.

Ms. Wilson referenced page 6 lines 22-27, section (1):

This is language regarding regulations adopted by the department that was inadvertently combined in the drafting. She noted an amendment will be forthcoming to correct it.

Section (m) is new language, regarding barrels of oil equivalent, measured on energy units to establish regulations for sampling and testing.

[9:39:25 AM](#)

Ms. Wilson referenced page 9, highlighting the basic tax on line 8. Mr. Mintz pointed out that wording on page 9, line 10 was changed from "elected" to "substitution" to allow a substitution under 160(f). AS 43.55.160 (f) provides for a producer to either deduct actual lease expenditures for one month or to annualize expenditures and deduct 1/12 calendar year lease expenditures. The producer is required to annualize for progressivity purposes. If the progressivity tax kicks in during the year, it is not an election, it is a requirement, hence the change of the wording from "election" to "substitution".

[9:40:55 AM](#)

Ms. Wilson referenced page 10, line 5. The credit conversion of net operating loss at 20 percent is outlined. The phrase "may be applied irrespective of if the producer pays the credit" was taken out of this section due to a lack of clarity: page 8, lines 23 and 24 of CSSB 2001 (FIN). Mr. Mintz explained that the language was superfluous and caused confusion. It does not change any intent or meaning by its removal.

[9:42:42 AM](#)

Ms. Wilson related that page 11, line 12, (f) explains the refundable credit. On line 15 - 17 is the production limit {Of 50,000 BOE}.

[9:43:13 AM](#)

Representative Kelly referred to the \$25 million credit. He noted that Dr. Van Meurs indicated the credit could cause problems when oil prices are on the decline. He questioned if the provision was addressed. Mr. Dickinson explained that the Administration is not comfortable with the \$25 million credit and felt credits should stay with the PPT. A direct credit would have to come from income tax credits or other sources. The state of Alaska feels that the full amount should be paid. Representative Kelly observed that it is a policy call.

Co-Chair Chenault noted that the issue was not addressed.

[9:46:07 AM](#)

In response to a question by Representative Kelly, Mr. Dickinson explained that the credit was not a key issue of the PPT or part of the major focus. Ms. Wilson added that the more potential refund there is the more the risk. The \$10 million refund limit was in one of the versions.

[9:47:29 AM](#)

Ms. Wilson explained page 20, line 28 section 24, determination of production tax value of oil and gas. She pointed out that the Gas Revenue Exclusion (GRE) was taken out. Separate accounting would be required for Cook Inlet oil net value and Cook Inlet gas net value. The section's purpose is to clarify accounting of the net value.

[9:48:22 AM](#)

Ms. Wilson noted changes on page 22. Subsection (c), lines 6 - 14, changes word order and clarifies "ordinary" and "necessary". It does not change meaning or intent. Mr. Mintz pointed out a drafting error on lines 12 - 14, which can be addressed in the form of an amendment that substitutes "lease expenditures" after "in determining whether costs are". Mr. Mintz further clarified intent by noting "other than items listed in (d) of this section" was added on line 31. Subsection (d) is a list items that are not allowed as deductions of lease expenditures.

[9:51:03 AM](#)

Ms. Wilson referred to page 23, and noted that there should be a comma after oil and gas line 17. The list of nondeductible items is on page 24. Abandonment is addressed on lines 28 - 31 and again on page 25. It is substantially the same language except for lines 11 and 12, which is a clarification of what and when abandonment would be allowed as a deduction. The original intent was to disallow the abandonment costs but not to preclude the expenses for the purposes of improvement. Subsection (17) on page 25, lines 13 - 19 contains oil spill language that disallows expenses regarding unpermitted oil discharge. The new language is on line 14: "is not confined to a gravel pad". She explained that the accounting would outweigh the benefit of disallowing expenses associated with small pad spills. She went on to say that any significant spill is expected to exceed the gravel pad.

[9:53:43 AM](#)

Representative Kerttula asked if there is a definition of "gravel pad". Mr. Dickinson responded that it is not defined in statute, but would be defined through regulation.

Representative Kerttula expressed concern regarding the amount of barrels that could go into a gravel pad. She asked if the Department of Environmental Conservation had been consulted. Dickinson explained that within a gravel pad there is a normal containment system set up and referenced on line 15 of the bill.

[9:55:07 AM](#)

Ms. Wilson discussed page 28, AS 43.55.170, which contains the base allowance. Lines 10 - 19 has the added production limit.

[9:56:00 AM](#)

Ms. Wilson addressed the transitional provisions on page 35, line 6 and 14. The language does not change anything, it just clarifies the 10 month rule; 300 days is the equivalent of 10 months.

Mr. Mintz explained that the intent is to have a 10 month period for the producer to pay under the old system and then true up under the new system. There would be 270 days under the old system and then the new system true up would start at the 300th day.

[9:59:42 AM](#)

Representative Joule noted that previous deliberations were without the benefit of a gas contract. He questioned if the current legislation could be put into context of a gas [pipeline] contract. He observed that testimony from the needed authorities can only take place during the committee process. Mr. Dickinson explained that the contract reflects the bill the governor submitted in the special session. If the legislature changes the parameters, the contract would have to be adjusted.

[10:02:14 AM](#)

Mr. Dickinson reiterated that the changes and comparisons would be available online. He also noted that those changes could be updated based on the CS if necessary.

Representative Weyhrauch questioned if fiscal certainty would be achieved by enacting PPT with a 3 - 5 year sunset date, thereby circumventing the 30 year contract.

Mr. Dickinson observed that the PPT could be changed anytime the legislature deems appropriate, while a contract would be binding.

[10:04:05 AM](#)

Ms. Wilson returned to page 24 and pointed out the addition of "gross" before "negligence" on line 9, which differs from the Senate version. There was another change on line 29 with the addition of "pad" after "well". Mr. Dickinson added that operations continually reconfigure wells. The intent is to pertain to the end of actual operations without inserting into day to day operations.

[10:07:12 AM](#)

Mr. Dickinson discussed Cook Inlet. He provided members with a spread sheet, Cook Inlet Examples PPT with various adjustments (copy on file). The chart compares the effect of three items that have been built into various versions of the bill: The GRE at 2/3, the lookback test, and the \$12 million credit. He asserted that the CS, with the lookback provision, accomplishes what the other tools were attempting to without overlapping.

The chart compares the impact of the aforementioned tools, with the different rate and volume scenarios. Under each "tool" there are three columns illustrating the impact of scenarios created under volume and rate. He explained that average rate was calculated at \$2.50; \$4.50 represents the average for the last few years. The \$6.50 and \$8.50 rates were added to project rising gas prices for Cook Inlet.

The scenarios were created for big volume fields with high ELF, big volume fields with low ELF, small volume fields with low ELF, and small volume fields with high ELF. He explained that under the 2/3 GRE, Cook Inlet gas prices would need to be in the \$8.50 range in order to see the same return as under the status quo.

[10:13:06 AM](#)

Mr. Dickinson explained that there is a break even at \$8.50 for today's prices using the 2/3 GRE.

Under the lookback [provision in the CS], the taxes stay basically the same. The difference would be the built in credits to incent production. The producers would pay the same tax, but they would have their tax lowered if they make investments.

[10:15:00 AM](#)

Mr. Dickinson noted that as prices increase the tax would stay at \$21 million due to the cap. In response to a question by Representative Kelly, Mr. Dickinson explained that there is no GRE under the current CS. The cap would not kick in below \$8.50, which is twice that of the current price.

[10:16:39 AM](#)

Mr. Dickinson noted that column three outlines the rates under the Senate version, which provides for a \$12 million credit for large volume, high ELF producers. He observed that at low prices the applications of credits would bring all producers to zero. Taxes would rise as prices rise if the credit is the only mechanisms controlling taxes. At \$8.50 price, taxes collected would be \$180 million. They would only be reduced with the amount of available credit, which would be \$12 million for the larger producers and \$6 million for the smallest producers. He observed that the \$12 million credit would not maintain the current tax rates within Cook Inlet, if that is the intent. Taxes would still reflect price increase, although not as directly as without the credit. The GRE also allows prices to rise with taxes, but it would only occur at the highest prices.

[10:18:37 AM](#)

Representative Holm questioned the difference between the cap amount and no cap amount with the \$12 million credit. Mr. Dickinson explained that the tax does not get added on top of credit. The state would collect less tax with the cap. Representative Holm questioned what rationale dictates treating one area of the state differently from other areas in the state.

[10:20:11 AM](#)

Mr. Dickinson summarized that the Cook Inlet life cycle is more mature than the North Slope. Investments are smaller in magnitude and more conservative. The intent is to arrest the decline. He added that the product is used for industry and consumption in the state and is part of the economic picture of the state. Severance taxes are typically passed on to the consumers. He contrasted Cook Inlet gas with the North Slope and concluded that the North Slope product is shipped out of state.

[10:22:32 AM](#)

Representative Holm questioned if the same argument could be made for oil. He observed that most of the state does not use Cook Inlet gas. He questioned if it is okay to raise the price on oil through the PPT process, which is consumed by other parts of the state. Mr. Dickinson referred to subsection (j). He observed that Cook Inlet oil has not paid any production tax for years and the status quo would be retained. He noted that the cost associated with North Slope barrel and Cook Inlet barrel are approximately the same. The difference is that for Cook Inlet, all the production costs are upstream.

[10:24:41 AM](#)

Representative Holm reiterated his question and noted that, for interior refineries, price is translated back to the state as a fixed price. Cook Inlet oil is the only oil that is tax capped, which would result in better prices in that area. He concluded that if different levels of taxation are implemented it would impact areas of the state differently.

Mr. Dickinson felt that oil contracts do not have a reimbursement severance tax amendment whereas the gas contracts do. The affect of changing the tax rate may not flow through what refineries do.

Co-Chair Chenault interjected that there is a similar problem with North Pole and Nikiski and pointed out that [the price difference] doesn't translate down to the consumer.

[10:27:30 AM](#)

Representative Kelly observed that the original intent was to "cap" the tax. He also noted that revenues to the state would be higher in the GRE scenario. He noted under the current CS, the tax return to the state would be less. He questioned if there is an unintended consequence. Mr. Dickinson explained that the tax credits are the difference. A company has more incentive to invest if they receive a credit and hence a lower tax.

[10:29:33 AM](#)

Mr. Dickinson acknowledged that the tax would be less when investment is up and the tax would be higher without investment. Representative Kelly questioned what the result would be of leaving the ELF in place and capping it in Cook Inlet. Mr. Dickinson stated that there would be a slow decline with credits for exploration. He maintained that the 20 percent incentive should be applied. He further pointed out that the state would still be receiving royalties, property tax, etc.

[10:32:15 AM](#)

Representative Kelly emphasized his concern about providing too much incentive with the possibility of going into a negative tax. Mr. Dickinson reiterated comments regarding the advantages of incenting companies. Representative Kelly commented on the affect on the smaller producer. He thought that the change would involve a discount of \$16 million dollars in addition to credits, providing a greater discount than anticipated.

[10:35:09 AM](#)

Mr. Dickinson emphasized two points:

- The lookback (current CS) only runs through 2020-21.
- Many rules have been created to deal with a small piece of the tax proposal. There are other changes on the North Slope that have much greater effects.

Mr. Dickinson referenced sheet #1, focusing on the Cook Inlet gas. He concluded that the only gross dollar increase to occur would come from increased volumes. This was based on a one year period ending March 31, 2006, including the ELF on property bases, with prevailing value (single value applied to all leases) and a ceiling set on a per unit basis. Credits can be deducted once there is a decision to use PPT or the 11(i) ceiling, however, Cook Inlet taxes can only be taken to zero and can not be sold or transferred to other parts of the state unless the credits would have been available under PPT.

Mr. Dickinson stated that new gas production would be subject to the same test; it would be applied to any new unit setting a cap. Credits generated would be creditable on tax in Cook Inlet only.

Mr. Dickinson stated that Cook Inlet oil would use the same scheme. There has not been a positive ELF for that oil for over a decade. Credits would only be available if previously under the PPT. The credits will adhere to the gas concerns. Oil and gas would be applied against operations.

[10:40 35 AM](#)

Mr. Dickinson concluded his presentation by saying that if the mechanism (provisions in the CS) is in place the GRE is not necessary.

Representative Kelly asked what would happen by removing the cap. Mr. Dickinson responded that page 2, indicates what the taxes would be in Cook Inlet if the credits apply. The current tax is always less than the PPT, without the \$12 million dollar credit current. He explained that with the stand alone \$12 million credit there may be less under PPT than under the current system, at low prices, if enough producers apply the credit. He pointed out that based on profitability, if costs stay the same, there would be higher taxes. At \$8.50 the gas taxes would be \$200 million under PPT; and \$70 million under the current system.

Mr. Dickinson pointed out that it does not include any "kick" from progressivity.

[10:43:16 AM](#)

Representative Kerttula summarized that the tax could not go down to zero, but credits could be rolled forward.

Mr. Mintz agreed with Representative Kerttula's conclusion to the extent that the credits are otherwise allowed to be carried forward, but pointed out that \$12 million credit is not allowed to be carried forward. Representative Kerttula asked if there was any time limit on rolling forward credits. Mr. Mintz affirmed that there is no time limit in general and the Cook Inlet provisions do not add a time limit.

[10:44:31 AM](#)

Representative Kerttula inquired if there had been an analysis of the scenario at Pt. Thompson. Mr. Dickinson ob that it would be a major development costing dollars in the upstream percentages.

Representative Kerttula asked if the level of investment stays the same as last year, what would it would cost the state under the look-back. Mr. Dickinson replied that over that time period, roughly a billion dollars.

Representative Hawker asked if the cost to the state, credits related to expenditures of development with significant increase of taxes paid on existing production. Mr. Dickinson affirmed it would be through the higher tax.

Representative Hawker emphasized that it would be a massive increases in taxes with the proposed legislation.

[10:47:35 AM](#)

Representative Kerttula asked if there have been calculations to see exactly what the gain to the state would be after considering all the credits and deduction. Mr. Dickinson offered to recap previous discussions. He emphasized that at current prices, the gain will be massive; as prices fall there could be a tax decrease.

In answer to a previous question by Representative Meyer, Ms. Wilson addressed total taxes regarding progressivity. She referenced a handout: Source ADOR-Draft, Severance Tax per Barrel with Variations in Tax and Progressive Surcharge Rate (Copy on File). She noted that the numbers on the chart are in a draft. The CS is the yellow line; the red line represents the Senate bill; and the blue line matches the old House bill for progressivity, with a slightly lower

tax rate. At \$70.00 oil the current CS would bring in approximately \$11.00 per barrel total tax; the Senate CS would bring in approximately \$12.00; and the last scenario would bring in \$12.50, which is slightly less than the House version.

Mr. Dickinson suggested that with the current data, under the status quo, the tax would be \$4.90 at \$70 per barrel.

[10:52:42 AM](#)

Co-Chair Chenault stated that the committee would recess to address amendments.

RECESS: [10:53:59 AM](#)

RECONVENE: [5:27:48 PM](#)

Co-Chair Chenault said his intention for the meeting was to discuss Cook Inlet and take up amendments.

Ms. Wilson provided members with a handout: Cook Inlet Gas Credit Usage Examples (copy on file). She itemized examples illustrating use of the base credit. The first example was based on production in the Cook Inlet, with a PPT tax before credits of \$100. The base credit is applied first, is not transferable and cannot be carried forward. From the \$100 tax a base credit tax of \$12 would be removed. The capex tax is assumed at \$110, which is more than the tentative tax, that is why the usable capex credits would be \$88, which brings the tax down to zero. Under example B, the ELF tax before credit would be \$95. The lower of the two would be taken. The tax benefit enjoyed would be \$5. The actual tax calculation would be the lower of, which would be \$95 in this example; apply a base credit of \$12; and then the usable capex credits would be \$83. Tax credits of \$83 would be used, but there would still be a tax credit of \$5. The \$5 is deemed to be used by the credits. The total capex credit used would be the \$83 actually used, plus the \$5 deemed to be used; for a total of \$88. The effect would be a zero net tax. When calculating capex credit usable outside Cook Inlet it would be the \$83 capex credits used plus the difference of \$5 (PPT tax of \$100 and ELF of \$95) would leave \$22 as a carry forward outside Cook Inlet.

[5:33:07 PM](#)

Ms. Wilson referred to example A2, which is an example of a producer who has 50% production in Cook Inlet and 50% on the North Slope. The PPT is the same, but the base credit of \$6 is allocated on the production, which is found on page 5 of the CS, 011 (k). The result would be a capex credit available for use outside of Cook Inlet or as a carry forward of \$16.

Ms. Wilson referred to example B1 when ELF is lower than base credit. The PPT tax before credits is \$38. The ELF tax before credits is \$8. The resulting base credit would be \$6, but only \$5 would be utilized. Capex credit used would be \$2 under example B1. The difference would be the tentative base credit used and the actual credit used. Under these variables and calculations there would be an \$8 capex credit available for use outside Cook Inlet.

[5:38:46 PM](#)

Ms. Wilson provided members with a revised chart 3, which added HCS CS SB 2001 (FIN)(copy on file). The Senate version is the blue line. HCS CSSB 2001 (FIN) would be yellow. The version passed by the House would be red.

Mr. Dickinson provided members with a spreadsheet comparing the Current CS with the versions previously passed by the House and Senate (copy on file). He concluded that the current CS would have an effective tax rate of \$21.75, which is the lowest of the three versions.

[5:42:46 PM](#)

Co-Chair Meyer referred to statements made on the Senate Floor that indicated that the House version would have brought less revenue into the state, but observed that the House version (that passed out) would have brought more revenue than the previous Senate version.

Mr. Dickenson said he was aware of those statements and further noted that he would not be able to back that statement up if asked.

Co-Chair Meyer asked if perhaps that statement were based on a scenario where the price of oil was much less than current prices. Mr. Dickenson noted that the Senate version does have the higher credit rate, which impacts rate. He further commented that ECONONE reported that over a broad price range there was comparability with both bills.

[5:44:57 PM](#)

Co-Chair Chenault MOVED to ADOPT Amendment 1. Co-Chair Meyer OBJECTED for the purpose of discussion.

Mr. Mintz explained amendment 1. He observed that the first two pages restore a provision in the bill, which would determine the amount of production for the base of the progressivity tax. It would establish value based on btu content rather cubic feet measurement. To avoid confusion with "barrel of oil equivalent", the term "btu equivalent barrel" is used.

[5:48:36 PM](#)

Mr. Mintz discussed amendments to pages 5 and 6, which addresses provision regarding the handling of credits and the relationship between tax credits and the tax cap for Cook Inlet oil and gas. The first change is to delete "carry forward to a later period" and insert "use for a different month". In some cases a credit that can not be used in a calendar year may be used for previous months hence the change in wording.

Page 6 line 5 wording is changed to accommodate grammatical correction.

Page 6, lines 5, 7, 8 and 9 are also technical/grammatical changes.

Page 6, line 10, following "levied", "under" is deleted and "by" is inserted. This provides consistency of language use. Page 6, line 15 deletes "the" for consistency.

Page 6, line 19, makes wording changes deleting "carried forward to a later period" and insert "used for a different month" to be consistent with earlier changes.

[5:51:01 PM](#)

Mr. Mintz discussed the changes to page 6, line 19; "and" is deleted and "or" is inserted. The purpose is to clarify that a credit could be transferred, carried forward or used on a different lease of property. A given tax credit can only be used for one thing.

The reference to regulations was deleted. The sentence on page 6, line 23 following "department" deletes "and be consistent with the regulations adopted". The sentence was confusing and unnecessary; page 6, line 24 deletes "under AS 43.55.160 © (4)" for the same purpose.

Page 6, line 31 through pages 7, line 1, deletes all material because over time the concept of barrel of oil equivalent has been expanded to more than one place in the bill ; it was moved to the general definition section of the bill. Page 14, lines 9 - 10 and line 11 deletes all material for the same reasons.

[5:53:36 PM](#)

Mr. Mintz observed that the drafting errors discussed earlier regarding "ordinary" and "necessary" would be addressed on page 22, lines 12 - 14.

Page 23, line 17: this change put a comma back in to correct an error in drafting. Paragraph 16 provides for the department to adopt regulations that explain how costs are allocated between Cook Inlet and the state as well as between oil and gas and leases and properties within the Cook Inlet.

On page 25, lines 2 and 5, "barrel of oil equivalent" is inserted to be consistent with earlier proposed changes. Further changes providing consistency regarding this are on page 25, lines 8 and 9.

Page 25, line 14 is a general exclusion saying that, if discharge is confined to the gravel pad, it is an acceptable exclusion. A question was raised earlier in discussion whether "grave pad" was the correct concept to interpret intent. The amendment proposes to expand the concept to add pad, platform, or other structure. The concept is, if the spill is confined to a manmade structure and does not get out into the environment, then it could be a deductible cost.

[5:57:59 PM](#)

On page 31, line 29 added a new definition for "barrel of oil equivalent" to the list of definitions at the back of the statute.

The rest of the amendment renumbers the definitions currently in place until page 35, which addresses the 10 month transitions provisions issue. The true up would always take place on the last day of the month after the provision has taken place.

[This clarifies that what is paid on the true up date is the amount that is levied under the new tax regime that exceeded the amount that was paid under the transition provision.]

[6:00:03 PM](#)

Representative Kertula referred to the amendment on page 25, line 14. Mr. Mintz clarified that a pad would include a gravel pad. Representative Kerttula questioned if an ice pad would be included and how many barrels would be safe to spill on an ice pad. Ms. Wilson clarified that the North Slope generally uses a gravel pad but during exploration an ice pad is used. (She noted that as far as Department of Environmental Conservation is concerned a spill is a spill).

Representative Kertula asked what is considered to be routine costs. She observed that what is not allowed are the losses or damages that are not confined or exceed routine costs. Mr. Mintz clarified that "routine costs" would only be costs incurred as lease expenditures, which are in the

absence of an oil discharge. He further pointed out that the reason for this language is to avoid the need of excess administrative work regarding employees cleaning up a spill and using it as a deduction. It is an attempt to clarify what should be considered a deductible cost. If a producer has employees that are being paid to do a variety of activities, a small spill would not add to the deductible lease expenditures.

[6:04:51 PM](#)

Representative Kertula questioned why barrels would not be used as a defining measurement for accounting. Ms. Wilson noted that the original language pertained to catastrophic oil spills. There was a concern expressed regarding volume. As a result of discussion regarding that language, the decision to use the current language was reached.

Representative Kertula questioned how much contingency plans cost to develop and maintain. Mr. Dickinson said that there are millions of dollars involved. Representative Kerttula asked if they are tax deductible. Mr. Dickinson observed they would be allowed for corporate income tax. For production tax, those that are upstream would not be deductible. Representative Kertula maintained concerns.

Co-Chair Chenault clarified that the costs discussed are associated with current costs of doing business. Mr. Dickinson agreed that they were associated with transportation costs.

[6:09:05 PM](#)

There being NO OBJECTION, Amendment 1 was adopted.

Representative Kelly MOVED to ADOPT Amendment 2:

Page 4, line 9:  
Delete ".175 percent"  
Insert: ".25 percent"

Page 4, line 16:  
Delete "45"  
Insert "35"

Co-Chair Meyer OBJECTED. Representative Kelly explained the amendment would change both the progressivity rate and the trigger point.

[6:12:53 PM](#)

Representative Holm asked for further discussion, specifically in regards to Mr. Van Meurs' testimony. Mr. Dickinson said Mr. Van Muers' testimony stressed the

insertion point, where progressivity starts. He further noted concerns of the costs of getting heavy oil out of the ground. Given the fact that the amount of heavy oil will increase and with that costs will increase. He felt that \$50 may be misleading and noted that estimations of \$15 to get the oil out of the ground and then added transportation costs. He stressed that there must be room for costs to grow in relations to market value. "If oil from the North Slope is going to be more costly then it is important that progressivity not kick in to soon". Dr. van Muers' memo suggested a progressivity insertion point of \$45.

[6:15:31 PM](#)

Co-Chair Meyer spoke in support of the amendment, but he stressed the need to be competitive. He said he could support the amendment if he could be assured the tax rate would be 20 percent. If the tax rate is higher, then the progressivity would have be lower. He felt it was more important to focus on the tax rate.

Representative Hawker summarized that taxes would be raised on the most productive state industry. He was not convinced that an industry can be taxed into productivity. He stressed the legislation should be viewed individually. He felt that the current bill must be viewed on its own without having it hinge on unknown variables such as a gas line.

[6:19:07 PM](#)

Representative Kertula noted that even with progressivity factored in companies would be making more money. Mr. Dickinson agreed.

Representative Kerttula observed that Daniel Johnston, Legislative Consultant, Daniel Johnston & Co., Inc., said that progressivity could start as high as .375 and companies would still be making money.

Representative Kelly concluded by saying he wants the oil companies to thrive, but maintained that though what passed the House was timid it is well with in reasonable range.

[6:23:32 PM](#)

Co-Chair Meyer did not think what was passed on the House floor was timid. He argued that due to the progressivity piece, the amount coming back to the state would be greater than that proposed in the Senate version. He went on to say, he did not think the CS mirrored the Administration's because the CS has the progressivity piece. In conclusion, he noted that the PPT tax is not the only revenue received from the industry. He observed that the state receives

property tax, corporate income tax, production tax and royalties.

Representative Holm stressed the importance of not hindering the extraction of heavy oil. He noted that the costs for heavy oil are not certain. It is known that as there is a decline the state needs to make sure there are more barrels produced.

[6:27:12 PM](#)

Representative Hawker referred to the comments from Pedro Van Meurs (copy on file) and noted that industry has never been taxed into productivity.

Representative Kelly pointed out that the tax would be on the net. He maintained that the heavy oil situation would not be affected. He spoke in support of the amendment.

[6:29:56 PM](#)

Representative Kerttula pointed out that Dr. Van Meurs' memo recognizes that at high prices the state will not be getting a fair share.

A roll call vote was taken on the motion.

IN FAVOR: Holm, Joule, Kelly, Kerttula, Stoltze  
OPPOSED: Foster, Hawker, Wehyrauch, Meyer, Chenault

Representative Moses was absent from the vote.

[6:31:56 PM](#)

Representative Kelly MOVED to ADOPT Amendment 3. Co-Chair Chenault OBJECTED. Representative Kelly explained that the amendment would allow, but not require the Department of Revenue to issue a cash refund for a transferable tax credit certification held by the Alaska Retirement Management (ARM) Board He noted that legislation enabling the ARM Board to purchase transferable tax credits would be introduced next session.

Representative Hawker observed that there currently is language in the bill providing for cash refunds at 100% (rather than the 92% outlined in the amendment) for the first \$25 million. Representative Kelly explained that credits may exceed that amount.

[6:34:56 PM](#)

Representative Hawker did not agree with the conclusion that all could be put into the package. Representative Kelly noted that the purchase and exchange is only permitted by

the state and the oil companies. The amendment would add the ARM Board. The intent is to be permissible.

Co-Chair Meyer commented on the amendment saying he agreed with the concept, but did not think the amendment was the right approach. He further noted that whatever PPT was, the state would see a large return and he expected some of that would go towards unfunded liability. He said he would vote against the amendment.

A roll call vote was taken on the amendment.

IN FAVOR: Holm, Kelly, Joule, Kertula

AGAINST: Hawker, Stolze, Weyhrauch, Foster, Chenault, Meyer

Representative Moses was absent from the vote.

The MOTION FAILED (4-6).

[6:38:07 PM](#)

Representative Kerttula MOVED to ADOPT Amendment 4. She explained that it would limit the carry forward on tax credits, similar to what is being done with the nontransferable tax credits for small tax companies. She pointed out that the amendment sets a ten year limit, but she is open to changing that if a more reasonable timeframe is thought to be appropriate. She said it is an effort to put a reasonable time limit on how long companies have to use credits.

Ms. Wilson explained that the non-transferable credit sunsets in two years. She questioned if the amendment would limit the carry forward "period" and pointed out that the intent of the credit is to encourage investment. Mr. Dickinson said that a sustained period of low prices could result in the need to prolong the carry forward, and that it would be reasonable to do so.

Representative Kerttula observed that there is no limit on the timeframe of the carry forward. She observed that it could be difficult to determine what the credit is for or where it came from. Mr. Dickinson said that if there is still oil in 50 years, the bill would be successful. There will be a point in time when shut down will occur. He noted that he was not concerned about companies taking advantage of the credit carry forward.

[6:43:00 PM](#)

Representative Kerttula spoke in support of the amendment.

A roll call vote was taken on the motion.

IN FAVOR: Joule, Kerttula  
OPPOSED: Holm, Kelly, Stoltze, Weyhrauch, Foster, Hawker,  
Meyer, Chenault

Representative Moses was absent from the vote.

The MOTION FAILED (2-8).

Representative Joule MOVED to ADOPT Amendment 5.

Representative Joule explained that the amendment deals with how the net profits are determined. It allows the state to require the department to establish regulations for determining the taxable net profit.

LISA WEISSLER, STAFF, REPRESENTATIVE BERKOWITZ, explained that there are certain things that need to be addressed under the net profits tax: allowable costs that can be deducted, the auditing of those costs and enforcement. The amendment deals with the allowable costs. Since 2001, the department is required to give "substantial weight" to industry standards to determine what costs the operators can bill the producers. She elaborated that the term "substantial weight" is not defined and that the regulatory authority for the department appears to be permissive rather than mandatory. The amendment would require the department to adopt regulations to establish a list of allowable costs to determine net profits. It would still use the industry standards and operating agreements for guidance.

She stressed the importance of having a list of allowable costs in regulations. She noted that currently in the contract anything can be an allowable cost that was written into the operating agreements and it is not at the purview of the department.

[6:48:39 PM](#)

Mr. Dickinson stated that, under the contract, costs are divided into three categories. Under a joint venture, if the standards of the state are met, then the state would audit to make sure that any items are disallowed. The state will audit to make sure the costs are correct.

[6:51:19 PM](#)

In response to a question from Representative Kertula, Ms. Wilson said that the wording, "give substantial weight" provides adequate direction to the department as to legislative intent.

Mr. Mintz responded that it is a policy call. He noted concern with the amendment with two different and parallel concepts of what lease expenditures are.

Representative Kerttula said that under the amendment, industry practices can be used but the state is not bound by them.

[6:54:39 PM](#)

Ms. Weissler explained that it is important to make clear in the legislation that the department will be in charge of establishing regulations. She noted that it was not clear in the contract. She further pointed out that the wording in the contract seems to say that the operating agreements between the producers and the operators will determine allowable costs.

Mr. Dickinson stressed that under a joint venture they rely on tension between the parties. The presumption is that a joint venture is organized for the purposes of exploring, producing and developing oil. He further noted that there is much the department can do if the decisions step outside of that purpose. Things can be removed from the joint venture category.

Mr. Dickinson pointed out that the Department passed statutes defining the obligation; developing the regulation would appear in the contract. The rules would be set forth there.

Ms. Weissler pointed to language in the current gas contract and asked if there was anticipation that it would be different. Mr. Dickinson agreed and noted that it reflects the bill presented by the Governor.

[7:00:02 PM](#)

Co-Chair Chenault asked what would happen if the gas line did not pass. Ms. Wilson stated that they were "interested" in getting a good bill that could be administered with or without a contract. She highlighted the rule for allowable costs needing to be "ordinary, necessary or direct" it also addresses a list of things that might be confusing. There is also a list of things that are absolutely not deductible. She maintained that that the format allows for the time when there are unknown expenses, the department must determine if they fall under the description outlined in the bill: "ordinary, necessary or direct". She felt this was clear enough.

She encouraged the committee to retain current language.

Mr. Dickinson stated that without a contract, current law stands. The current proposed law is not dependent in anyway on the contract. The legislation will stand alone.

[7:03:15PM](#)

Representative Joule recollected rumors regarding the gas contract, which was intended to "stand alone".

Representative Kerttula reiterated comments in support of the amendment. Ms. Wilson reiterated that "substantial weight" is used in writing regulations and provides direction. She reiterated the difficulties of attempting to establish a list within regulations of all the allowable costs.

Representative Kerttula stressed that the entire list does not need to be included regarding substantial weight. Ms. Weissler pointed out that there are lists, which include many allowable costs in state and federal law and did not feel it would be an unusual task to take on.

[7:06:22 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Joule, Kerttula, Stoltze,  
OPPOSED: Kelly, Weyhrauch, Foster, Hawker, Holm, Meyer,  
Chenault

Representative Moses was absent from the vote.

The MOTION FAILED (3-7).

Co-Chair Chenault noted that the meeting would reconvene 6/02/06 to further address the bill and amendments.

Co-Chair Meyer asked about Dr. van Meurs participation.

[7:09:03 PM](#)

#

ADJOURNMENT

The meeting was adjourned at 7:08 P.M.