

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

February 11, 2005

8:39 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg
Representative Ralph Samuels
Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE BILL NO. 71

"An Act relating to a credit for certain exploration expenses against oil and gas properties production taxes on oil and gas produced from a lease or property in the state; relating to the deadline for certain exploration expenditures used as credits against production tax on oil and gas produced from a lease or property in the Alaska Peninsula competitive oil and gas areawide lease sale area after July 1, 2004; and providing for an effective date."

- MOVED CSHB 71 (W&M) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 71

SHORT TITLE: AK PENINSULA OIL & GAS LEASE SALE; TAXES

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/12/05	(H)	READ THE FIRST TIME - REFERRALS
01/12/05	(H)	W&M, O&G, RES, FIN
02/11/05	(H)	W&M AT 8:30 AM CAPITOL 106

WITNESS REGISTER

WILLIAM CORBUS, Commissioner
Department of Revenue (DOR)

Juneau, Alaska

POSITION STATEMENT: Testified in support of HB 71

GARY ROGERS, Senior Auditor

Tax Division

Department of Revenue

Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding HB 71

DAN DICKINSON, Director

Tax Division

Department of Revenue

Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding HB 71

JIM COWAN, Geologist

Division of Oil and Gas

Department of Natural Resources (DNR)

Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding HB 71

PAT GALVIN, Leasing Manager

Division of Oil and Gas

Department of Natural Resources

POSITION STATEMENT: Answered questions regarding HB 71

ROBERT JEUTTNER, Administrator

Aleutians East Borough

Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 71

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at 8:39 AM. Representatives Weyhrauch, Wilson, Gruenberg, and Moses were present at the call to order.

[8:39:07 AM](#)

HB 71-AK PENINSULA OIL & GAS LEASE SALE; TAXES

CHAIR WEYHRAUCH announced that the only order of business would be HOUSE BILL NO. 71 "An Act relating to a credit for certain exploration expenses against oil and gas properties production taxes on oil and gas produced from a lease or property in the state; relating to the deadline for certain exploration

expenditures used as credits against production tax on oil and gas produced from a lease or property in the Alaska Peninsula competitive oil and gas areawide lease sale area after July 1, 2004; and providing for an effective date."

WILLIAM CORBUS, Commissioner, Department of Revenue, said he wanted to make it clear that the administration strongly supports this bill. The goals of HB 71 are to encourage exploration on the Alaska Peninsula. He said that both large and small companies will benefit by the incentives laid out in the bill. He also sees economic benefits to the local communities. He said that the legislation is part of the administration's effort to encourage resource development.

CHAIR WEYHRAUCH said that HB 71 has been referred to four committees, and that the House Special Committee on Ways and Means has proposed a committee substitute.

REPRESENTATIVE Wilson moved to adopt the proposed committee substitute (CS) HB 71, Version 24-GH1040\G Chenoweth 1/17/05, as a work draft.

CHAIR WEYHRAUCH objected for discussion purposes.

[8:42:02 AM](#)

GARY ROGERS, Senior Auditor, Tax Division, Department of Revenue, said he is responsible for auditing exploration tax credits. He told the committee that oil and gas explorers get a credit against their production taxes of 20 percent for exploration wells that are more than three miles from existing wells, and they get an additional 20 percent credit if they explore wells more than 25 miles away from a unit boundary. A third category is seismic exploration where companies can get 40 percent of exploration costs as tax credit when it is outside the boundary of any unit of the state, he said. Producers can use this credit against their tax liability or they can sell it to other producers. Under existing law the work must be performed between July 1, 2003, and July 1, 2007, he added.

[8:44:01 AM](#)

MR. ROGERS explained that producers can only get credit for direct costs, and not from indirect expenses such as overhead, administration, supervision, lease operating, and environmental protection costs. He said that this bill extends the period for this credit for the proposed Alaska Peninsula competitive lease

sale until July 2010, because that work can't start until after the lease sale, and the current law will expire before that time.

8:45:00 AM

JIM COWAN, Petroleum Geologist, Division of Oil and Gas, Department of Natural Resources, deferred to Pat Galvin regarding the leasing process.

PAT GALVIN, Leasing Manager, Division of Oil and Gas, Department of Natural Resources, said he was available to answer any questions regarding the leasing process.

REPRESENTATIVE GRUENBERG questioned if, legally, the retroactivity clause is required on the last page.

DAN DICKINSON, Director, Tax Division, Department of Revenue, said his belief is that all DOR is saying is that work that was done before 2003 will qualify. He added that no one applied prior to this date, but if they had done work, it would qualify, and it is not the intent to make this extension for the Alaska Peninsula more restrictive.

REPRESENTATIVE GRUENBERG said he "tends to agree."

8:48:59 AM

ROBERT JEUTTNER, Administrator, Aleutians East Borough, said the Aleutians East Borough municipality has no problem with HB 71. "We support it," he said. "The idea of new oil and gas exploration on the Alaska Peninsula is very exciting to us." He stated that oil exploration has been a topic of debate for years because of the area's dependence on fisheries, but because of the decline in the fisheries economy, "people have gotten together." He said the Lake and Peninsula Borough, Bristol Bay Native Corporation, the Aleut Corporation, and the Aleutians East Borough "are all on line with this plan to go forward with oil exploration and development, so any bill that is going to offer incentives to help move it along to help create a diversified economy, we're behind 100 percent."

8:52:03 AM

REPRESENTATIVE GRUENBERG said he had a question regarding line 15, on page 2 of the original bill which was deleted in the committee substitute. He said the original bill defined the

limitations of the legislation to the 43 areas described in Section 5, and with that limitation deleted, he expressed concern that this would apply to a much broader area than intended.

[8:53:29 AM](#)

MR. DICKINSON said that it is his belief that that was a stylistic change only, and that he had spoken with the attorney in DOL who said it didn't change the intent of the bill. He said there was no intent to "broaden it beyond that area."

REPRESENTATIVE WILSON asked for clarification regarding page 5, line 15 which says "as described in section a" in the committee substitute. Going back to section a, it says "subject to the terms and conditions of this section," she said, and "it doesn't talk about specific areas."

REPRESENTATIVE GRUENBERG explained "that is a contingent effective date; it requires that for the act to occur there must be a condition precedent, and that means the Commissioner of Natural Resources must find that certain legal requirements are met, and that the sale has occurred." He added that it is a technical requirement to notify the publisher.

[8:56:14 AM](#)

REPRESENTATIVE GRUENBERG read from a memo written on January 17, 2005, by Mr. Chenoweth in Legislative Legal Services: "I have deleted references in the amendment...to section 5 of this Act...to omit temporary law bill section references in the body of permanent law." Representative Gruenberg said that he didn't think the omission was appropriate here because the language is not talking about a legal description. "Unless the entire Alaska Peninsula is included in the legal descriptions in section 5...they need to limit it to those areas in section 5," he stated. He added that he was not sure, and that an attorney should be consulted.

CHAIR WEYHRAUCH said that he will ask Mr. Chenoweth to respond to the committee on that issue.

REPRESENTATIVE GRUENBERG said that he did not want to hold up the bill.

CHAIR WEYHRAUCH asked Mr. Dickinson if the tax credit is applied to production tax before or after the economic limit factor.

MR. DICKINSON said that the total amount of tax due is calculated, and then the credit is applied, so it has no bearing on the calculation of tax liability.

REPRESENTATIVE WILSON referred to Mr. Chenoweth's memo which said that "the change of the 'or' to 'and' on page 2, line 5 of the measure as introduced allows for a doubling of the potential cumulation of expenditures that may be claimed as credits from the 40 percent maximum of current law to a possible maximum of 80 percent."

[8:59:46 AM](#)

MR. ROGERS said that "the way the tax credit works is that the expenditure is either under [sub]section (c), which is 20 percent for a 3-mile well, or [sub]section (d), which is 20 percent plus 20 percent for a well that's both 3 miles and 25 miles from a unit, or under [sub]section (e), which is for seismic which is 40 percent. So a seismic expenditure can never be a well expenditure, and they can't be added together...so there is no addition of 40 percent plus 40 percent."

REPRESENTATIVE WILSON said that the word "or" was exchanged for "and".

MR. DICKINSON said the change was made because using the word "or" would imply that a company could only get a tax credit on one type of exploration. "The kinds of expenses you submit for seismic work and the kinds of expenses you submit for well [work] are different," because overhead costs are not included, he said.

REPRESENTATIVE WILSON said it is confusing.

REPRESENTATIVE GRUENBERG expressed his confusion.

MR. ROGERS stated that "in line 1, you get 20 percent of the expenditures that qualify under (c), or 20 percent of the expenditures that qualify under (d), or both...and that cannot exceed 40 percent. And then on line 6, paragraph 2...you can get 40 percent for expenditures that qualify under (e), which is seismic."

REPRESENTATIVE GRUENBERG said he understood but that an uninitiated lawyer would read it wrong because it is highly ambiguous. "I do think that it should be 'or'," he said.

MR. DICKINSON said that the important point is that "no invoice...could be submitted under [sub]section (e) and under the other [sub]sections." He said that costs for wells and costs for seismic work are different expenditures, and that much time was spent on this language. He said the attorneys were concerned that if the word "or" was used it would mean that a company could either choose credit for its seismic work or its well work, but it could not apply for both credits - even if it did both kinds of work.

REPRESENTATIVE WILSON asked "if there is no way that they could turn in anything that's the same, then why not have 'or'?"

REPRESENTATIVE GRUENBERG said the language should be made "absolutely clear" so that concerned parties "don't have to look at some obscure committee minutes" for clarification.

MR. DICKINSON said this was discussed repeatedly. He said that if the bill said "or," and a company did seismic work one year, and then in the next year it did well work, the company may not be able to apply for both types of credit. He said they may not have achieved clarity and would like to make it clear.

[9:07:46 AM](#)

REPRESENTATIVE WILSON asked Mr. Dickinson if he means that if a company is doing work in one phase they will not be excluded from the credit when they move on to the next phase.

MR. DICKINSON said that is right, and no costs will occur concurrently in both phases.

REPRESENTATIVE GRUENBERG requested that DOR attorneys make it "crystal clear."

MR. DICKINSON said he will bring these points up with the attorney next week.

REPRESENTATIVE WILSON asked that if the policy of getting tax credit for different phases of exploration is "the current way we do business."

[9:09:38 AM](#)

MR. ROGERS said that the way companies explore is by discrete projects, one project might be a well and one might be seismic

work. He said they file a claim for each separate project, and the claim is audited to make sure the costs aren't duplicated between two projects. He added that it is "not so much phases but it's projects."

REPRESENTATIVE WILSON asked if it is current policy that a company can get a 40 percent credit for one project, and then move on to a new project and then get another 40 percent credit.

MR. ROGERS said yes, as long as the conditions qualify under law.

CHAIR WEYHRAUCH asked if the proposed amendment creates a smaller or larger tax credit than the previous lease agreement.

MR. ROGERS answered that it is the same.

MR. DICKINSON said our intent was to provide the same credit, while clarifying the language.

REPRESENTATIVE GRUENBERG requested a letter of intent which flags the issues of concern for next committee.

CHAIR WEYHRAUCH said he will write a memo to the next committee.

REPRESENTATIVE GRUENBERG asked if the proposed language is "triple checked" for errors.

MR. DICKINSON said we have worked with the DOL and DNR, and "it is our belief that these are accurate."

CHAIR WEYHRAUCH closed public testimony.

REPRESENTATIVE GRUENBERG referred to the areas listed in the bill and asked, "How much wiggle room does it give the commissioner in adding additional lands?"

MR. GALVIN said that language is added to acknowledge that the lease sale boundary may be smaller than what is proposed - it will not be larger. He said that DNR starts with a proposed boundary, and if there are areas within it that are found not to be in the state's interest to offer then the area may be restricted, but it can't be expanded.

REPRESENTATIVE GRUENBERG asked if it would be appropriate to say that in the bill.

[9:16:06 AM](#)

MR. GALVIN said that statutes dealing with the leasing process make that clear.

MR. DICKINSON said this is a stylistic question. It is not good to put things in two places because when something is amended, it needs to be amended twice, but he said, he will bring it up with DOL.

CHAIR WEYHRAUCH expressed the need to take care of issues in committee, not on the floor.

MR. DICKINSON said he doesn't think it would expand the area and doesn't need to be restated.

[9:17:43 AM](#)

REPRESENTATIVE GRUENBERG asked the testifiers to address the other potential problems raised in the Chenoweth memo. He said that the bill refers to expenditures claimed as credit on oil and gas produced from a lease sale after July 1, 2004, but the authorization in the body of the bill refers to activity occurring on or after July 1, 2003. Representative Gruenberg asked if the date should be in the title.

[9:19:19 AM](#)

MR. ROGERS responded, "Actually we want to leave the title because activity before the lease sale could qualify...if there has been exploration prior to the lease sale. We didn't want to change any of the dates in the bill other than extending the period."

REPRESENTATIVE GRUENBERG said he doesn't want to hold up the bill, but he wants to get the legal issues resolved. He asked for a response regarding page 3, line 10.

MR. GALVIN said that the reference in this statute is the 25 miles from the boundary of the unit, and that is a separate issue than the boundary of the lease sale area. He added that the lease sale boundary is a completely separate designation, and he believes that Mr. Chenoweth did not recognize the difference between unit and sale boundaries.

REPRESENTATIVE GRUENBERG said that Mr. Chenoweth has the same concern as Representative Wilson about the possible doubling of the tax credit.

[9:22:27 AM](#)

REPRESENTATIVE WILSON moved to report CSHB 71(W&M), version 24-GH1040\G Chenoweth, 1/17/05, from committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 71(W&M) moved from the House Special Committee on Ways and Means.

CHAIR WEYHRAUCH said, "We will get the memo to the next committee."

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:23 AM.