

MINUTES
SENATE FINANCE COMMITTEE
March 31, 2006
9:01 a.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [9:01:50 AM](#).

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice Chair
Senator Fred Dyson
Senator Bert Stedman
Senator Donny Olson
Senator Lyman Hoffman

Also Attending: SENATOR GARY STEVENS; SENATOR BEN STEVENS; BILL CORBUS, Commissioner, Department of Revenue; ROBYNN WILSON, CPA, Director, Tax Division, Department of Revenue; DAN DICKINSON, CPA, Consultant;

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

SB 305-OIL AND GAS PRODUCTION TAX

The Committee heard from the Department of Revenue. The bill was held in Committee.

#SB305
[9:02:24 AM](#)

CS FOR SENATE BILL NO. 305(RES)
"An Act providing for a production tax on oil and gas; repealing the oil and gas production (severance) tax; relating to the calculation of the gross value at the point of production of oil or gas and to the determination of the

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

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Green announced the intended schedule for this legislation.

[9:03:58 AM](#)

BILL CORBUS, Commissioner, Department of Revenue, presented the bill, giving the following testimony.

Before focusing on SB 305 I would like to comment on DOR policy of providing tax and economic staff expertise, and in some cases consultants under contract, to Legislators and their staffs when contemplating or preparing their own

new legislation or amendments to legislation under consideration.

The Tax Division routinely provides this assistance, subject to the availability of resources, to members on both sides of the aisle.

If so requested, DOR provides this assistance on a confidential basis.

DOR provides it for two reasons:

In some cases it is the only part of government that has the background, data base and the pool of talent

If such legislation is enacted, we want to make sure it works and is in the best form for the Tax Division to administer

Providing this assistance does not signal Administration support of a bill or amendments to a bill before a committee.

The Commissioner or Deputy Commissioners normally articulate the policy positions - which is why today I am representing the Administration.

The Governor and his Administration strongly support the Petroleum Profit Tax as originally proposed.

SB 305 is an historic piece of legislation that will:

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

We commend the Senate Resources Committee for their many hours of hard work.

We note that the Senate Resource CS supports the 25% tax rate; we support the 20% investment as originally proposed.

The Administration does not support the 25% tax rate.

Over time oil production has dropped dramatically and must be restored:

- TAPS operating at less than 50% capacity
- Oil production was once 2m b/d now about 870k b/d, projected to 772k b/d by 2016
- Recent investment in development and production has been inadequate
- Higher tax rates will further discourage new investments
- Must not emphasize short term revenues - must maximize State's wealth over the long run
- We believe 20/20 is the appropriate tax and tax credit rate to arrest this trend

And we need to keep eye on the prize, which is the gas pipeline.

Although the PPT includes investment incentives, the stronger link for effecting investment is the tax rate.

As tax rates go up, investment goes down.

Let's try to boil down what a change in the tax rate might mean - in numbers for 20/20 vs. 25/20.

Assumptions

- \$60 oil and \$7 gas
- Uninflated or today's dollars
- Governor's bill - no progressivity factor, July 1 effective date, transition provision

With 20/20

- A gas line \$2b/yr for 35 yrs or \$70b
- Extend life of Prudhoe Bay thru at least 2050
- 20 year longer life than without a gasline
- State royalty and 20% PPT revenues on oil of \$2.3b/yr for at least 35 yrs worth \$83b

With 25/20

- Risking gasline or attempt to change gas economics

- Shortened field life at Prudhoe Bay - say 2030
- State revenues for royalties and 25% PPT \$80b
- During the same period \$69b for 20% tax rate

What do you want? \$80b from oil only in the short term with 25/20 or with the 20/20 \$70b from the gasline and \$83b from oil life thru 2050, a total of \$153b.

This Administration believes we should go with the 20% tax rate.

We note that the CS has several changes from the Governor's original bill:

- The transition provision
- The \$73,000,000 deduction for the small companies
- Change of the effective date
- Introduction of a progressivity factor
- They should be carefully scrutinized

In conclusion, this Administration strongly supports the original SB 305, not the Senate Resource CS.

- Although we commend Senate Resources for their hard work on this complex legislation
- We continue to believe the 20/20 is the appropriate level to attract investment, bring us a gasline and maximize the State's wealth over the long term

[9:16:20 AM](#)

Co-Chair Green requested the figures the commissioner cited.

[9:16:37 AM](#)

Mr. Corbus noted an editorial opinion paper written by Governor Murkowski distributed to the Committee, which also lists the figures [copy on file].

[9:17:06 AM](#)

Co-Chair Wilken asked the date of the Governor's letter.

[9:17:15 AM](#)

Mr. Corbus replied the letter is current of as of today and would be submitted for publication in newspapers across the state.

[9:17:30 AM](#)

Co-Chair Wilken asked, "Are we now in the process of changing the rules that we started with two months ago?" He explained that at the start of this legislative session when a change to the oil tax system was first proposed, the issue was clear that the current Economic Limit Factor (ELF) was "broken" given the higher oil prices. The commissioner had also voiced this to him two years prior.

Co-Chair Wilken continued that the legislature was instructed to consider the merits of this bill separately, as it would be a tax on oil. However, the Department of Revenue is now asserting that to increase the proposed tax rate of 20 percent would affect negotiations to secure a natural gas pipeline. Therefore, he concluded that the "rules" had been changed. If this is the case, the legislature must change its approach and investigate the negotiations. The details of the negotiations must be learned if the legislature were to make an informed decision regarding this bill. The legislature could not be expected to act upon this legislation without full knowledge of all its impacts. Two months ago, the legislature was advised this bill had no linkage to the gasline negotiations; however, such a linkage is clear. He would be unable to make a decision on a tax changes without knowing how it would affect the development of natural gas resources.

[9:20:20 AM](#)

Mr. Corbus indicated he would provide a written response.

[9:20:28 AM](#)

ROBYNN WILSON, CPA, Director, Tax Division, Department of Revenue, introduced Mr. Dickinson. They would provide a comparison of the Senate Resources Committee substitute to the original version submitted by Governor Murkowski. They gave a presentation titled, "Petroleum Profits Tax (PPT), CS for SB 305 (RES) Overview, Alaska Department of Revenue before the Senate Finance Committee, March 31, 2006..." [copy on file].

[9:21:56 AM](#)

DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor, began the presentation.

Page 2

Alaska Oil Production

[Line graph showing Million Barrels/Day for the fiscal years 1965 through 2020 of: Other (Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and N-PRA), Northstar, Alpine, Kup-Sat, Kuparuk, PBU-Sat, and Prudhoe Bay.]

Mr. Dickinson would focus on the "ideas that motivated the Governor when he submitted this bill." The graph demonstrates the production history, which peaked between 1985 and 1990 and is steadily declining. In the middle 1980s nearly \$2 million barrels were produced per day, of which \$1.6 million were from fields at Prudhoe Bay. Prudhoe Bay production has been steadily declining. Production at other smaller fields is beginning and is offsetting the decline. However, the Governor is concerned that if more investment does not occur, the decline would increase. This would not be in the best interest of the State treasury or Alaska's economy.

[9:23:22 AM](#)

Page 3

The Governor's 3 Big Ideas

- The current Production Tax system is broken.
- We need to use the tax system to encourage investment
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low

Mr. Dickinson listed the items, expressing the Governor's particular concern that the current tax system could be discouraging investment.

[9:24:12 AM](#)

Page 4

The Governor's 3 Big Ideas

- The current Production Tax system is broken. The CS also replaces it.
- We need to use the tax system to encourage investment. The CS has incentives for investment.
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low. The CS pushes the tax rate to 25%, maintains credit rate of 20%.

Mr. Dickinson overviewed this page. Many of the incentives included in the committee substitute reflect the Governor's proposals and some are different.

[9:25:09 AM](#)

Page 5

The Governor's 3 Big Ideas

- Idea one: The Production Current Tax System is broken
 - We are not getting the investment we need - could the structure of the Production Tax be to blame
 - We are not getting a fair share of revenues when Prices are high and investment is low

Mr. Dickinson read this into the record.

[9:25:30 AM](#)

Page 6

Unrestricted & Restricted Revenue
\$ Billion

[Pie chart indicating the breakdown for FY 05: Federal \$1.9; Investment \$2.8; Oil \$3.4; and Other \$0.8.]

Mr. Dickinson utilized this chart to give perspective. The total State revenues are divided into three main categories and a category for other sources. The "investment" revenue represents investment from the Alaska Permanent Fund.

[9:26:17 AM](#)

Slide 7

FY 2005 Petroleum Revenue

\$ Million

[Pie chart listing the breakdown of: Royalties + Bonuses + Interest \$1,419.8; Production Tax \$863.2; Corporate Income Tax \$524.0; Property Tax \$42.5; NPR-A Rents & Bonuses \$31.6; Royalties to PF & PSF \$486.5; and CBRF Settlements \$27.4]

Mr. Dickinson noted the revenues were unrestricted with the exception of Constitutional Budget Reserve (CBR) Fund settlements, royalties to the Alaska Permanent Fund and the Public School Fund, and the National Petroleum Reserve - Alaska (NPR-A) rents and bonuses. This bill relates to the production tax. It would have no affect on the restricted funds or the corporate income tax.

[9:28:07 AM](#)

Page 8

1. Destination Value at Market (2005)

[Table calculating the following information related to the 330 million barrels produced:

Destination Value at Market	
\$43.43 per barrel	
\$14,332 million	
Less Tankering & Pipelines	
\$4.51 per barrel	
(\$1,488) million	
Gross Value at Point of Production	
\$38.92 per barrel	
\$12,844 million	
Less Upstream Costs	
Operating: \$3.33	
Capital: \$3.18	
Total: \$6.52 per barrel	
(\$2,150) million	
Net Value at Point of Production	
\$32.40 per barrel	
\$10,694 million]	

Mr. Dickinson outlined this information. He corrected an error, as the \$6.52 amount was incorrectly shown as \$96.52.

Mr. Dickinson noted the destination value reflects the cost of transportation mostly to Los Angeles, California.

Mr. Dickinson stated this information provides an understanding of the value of Alaska resources.

[9:30:24 AM](#)

Page 9

2. Current Production Tax
\$ in Billion

Gross Value at Point of Production	\$12,844
1 - Royalty Rate	0.875
Value Net of Royalty	\$11,238
Tax Rate	0.15
ELF Rate	0.55
Tax	\$927

Mr. Dickinson posed the question of how to tax the value. He detailed this page. The State does not tax royalties, which reduces the gross value 0.875 percent to the amount to be taxed. The gross value is then multiplied by the tax rate and the ELF.

[9:31:55 AM](#)

Page 10

Implicit Cost
\$ in Billion

Production Tax Net of Royalty	\$11,238
Less Implicit Cost from Proxy	(\$5,057)
	\$6,181
Tax Rate	1.05
Proposed Production Tax	\$927

Mr. Dickinson defined ELF in this table as "a proxy for the cost of getting the oil ready to go to market; the cost of getting the oil out of the ground". He stated, "If the ELF is a proxy it isn't working" explaining this is why the system is "broken".

Mr. Dickinson posed the question that if the State were allowing deductions of actual costs instead of utilizing a proxy, how much investment would be necessary to equal \$927 million. He answered that approximately \$5 billion worth of deductions would

be required. Less than one-half that amount was actually invested.

Mr. Dickinson emphasized that the ELF was designed as a proxy when the gross value was at a "certain dollar range", which "worked". When prices increased to unprecedented levels and the ELF is a percentage, the proxy is no longer effective. Oil companies operating in the North Slope are being allowed deductions that are "all out of line" with the actual costs. "They are paying their taxes as if they were making huge investments," although they are not making those investments. The Governor suggests that the proposed Petroleum Production Tax (PPT) should reflect the actual investments. The deduction should be allowed only for investments actually made.

[9:33:31 AM](#)

Page 11

Kuparuk Crude Oil Production & ELF

[Bar graph showing Production in Million Barrels per Day and ELF for the years 1990 through 2005 and forecasted for 2006 through 2015.]

Mr. Dickinson stated that the relationship between volumes and the ELF could become "supercharged". This slide demonstrates that ten to 15 years ago, Kuparuk was producing approximately 320,000 barrels per day with an ELF of approximately 0.8. An ELF of 1.0 would pay the full 15 percent rate. Over that ten-year period, the volume has decreased by about one-half to about 160,000 barrels per day. However, over that same period, the ELF has decreased from 0.8 to zero and the field is paying no production tax. The method of exempting certain fields from tax could have been considered effective at one point, but it is not.

Mr. Dickinson informed that Kuparuk is the second largest oil field in the United States even with the dramatic decline. Yet it is not paying any production tax as of this year. That suggests that the mechanism used to exempt fields from tax was no longer effective.

Mr. Dickinson surmised agreement has been reached on this issue and how the system should be changed is the next step in the process.

[9:35:14 AM](#)

Page 12

Economic Limit Factor

FY 1995-2005 and FY 2006-2016

[Bar graph showing the percentage rate of ELF for the years 1995 through 2005 and the projected rate for 2006 through 2015.]

This page was not directly discussed.

Page 13

The Governor's 3 Big Ideas

- Idea two: We need to use the Tax system to encourage investment
- Investment leads to more production
- More production leads to more revenue
- Four ways the bill recognizes investment

Mr. Dickinson indicated Ms. Wilson would give this portion of the presentation.

[9:35:41 AM](#)

Ms. Wilson stated the Governor's legislation utilized the tax system to improve and encourage investment. The understanding is that investment leads to more production and more production leads to more revenue. The bill recognized four ways to encourage investment.

[9:36:00 AM](#)

Page 14

Governor's Bill: 4 ways of encouraging investment

- Net vs. gross - all investment is a deduction
- 20% credits for capital investments
- Up to a \$73 million Annual Allowance
- Recognition of Transaction Investment Expenditures

Ms. Wilson outlined this page.

[9:36:31 AM](#)

Page 15

CS: 4 ways of encouraging investment

- Net vs. gross - all investment is a deduction - CS preserves
- 20% credits for capital investments - CS preserves
- Up to a \$73 million annual allowance - CS has a tax-free allowance based on production
- Recognition of Transition Investment Expenditures - CS changes this from a deduction to a credit with a requirement for current investment

Ms. Wilson overviewed the comparison of the committee substitute adopted by the Senate Resources Committee to the original bill submitted by the Governor.

Page 16

Tax Based on Net Profits

- Governor's bill provided a tax based on Net Profits
- CS maintains this approach.

This page was not specifically discussed.

[9:37:21 AM](#)

Page 17

Gross vs. Net

Current Tax on Gross	
Value at wellhead	\$50.00
Times: tax rate	15%
Tax before ELF	\$7.50
PPT on Net	
Value at wellhead	\$50.00
Less:	
Lease op exps	(12.50)
Net taxable	\$37.50
Times: tax rate	20%
Tax before credits	\$7.50

Ms. Wilson remarked this page demonstrates that simply changing tax from net to gross would not necessarily change the bottom line taxable collections. The tax rate is the real issue. Additionally, the tax rate is expected to increase by changing from gross to net.

[9:38:12 AM](#)

Page 18

Tax Base
Gross value at point of production

Ms. Wilson explained the rate starts with the tax base, which is the gross value at the point of production. The tax base is what is taxed.

[9:38:27 AM](#)

Page 19

Determining value under current system
[Illustrations depicting: West coast value \$; an oil tanker; a pipe with oil flowing out the end; and an off-shore drilling platform.]

Ms. Wilson surmised the matter would be simple if all oil sales occurred on the North Slope. However, most sales occur on the West Coast and therefore, the selling price at the West Coast must be considered. This price is not the value at the wellhead. To account for the differences, transportation costs and pipeline tariffs are backed out to calculate the wellhead value.

[9:39:16 AM](#)

Page 20

Gross Value under PPT
Department of Revenue can allow a producer to elect the use of:

- Royalty value
- DOR formula that estimates a value at a specific location such as point of delivery into a common carrier pipeline

Ms. Wilson stated the intention of both the original bill and the committee substitute is simplification. Currently, two sets of State auditors review the same "number" and are reaching close, but not identical results. The bill would instead allow royalty values to be used. The formula may include other factors, such as published prices, quality differentials, applicable transportation costs and inflation adjustments.

Ms. Wilson noted this approach preserves the current statutes and regulations pertaining to gross value.

[9:40:23 AM](#)

Page 21

Tax Based on Net Profits
Gross value at point of production
Less: Lease expenditures

- Operating costs
- Capital expenditures
- Allowance for overhead

Equals: Net Profits

Ms. Wilson overviewed this page. She qualified that allowable operating and capital expenses must be necessary and directly attributable to the lease. Allowance for overhead must be directly related to exploration, development and production.

Ms. Wilson furthered that the bill directs that substantial weight be given to industry practices. An option is provided that would include as lease expenditures, the costs paid by a producer that are paid by an operator under the terms of a unit operating agreement. Lease expenditures would be reduced by any reimbursements received by the producer from other producers or government.

Ms. Wilson noted that capital expenditures are allowed at 100 percent in the year of acquisition. This is in contrast to usual accounting practices in which an asset is purchased and depreciated against its useful life. The intent is to encourage investment and allow for an immediate deduction for those expenditures.

[9:42:23 AM](#)

Non-deductible expenses

- Depreciation
- Royalty Payments
- Taxes based on net income
- Interest & financing charges
- Lease acquisition costs
- Other costs

Ms. Wilson reiterated that because 100 percent of write off is allowed in the first year an asset was purchased, depreciation in future years would not be allowed.

Ms. Wilson listed two reasons royalty payments could not be deducted, the gross value at point of production excludes federal and state royalties and therefore royalties are not included in the calculation of the tax, and because private royalty leases is taxable. Other costs would include the costs of arbitration, donations, cost of organizing partnerships and joint ventures and other business entities.

[9:43:37 AM](#)

Senator Stedman asked for additional information about the depreciation factor, as the proposal would differ from current income tax procedures. He wanted to know how the issue would be handled with a producer paying both PPT tax and corporate income tax.

[9:44:00 AM](#)

Co-Chair Green remarked this matter would be discussed.

[9:44:20 AM](#)

Ms. Wilson explained that depreciation would be taken over the lives of the assets on federal income taxes. Much of the equipment is depreciable over seven years, some offshore drilling equipment has a five-year life and other equipment is depreciable up to 17 years. Longer useful life is granted for State corporate income tax purposes, with slower depreciation for oil and gas companies. This legislation would allow immediate write-off.

[9:45:17 AM](#)

Senator Stedman understood that the State corporate income tax is calculated on a percentage of a company's worldwide income. Despite the loss of the depreciation schedule for the proposed PPT tax, equipment would still be depreciable.

[9:45:57 AM](#)

Ms. Wilson affirmed. The State corporate income tax considers worldwide income and apportions income attributable to Alaska, based on a formula. That result is taxed. Depreciation is taken into account in that calculation.

[9:46:46 AM](#)

Page 23

Governor's Bill: Credits to Encourage Investment

- 20% of qualified capital expenditures
- May be taken on:
 - o Exploration costs
 - o Capital costs incurred on lease

Credits are transferable

Ms. Wilson told of another key element for encouraging investment is a provision that credits would be transferable. The third party to whom credits are transferred could only use those credits to offset up to 20 percent of the transferee's tax. The recipient of transferred credits would apply to the Department of Revenue for a credit certificate. The Department would maintain information on credits and if deemed appropriate, the certificate would be issued. This would not preclude the Department from undertaking future audits and reviewing the credit in more detail.

Ms. Wilson noted that exploration costs would include geological and geophysical expenses.

[9:48:35 AM](#)

Page 24

CS: Credits to Encourage Investment

- CS maintains credits
- Credits may not be taken on:
 - Abandonment costs

Ms. Wilson noted that the committee substitute added an additional exemption for abandonment costs.

[9:48:57 AM](#)

Page 25

Friendly to New Investors

- Ability to monetize credits
- Ability to monetize losses
- Base allowance
 - Governor's bill: \$73M deduction
 - CS: converts this to tax-free allowance based on production:
 $(5000 - .2 \times [ADP - 5000]) / ADP$
 ADP = average daily production
 Sunsets in 2013

Ms. Wilson outlined the comparison.

[9:50:05 AM](#)

Page 26

CS: 5,000 bbl plan

[Table showing the following:

Daily Production: 5,000
 PPT tax-free production: 5000
 Percentage of net income tax-free: 100%

Daily Production: 6,000
 PPT tax-free production: 4800
 Percentage of net income tax-free: 80%

Daily Production: 7,000
 PPT tax-free production: 4600
 Percentage of net income tax-free: 66%

Daily Production: 8,000
 PPT tax-free production: 4,400
 Percentage of net income tax-free: 55%

Daily Production: 9,000
PPT tax-free production: 4200
Percentage of net income tax-free: 47%

Daily Production: 10,000
PPT tax-free production: 4000
Percentage of net income tax-free: 40%

Daily Production: 15,000
PPT tax-free production: 3000
Percentage of net income tax-free: 20%

Daily Production: 20,000
PPT tax-free production: 2000
Percentage of net income tax-free: 10%

Daily Production: 25,000
PPT tax-free production: 1000
Percentage of net income tax-free: 4%

Daily Production: 30,000
PPT tax-free production: 0
Percentage of net income tax-free: 0%]

Ms. Wilson outlined this information.

[9:50:13 AM](#)

Senator Bunde asked why the presenter chose to demonstrate a five-year "window".

[9:50:25 AM](#)

Ms. Wilson deferred to the sponsor of the committee substitute.

[9:50:49 AM](#)

Senator Stedman requested conversion of the information contained on pages 25 and 26 from percentages to dollars and determine which producers were included and excluded from the tax to show how broad the provision would be.

[9:51:21 AM](#)

Mr. Dickinson explained the current three-tier system. The three large producers have productions of significantly more than 100,000 barrels per day. These producers would never realize a tax savings from this provision of more than five or ten percent. Two other producers intend to produce 20,000 barrels per day and other companies would likely produce less. He deferred to the upcoming presentation to further explain this.

[9:53:16 AM](#)

Senator Stedman relayed that the Senate Resources Committee spent numerous hours on this issue, deeming it important. The Senate Finance Committee should understand it as well. The risk of potential gains or increased number of producers must be understood and further investigated.

[9:54:21 AM](#)

Mr. Dickinson would address this in an upcoming hearing.

[9:54:28 AM](#)

Senator Stedman remarked that the committee substitute before the members is "radically different" and that both versions must be understood.

[9:55:01 AM](#)

Page 27

Transition Provision

- Governor's bill allowed deductions for recent capital expenditures
 - o Last five years' capital expenditures
 - o Allowed over 6 years
 - o Allowable on when price of oil exceeded \$40

Ms. Wilson corrected an error indicating that the deductions would be allowed over six years rather than five, as shown on the original version of the presentation.

Ms. Wilson characterized this provision as one of fairness. Assets purchased over the past several years would be generating revenues calculated at the higher rates proposed in this legislation.

[9:56:08 AM](#)

Senator Bunde surmised that investments made five years prior were not made with expectation of this "claw back" provision. Instead the investments were made based on the economics at that time.

[9:56:38 AM](#)

Ms. Wilson agreed, but qualifying that the investments were made with the expectation that the ELF based system would not be changed.

[9:56:49 AM](#)

Senator Bunde found the argument counterintuitive and that the producers would need a claw back for times when oil was less than \$40 per barrel.

[9:57:04 AM](#)

Ms. Wilson remarked the decision was a policy call made by the Governor in conjunction with the "balance he envisioned".

[9:57:16 AM](#)

Senator Hoffman asked why an increased tax for the past six years was not included in the bill. Deductions would be permitted but increased taxes would not be imposed on revenues generated during this period.

[9:57:48 AM](#)

Mr. Dickinson responded that the tax would not be retroactive.

[9:57:55 AM](#)

Senator Hoffman understood, and asked why the tax change would not be retroactive if the deductions would be.

[9:58:04 AM](#)

Mr. Dickinson relayed the intent is that producers not regret any investments already made. Those companies that had been

investing in Alaska should be allowed to recuperate from those investments.

[9:58:53 AM](#)

Senator Stedman identified two incentives: a transition period aimed to benefit larger producers that have made more investments, and a "barrel holiday" exempting low production rates from the tax that would benefit smaller producers.

[9:59:41 AM](#)

Co-Chair Green discerned the claw back is designed as a transition between the old and new tax systems.

[9:59:56 AM](#)

Ms. Wilson affirmed.

[9:59:59 AM](#)

Mr. Dickinson agreed, but pointed out that Pioneer Natural Resources is investing currently. The transition provision would acknowledge those investments if the tax structure were to change in the midst of their project. Smaller producers would also benefit from this provision.

[10:00:30 AM](#)

Page 28

Transition Provisions in CS

- CS maintains 5 year look-back
- Allows recoupment of \$1 for every \$2 currently invested
- Removes oil price test
- Changes from a deduction to a credit

Ms. Wilson noted the committee substitute would allow for less recoupment.

[10:01:00 AM](#)

Co-Chair Wilken asked for an explanation of the change from a deduction to a credit.

[10:01:16 AM](#)

Ms. Wilson gave an example of personal income tax in which charitable contributions and business expenses are utilized to establish the amount of income to be taxed. Credits allowed for personal income tax include childcare and education. The committee substitute assigns a deduction of 25 percent, to a credit worth 20 percent.

[10:02:28 AM](#)

Senator Dyson understood that for this application, the credit is for investment rather than credit against taxes.

[10:02:51 AM](#)

Ms. Wilson corrected that the credit is against taxes and only pertains to the transition recognition of previous investments.

[10:03:27 AM](#)

Senator Dyson shared that credits are significantly more valuable than deductions in calculating his income tax. He asked the extent of the value difference for oil companies.

[10:03:53 AM](#)

Ms. Wilson replied that how the tax rate compares to the credit rate is the determining factor. She affirmed that credits are more valuable in relation to personal income tax.

[10:04:28 AM](#)

Senator Dyson asked if the variation would be different for the major producers than smaller producers.

[10:04:38 AM](#)

Mr. Dickinson clarified that the credit is not 100 percent. A \$1 million investment allowed as a deduction would lower taxes by \$250,000 at the 25 percent rate. As a credit, \$200,000 at the 20 percent rate would be applied after taxes were calculated, reducing the tax by that amount.

[10:05:30 AM](#)

Senator Dyson asked if the provisions of the committee substitute would benefit all participants equally.

[10:05:47 AM](#)

Mr. Dickinson responded that credits don not always transfer at face value. A small explorer might need to monetize the investment credit before production begins, by selling the credit. In such an instance, the explorer would likely only receive 90 percent of the credit amount. Credits do not always transfer at face value.

Mr. Dickinson pointed out that a small explorer took the deduction but did not reach production, that deduction could increase the size of the loss. As a consequence that amount would be transferred to a credit to carry forward.

Mr. Dickinson identified the main feature between the deduction and the credit as the 25 percentage and the 20 percentage.

[10:06:56 AM](#)

Senator Stedman noted that the common assumption of these credits is as investment tax credit, in which a 20-cent investment would reduce the tax bill by 20 cents. He asked Mr. Dickinson to further explain this.

[10:07:30 AM](#)

Mr. Dickinson detailed that a small business owner could deduct from income tax the entire amount paid for an equipment item. The amount of marginal rate would be the amount gained from that transaction. The investment tax credit provides that ten percent of the purchase price could be applied against income for a reduction of basis.

[10:08:12 AM](#)

Senator Stedman informed that the tax credit is subtracted directly from the tax "bill". The credit is therefore a "much more powerful mechanism" than a business expense.

[10:08:28 AM](#)

Mr. Dickinson agreed. A \$10 tax credit reduces tax by \$10; a \$100 investment results in a tax reduction of \$10.

[10:08:43 AM](#)

Senator Stedman stressed the importance of this issue because of the multiple complexities.

[10:09:11 AM](#)

Senator Bunde asked if the difference between a deduction and a credit is that a credit could be sold and a deduction could not.

[10:09:33 AM](#)

Ms. Wilson corrected that deductions, if they generate loss at end of year, could be converted to credits then sold. The net operating loss could not be sold. The depreciation provision could not generate a loss, which could be sold.

[10:10:15 AM](#)

Senator Bunde concluded that a credit is more valuable to the producers than a deduction.

[10:10:20 AM](#)

Ms. Wilson affirmed.

[10:10:25 AM](#)

Mr. Dickinson qualified this is generally true; however in the context of committee substitute it is reverse because the tax rate is 25 percent and the credit is only 20 percent.

[10:10:45 AM](#)

Senator Stedman noted, "The magnitude of the tax is approximately five to one versus the credit." As the tax is increased, it would have substantially more impact than increasing the credit percentage.

[10:11:11 AM](#)

Mr. Dickinson acknowledged this is correct at current oil prices. However, at different prices the amount would vary.

[10:11:32 AM](#)

Page 29

The Governor's 3 Big Ideas

- Idea Three: We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low
- With high prices we are not getting a fair share
- We should be treated as fairly as other jurisdictions while remaining competitive with them for reinvestment

Mr. Dickinson pointed out that investment dollars "would move around" and Alaska must therefore remain competitive. Other regimes protect, so must remain competitive. Other regimes act in manners to protect their natural resources, and do not allow investment to "escape", which the Governor's proposal intends to accomplish.

[10:12:15 AM](#)

Senator Bunde asserted that the State should be treated fairly and should treat industry fairly. Some discussions have given him the understanding that either the Governor's proposal or the Senate Resources Committee proposal is very competitive and would provide a better tax break than other venues. He asked if this information is accurate and whether Alaska would remain competitive.

[10:13:08 AM](#)

Mr. Dickinson responded that "peer groups" to which Alaska could be compared, Dr. Pedro Van Muirs concluded that the 20-percent proposal would place Alaska in a better relationship to the other jurisdictions than the 25-percent proposal would.

Mr. Dickinson cautioned on the need to be careful in comparing Alaska to a location with large resources near tidewater and markets and without arctic engineering challenges.

[10:14:02 AM](#)

Page 30

Fair Tax Rate
Governor's bill: 20%

Page 31

Fair Tax Rate
Governor's bill: 20%
CS pushes tax rate to 25% and adds progressive feature

Mr. Dickinson overviewed these pages.

[10:14:27 AM](#)

Page 32

Progressivity Surcharge

- Oil surcharge applies when oil price (ANS West Coast) exceeds \$40/bbl
(ANS_{WC} - \$40) x .0015
x ANS PV "wellhead" x taxable barrels of oil

Different definition for gross value at point of production

- Deductible from PPT

Mr. Dickinson detailed the formula. The formula contained in the committee substitute has several more terms, but those are fixed.

Mr. Dickinson noted that although not expressively stated in the bill, it is likely that a surcharge would be deducted as a business expense in calculating PPT.

[10:16:10 AM](#)

Co-Chair Green asked why the formula includes both ANS West Coast price and wellhead price.

[10:16:40 AM](#)

Mr. Dickinson replied that the ANS West Coast price just forms an index and is taken as a marker to compare to the \$40 amount. The wellhead value would be lower by approximately \$5 for 2005

and would likely increase to approximately \$7. This definition of the wellhead value is different than the gross value definition.

10:17:36 AM

Senator Stedman surmised that the tax provision language could require amending. The surcharge should not be a "double deduction". He suggested stipulating an "in effect" or "after tax deduction" to avoid this due to the calculation on the gross rather than the net. The surcharge should not be embedded in the formula and then allowed as a deduction. He preferred "one less the PPT rate". He cautioned against allowing the surcharge to be taken as a deduction, stating it would allow the industry to "move expenses forward and backward" depending on the price of oil or other factors for the benefit of industry versus the State.

Senator Stedman next spoke to the issue of utilizing West Coast pricing rather than West Texas pricing. Both options have benefits and drawbacks. When this bill was under consideration by the Senate Resources Committee, West Texas pricing was originally proposed because it is considered a "more liquid market, more actively traded and less likely to be manipulated." That Committee amended the bill to provide for West Coast pricing. In the event of decreasing production, the West Coast pricing would be subjective to significant variations due to a lower volume. However, the current version of the bill includes language providing the State the ability to utilize a proxy if published West Coast prices were not an "accurate reflection" of the worth of the commodity. He acquiesced to the "logical argument" for utilizing West Coast pricing.

Senator Stedman continued explaining that Alaska North Slope wellhead (ANS) West Coast pricing, less the trigger amount of \$40, is the current formula. He noted the \$40 amount is subject to discussion. The ANS price, at the point of sale would be multiplied by the taxable barrels to calculate the surcharge on the barrels produced at the wellhead. This involves considering "where the oil is produced" and "where the price is triggered from".

Senator Stedman noted that the formula is not mathematically correct, or "compressed" because the calculation would change if the PPT rate was increased to .25, .3, or another amount. The

surcharge formula would be adjusted to "float with" the PPT rate ultimately adopted. This is a "conceptually easier way" to understand the PPT tax rate embedded in the formula.

[10:22:40 AM](#)

Co-Chair Green pointed out this is reflected in the committee substitute.

[10:22:43 AM](#)

Senator Stedman affirmed. The actual formula would be longer. The abbreviated formula is utilized at this stage to provide clarity.

[10:22:54 AM](#)

Mr. Dickinson further confirmed this, stating that once the legislature determines the PPT tax rate, the formula would be compressed. This is intended to avoid drafting errors made during the amendment processing of the bill remaining unidentified before enactment into law.

[10:23:22 AM](#)

Senator Stedman supported this method, as he anticipated significant discussion on the trigger point and the "slope number".

[10:23:46 AM](#)

Senator Hoffman asked how often the formula would be calculated and whether it would be done daily.

[10:23:59 AM](#)

Mr. Dickinson responded the formula would be calculated monthly.

[10:24:04 AM](#)

Senator Hoffman hypothesized the price of oil increasing from \$20 per barrel at the beginning of a month to \$30 at the end of the month, although at some point in that month reaching a maximum of \$40. He asked if in such an instance if the formula

would be calculated on the ending price of \$30 and not take into account the temporary higher price.

[10:24:23 AM](#)

Mr. Dickinson clarified the formula would be calculated on the average daily price during the one month period.

[10:24:41 AM](#)

Senator Stedman asked if the Senate Resources Committee substitute stipulated that a "weighed average" of "barrels produced" would be utilized in the formula, rather than a "simple average on barrels produced". He recommended the weighted average, as it would take into consideration rate of production at different price levels.

[10:25:11 AM](#)

Mr. Dickinson replied that over time, a "different effect" would be experienced. He questioned the benefits of establishing different triggers for each producer and subsequently different calculations for every producer.

[10:25:29 AM](#)

Senator Stedman pointed out the need to amend the bill to stipulate the use of "average" North Slope wellhead price, nothing the multiple wellhead prices for the North Slope.

[10:25:48 AM](#)

Co-Chair Green asked if the intent is to be consistent with West Coast prices.

[10:25:58 AM](#)

Senator Stedman affirmed, as he understood there to be several wellhead prices for the North Slope. The State must specify which would be utilized for these calculations. The Administration could assist in accomplishing this.

[10:26:11 AM](#)

Mr. Dickinson informed that "gross wellhead" is already defined in statute and proposed utilizing it for this tax as well. All terms affecting the gross at the point of production are detailed in the Department's regulations, including calculation of the average, rounding, accounting for days not reported, and addressing retroactive changes in reporting services. These small amounts when accumulated are significant.

[10:26:33 AM](#)

Co-Chair Green clarified such regulations currently exist.

[10:26:37 AM](#)

Mr. Dickinson answered in the affirmative.

[10:26:45 AM](#)

Page 33

CS: Progressivity Feature

House Resource Progressivity Feature

[Line graph depicting additional billions of dollars in tax based on the ANS West Coast price per barrel. The additional tax is imposed at a price of \$35bbl and increases steadily to approximately \$15 at a price of \$120bbl.]

This page was not discussed.

Page 34

Governor's bill provided a fair tax rate

ANS West Coast Price	\$70.00
Downstream Transportation	<u>(7.00)</u>
Wellhead Value (gross)	63.00
Upstream Production Costs	<u>(7.00)</u>
Production Tax Value (net)	56.00
	<u>20%</u>
	11.20
Percentage Gross	17.8%

Percentage Net 20.0%

And

Page 35

CS: How Does Progressivity Feature Work?

	PPT	Progressivity Factor
ANS Wellhead (PV)		\$63.50
ANS wc	\$70.00	
Downstream Transportation	(7.00)	4.5%
Wellhead Value (gross)	63.00	
Progressivity		4.5%
Progressivity Amount	(2.90)	2.90
Upstream Production Costs	(7.00)	
Production Tax Value (net)	53.10	

Mr. Dickinson stated that these pages, plus the following page, provide a comparison of the committee substitute to the original bill introduced at the request of the Governor.

[10:27:34 AM](#)

Page 36

How Does Progressivity Feature Work?
(Cont.)

Senate Resources CS

	PPT	Progress- ivity	Total
Production Tax Value (net)	\$53.10		\$53.10
PPT Rate	25%		
Total Tax	13.29	2.86	16.15
Percentage Gross	25.5%		28.8%
Percentage Net	21.1%		25.6%

Mr. Dickinson explained that the same ANS West Coast Price figure of \$70 is utilized in this chart. The tax has increased to almost 29 percent calculated on the net.

[10:28:09 AM](#)

Senator Bunde asked if the 29 percent increase is to the current economic limit factor (ELF) rates.

[10:28:23 AM](#)

Mr. Dickinson corrected that these are the "current rates". The current "take on gross" for the North Slope on average is approximately seven to eight percent.

[10:28:43 AM](#)

Senator Bunde requested further definition of the 28.8 percent figure cited on Page 36.

[10:28:52 AM](#)

Mr. Dickinson replied this would be the effect of the committee substitute at a price of \$70 per barrel expressed as a percent of the gross value at the point of production. This would compare to the ELF tax, which also taxes at the gross value at the point of production.

Senator Bunde asked the net tax in this scenario.

[10:29:11 AM](#)

Mr. Dickinson answered the net tax would be approximately 25.6 percent.

[10:29:20 AM](#)

Mr. Dickinson qualified that Senator Stedman had expressed that he did not intend for this as calculated to be deductible. Therefore, the actual amount would be higher. The current language of the committee substitute provides that it would be deductible.

[10:29:39 AM](#)

Senator Bunde had understood that a PPT rate of 25/20 would result in a net tax burden of approximately 12 percent.

[10:29:57 AM](#)

Mr. Dickinson explained that a price per barrel of \$70 would trigger the progressivity increase. The cited amount includes the progressivity feature.

[10:30:16 AM](#)

Senator Stedman referred to Mr. Dickenson's comment that the percentage would be higher if treated as a deduction. Senator Stedman again cautioned against double deduction, as progressivity formula is written to reflect the deduction.

Senator Stedman reported that the consulting firm, EconOne, had also calculated the Percentage Net at 25.6 percent under a 25/20 rate with a .2 escalator at \$70 per barrel. That is an effective tax rate estimated for 2007 to 2016. The formerly considered six-year transition would have allowed deduction of 75 percent of expenses incurred in FY 05, 50 percent deduction for FY 04 expenses, and 25 percent deduction for FY 03 expenses with an exclusion of \$75 million. He was unsure whether the percentages include the six-year transition provisions.

Senator Stedman expressed intent to request that EconOne recalculate the figures incorporating the changes made by the Senate Resources Committee.

Mr. Dickenson indicated the Department has prepared a fiscal note that includes this information. This would be detailed to the Committee at a later date.

[10:32:00 AM](#)

Senator Hoffman, noting that the graph on Page 33 reflected action of the House Resources Committee, requested a similar chart reflecting the Senate Resources Committee substitute.

[10:32:24 AM](#)

Mr. Dickinson acknowledged the title of the graph is in error and should read Senate rather than House. The data is reflective of the Senate Resources Committee actions.

[10:32:33 AM](#)

Governor's Bill: Other Provisions

- Monthly return filing
- 90% payment safe harbor
- Yearly true-up on 3/31

Ms. Wilson reiterated that the existent practice of producers filing on a monthly basis would not change under either the Governor's proposed legislation or the committee substitute.

Ms. Wilson stated that the Governor's version contained a 90 percent "safe haven" payment provision, which is similar to citizens' estimated tax payments for federal personal income tax returns. The intent is to accommodate for the necessary estimates involved. As a matter of fairness, the Governor determined that a safe haven be provided. This provision also includes a "yearly true-up" on March 31, to correct any differences between the estimates and the actual tax.

[10:33:30 AM](#)

Senator Stedman referenced the graph on Page 33, noting that the exponential curve starts at the price per barrel of oil at \$35 rather than \$40. The higher amount is the point specified in the committee substitute at which progressivity would take effect.

[10:34:04 AM](#)

Mr. Dickinson identified this as an error made in the graph. He confirmed progressivity would begin at \$40 under the provisions of the committee substitute and stated that a corrected graph would be prepared.

[10:34:33 AM](#)

Senator Stedman requested that once details including the tax percentages had been agreed upon, other provisions, such as "trigger points" could be discussed.

Co-Chair Green agreed.

[10:35:03 AM](#)

CS: Other Provisions

- Monthly return filing
CS maintains
- 90% payment safe harbor
CS increases this to 95%
- Yearly true-up on 3/31
CS changes this to quarterly true-up

Ms. Wilson outlined the differences between the original bill and the committee substitute.

[10:35:22 AM](#)

Co-Chair Green surmised that the producer would have less time to reconcile discrepancies once the actual tax amount was determined.

[10:35:40 AM](#)

Ms. Wilson affirmed that the true-up period would be shortened. Governor Murkowski determined that an annual reconciliation would be more appropriate.

[10:36:07 AM](#)

Page 39

Other Provisions in CS

Spill fee increases total fee 1¢ to 6¢

- Suspended fee (AS 43.55.201)
 - o 2 cents changed to 1 cent
- Non-suspended fee (AS 43.55.300)
 - o 3 cents changed to 5 cents

No Longer Creditable as in Governor's Bill

Ms. Wilson overviewed this information.

[10:36:30 AM](#)

Page 40

Other Provisions in CS

- o Existing Private royalty oil tax rate set at 5%, 1.5% in Cook Inlet
- o Bill sets no tax rate on new private royalty lease production
- o Effective date changed from 7/1/06 to 4/1/06

Ms. Wilson explained that the commission of the Department of Revenue would recommend a tax rate for new private royalty leases; however no tax would be established until the legislature took specific action.

[10:37:14 AM](#)

Ms. Wilson remarked that retroactive taxes are problematic from effective date, from "a tax administration standpoint". The Governor determined that July 1 would be a "fair" date for the new tax structure to be implemented.

Ms. Wilson announced this concluded the prepared presentation.

[10:37:48 AM](#)

Co-Chair Wilken returned to Page 8 depicting Destination Value at Market (2005). He asked if the referenced Point of Production would be established at Pump Station 1.

[10:38:15 AM](#)

Mr. Dickinson replied that this is correct for resources originating at Prudhoe Bay. Point of production for the Alpine field and other sites would be established at the point the resources enters a common carrier pipeline. Typically, the point of production is established where the resource enters a pipeline that has a published tariff.

[10:38:43 AM](#)

Ms. Wilson next spoke to the fiscal note provided for the committee substitute. She directed attention to the final two pages outlining the projected revenues. The calculations are based on the projections of the Spring 2006 Department of Revenue forecast. She detailed the information, noting the comparisons of the original bill to the committee substitute and to the existing tax structure.

[10:40:48 AM](#)

Ms. Wilson informed that the Department requests four additional positions to administer the new tax structure: three auditors and one tax technician. Although the workload would be somewhat less, additional responsibility would be required.

[10:41:33 AM](#)

Ms. Wilson referencing page 3 of the fiscal note, spoke to the transitional and auditing costs. Records of the prior five years must be audited to implement the new structure. Funds would also be necessary for costs associated with the adoption of new regulations to provide for an immediate or retroactive effective date.

[10:42:21 AM](#)

Senator Stedman asked if the information contained on the third page of the fiscal note pertains to the Senate Resources Committee substitute or a committee substitute adopted by a House of Representatives committee, as stated.

[10:42:46 AM](#)

Ms. Wilson clarified that the fiscal note should state that the information relates to the Senate Resources Committee substitute.

[10:42:52 AM](#)

Senator Stedman spoke the issue of the proposed 20 percent tax credit for exploration expenses and the effect this credit would have on revenues for the State. He requested an explanation of the "magnitude" of the credit and how it is addressed in the fiscal note.

[10:43:30 AM](#)

Ms. Wilson deferred to Roger Marks, who would be giving the next presentation.

[10:43:45 AM](#)

Senator Hoffman, speaking to the number of positions required to administer the new tax. He surmised that transitioning from a tax based on gross profits to one based on net profits could jeopardize billions of dollars if the calculations were incorrect. He asked if the four additional positions would be sufficient for this undertaking.

[10:44:18 AM](#)

Ms. Wilson explained that the four mentioned new positions would be in addition to three existing positions that are currently vacant. Once filled, six positions would be utilized for this purpose. Also, the Department intends to secure assistance from outside auditors to garner baseline data. Many fields located on the North Slope are under joint ownership and each producer effectively monitors the expenses of the others. This information would also be utilized, although the calculations would not be solely dependent on producer-generated figures. Safeguards would be in place to ensure that the data and calculations were accurate.

[10:45:43 AM](#)

Senator Hoffman requested affirmation that the number of requested positions to implement the committee substitute is unchanged from that of the original version.

[10:45:58 AM](#)

Ms. Wilson answered this was correct. She qualified that additional expenses would be incurred for the contractual costs of writing new regulations to provide for the retroactive date stipulated in the committee substitute.

[10:46:30 AM](#)

Co-Chair Wilken questioned the figure of \$25.50 reflecting the Department's forecasted price per barrel for FY 09.

[10:46:49 AM](#)

Ms. Wilson replied that the long-term forecast, which is updated every two years, is currently projected at \$25.50 for 2009 and into the future. The fiscal note also provides calculations using a price per barrel of \$40.

[10:48:23 AM](#)

ROGER MARKS, Petroleum Economist, Department of Revenue, gave a presentation titled, "PPT Revenue Studies, Presentation to Senate Finance, Alaska Department of Revenue, March 31, 2006" [copy on file].

[10:49:58 AM](#)

Page 2

Overview

- o Description of tax
- o Description of model
- o Long-term cumulative revenues
- o Annual revenues
- o Effective tax rate
- o State take
- o Cook Inlet

Mr. Marks listed these items, which would be discussed in the presentation.

AT EASE [10:50:15 AM](#)

[10:51:06 AM](#)

Mr. Marks noted that due to time constraints, he would focus on certain issues during this meeting, deferring others to the following meeting.

[10:51:32 AM](#)

Mr. Marks provided observations on certain aspects of the tax proposals.

[10:51:44 AM](#)

Page 5

Assist Small Companies & Attract New Investors

- o Small Investors
 - o Bigger appetite for smaller targets
 - o New targets

- o Diversity
- o Less risk averse
- o New Investors
 - o ANWR, NPRA

Mr. Marks reiterated Ms. Wilson's testimony that provisions were contained in the original version of the bill to encourage investors for both large and small new investors. One is the ability to deduct costs. Historically, the tax has been based on the gross value at the point of production and does not include any capital or operating costs. Under this system, any investments made do not reduce taxes. As a result, producers could take the profits earned on Alaska operations and reinvest those monies in localities where investments do reduce taxes.

Mr. Marks relayed that the Murkowski Administration determined that small investors should comprise an important part of oil development in Alaska. He listed the Nenana Basin, Minto Flats, and the southern foothills of the North Slope as locations that smaller investors would be interested in developing. Additionally, opportunities would be available for new investors to participate in the development of the Arctic National Wildlife Reserve and offshore operations. Provisions in the bill are intended to attract these investments.

[10:53:48 AM](#)

Page 6

Small & New Investors Mechanisms

- o Selling credits
- o Converting losses to credits
- o Big NPV boost
- o Standard allowance
 - o $(5,000 - 0.2 \times [ADP - 5,000]) / ADP$
 - Where ADP is average daily production for company
 - Expires after 2013

Mr. Marks characterized the Governor's proposal as a three-part approach. Development of an oil field takes a couple of years and requires investment during that time. Revenues would not be achieved for several years. The original bill would allow credits on the investment to be sold immediately. This would

"monetize credit on day one on a net present value (NPV)" and would be a significant value for new investors.

Mr. Marks compared this to the current system in which investments made on operations that prove unproductive would be lost to the investor. A wildcat outfit that spent \$10 million to drill a well that "came up dry" would carry the entire burden of that investment. Under the provisions of the Governor's proposal, the investor could convert the expenses to credits and sell those credits. The State would be "risk sharing" in these activities would essentially pay 40 percent of the costs. The State would pay 45 percent of these costs under the provisions of the committee substitute. This is important for promoting exploration.

Mr. Marks detailed the standard allowance. The original version of the bill provides a standard allowance of "5,000 barrels per day at a \$40 barrel net income". Under the current system, small fields pay no tax, a provision important to attract small investors.

[10:56:37 AM](#)

Page 7

[Line graph showing the Percentage Allowance of the Company Daily Production. At a production rate of 5,000 barrels per day, the allowance would be 100 percent. The percentage of the allowance would decrease as production increases and would be eliminated at a production rate of 30,000 barrels per day.]

Mr. Marks explained this graph depicts "what percentage of your production is tax fee depending on what your total production in the state is." No tax would be imposed on a production rate of 5,000 barrels or fewer per day. Daily production rates higher than 5,000 would be assessed a tax on a percentage of the barrels produced; for example 50 percent of the barrels produced would be taxed on a production rate of 9,000 or lower. The tax would be assessed on all barrels produced for production rates of 30,000 barrels and higher.

[10:57:43 AM](#)

Senator Bunde asked if the graph reflects the original bill or the committee substitute.

[10:57:49 AM](#)

Mr. Marks responded this information pertains to the provisions in the Senate Resources Committee substitute.

[10:57:55 AM](#)

Mr. Marks gave examples of the amount of barrels that would be taxed for independent operators developing smaller fields.

[10:58:42 AM](#)

Mr. Marks noted that all producers would receive a tax waiver on the first 5,000 barrels produced each day. Because this is "gauged to income" as prices increase and decrease, the number of tax free barrels would vary.

[10:59:41 AM](#)

Senator Dyson asked if smaller producers would make an effort to limit production to less than 5,000 barrels per day to avoid the tax, thus extending the production over a longer period.

[11:00:12 AM](#)

Mr. Marks replied that the incentive for doing this is insignificant because the allowance percentage is provided on a sliding scale. Forgoing the revenue of \$50 per barrel to save the tax is illogical unless the tax rate is very high. He was also unsure why a producer would limit production under a net present value basis, thus delaying earnings. He remarked, "Time is everything in business."

[11:00:50 AM](#)

Senator Stedman informed that the under the provisions of the original bill, at a price per barrel of \$40, approximately \$14.6 million of production annually would be tax free per producer. The number of producers operating in the future is unknown, although it is hoped that more producers would be operating and that production would be higher than the current level. The forgone tax on \$14.6 million annually for each producer would

over ten to twenty years be a significant amount of lost revenue to the State. Concern was expressed in the Senate Resources Committee that the "large exclusion" would raise questions. The amended provision in the committee substitute represents a "re-manipulated" of the tax exemption. However, new concerns have been raised that the amended provision could be too restrictive. Regardless, the intent is to have "a tax-free holiday [of] less than 5,000 barrels for all the companies."

Senator Stedman emphasized this is one portion of the incentives for smaller producers. The other portion is a "two for one look-back". This matter should be revisited by this Committee.

[11:03:17 AM](#)

Co-Chair Green announced that Mr. Mark's presentation would continue the following day.

#

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [11:03:52 AM](#)