

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 3, 2006
12:37 p.m.

MEMBERS PRESENT

Representative Jay Ramras, Co-Chair
Representative Ralph Samuels, Co-Chair
Representative Jim Elkins
Representative Carl Gatto
Representative Gabrielle LeDoux
Representative Kurt Olson
Representative Paul Seaton
Representative Harry Crawford

MEMBERS ABSENT

Representative Mary Kapsner

OTHER LEGISLATORS PRESENT

Representative Eric Croft
Representative Les Gara
Representative David Guttenberg
Representative Beth Kerttula
Representative Vic Kohring (via teleconference)
Representative Mark Neuman
Representative Norman Rokeberg

COMMITTEE CALENDAR

HOUSE BILL NO. 488

"An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports,

under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 488

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/21/06	(H)	READ THE FIRST TIME - REFERRALS
02/21/06	(H)	RES, FIN
02/22/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/22/06	(H)	Heard & Held
02/22/06	(H)	MINUTE(RES)
02/23/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/23/06	(H)	Heard & Held
02/23/06	(H)	MINUTE(RES)
02/24/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/24/06	(H)	Heard & Held
02/24/06	(H)	MINUTE(RES)
02/25/06	(H)	RES AT 10:00 AM SENATE FINANCE 532
02/25/06	(H)	Joint with Senate Resources
02/27/06	(H)	RES AT 12:30 AM CAPITOL 124
02/27/06	(H)	Heard & Held
02/27/06	(H)	MINUTE(RES)
02/28/06	(H)	RES AT 12:30 AM CAPITOL 124
02/28/06	(H)	Heard & Held
02/28/06	(H)	MINUTE(RES)
03/01/06	(H)	RES AT 12:30 AM CAPITOL 124
03/01/06	(H)	Heard & Held
03/01/06	(H)	MINUTE(RES)
03/02/06	(H)	RES AT 12:00 AM CAPITOL 124
03/02/06	(H)	Heard & Held

03/02/06 (H) MINUTE(RES)
03/03/06 (H) RES AT 12:30 AM CAPITOL 124

WITNESS REGISTER

ROBYNN WILSON, Director
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Presented HB 488.

CHERIE NIENHUIS, Petroleum Economist
Tax Division
Juneau Office
Department of Revenue
Juneau, Alaska
POSITION STATEMENT: Presented HB 488.

DAN DICKINSON, CPA, Consultant
to the Office of the Governor
Anchorage, Alaska
POSITION STATEMENT: Presented HB 488.

ROBERT MINTZ, Assistant Attorney General
Oil, Gas & Mining Section
Department of Law (DOL)
Anchorage, Alaska
POSITION STATEMENT: Presented HB 488.

ACTION NARRATIVE

CO-CHAIR RALPH SAMUELS called the House Resources Standing Committee meeting to order at [12:37:57 PM](#). Representatives Ramras, Samuels, Gatto, LeDoux, Olson, and Seaton were present at the call to order. Representatives Elkins and Crawford arrived as the meeting was in progress. Also in attendance were Representatives Croft, Gara, Guttenberg, Kerttula, Kohring (via teleconference), Neuman, and Rokeberg.

HB 488-OIL AND GAS PRODUCTION TAX

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CO-CHAIR SAMUELS announced that the only order of business would be HOUSE BILL NO. 488, "An Act repealing the oil production tax and gas production tax and providing for a production tax on the

net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

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ROBYNN WILSON, Director, Anchorage Office, Tax Division, Department of Revenue (DOR) introduced speakers.

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CHERIE NIENHUIS, Petroleum Economist, Tax Division, Department of Revenue (DOR), said she was asked to present charts showing the difference between the proposed profit-based petroleum production tax (PPT) for different tax and credit levels with the status quo under different oil prices. She said she used the same assumptions that Roger Marks used in his testimony. She noted that there has been a low-volume scenario, with 5.5 billion barrels [per year] and a high-volume scenario, with about twice as much barrels being produced.

CO-CHAIR SAMUELS asked if her volume scenarios include development of the Arctic National Wildlife Refuge.

MS. NIENHUIS said the high-volume scenario does. She said there is no gas line assumed in these revenues. The numbers are not inflated; they are in today's dollars, and she referred to charts handed to the committee, including documents on the average effective tax rates in these scenarios and cumulative severance tax revenues.

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MS. NIENHUIS said today's PPT charts will compare tax/credit ratios of 25/20, 30/20, and 30/15 at oil prices of \$20, \$40, and \$60 per barrel. She noted that at 25/20 the average annual state revenues are \$80 million less than the status quo and \$20 million more than the proposed 20/20 ratio [in HB 488].

REPRESENTATIVE GARA noted that those numbers are the long-term average, but just for next year the state will receive about \$300 million less than the status quo under HB 488. Under 25/20, the state will receive about \$200 million less than the status quo.

MS. NIENHUIS confirmed that her numbers are averaged out over 24 years. She then showed the outcome for oil at \$40 per barrel under a 25/20 regime. The average annual revenues will be \$565 million more than the status quo, and \$220 million more than under HB 488. She said the severance tax amounts change.

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REPRESENTATIVE GARA clarified that Ms. Nienhuis is reporting additional amount of severance tax the state will raise, but it is before the deduction on the corporate income tax. "I would personally find it most useful to know how much extra state revenue we're going to receive, not how much severance we'll receive before we lose it on the corporate income tax side."

CO-CHAIR SAMUELS asked how much the corporate income tax drops.

MS. WILSON said the net decrease would be about 3 percent, but she has not seen the modeling.

REPRESENTATIVE SEATON asked if that is based on a 9.4 percent corporate tax.

MS. WILSON said it is based on 9.4 percent, but it is also based on a apportionment factor that is taxpayer specific. She said

one company may have a 20 percent apportionment factor and another may have 5 percent.

REPRESENTATIVE ROKEBERG asked, "It is 3 percent of what? The amount of corporate tax dollars or percentage made, or what?"

MS. WILSON said in the fiscal note is production tax only, and if the corporate income tax is factored in, the numbers could change by as much as 3 percent, "or so."

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CO-CHAIR SAMUELS said, "So in the net to the state you could take 3 percent off of these numbers and that incorporates the decrease in the corporate income tax they would pay to the state by writing off this increased tax."

REPRESENTATIVE ROKEBERG asked if the 20/20 scenario for \$40 oil price, shows a \$16 million increase, or what?

MS. NIENHUIS said, "That is the cumulative revenues under the severance tax at the different rates, and what that would be--the \$16 million--would be the amount that is cumulative over the 30 years presented here. So to figure out what that would be different from the other numbers presented here, you just subtract the other numbers from that number. So I don't have the deltas there."

REPRESENTATIVE ROKEBERG asked if it's \$16 billion over 30 years.

MS. NIENHUIS said yes.

REPRESENTATIVE ROKEBERG stated that it is not like a typical fiscal note showing impacts for each year.

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REPRESENTATIVE LEDOUX noted that Ms. Nienhuis is saying 30 years, but the graph is only showing from 2005 to 2030.

MS. NIENHUIS said she meant 24 years, not 30, for the figures she is speaking about and the graph.

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CO-CHAIR SAMUELS said, "Without the gas line scenarios, are you picturing that in 20/30 the [oil] pipeline shuts down?"

MS. NIENHUIS said in the low-volume scenario, the pipeline will shut down at any price. Projections are started in 2007, she clarified, so between then and 2030 is 24 years.

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MS. NIENHUIS said at a 25/20 PPT and a \$60 price, the average annual revenues over the 24-year period would \$1.3 billion more than the status quo and \$400 million more than HB 488. She referred to another page with effective tax rates, which might be more meaningful "than what's up here in total revenue."

REPRESENTATIVE ROKEBERG asked her to explain the effective tax rate.

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MS. NIENHUIS explained that the effective tax rate is "the gross revenues minus the royalties, so in other words, the gross wellhead value. So it's the severance tax as a function of the gross wellhead value." She said, "Under these scenarios, they do vary, but this is the average over the 24 years."

REPRESENTATIVE GARA asked if the effective tax rate is a percentage of profit or a percentage of gross minus transportation costs.

MS. NIENHUIS said the slide is a representation of the severance tax as a percentage of the gross wellhead value. "The amount that we assess at the wellhead minus the royalty."

REPRESENTATIVE GARA said, "On one hand we're considering the percentage of profits in the PPT, but here you're having us consider the percentage of something that's not [indecipherable]. I don't know how to use these numbers."

MS. WILSON said she thinks there was some interest in the effective tax rates. This was done in order to compare the status quo, which is a tax based on gross value, with a system based on net value. She is presenting what this would look like if it was based on gross.

CO-CHAIR SAMUELS said the public thinks the 20 percent tax rate is a wash with the 20 percent credit. He asked to show the effective tax rate. He said he wanted the public to know that the legislature is tripling the tax rate under HB 488's 20/20

ratio with the price of oil at \$60 per barrel. He said it is important to know the overall government take, which he believes is somewhere between five and ten percent. He said "Saying 20/20 didn't mean anything to a lot of the people who testified, which is why we wanted to get the discussion based more around the effective tax rate."

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REPRESENTATIVE ROKEBERG said part of the confusion is the requests for tax rates against the fiscal note that showed dollars. "But this is not that."

CO-CHAIR SAMUELS said he wanted to show what the state is really doing to the industry's tax rate at various price scenarios. He said this is a number that can be compared worldwide.

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CO-CHAIR SAMUELS said the committee has been advised by its consultants, the administration's economists, and the oil companies to look at all the statistics in context.

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MS. NIENHUIS said the next analysis is the 30/20 ratio, and at \$20 per barrel, the two PPT models go to zero rapidly. The average annual revenues are \$55 million less than the status quo, but \$45 million more than HB 488. At \$40, they're spread out a little more; the average annual revenues are \$790 million more than the status quo and \$440 more than HB 488. At \$60 per barrel the differences are \$1.7 billion and \$820 million. The last scenario analyzed is the 30/15 ratio. At \$20 per barrel, it crosses the status quo line with slightly more revenues earlier. It goes to zero at 2019, and overall, it is \$70 million more than HB 488. At \$40, it is a similar trend, but higher. At \$60 per barrel, it produces \$1.8 billion dollars more in revenue than the status quo and \$870 million more than HB 488. She said the last graph shows that the 30/20 and 30/15 are fairly close to each other. Both are above the 25/20, and all are above HB 488 and the status quo.

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CO-CHAIR RAMRAS said "very close" is a dangerous term. It's not an accurate representation, because there is an enormous amount of money at stake. His school district is looking for \$3

million more this year, and the values Ms. Nienhuis is showing are separated by hundreds of millions of dollars per year. He said to be mindful of the enormous amount of money between, for example, 20/20 and 21/20. It is easy to get calloused as if \$50-\$100 million annually is not exceptional, but the legislature gets groups testifying week after week for incremental budget increases.

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REPRESENTATIVE GARA recommended looking at the impact on company profit margins under these various scenarios. The Department of Revenue (DOR) projects that information, and between \$20 and \$60 dollars per barrel, those profit margins are in the 20 to 45 percent range. "Under these scenarios...we're still leaving profit margins of 30/20 in the 30 percent range, roughly across those prices, and upwards of 35 and 40 percent at 20/20." He said he would like that information from the DOR, "so we can figure out the impact on the companies that invest."

REPRESENTATIVE ROKEBERG said using statistics is a deadly game. He said he would like them verified.

REPRESENTATIVE GARA said that is what he is asking for.

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MS. NIENHUIS said she is glad to take on more modeling requests.

CO-CHAIR SAMUELS asked at what high price does the life of the pipeline get extended. At a certain level, the price will dictate the life of the pipeline, he opined.

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MR. DICKINSON, Consultant to the Office of the Governor, said he did not do that modeling. The four scenarios did not try to build in assumptions on behavior. "If, as we approach that date, prices are high, you will see the pipeline will stay open, if they are low, it will close down." He said the figures shown are averages, and "we don't expect it to be that price, and it's very hard to hone in and say 30 years from now we expect it to be at the high end or the low end of this average."

CO-CHAIR RAMRAS noted that the average effective tax rate in the low-volume scenario without the gas line for the status quo at all prices is in the range of 4.1 to 4.4 percent. "Is that

correct?" He said the three major producers believe the current effective rate is 6 percent to 11.2 percent.

MR. DICKINSON said producers have wildly different tax rates on the North Slope. For example, Anadarko Petroleum Corporation only has production in one field and has the highest ELF [economic limit factor]. He said ExxonMobil Corporation has a significant interest in Prudhoe Bay, but only minor interests in other fields. At the other extreme, a corporation like Unocal, before it was merged with Chevron, had an ELF of zero.

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CO-CHAIR SAMUELS said he quoted Mr. Dickinson's severance tax rate of being between 4 and 5 percent. And the big three producers gave rates of between 5 percent and 12 percent.

MR. DICKINSON said he didn't pick up on that point, "but at least one of them was stating what their effective rates that year was." The 4 and 5 percent figures provided by him were from a 20-year average. "You just need to be careful about what the numbers represent."

REPRESENTATIVE ROKEBERG asked if he means 24-year averages.

MS. NIENHUIS explained, "What we're looking at here are projections for 24 years out, as opposed to what you were asking the companies [which was] what they have had historically." She referred to page 17 of the committee packet with effective tax rates on the North Slope by field, which is the ELF rate multiplied by the severance tax rate for fiscal years 1986-2005.

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MR. DICKINSON said those are the individual rates for each year; however, within each year, they are the average for that year. For the Northstar Unit or Alpine that started midway through the year, the first year's effective tax rate is about half of the next year's because of the six months with a zero rate. After aggregation, the numbers might reflect five months at the aggregated rate and seven months at the non-aggregated rate.

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CO-CHAIR SAMUELS said he will try to track down the information from the big three companies.

REPRESENTATIVE ROKEBERG asked for the current snapshot rate for each company.

MR. DICKINSON noted that the division has an internal monthly report, with each field and each company's amalgamated rate, which is confidential.

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MS. WILSON said there was a request to identify the values and amounts for the look back [or claw back] provision per year, and "we've used \$1 billion per year for capital costs for the transition period. So that would total \$5 billion for the companies, and the annual costs are based on historical data." She said she only put public information on her handout.

CO-CHAIR RAMRAS asked for the amount per year. He said if the committee opts to limit that provision, he wants a better sense of what part of that 5 billion will be captured.

MS. WILSON said that in 2001, it was \$1.7 billion, and HB 488 would be looking at half of that year, and then it is averaged at \$1 billion for each of the other years.

CO-CHAIR RAMRAS asked for the information on an annual basis.

MS. WILSON said it is by year. She will also provide a breakdown between exploration costs versus development [costs].

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REPRESENTATIVE ROKEBERG said, "There is a twist in there because it calculates those credits back monthly on a 1/72 basis. If you drag it backwards and you wish to, as a committee for example, and make any kind of adjustment to that, then you have to confront the issue of how much the payback period is. Because this is a five-year look back with a six-year forward."

MS. WILSON referred to a question on how mobilization, demobilization, and abandonment costs are treated. Mobilization costs are capitalized for federal tax purposes as intangible drilling costs and are available both as a deduction under HB 488 and as a capital credit. Demobilization and abandonment expenditures are expensed as incurred, and so they're deductible but are not subject to the credit. She said she does not have any information on quantifying political risks. Moving the effective date from January 1, 2006 to July 1, 2006 decreases

state revenues by \$400 million under the 20/20 scenario, and it would be \$770 million under a 25/20 ratio.

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MS. WILSON said she was asked about private royalties in Section 9, and what amount is involved. She said a very small amount is affected, no more than 1 percent of total state revenue from oil and gas. It is limited to three areas: Alpine and satellites, National Petroleum Reserve-Alaska, and Cook Inlet.

REPRESENTATIVE SEATON asked if the 1 percent includes the total tax or just the severance tax.

MR. DICKINSON said, "The 1 percent was sort of a feeling. I think it's actually quite a bit less than that." There would be no royalties involved, and he supposed there would be a proportional effect on income and property taxes.

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REPRESENTATIVE LEDOUX asked if there is any constitutional problem with moving the effective date back to January 1.

MS. WILSON said no, but taxpayers like to know what their tax is going to be so it is problematic from a policy standpoint.

ROBERT MINTZ, Assistant Attorney General, Oil, Gas & Mining Section, Department of Law (DOL), said courts have been lenient for brief periods of retroactivity, and January 1, 2006 would be considered a brief time frame. Most of the situations where tax dollars were changed retroactively, they have gone back to the beginning of the calendar year. He said he could research attempts to go back two to three years.

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REPRESENTATIVE GATTO asked if the date could go back to the first meeting when negotiations began.

MR. MINTZ said courts have acknowledged the time when affected persons have been on notice of the likelihood of a tax change.

REPRESENTATIVE ROKEBERG asked if compelling state interest is required by the courts for retrospective legislation.

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MR. MINTZ spoke about a retroactive change in the law, which essentially resulted in giving back money that taxpayers had paid. In the bill review, the Attorney General addressed that and indicated that the law was strict in terms of justifying giving back money. He said he is not aware that kind of strictness is applied to other changes in the tax law. In fact, the cases he is familiar with, it is a question of meeting due process, but a relatively brief period of retroactivity need only be justified by rationality.

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CO-CHAIR SAMUELS asked why HB 488 wasn't treated like any piece of legislation that becomes law 15 days after it passes.

MR. DICKINSON said he pleaded with the administration to make the effective date relevant to a quarterly calendar.

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MS. WILSON said she was asked if there was consideration of phasing out the \$73 million deduction over a certain period of time. She said that was not considered. She said the next question asks: Of the current 13 producers in Alaska, which would pay a severance tax after employing the proposed \$73 million standard deduction? She answered that BP, ConocoPhillips Alaska, Inc., and ExxonMobil Corporation will all pay severance taxes at most price levels after using that deduction based on her cost assumptions. She said she believes that Anadarko Petroleum Corporation, Marathon, and Chevron-Unocal will pay severance tax at high oil prices.

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MS. WILSON said question 9 deals with how many private royalty owners are in Alaska, and she does not have that information for non-state lands. She was asked to provide a graph showing the status quo, the PTT, and the gas line contract terms, "and those terms are not public information."

REPRESENTATIVE CROFT surmised that the state knows who the private royalty owners are because there are other taxes that apply to them.

MS. WILSON said producers are liable for the severance tax, so it is a contractual relationship.

MR. DICKINSON said the answer of how much production comes from those can be "nailed down a little easier."

REPRESENTATIVE CROFT stated that the principle private royalty owners are Native corporations.

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MS. WILSON said question 11 "asks for information on the effect of previous incentives—that is the costs--and claimed expenses under SB 185, which is currently in the statute at 43.55.025, totaled \$104.8 million generated credits, claimed credits of \$33.6 million. This answer references a table which will be provided." Those numbers include a recent credit claim.

CO-CHAIR SAMUELS asked if that is exploration only.

MS. WILSON said yes.

CO-CHAIR SAMUELS asked if there are other programs for development credits.

MR. DICKINSON said, "There are several in 38.05 in the royalty where the commissioner can grant certain credits. There is a specific one limited to the Kenai Peninsula, which, a 10 percent income tax credit that is tied to the full range of both exploration, actually successful exploration, development, and production."

CO-CHAIR SAMUELS spoke of concern regarding the state refunding the credits "by the little guys that want to explore because it is possible that the big three may run out of room under your 25 percent cap." The big three would then leverage the price down.

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MR. DICKINSON said there is a fear that the three producers will run out of room to buy the credits. He said he will show at what price there will be enough room to absorb all of the credits and at what price there won't. Currently, the market is not saturated so there are sales in the 90 percent range.

REPRESENTATIVE ROKEBERG said there is a gas infrastructure credit too.

CO-CHAIR SAMUELS asked if there is another layer for gas.

MR. DICKINSON said the credits are for any type of hydrocarbon exploration. The Kenai credit is focused on gas production.

REPRESENTATIVE ROKEBERG said there is one for infrastructure.

MR. DICKINSON said there is one for the Kenai, and the SB 185 credits were extended in the Cook Inlet with less stringent requirements because it has been heavily explored.

REPRESENTATIVE ROKEBERG said that at various times there have been special exceptions for the Cook Inlet region. In the use of royalty reductions, "they've actually specified particular pools of oil and gas that may be available, I think specifically oil, were they to be explored, they would be limited to a 5 percent royalty vis-à-vis a 12.5 percent, or whatever the standard royalty rate was in the existing leases."

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MS. WILSON referred to question 12, which asks the rationale for offering the same amount of credits for non-state lease lands where the state receives no royalty tax benefits, and if there was discussion of a reduction in the credit to offset this. She answered that incentives have the potential to increase severance taxes that are assessed on any oil and gas production within Alaska. Given the overall economic benefit of increased production, especially in Cook Inlet with lots of private land, even paying no taxes makes sense, she opined. She was also asked why Point Thomson should be incentivized, and she believes that the development of Pt. Thomson may be critical for the development of the gas line, "and, accordingly, incentivizing Pt. Thompson may well incentivize the gas line." She stated that Pt. Thompson is particularly problematic because it is a high-cost field, and "we do need the gas reserves to underpin the gas pipeline economics." She added that incentives may encourage the early production of the liquids that require expensive infrastructure.

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MS. WILSON was asked for better definitions for "point of production," "oil", and "gas" and if the state has litigated these terms. She said the question is unclear and she will be happy to work on the clarity of the definitions in the bill. Regarding past litigation, the point of production and the definitions of oil and gas have not been a major focus of

litigation; however, there has been considerable litigation of related concepts. "In the tax context, there was at least one dispute, which was decided at the internal Department of Revenue appeal stage, which related to point of production, but most of the controversy in this area is about the regulations defining gas processing plant rather than litigation. The use of the term 'gas processing' in the bill is consistent with existing department regulations, but under current law, gas processing generally is considered an activity occurring downstream of the point of production, while under the bill it is considered an activity occurring upstream."

CO-CHAIR SAMUELS surmised that changing it will allow the tax credit on the gas processing, "which allows the small players to not be beholden to the big three to use their plants."

MR. DICKINSON said he thinks that's correct, as Dr. Van Meurs indicated. Access to facilities is a complaint that he has heard frequently from those who try to develop pools outside of the main pool. The change may lead to the construction of other facilities or to negotiation leverage.

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CO-CHAIR SAMUELS asked about any unintended consequences or tradeoffs. "What about any associated feeder lines?"

MR. DICKINSON said the notion of including the pipeline is a little less problematic because most of these lines on the North Slope are publicly regulated, "and so folks will have access to them." "If I go out and develop a new field some place, I'll have to build a pipeline to the nearest place I can hook into. But where I do some of my gas processing is a choice."

ROB MINTZ said, "The philosophy in drafting this bill is, with regard to the current production tax statute, if it ain't broke, let's not fix it." He tried to preserve as much of the existing law as possible and supplement it with changes bringing the calculation of value upstream to be net value rather than gross value. "I would say there's not any particular downsides that we've identified to making these changes in the definition." He said there always could be unintended consequences.

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MS. WILSON said that question 15 asks what steps must be taken to make the tax credits refundable rather than transferable.

She said Section 12 would need to be changed, and she referred the committee to 43.55.024(d) and (e). Question 16 asks, on page 13, line 24, of the bill, what "payment in lieu of" ties into for oil. She said that phrase is about property taxes. She said Sec. 43.55.160(c) presents the general rule that lease expenditures are deductible, which would include property taxes. She noted that (d) simply clarifies those items that might be questionable, such as a payments in lieu of property taxes rather than straight property tax. Question 17 asks about the limit on transferable tax credits in Section 12, limiting the amount of tax credits that a single taxpayer can take against its own production tax in a single year. "I believe this was a question raised on that 20 percent limit, and I would just like to clarify that Section 12, that is Sec. 43.55.024(e), limits the amount of tax that can be reduced through purchased credits. There is no limit on the credit used when a taxpayer generates their own credit."

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MS. WILSON said question 18 is: The State of Alaska had relied on the services and expertise of multiple outside law firms to handle disputes over oil and gas issues; have you conferred with such counsel in the drafting or review of this legislation? If so, have they assessed the impacts of legislation on the state's legal position in past agreements, current disputes, or future disputes? She said yes; they have been consulted but discussions have not generated a formal document.

REPRESENTATIVE LEDOUX asked if there has been agreement.

MR. MINTZ said, as he looks through the bill, "the only significant change to the current law, other than the additional provisions that deal with net value, would be the changes in the definition that we were just alluding to." That would be the focus of future potential disputes, he said. "No, we didn't have any significant disagreement as to whether these changes would cause problems or what the impact would be."

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MS. WILSON said question 19 is: Have you asked the Department of Law to review this legislation in light of the 6th Circuit Court of Appeals' decision in Cuno v. DaimlerChrysler that is now pending before the Alaska State Supreme Court?

CO-CHAIR SAMUELS said it was in the United States Supreme Court.

MS. WILSON said the Cuno case is about the constitutionality of special tax credits. She said the Department of Law has examined the question and has noted it doesn't have any direct precedence for Alaska. Many analysts believe it won't be sustained in its current form, she stated.

REPRESENTATIVE ROKEBERG said legislation may be pending.

MS. WILSON said she was asked to provide information regarding the expenditures that will qualify for the transition credits--including the depreciation method chosen under the federal and state income tax systems. The expenditures that qualify are the same as those that qualify for capital credit, she answered. The expenditures include exploration costs and those that are capitalized for federal income tax purposes, including intangible drilling costs. Exploration expenses include geological and geophysical exploration. She referred to question 59. There are certain federal rules and lives, and Alaska lives are longer, she said.

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MS. WILSON said question 21 is: Have any of the definitions in sections 30-33 been the subject of disputes with tax and/or royalty payers in the past? To the extent they have, please provide the definitions the state asserted in those disputes. She will clarify that [later]. Question 22: Please provide an identification of the point of production at each unit in the state under existing statutes, regulations, agreements, and court decisions, and: Provide the same under the definition as proposed. She said that will be forthcoming. Question 24 asks what standard will be used to determine whether oil or gas is of 'pipeline quality' under the definition of 'gross value at the point of production.' She said this term only applies in the definition of oil; it was not in the old or new definition of gas. Current statute defines it as good and merchantable condition, and it is not changed by the bill.

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MS. WILSON said the answer to question 25 on a historical analysis of the results of the evaluation methodologies adopted by the Department of Revenue under all agreements will be provided. Question 26: Will abandonment costs be eligible for deductions or credits under the legislation? If so, what estimates of the timing and costs of those activities does the

Department project? She said she doesn't have any information of a field actually having been technically abandoned in Alaska. Question 27: How will AS 43.55.160(j) protect the state from a proliferation of corporate entities claiming the tax-free allowance? She said that will be provided later. Question 28 asks for the number of exploration and delineation wells estimated to be drilled over the first ten years of your economic models, and include the technical and economic success rates projected in this modeling. "We do not include a success rate in our model, but we show five exploration wells per year included in the model." The DOR assumes \$100 million is spent on exploration per year with an average cost of \$20 million per well. She said delineation wells are different and are included under development expenditures. She said, "The model assumes that four finds of large oil accumulations, reserves in place that would be on the order of 500 million barrels. There are four relatively small fields that are characterized as being heavy oil, and these fields would pay no production tax under the current system because their ELF would be zero."

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MS. WILSON said question 29 asks for estimates for undiscovered resources in Alaska, and the breakdown between technically recoverable and economically recoverable resources to the extent possible. She said DNR will provide that. Question 30: Provide a historical analysis of the effective tax rate on each field in production on the North Slope over the past twenty years. She said to look at attachments a1 and a2. Those tax rates vary from 15 percent for Prudhoe Bay to zero for a number of the fields. Question 31: How will the net profit share leases be affected by this legislation, and will the gross costs of exploration and development go into the development account--or those costs net of the credits and deductions? She said that information will be provided. Question 32: It's been reported that the gas line contract will propose the state take its gas production tax share in the form of gas, and how does that work in this bill? She said the state proposes, in the gas line contract, taking deliveries of gas in place of a production tax, and is not reflected in HB 488. If the producers sell gas, those revenues would be part of the net profit calculation, she noted, and under the gas line they would not. The state would receive a percentage of the gas and monetize it through marketing. "Note that the costs of developing, for example Pt. Thompson, or running, for example Prudhoe Bay, a field that produces both oil and gas would go into calculating the oil profits for the PPT."

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MS. WILSON said that question 33 asks what the cost to the state will be for legacy fields and frontier regimes from the claw back provision. She said, "This references item 20."

REPRESENTATIVE ROKEBERG asked about question 32, where the costs of developing Pt. Thomson and Prudhoe Bay, fields that produce both oil and gas, would be calculated for the purposes of the PPT. "Is that one of the primary reasons why we've come up with a single definition of production tax for both gas and oil, so they're consistent, so they could be applied to these large reservoirs of gas and oil that we have and we'll be producing together?"

MS. WILSON said one of the key reasons why they're combined is because costs are incurred "to pull both oil and gas out of the ground at the same time. So a real issue, if you have separate tax schemes for oil and gas, then, how do you allocate that piece of equipment? There are some real cost accounting problems with that."

MR. DICKINSON said, "The incentive here is that we are examining these upstream costs and if there is gas line development, for example, which includes Pt. Thompson, then this would, in fact, be an incentive available to encourage that. If Pt. Thompson doesn't go forward, then there would be very little gas development. I think Prudhoe Bay...except for the presence of extra CO2 and H2S, is, basically...8.5 billion cubic feet a day are already compressed a couple hundred yards from where the GTP would be, but instead of going to a sales line, that's nonexistent, they simple go back down in the ground."

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MS. WILSON said question 34 asks of the claw back provision, how many investment credits were sold under SB 185, and how do we ensure the person who holds the credit, not the original recipient, gets the credit? She answered that sales of credit under SB 185 do not affect the ability of the seller to claim those credits as transitional investment expenditures.

REPRESENTATIVE ROKEBERG said he is trying to absorb the answer to question 34. He asked if "there could a credit available under SB 185 provisions that can also be claimed as a TIE

[transitional investment expenditure], or does that mean they could be counted doubly?"

MR. DICKINSON said that is correct; the TIE is a deduction, and an investment made during that five-year look-back doesn't qualify for an additional credit, but it still might qualify for the existing credits under SB 185. "We really view the TIE as investments that you make and you then recoup them or...they show up in the calculation of your deduction of your profits, but they're not an additional credit."

CO-CHAIR SAMUELS said, "Do you get it twice; yes or no?"

MS. WILSON said, "Just as with new assets that would enjoy both a deduction and a credit, and in fact what you've identified is that potentially applicable assets that were purchased during the transition period would similarly have the potential of having received a credit under SB 185, and then would be subject to the transition deduction. So it would be treating those assets the same—the old assets as the new assets."

REPRESENTATIVE ROKEBERG said, "So the answer to the question is yes." He then asked about exploration licensing, which is a credit against future production. He asked about any other kinds of credits that could be applied that would provide dual credit under a current credit program.

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MR. DICKINSON said the 10 percent credit for certain investments in Kenai gas facilities would also get both a deduction and credit. He will think about the exploration license.

REPRESENTATIVE ROKEBERG asked if those are only used against future revenues.

MR. DICKINSON said, "My understanding of the exploration license is that the licensee makes a commitment. Instead of bidding on a lease, they make a commitment to spend a certain amount. If specifically excluded, those amounts, we view that simply as a lease acquisition cost, and even though the activity may look like something that gets the treatment under here as a credit, for example, it is excluded, specifically." He said he believes that he also made that exclusion for the exploration credits, but he will try to answer that later.

REPRESENTATIVE ROKEBERG said that seems to be inconsistent with Mr. Dickinson's previous testimony. "You could still have expenditures under your agreement under the license, but then it would seem to me, unless they're specifically restricted by this bill, they wouldn't apply for, let's say, tax loss credits and/or any other tax credits that would allowed under the PPT."

MR. DICKINSON said, "We specifically carve those out as not qualifying."

REPRESENTATIVE ROKEBERG said that is not consistent with the SB 185 credits.

MR. DICKINSON said he will check that out.

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MS. WILSON said question 35 asks: If we have a gas pipeline in 2015, what will the ELF tax "take" be on the North Slope gas, and what will it be under the PPT? What will the take be under PPT if we take gas in lieu of the production tax? She said the take would be the day-to-day value of the gas, less the state's cut in selling the gas on the marketplace. She said, "The upstream costs are covered in the PPT, so the difference could be as simple as, under the PPT a taxpayer would pay 20 percent of the gross value at the point of production, that is sales revenue less the tariff charged by the gas treatment plant, and the tariff between the North Slope and the point of sale would be paid to the state. And that's without taking into account the effect of the \$73 million allowance, or be, under the gas contract, the state will receive some percentage of the gas and then pay the tariff charged by the gas treatment plant and the tariff between the North Slope and the point of sale. If the state owns part of the pipeline, then the state will also receive that portion of the tariff, which is profit accruing to the owner."

MS. WILSON said question 36 is: Is current production tax deductible from corporate tax? If no, is this impact in the model presented by the administration. She answered yes; current production is deductible from corporate income tax for federal and state purposes.

MS. WILSON said Question 37 is: Referring to Section 5, what oil and gas is exempt from taxation--just what is discussed in Section 10? She said those are two separate topics. "The oil and gas royalty amounts paid to federal and state governments

are exempt. They don't even go into the initial calculation of the gross amount." She said current statutory language clarifies "ownership or right to which is exempt from taxation" means any ownership interest of the federal government or the state. "That doesn't change under this bill." She said Section 10 simplifies the treatment of flared gas. Under current law there are three categories of gas: gas used in production operations which is exempt from tax; gas produced in excess of that needed for safety purposes, which is taxable; and gas flare beyond the amount authorized for safety, which is taxed and subject to a penalty. She said that there is no free use of oil and she wonders if that should say free use of gas to produce more oil in statute. "The bill exempts from tax any oil or gas used in production operations unless the Alaska Oil and Gas Conservation Commission determines that it was waste, in which case it is taxed--but no penalty."

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MS. WILSON said question 38 is: Referring to Section 6, will there be any impact to current state taxes or municipal taxes from this change? "No, there should be no impact." She said it is just cleanup language. Question 39 is: Why was the payment for taxes and surcharges changed from the 20th day to the last day of the month, and what is the economic impact of this change? She said it is simply a cleanup provision that does not impact the PPT. Question 40: Do other nations with a net profit system have the 90 percent payment of taxes with the true-up provision the following year? And what is the economic impact of this change? She said Pedro van Meurs will answer that. Question 41: What are the penalties for underpayment when true-up is more than 10 percent of the taxes owed? She answered that there will be interest accruing on the difference between what the taxpayer paid and the 90 percent. "So if the taxpayer paid 75 percent, then interest would accrue on the difference between 75 and 90."

REPRESENTATIVE GATTO said the IRS usually charges interest and penalties.

MS. WILSON said, "In effect, what that estimated tax penalty is, is interest. It is labeled a penalty, but the function of that penalty is for the federal government to collect interest on money that they should have gotten."

CO-CHAIR SAMUELS asked what interest rate is charged.

MS. WILSON said that is in statute at 11 percent.

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MR. MINTZ said the interest is automatically assessed on an underpayment. There is also the potential for additional penalties under the revenue law; however, that depends on the reasons for the underpayment. If the underpayment is in good faith and there is a reasonable basis for it, then there would not be a penalty. But if there was intent to underpay, it could trigger penalties in addition to the interest.

REPRESENTATIVE SEATON said he is hearing that interest is assessed or not assessed. Which is it?

MR. MINTZ said, "What you owe is 90 percent of the tax at the end of the next month. And so, if you pay 90 percent, then you pay what you owe and there is no interest and there's no penalty. The interest would be triggered if there's an underpayment, which is to say less than 90 percent."

REPRESENTATIVE LEDOUX asked why would anybody pay 100 percent?

MR. DICKINSON said it is difficult to know the exact tax owed every month, "so I don't think people will target the absolute lowest number. What they will target is the number that they are safe, that they think will not get them their interest and, depending on the complexity of a taxpayer's business, they will build a lessor or smaller margin into that."

REPRESENTATIVE SEATON said if companies are willing to buy tax credits at a discounted rate of 90 or 95 percent, why would they not target the 90 percent amount?

DICKINSON said the companies will spend a good deal of time to make sure they will pay the smallest amount.

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REPRESENTATIVE KOHRING referred to question 40, which he believes should be the "centerpiece of our entire analysis and review of this legislation. And, that is, what is the economic impact of increasing taxes?" He said the legislature needs to evaluate its goal. Is it to "get a short-term chunk of money or is our goal to help the industry as a whole in the long-term?" He said he is really concerned about this legislation and said

that a tax increase is going to hurt the state, and he wants an expedited analysis of that.

MR. DICKINSON said question 40 is only focused on a narrow issue. He said there is no intent by the governor to drive the industry away, and he believes the PPT will benefit both the state and the industry. He clarified that the higher tax rate will only occur when companies are profitable. When the industry is not profitable, "the state will not be taxing them."

REPRESENTATIVE KOHRING said he is not convinced that a substantial tax increase is going to help, and he said that he has never seen a tax increase help any economy.

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MS. WILSON said question 42 is: Referring to Section 10, why does the Alaska Oil and Gas Conservation Commission (AOGCC) role change from focusing on excess [flared gas] needed for safety reasons to whatever they determine to be waste, and does this provision provide more power to the AOGCC on what is included or excluded for taxation? She said the categories for flared gas are different under the Department of Revenue than the AOGCC. The bill would simplify the categorization and harmonize it completely with AOGCC, so the state is moving from two standards administered by two agencies to one standard under one agency. She went on to question 43: Why does it seem that the credits and incentive are on production along with exploration, if our focus is to provide incentives for exploration? She said the bill is based on the expectation that exploration and existing field investments will increase.

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MS. WILSON said question 44 is: Can the carry-forward amount be used for a credit for more than the first year after the loss? She said they can be used indefinitely. Question 45: Is it the case that any allowable expenses for the exploration, development, or production of gas can be deducted from oil revenues in determining net value, and if so, could the expenses of a gas line be included in these deductible expenses?

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REPRESENTATIVE GATTO asked if carry-forwards can be changed legislatively with regard to their value.

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MS. WILSON said it is within the purview of the legislature to change it, but credits are dollar for dollar. A credit carry-forward does not carry a time limit, but it could be changed by another legislature.

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REPRESENTATIVE GATTO asked if the credits that are already issued are locked in, even if the legislature eliminated the program.

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MR. MINTZ said he is not sure, but courts have said taxpayers do not have vested rights in the current tax system, which is one reason why there is some leniency in making retroactive changes to taxes, but whether that would extend to someone who has already purchased a certificate, "I can't say at the moment."

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CO-CHAIR SAMUELS said someone purchasing a credit will use it immediately.

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MR. DICKINSON said the market could be saturated. He gave an example of a company going out of business and selling credits at basement prices, and in that case the purchasers may hold on to the credits for several years.

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REPRESENTATIVE GATTO said that if the incentive is designed to get people to "act on them, maybe the incentives ought to have a declining value."

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CO-CHAIR SAMUELS said one idea is for the state to give a 100 percent refund without the 10 percent leakage caused by selling the credit to ExxonMobil Corporation and requiring the money to be used for a lease purchase or another capital outlay.

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MS. WILSON said, "What we are trying to incentivize are the expenditures, the investment in the exploration and in the existing fields." Once that money is spent, a credit is generated, and the state shouldn't really care when it's used.

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MS. WILSON answered question 45. Expenses are allowable only if they are upstream costs, she said. A gas line is a downstream cost, and gathering lines are upstream costs.

MS. WILSON said question 46 is: Why not use GAP [general accounting principles] versus setting up our system of defining revenues and expenses? She said GAP is useful for determining if an expenditure qualifies to be an expense, but it doesn't differentiate between expenses that are applicable directly to a lease or items of expense that are indirect. For example, GAP does not distinguish between wages paid to a lease-based worker compared to an employee in the home office, she noted.

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MS. WILSON said question 47 is: Which credits can be applied to multiply years? She said there is no time limit for credit carry-forwards nor the optional credit in 43.55.025. A dollar spent can only generate one credit, and that credit can only be used one time, she stated.

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MS. WILSON said question 48 is: Can a tax credit be sold in any year or just after the year it's accrued? She said that once the credit has been turned into a certificate, it can be sold at any time. A person can apply for the certificate at any time.

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REPRESENTATIVE ROKEBERG asked if there will be a registry or paper trail for credit certificates.

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MR. DICKENSON said the state keeps a registry.

REPRESENTATIVE ROKEBERG said, "Under [SB] 185 you can get all the applications for those credits in a Volkswagen." He hopes there will be more under HB 488.

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REPRESENTATIVE ROKEBERG said there should be a consent provision in an assignment of a right, which is common in legal documents.

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MR. DICKENSON said page 7-g clarifies that DOR may adopt regulations for recording and for certification procedures for verifying the accuracy of credits claimed. On the specific legal point, it would be good to know where they are going. "We have certainly helped ensure those transactions occur."

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MR. MINTZ said the department currently has detailed regulations to address this kind of issue.

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MS. WILSON said question 49 is: What is the estimated economic impact to the state of the ability to sell tax credits? She said that will be provided.

MS. WILSON said question 50 is: Referring to Section 16, what is the current system, and why do we need this change in confidentiality? She said this section is specific to the production tax and is in addition to the current general confidentiality statute. She said Mr. Dickinson has covered it.

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MS. WILSON said question 51 is: In what circumstances would oil and gas taxes go straight into the Constitutional Budget Reserve fund (CBR)? She said any taxes collected in the resolution of a dispute would go to the CBR.

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CO-CHAIR SAMUELS asked about a settlement the state loses.

MR. DICKERSON said that when that happened before, it came out of the general fund.

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REPRESENTATIVE ROKEBERG said this could be significant. He suggested there would be more dispute in interpreting the PPT, putting a significant amount of money in play. He thinks there could be "quite a bit of money here that we'd miss out on."

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MR. DICKERSON said he thinks the constitutional language is one thing, and a certain lawsuit "really sets up the guidance that we use to figure out whether we have a resolution of a-whether it qualifies or not." Optimistically he said he is hoping the bill is clarifying a number of things, and the amount of conflicts will be limited, but rationally, envisions disputes lasting for many years with money going into the CBR. He said most of it will revolve around whether something qualifies as a lease expenditure or not. He said tens of millions of dollars could escape from the general fund into the CBR.

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MR. MINTZ said money going into the budget reserve fund is money the state receives as a result of a termination of an administrative proceeding; refunds would be from tax payments.

REPRESENTATIVE ROKEBERG requested that the department take a little closer look at this issue to quantify it.

[2:53:29 PM](#)

MS. WILSON said she would hope that the bill language is tight enough and taxpayers are careful enough that those disputes are minimized. She said question 52 is: Referring to Section 18 and 19, why change from "shall" to "is"? She said that was changed in accordance with the state style manual. Question 53: Why does the bill offer multiple methods to determine gross value, and who will choose a methodology? She answered that the bill does not directly allow a taxpayer to elect alternative methods, it just allows the department to authorize use of such. Question 54: Referring to Section 21, page 1, line 8, why is this clause constrained by December 1, 2005?

REPRESENTATIVE LEDOUX said regarding question 53, is it correct that if the department doesn't authorize an alternative method, the "usual" method will be used.

MS. WILSON said yes; the basic rules are still in place.

REPRESENTATIVE LEDOUX asked if the methodology is completely up to the department.

MS. WILSON said that is her understanding.

MR. MINTZ said that is absolutely correct.

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MS. WILSON said question 55 refers to Section 21 (h), and asks which consumer price index the administration will use. She said those have not been evaluated.

REPRESENTATIVE ROKEBERG said the legislature could adopt the U.S. city average consumer index and provide for an alternative in case there was a revision of that index. He said he has dealt with that index for 30 years, and he would rather use that instead of get in the debate about the Anchorage index, which would be inappropriate for this issue.

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MS. WILSON said question 56 is: Are the current oil conservation surcharges deductible from any other taxation? If no, what is the policy reason to make them a credit in SB 305 and what is the economic impact? The answer she gave is that yes, currently those surcharges are deductible from state and federal corporate income tax.

REPRESENTATIVE SEATON asked for the logic of that. He said the general fund will make all of the surcharge payments, because the production tax comes into the fund. "We're saying they can take a dollar-for-dollar credit against the general fund money they're going to deposit for the hazard mitigation money. So aren't we really saying we should just eliminate the credit, because it's all going to come out of the general fund anyway, if we do this as a credit?"

MR. DICKINSON said the focus was on trying to have a single point of taxation, which was the profitability. "For a while we were looking at a minimum tax...and we didn't want to tamper with, or mess with, the payments that were being made into the fund." Representative Seaton is correct, but "what we're trying to do is look at profitability, and that's what we tax."

REPRESENTATIVE SEATON said, "What we're doing is we're eliminating the hazard mitigation fund from anything other than the general fund." There is no use having a surcharge and then offering to pay for it. "We can make those direct deposits if we're going to do that." He doesn't look favorably at it.

MR. DICKINSON said these credits cannot be sold or carried forward. The payments need to be made every month, "so, in effect, on a smaller producer, in fact, is a real charge. It is a minimum tax and those payments are differentiated from...the, particularly if they're not making any payments of the general tax, these would still be there."

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REPRESENTATIVE ROKEBERG said he shares Representative Seaton's concern. The original surcharge was on a per-barrel basis. An oil spill doesn't differentiate between a large and small company. He questioned getting rid of a 3 to 5-cent surcharge and default it into the general fund, which creates a bigger fiscal gap.

MR. DICKINSON said, mathematically, that is correct. "We're not removing it. The funds will still be paid to those mitigation accounts without interruption or alteration." When the state is taxing profits and there is several hundred million dollars, this would not be an increment on top of it, he stated.

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MS. WILSON said question 57 is: Do any other state taxes have a standard deduction? She said four do: seafood marketing assessment, mining license, gaming tax, and Alaska's estate tax. She said two of those exemptions do not impose a tax if the taxable amount is at a low level but kicks in at a set amount. Question 58: How many net profit share Leases (NPSL) are in the state, and how much are they paying royalties? She said out of 19 NPSLs, 7 are paying net profit share payments in addition to royalties, and the total received in calendar year 2005 was \$81 million. The total NPSL receipts from 2001-2005 were \$254 million. She referred to attachment B.

REPRESENTATIVE ROKEBERG asked if the NPSLs are paying all of the other taxes and another charge on top of the royalty.

MR. DICKINSON said this is an additional element, and when the leases are put out for bid, the NPS is the bid variable. "The highest net profit share is the bidder that takes the lease."

REPRESENTATIVE ROKEBERG asked if they are paying all of the five elements required plus "a different element on top of even a stipulated royalty within that bonus bid application."

MR. DICKINSON said that is correct.

CO-CHAIR SAMUELS said, "So at Duck Island, if the 488 passes here, the royalty rate's at 20, and the net profit share rate is 80, and we're going to take 20 of the remaining 20. Because total cost recovery has already been achieved. Is that true?"

[3:07:31 PM](#)

MR. DICKINSON said the severance tax is calculated first; that would go into the account for calculating net profit share, and then the state would take the net profit share. The 79 percent would be what's left over after paying a PPT, he stated.

CO-CHAIR SAMUELS said, "So 80 percent of the 80 percent."

CO-CHAIR SAMUELS asked if corporate income tax comes last.

MR. DICKINSON said, "It is my belief that corporate income tax is not an element for the NPSL, so that would come last."

CO-CHAIR SAMUELS asked who operates Duck Island.

MR. DICKINSON said it's called "Endicott" and is operated by BP.

REPRESENTATIVE ROKEBERG said one of the major issues in his career as a legislator is the royalty relief or net profit share relief on the Northstar prospect. Because of very high percentages, the legislature agreed to lower it significantly, and it did allow that project to go forward until it ran into a lawsuit from a former member. "Those types of leases had stifled development and investment in the Alaska petroleum industry." He said there was a period of euphoria, which is similar to today, where everybody thought the price of oil was going to go over \$100 per barrel.

[3:09:53 PM](#)

MR. DICKINSON said he believes there was a lease there where the NPSL was above 90 percent.

REPRESENTATIVE ROKEBERG said that was a Northstar lease.

[3:10:18 PM](#)

MS. WILSON said question 59 has been discussed. Question 60: Produce a tax calculation under the bill, with the following assumptions: gross value of \$60 million; operating expenses of \$15 million; capitalized expenditures of \$10 million. She said it comes to a net taxable income of zero. This calculation assumes that the taxpayer has not reached the \$73 million limit for the standard deduction. Question 61: Are net profit lease payments included as a direct cost under 43.55.160? She said net profit share payments under NPSLs would not be deductible lease expenditures because they are in the nature of lease acquisition costs.

REPRESENTATIVE SEATON asked if NPSLs are currently deductible because the production tax is calculated first, and under the PPT it will be calculated last.

MR. DICKINSON said the PPT will not have an effect on the calculation made for the NPSL. The order of the calculations will not change the consequence of this bill, he stated.

MS. WILSON said the production tax is a deduction for the NPSL.

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MS. WILSON said question 63 is: How are payments for "spec 3D" handled? Are they credit eligible under 43.55.024 or only allowed as a deduction under 43.55.160? She said "spec 3d" are certain seismic costs, which are allowed as deductions under section 21, and they are also eligible for credits under section 12. Question 64: Please explain the taxation or exemption of royalties. She said public royalties paid to the state or federal government never enter into the base calculation of gross value because of the way current statute works. She referred to AS 43.55.011(a), which levies the tax on oil, except that which is exempt, which is defined in AS 43.55.900(13). Regarding deductions, because the bill changes the tax to a tax on net profits, it's necessary to address deductions, she stated. Public royalties are not in the starting number so they cannot be deducted. Private royalties are not exempt in line 1 so they are not deductible. Question 65: Under Section 21 (Sec.

43.55.160(d)), where it says, "direct costs... include...", does the word "include" serve to restrict the list of allowable expenses to only those items included below in (A)-(C). She said subsection (c) provides the general rule that lease costs are deductible, and (d) only addresses questionable items. It is merely a clarification.

[3:17:08 PM](#)

REPRESENTATIVE ROKEBERG asked for [an analysis of tax/credit ratios of] 25/25, 15/20 and 15/25.

[3:18:43 PM](#)

CO-CHAIR SAMUELS pointed out that the discussions are in increments of 5 percentage points. He asked if 22.5 percent, for example, would be on a straight line across the models.

MS. NIENHUIS said she would have to look at the effective tax rate separately.

REPRESENTATIVE OLSON asked for a analysis of 22.5/22.5.

REPRESENTATIVE ROKEBERG asked for a 1 percent increment. He said the graphs are hard to understand in terms of dollars.

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REPRESENTATIVE ROKEBERG said for example, "You have 20/20 at 2010, at \$20/\$40/\$60 per barrel. What's the number? We're not going to make decisions off a graphic chart." He asked the difference between 21 percent and 26 percent, for example.

MS. NIENHUIS said she will provide it.

[3:23:16 PM](#)

CO-CHAIR SAMUELS said it doesn't hurt to see things in a different way.

REPRESENTATIVE ROKEBERG said it would be a lot easier if he had a spreadsheet to compare different prices at different percentages, including how to account for the tax credits—to say nothing for the claw backs and other aspects of the bill.

MR. DICKINSON said he can provide the spreadsheets that back up the graphs. He said he could also do an iso-revenue graph with

tax rate on the x axis and credit rate on the y axis for a given set of assumptions, like volume and price, and then show what combinations of a tax rate and credit rate bring in the same amount of revenue.

REPRESENTATIVE ROKEBERG said, "The expression of the dollar amounts, like in a spreadsheet, are very valuable. But what you run into, if you use that only, is you have, like this crossover point you can take from this model for FY07 price-sensitivity, and it shows somewhere between \$24 and \$25 per barrel, where the state take equates with the company take." He said it doesn't show what the downside is, "so you need to make sure you're following that there's a continuum on the up or downside to see where the revenue growth is. So you've got to look at them together."

[3:26:03 PM](#)

MR. DICKINSON said, "The more we generate, the more you need to keep in front of you", and each one is an abstraction from one point of view.

MR. NIENHUIS asked if the one percent increment request was for the tax rate or credit rate.

CO-CHAIR SAMUELS said he wants it at a tax rate at a given credit rate and vice versa, so that he can extrapolate numbers under his set of assumptions.

REPRESENTATIVE ROKEBERG said no one knows the behavior of the companies due to the credits.

[3:28:13 PM](#)

[HB 488 was held over]

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:28 p.m.

