

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
April 3, 2006  
9:04 a.m.

**CALL TO ORDER**

Co-Chair Lyda Green convened the meeting at approximately [9:04:09 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:** DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor; CHERIE NIENHUIS, Petroleum Economist, Department of Revenue

**Attending via Teleconference:** From an offnet location: ROBERT MINTZ, Assistant Attorney General, Oil, Gas & Mining Section, Department of Law; From Anchorage: ROBYNN WILSON, CPA, Director, Tax Division, Department of Revenue

SUMMARY INFORMATION

SB 305-OIL AND GAS PRODUCTION TAX

The Department of Law, the Department of Revenue, and a consultant hired by the Office of the Governor reviewed two presentations pertinent to the bill. The bill was held in Committee.

#sb305

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 third hearing for this bill in the Senate Finance Committee.

CSSB 305(RES):  
The Rest of the Story

DAN DICKINSON, CPA, Consultant to the Office of the Governor, noted that the Committee's first two hearings on this bill focused on the key elements of the proposed Petroleum Production Tax (PPT). Today's "The Rest of the Story" presentation [copy on file] would focus on the relatively "minor" issues" in the bill.

Mr. Dickinson communicated that this presentation would be followed by a discussion comparing the provisions of the Senate Resources committee substitute (CSSB 305) to those of the

Governor's bill (SB 305) and the House of Representatives Resources committee substitute, CSHB 488(RES).

[9:05:54 AM](#)

ROBERT MINTZ, Assistant Attorney General, Oil, Gas & Mining Section, Department of Law testified via teleconference from an offnet location. The "miscellaneous provisions" addressed in this presentation could be categorized into two types. The first being "improvements or corrections or updates" to current production tax statutes, and the second being elements, which while not being "core points" of the bill, should be discussed.

Mr. Mintz communicated that rather than "the logical approach" taken in the discussions of the key elements of the PPT, the provisions discussed today would be addressed in numerical section order.

Page 2

Sections 1 & 11

- Clarify AS 43.55.020 (f) to reflect consistent department interpretation, upheld in formal hearing decision in 1996
- Prevailing Value is used to set a taxable value for internally refined barrels
- May be moot for a taxpayer using "DNR" or formulaic valuation

Mr. Mintz noted that Sections 1 and 11 of CSSB 305 would amend AS 43.55.020(f) to include legislative intent, "recognizing this is not actually intended to be a change in the law, but simply a confirmation and clarification of the law" as historically interpreted by the Department of Revenue. These sections would affirm the Department's interpretation of "the valuation of oil and gas where either the selling price is not reflective of market conditions or where there is no actual sale". Previous controversy in this issue had been resolved in favor of the Department. There is currently no controversy in this regard.

Mr. Mintz exemplified a situation to which this provision would apply: "a producer in an integrated company that instead of selling oil to someone else, internally refines it in its own refineries; there is no real sale price to use to value the oil.

Thus, the Department of Revenue would determine the value of the oil based on "prevailing values". Taxes would be levied on that basis. While there was no continuing controversy in this regard, the effort was to confirm the use of this practice as "the appropriate interpretation of the law".

Page 3

Sections 2 & 17

- Amends current statute (AS 43.05.230 and 43.55.040) to clarify rules for using one taxpayer's information to determine another taxpayers tax
- Generally limited to Prevailing value calculation, which may be moot for taxpayer electing alternative valuation formula
- Taxpayer recipients of information are brought under confidentiality provisions of AS 43.05.230

Mr. Mintz expressed that the explanation of this language was "longer than its importance" since the issue being addressed does not often arise. The Prevailing Market Value (PMV) is where "the Department would calculate what oil and gas is worth in the market, and tax the taxpayer on that basis". In order to make this determination, the Department might be required to gather transaction information such as transportation costs from a variety of taxpayers.

Mr. Mintz stated that a taxpayer paying under the PMV scenario might request to know the basis of the assigned value, and "in fairness", it would be necessary to provide that taxpayer access to "certain information subject to appropriate confidentiality protections"; specifically when one taxpayer's PMV determination depended on information from other taxpayers. Thus, this language would affirm that the Department could disclose that information provided that disclosure adhered to appropriate conditions preserving the confidentiality of the information.

Mr. Mintz noted that this language would also apply "existing criminal penalties for violating confidentiality to the persons associated" with the taxpayer granted access to confidential information. Currently such penalties only apply to State employees and officers; this would expand the penalties to private individuals.

Page 4

Sections 3 & 4

- Clarify state income tax code that production tax is not a tax "based on or measured by net income"
- Ensures that the PPT is deductible for state income tax purposes.

Mr. Mintz communicated that this language would clarify, rather than change, existing law allowing production taxes on oil and gas to be deductible when calculating income taxes. Concern had been raised regarding whether Alaska or another state "might interpret the new tax differently because the tax is on the net value rather than the gross value". These provisions would clarify "the general rule that production taxes are deductible for income tax purposes".

Page 5

Section 6

- Amends AS 43.55.017 (a) to conform language to the Internal Revenue Code provision to which it refers

Mr. Mintz noted that a law regarding tangible billing costs currently existed in the federal Internal Revenue Code. Section 6 was a technical amendment which would "conform" existing statutory language to that Code.

[9:12:44 AM](#)

Senator Stedman asked whether Mr. Mintz's references to amendments meant that an amendment would be forthcoming or that the language was already included in the bill.

Mr. Mintz clarified that the amendments being discussed were included in the bill.

Mr. Dickinson interjected to clarify that the Section numbers referenced in the presentation pertain to provisions in CSSB 305(RES), Version 24-GS2052\C.

Senator Stedman expressed that the intent of his question was to clarify that the language being discussed was included in Version "C".

Mr. Dickinson affirmed. The purpose of this presentation was to explain the affect of language included in CSSB 305(RES), referred to in this presentation as CSSB 305.

[9:14:16 AM](#)

Mr. Mintz reiterated that any amendment being referenced was embodied in CSSB 305.

Page 6

Sections 9, 19, 20

Conforming amendments for language consistency and modernization.

[NOTE: The reference to Section 9 is incorrect. The correct section is Section 8.]

Mr. Mintz pointed out that the current State production tax law applied a separate tax on oil and gas. The production tax proposed in the PPT would apply "a single tax" to both oil and gas. Thus, the purpose of the language in Sections 8, 19, and 20 would be to replace the word "or" with "and" where applicable in this regard.

Page 7

Sections 10, 24, 26

- Repeals and Reenacts AS 43.55.020 (e)
- Simplifies three tiered system where flared gas was either tax free, taxed, or subject to tax and a penalty.
- Now gas and oil are not taxed or subject to conservation surcharges if used for necessary lease operations. (If AOGCC determines they have been wasted, then they are taxed.)

Mr. Mintz stated that this language would simplify existing production tax provisions relating to "flared gas" which is gas "released, burned, or otherwise vented" and gas or oil used in

the production process, such as gas or oil burned as fuel or "gas that is re-injected for pressure maintenance".

Mr. Mintz stated that existing production tax law recognized three categories of flared gas: flared gas "authorized for safety purposes by the Alaska Oil and Gas Conservation Commission" (AOGCC) was not subject to the production tax; waste flared gas was subject to the tax as well as a penalty equal to the amount of the tax; and flared gas authorized by AOGCC for something other than safety purposes was subject solely to the tax. The PPT would condense the three categories into two: any flared gas authorized by AOGCC would be exempt from the tax and flared gas not authorized by AOGCC would be taxable. The penalty currently assessed on waste gas was eliminated in consideration of the fact that AOGCC would continue to levy its separate penalty on it. Their penalty was higher than the penalty currently levied by the Department of Revenue.

[9:16:57 AM](#)

Mr. Mintz stated that the PPT would also expand the provision exempting the tax on "gas used in lease operations for production" to also exempt oil used in that manner. This oil and gas would also be exempt from conservation surcharges.

Page 8

Section 14 and 15

- Conforming changes to 43.55.030(a) (dealing with tax returns)
- Gross/net, and/or, simplified reporting
- Repeals the \$25 a day filing penalty which predated the 43.05 civil penalties

Mr. Mintz categorized the language in Sections 14 and 15 as conforming changes. The PPT would require additional information in tax returns; specifically in regard to lease expenditures as "that would be a major new deduction". In addition, the \$25 per day late filing penalty would be repealed as current State's revenue statutes apply stiffer penalties to both late filings and late taxes.

Mr. Mintz recalled a situation in which the filings of a small producer who owned a minuscule amount of production internally

"fell through the cracks". The \$25 per day late filing penalties "cascaded ... into many times the tax due".

[9:19:02 AM](#)

Mr. Mintz stated that since the Department of Revenue is provided "limited discretion" in terms of "compromising penalties", a question of "fairness and proportionality" sometimes arose.

Mr. Dickinson also shared a situation in Cook Inlet in which, as the result of a number of equity trades, a producer became unknowingly responsible for the filing due on "a fraction of a percentage in a lease". Four years later when the producer became aware of the situation, the \$25 per day late filing penalty generated a total penalty exceeding one million dollars on a tax liability of approximately \$100. Such situations attributed to the decision to eliminate the \$25 a day penalty. "This was a superfluous situation which led to bizarre results".

[9:20:11 AM](#)

Page 9

Section 18

Amends AS 43.55.080

- Conforms statute to constitution
- Namely: recognizes that money from resolved disputes goes into Budget Reserve Fund and not into the general fund

Mr. Mintz communicated that AS 43.55.080 allowed money resulting from oil tax disputes to be deposited into the State's general fund. Amending this statute, which predated the adoption of the [Constitutional] Budget Reserve Fund (CBR) amendment that required certain revenues resulting from the resolution of tax disputes to be deposited into the CBR, would conform the Statute to the State's Constitution.

Page 10

Sections 27, 29

- New definition of "gas"
- Point of production moved downstream
- Gas processing now included in Upstream
- New definition of "oil"
- Liquid hydrocarbons recovered by mechanical separation or gas processing

[9:21:14 AM](#)

Mr. Mintz reiterated that the definition of gross value at the point of production would change under the proposed PPT. While the point of production for oil "would not be materially changed", the point of production for gas would move downstream of its current location. In addition, the definitions of gas and oil would be changed. This "common sense approach" to the definitions would consider "anything that is in a gaseous phase at the end of the production process" to be gas and "anything that is in a liquid phase" would be considered oil.

Page 11

Section 28

- Redefine "gross value at the point of production"
- Oil pt.-of-prod. definition essentially unchanged (but if there is gas processing, the pt.-of-prod. for extracted liquids is downstream of processing)
- Gas pt.-of-prod. is downstream of any gas processing
- If there is a combined processing / treatment plant facility, pt.-of-prod. is further upstream point where processing ends or treatment begins

Mr. Mintz stated that under current Statutes, "gas processing, which is the extraction of liquid hydrocarbons from gas, is considered downstream from the point of production". Under the PPT, gas processing would be upstream from the point of production. Furthermore, certain liquid hydrocarbons extracted during gas processing are considered gas under current production tax statutes; however, they would be considered oil under the definitions of the PPT.

[9:22:41 AM](#)

Mr. Mintz stressed that there was an important distinction between gas processing and gas treatment. While gas processing was the extraction of liquid hydrocarbons, gas treatment, which was "associated with the gas transportation process, would involve extracting non-hydrocarbon components such as carbon dioxide and conditioning gas to make it suitable for pipeline transportation". In addition, gas processing would be considered upstream of the point of production while gas treatment would be considered downstream of the point of production

Mr. Mintz stated that Section 28 would also address the situation in which an integrated facility conducted both gas processing and gas treatment. The point of production for gas would be considered upstream of gas treatment.

Mr. Dickinson advanced the presentation to page 14, as that schematic would assist in understanding the point of production process.

Page 14

[This chart depicted a schematic pertaining to the Point of Production process for oil and two schematics applicable to the Point of Production process for gas.]

[9:24:00 AM](#)

Mr. Dickinson reviewed the current point of production process. The point at which well fluids were mechanically separated would be considered the point of production for the majority of oil and gas. The point of production for oil was the place at which it is "metered and measured and placed in a sales line". The point of production for gas, were "a simple lease" in place, would mirror that of oil.

Mr. Dickinson communicated, however, that the fluids on the North Slope tend to consist of "a gaseous mixture of hydrocarbons" which, could not be defined as either oil or gas. In Prudhoe Bay that fluid would be transported to a central gas facility which is "a gas processing plant where valuable liquid hydrocarbons are removed".

Mr. Dickinson communicated that under current definitions, the stream of approximately 45,000 barrels a day of liquid

hydrocarbons emitting from the central gas facility would be transported via the Trans Alaska Pipeline Service (TAPS) and "for all intensive purposes sold as oil downstream". However, "for tax purposes", that material would be treated "as if they were gas".

Mr. Dickinson estimated that approximately eight percent of the fluid moving through TAPS was gas not oil. Under the revised definitions of gas and oil in the PPT, any material transported via TAPS would be recognized as oil.

Mr. Dickinson stated that, under the PPT, the gas processing plant would be moved upstream of the point of production rather than downstream as is currently the case. Gas processing expenses would qualify as a credit in addition to being a tax deduction under the PPT.

Mr. Dickinson stated that the credits allowed by moving the gas processing plant upstream of the point of production would increase a small producer or explorer's ability to build a plant. "This may change the dynamic of the negotiations". Rather than the end result being "a dozen half empty or half used processing plants in the North Slope", it is anticipated that this scenario would improve a small producer's negotiating position with a producer who currently has a facility.

[9:27:40 AM](#)

Senator Stedman suggested that the gas processing schematic depicted on the right portion of the page 14 graph more identifiably reflect the TAPS transportation component. While the verbal discussion clarified that point, the graph as a stand-alone did not.

[9:28:34 AM](#)

Senator Stedman requested that further information be provided as to whether the credits issued to a producer via the gas processing component might be affected by Federal Energy Regulatory Commission (FERC) federal regulations.

[9:29:45 AM](#)

Mr. Dickinson pointed out that, as depicted in the gas production schematic on the right side of page 14, gas

processing would be upstream of the point of production and gas treatment would occur downstream of the point of production. In the event of a combined gas processing/gas treatment plant the point of production would be between the two processes.

[9:30:21 AM](#)

Mr. Dickinson shared the Administration's determination that, were a gas pipeline constructed, the gas treatment plant, which would be the last facility before the gas entered a main transportation line, would be considered "part of the transportation infrastructure". As a condition of a gas pipeline proposal currently being considered, the State would acquire an ownership percentage in project components downstream of the point of production, such as the gas treatment plant. Further information in this regard would be forthcoming.

[9:31:40 AM](#)

Mr. Dickinson concluded that "once you cross" the line between the upstream and downstream processes, a different set of building and facility maintenance regulations would be in effect, as the downstream facilities would be regulated by the Federal Energy Regulatory Commission (FERC). FERC would ensure there being just and reasonable rates and that access would be allowed for anyone desiring to use the line at that just and reasonable rate. "The whole issue of credits and support would" become more complex.

[9:32:12 AM](#)

Co-Chair Green noted that a six-page memorandum [copy on file] dated March 19, 2006 to Senator Gene Therriault from Donald Shepler with Greenberg Traurig, a consulting firm to the Department of Revenue, clarified that FERC would have the ability to make decisions regarding downstream events.

[9:32:35 AM](#)

Senator Stedman asked that time be allotted to discuss the information in Mr. Shepler's letter, as this issue has a "huge impact". While the parameters of such a discussion could be limited to the issues addressed in this bill, the issue would become more complicated as discussions advanced. It would have

"major consequence" on how the credits provided to producers could be utilized.

Co-Chair Green asked whether Senator Stedman was referring to the 20 percent credit provision in the bill.

Senator Stedman affirmed. FERC's involvement could negatively influence how production tax credits could affect a producer's equity position. There is nothing concrete as to how the credits would be recognized. His understanding was that FERC's regulations would, in the case where a producer had a 40 percent equity position and a 20 percent credit, result in the credits "diluting" the producer's equity position. The Committee must "understand the full flow through of impact on rates, impact on the value of the commodity we're selling, when we make these decisions".

[9:33:56 AM](#)

Senator Bunde stated that the schematics on page 14 were confusing as they depicted two points of production for gas: the center schematic depicted a point of production immediately following the mechanical separation and the schematic on the right depicted a point of production involving processing and treatment.

[9:34:35 AM](#)

Mr. Dickinson explained that the Point of Production for Gas following the mechanical separation referred to gas utilized on the North Slope or small amounts of gas sold for industrial purposes. The majority of North Slope gas would be the gaseous mixture of hydrocarbons process reflected in the schematic on the right side of the page. It's metering and weighing would occur at the point of production after processing.

Mr. Dickinson communicated that the 8.5 billion cubic feet (Bcf) per day of gas that is re-injected into the ground was not considered "produced" and as such was never metered or measured. "Produced is a technical term of having a gross value at a point of production."

Senator Bunde understood therefore that re-injected gas was not considered "produced". Metering would only occur for gas

identified in the schematic on the right side of the page 14 chart.

9:35:50 AM

Mr. Dickinson affirmed. Were the Central Gas Facility (CGF) at Prudhoe Bay to remain in its current location, and a separate gas treatment facility constructed near it, the point of production for gas would be between those two facilities.

9:36:08 AM

Senator Bunde asked for further clarification regarding the point of production in a combined gas processing/treatment plant.

Mr. Dickinson clarified that the schematic on the right side of the page contained two scenarios. One involved separate processing and treatment facilities, and one involved a combined processing/treatment facility. In the latter case, the point of production would be considered the point between the two processes.

Senator Bunde acknowledged.

9:36:46 AM

Co-Chair Wilken referenced a three-page handout titled "Prudhoe Bay: Point of Production" [copy on file] provided by Mr. Dickinson and asked whether the point of production was treated the same under SB 305, CSSB 305(RES) and CSHB 488(RES).

Mr. Dickinson affirmed it was.

Senator Stedman reiterated that the impact of FERC's regulations on how proposed PPT gas credits might affect producers was "a big big issue". To that point, he requested Committee members to carefully read the first paragraph in the Conclusion section on page 6 of Mr. Shepler's memorandum. This language reads as follows.

I have not found any clearly binding precedent that answers the question you posed. However, since FERC bases rates on the costs incurred to provide the services, the fact that Project Sponsors received quantifiable state tax credits

and deductions as a direct result of investing in a GTP suggests that FERC would be included to require that those benefits be flowed through to shippers whom make us of the GTP this would be the result I would expect.

[9:37:52 AM](#)

Mr. Dickinson stated that under the provisions of CSSB 305, there was "a line between gas treatment and gas processing". No credits would be issued in regards to gas treatment. "It is gas treatment that typically is regulated by the FERC." Continued maintenance of that line would provide "the clear clean separation" required.

Co-Chair Green understood that CSSB 305 would maintain that line.

Mr. Dickinson affirmed.

Senator Stedman informed the Committee that the Point of Production line being drawn between Gas Processing and Gas Treatment was the result of numerous amendments to the bill. He supported those amendments. Members should be cognizant of the fact that many issues had been addressed during the bill's Legislative committee process.

Co-Chair Green pointed out that several issues had been addressed in the Senate Resources committee substitute.

Senator Stedman affirmed. His point was that, even though this issue was addressed by the Senate Resources Committee, issues such as the one he raised regarding FERC, should be issued addressed by the Finance Committee.

Co-Chair Green reiterated her understanding that the issue had been addressed in CSSB 305(RES).

Senator Stedman affirmed.

[NOTE: The discussion regarding the information on page 14 concluded and the presentation cycled back to page 12.]

[9:39:08 AM](#)

Section 30 (part 1)

- New definition of "Cook Inlet Basin"
- For purposes of the 1.5 percent tax on lessor's royalty share (outside of Cook Inlet Basin the tax is 5 percent)

Mr. Mintz noted that the royalty tax rate included in CSSB 305 for oil and gas activities specific to Cook Inlet prompted the inclusion of a new definition of Cook Inlet Basin in the committee substitute.

Page 13

Section 30 (cont.)

- Define "gas processing" and define "gas treatment"
- Gas processing: physical processes that extract liquid hydrocarbons, upstream of a sales line or gas treatment plant
- Gas Treatment: removing non- hydrocarbon substances and conditioning gas for sales line

Mr. Mintz noted that Mr. Dickinson had addressed this information in the discussion pertaining to page 14.

[9:39:47 AM](#)

Page 15

Section 31

- Repeal of superseded provisions, including individual gas and oil taxes, ELF, and some definitions

Mr. Mintz identified Section 31 would repeal sections of the current production tax statute.

Page 16

Sections 32, 33

- Applicability: Sections pertinent to taxing oil and gas under the PPT apply to oil and gas produced starting April 1, 2006
- Applicability: Prevailing value clarification of existing law applies to all oil and gas
- Part-year conventions for 2006
- ELF based safe harbor for 6 months

Mr. Mintz stated these Applicability sections clarified that the proposed PPT would apply to oil and gas produced as of April 1, 2006. The prevailing value statutes addressed earlier in Section 1 page 2 were "simply a clarification rather than a change in the law", and therefore, that language would apply to oil and gas produced before or after April 1, 2006.

Mr. Mintz noted there being several transition sections in the committee substitute. Since the PPT tax would not be in effect until April 1, 2006, the first three months of the calendar year must be removed from the determinations. The bill must clarify that the PPT provisions would apply to nine months rather than 12 months of the initial year of implementation.

[9:41:03 AM](#)

Mr. Mintz also noted the bill would include safe harbor tax reporting and payment to taxpayers for the initial six months, as taxpayers could not be expected "to retroactively pay the correct amount". In addition, both the Department and taxpayers would require time to "adjust their accounting and payment procedures to comply with the new tax provisions". In essence, a taxpayer could pay the tax due under existing production tax provisions for the first six months, then be required to make up the difference in the tax paid and the tax that would have been levied under the PPT.

Page 17

Section 34

- Transition provisions --
- Department may develop PPT implementing regulations immediately
- Implementing regulations may have retroactive effect to April 1, 2006

Mr. Mintz noted the additional transitional provisions. This language would authorize the Department of Revenue to begin work immediately, rather than waiting for the effective date, on implementing regulations in the case the effective date was something other than April 1, 2006. Language providing retroactive authorization for implementing regulations was considered "very important". Regulations must specifically address the retroactive affect of the bill.

[9:43:26 AM](#)

Page 18

Section 35

- Conform headings of statutory provisions

Mr. Mintz stated this Section would allow for conforming headings of provisions "to the new tax law".

Page 19

Sections 36, 37, 38

- Effective dates -
- PPT provisions take effect April 1, 2006but if they take effect after April 1, they are retroactive to April 1
- Other provisions take effect immediately

Mr. Mintz noted that, while the bill specified an effective date of April 1, 2006, this language would allow the bill's provisions to be retroactive. "Provisions not integral to the PPT, would have an immediate effective date."

Mr. Mintz concluded the presentation.

[9:44:31 AM](#)

"PPT: Comparing the Options" dated April 3, 2006

ROBYNN WILSON, CPA, Director, Tax Division, Department of Revenue, testified via teleconference from on offnet location to

address the power point presentation titled "PPT: Comparing the Options" dated April 3, 2006 [copy on file].

Mr. Dickinson noted that this presentation would review the differences between the Governor's bill, SB 305, the House of Representatives committee substitute, CSHB 488(RES) and the Senate Resources committee substitute, CSSB 305(RES).

[NOTE: In these minutes, the Governor's bill is referred to as SB 305, the Senate Resources committee substitute is referred to as CSSB 305 and the House committee substitute is referred to as CSHB 488.]

[9:46:08 AM](#)

Page 2

#### Effective Dates & payments

- Governor's bill  
\*Effective 7/1/06
- House CS & Senate CS  
\*Effective 4/1/06

Mr. Dickinson expressed that both CSSB 305 and CSHB 488 would designate the provisions of the bill to be retroactive to April 1, 2006. SB 305 would have an effective date of July 1, 2006. CSSB 305 with its April 1 effective date and Progressivity component would generate approximately \$430 million more revenue than SB 305 with its July 1 effective date based on a forecasted price of \$58 per barrel. Oil was selling at \$65 per barrel on April 2, 2006. CSHB 488 would generate approximately \$300 million more than SB 305.

Page 3

#### Effective Dates & payments

- Governor's bill  
\*Effective 7/1/06
- House CS & Senate CS  
\*Effective 4/1/06  
\*6 mo. payment on ELF system, 7th mo. true-up

Mr. Dickinson communicated the Administration's support of the transitional period included in both the House and Senate bills. Such language was not included in SB 305 because the thought was that were the bill adopted early in the Legislative session, a six month transitional timeframe would have been provided between its adoption and effective date. That not being the case, a transitional timeframe should be specified regardless of whether the Governor's bill or a Legislative committee substitute was adopted.

Mr. Dickinson explained the transitional period included in CSSB 305: a taxpayer could pay their tax as determined under the status quo tax system for the first six months after the effective date of the bill. The difference, or "true up", between the taxes paid and the amount due under the PPT would be due during the seventh month. Interest and penalties would be applied to any tax not satisfied at that time. From that point forward, the monthly tax paid must comply with the provisions of the PPT. A true up of a calendar quarter's taxes must occur by the end of the following calendar quarter.

[9:48:56 AM](#)

[NOTE: The charts depicted on pages 4 and 5 were not discussed.]

Page 6

Tax Rate  
Annual Oil Severance Tax(Millions of 2005 Dollars)  
Low Volume Scenario, \$20, \$40, and \$60 per bbl  
Governor's PPT at 20/20 and 25/20

[This chart depicts various scenarios of the Severance Tax under a low volume scenario based on a 20 percent and 25 percent tax as influenced by \$20, \$40, or \$60 per barrel prices between the years 2005 and 2030.]

Mr. Dickinson communicated that the information on the charts in this presentation were presented in the format previously suggested by the Committee. For comparison purposes, a variety of scenarios were depicted on one chart. Additional grid lines were added, and the information on the vertical "Y" axis and the horizontal "X" axis would be uniform from chart to chart.

Mr. Dickinson stated that the chart on page 6 represented six scenarios: the anticipated severance tax revenue generated by the 20 percent tax rate proposed in SB 305 at a \$20, \$40 and \$60 per barrel oil price as compared to CSSB 305's 25 percent tax at those same prices. The difference between the 20 percent and 25 percent tax at a \$20 per barrel price would each generate "tens of millions of dollars"; however, they would provide an "inconsequential" amount of revenue in comparison to the revenue the State would receive at higher prices. He pointed out that regardless of whether the 20 or 25 percent tax rate were in place, a \$20 per barrel price would provide zero revenue to the State by approximately the year 2014.

Mr. Dickinson continued that, at \$40 per barrel, both SB 305 and CSSB 305 would generate substantially more revenue; however, that revenue would start to decrease around the year 2014 and would approach zero revenue around 2030.

Mr. Dickinson stated that, as would be expected, higher revenues would be generated under both tax proposals at \$60 per barrel. CSSB 305 would initially generate approximately \$250,000,000 per year. The Governor's bill would generate a lesser amount. However, as oil production, and consequently, revenues declined the downward revenue slopes of the two tax rates "stay fairly constant".

CHERIE NIENHUIS, Petroleum Economist, Department of Revenue distributed a four page handout [copy on file] which further portrayed the tax percentage comparisons. The first page, titled "Slide 6: Tax Rate: Governor's Bill with 20/20 and with 25/20, Low Volume", presented line item Low Volume revenues, in a "table" format, for the 20 percent and 25 percent tax rates at \$20, \$40 and \$60 per barrel for the years 2007 through 2030.

Utilizing the information on the Slide 6 sheet, Ms. Nienhuis pointed out that at \$60 per barrel, the 25 percent tax proposed in CSSB 305 would generate an "average annual increase" of \$394 million dollars more than the 20 percent tax proposed in SB 305. The \$597 million 24 year cumulative revenue generated by the 25 percent tax at \$20 a barrel would be a 231 percent increase over the \$180 million cumulative revenue generated by the 20 percent tax at that price. "That's a significant increase." Additional comparison information could be deemed from the Table.

[9:53:51 AM](#)

Mr. Dickinson stressed that, while the percentage difference between the two tax rates at \$20 a barrel might be "huge, as a dollar amount it's very very small".

Ms. Nienhuis concurred. She reiterated that the amounts she had quoted were cumulative rather than yearly revenues.

[9:54:08 AM](#)

Ms. Nienhuis noted that the cumulative difference between the 25 and 20 percent tax at \$40 a barrel was approximately five billion dollars. The 24 year cumulative difference at \$60 per barrel was approximately ten billion dollars.

[9:54:50 AM](#)

Mr. Dickinson stated that the two tax rate scenarios at \$60 a barrel as referenced by Ms. Nienhuis were depicted in graph form on page 6 of the presentation. Initially the 20 percent and 25 percent tax rate at \$60 a barrel would generate annual revenues of approximately \$2,000,000,000 and \$2,500,000,000, respectfully. "The two would fall off proportionately" as oil volume declined.

[9:55:30 AM](#)

Senator Stedman characterized these revenue forecasts as "ghastly looking numbers". However, the situation would appear different where it viewed in terms of Total Government Take verses industry take. The "fairness issue" is "the fundamental issue in front of us".

[9:55:58 AM](#)

In response to Senator Stedman's remark, Ms. Nienhuis distributed a graph titled "Total Government Take, Senate CS at 25/20 and 20/20, Low Volume Scenario" [copy on file], which reflected the Total Government Take as a percent of the barrel price, based on CSSB 305's 25 percent tax rate and SB 305's 20 percent tax rate at prices ranging from \$15 to \$65 Alaska North Slope (ANS) prices per barrel.

Senator Stedman stressed that the State's royalty and property tax system were "regressive". The State must have a progressive

tax system "to counteract" those systems. The PPT being proposed would provide the necessary progressive tax system. Viewed on its own, the PPT would appear "more egregious" than were it viewed as an element of the overall State tax structure.

Senator Stedman understood the inclination to focus on the revenue the tax would generate; however, he worried that concentrating solely on the revenue might "lead [the State] down the wrong road. And at the end of the day", an "incorrect decision" about what would be in "the best interest of the citizens" of the State for the sale of this commodity might be made. Legislators should be mindful of the fact that royalties and taxes have been used "as a selling mechanism".

[9:57:07 AM](#)

Senator Bunde addressed Senator Stedman's comments by voicing that his "egregious concerns" were his grandchildren and what they would utilize to support their government. He pointed out that a barrel of oil could only be "sold once".

Senator Bunde understood that the oil industry was anticipating oil prices to hover around \$40 a barrel for the next several years. Were that the case, some of the scenarios being reviewed were optimistic rather than reality.

[9:58:20 AM](#)

Ms. Nienhuis acknowledged there being a variety of revenue forecasts. The Department of Revenue's long-term forecast anticipated that ANS oil prices would range between \$25 and \$50. The Department's long term forecast is revisited every two years and would next be reviewed in the fall of 2006. The federal Energy Information Administration (EIA) long term forecast was \$58. Because, oil prices are "all over the board", the decision was made to present "several different scenarios" to the Legislature.

Senator Bunde characterized the barrel as being "either half full or half empty" depending on the source.

[9:59:15 AM](#)

In response to a question from Senator Stedman, Ms. Nienhuis stated that, while the "Total Government Take" handout, was not part of today's presentation, it could be discussed.

Senator Stedman observed the information depicted on the Total Government Take handout to indicate that at ANS prices between \$25 to \$60 a barrel, the Government Take under either the 25 or 20 percent tax rate "stay relatively constant at approximately 60 percent".

Senator Stedman stated that the effort should be to maintain that percentage going forward. It was his intention to ask Econ One Research, Inc., the economic research and consulting firm hired by the Administration, to update their Total Government Take analysis to reflect CSSB 305 rather than previous versions of the bill.

[10:00:55 AM](#)

Co-Chair Wilken recalled Senator Stedman previously developing a chart [copy not provided] which compiled Econ One's analyses. Thus, he asked whether Senator Stedman's intent was to update that information.

Senator Stedman affirmed that to be his intent. The \$60 ANS price range projections presented today by the Administration were "slightly less" than those presented in the Econ One's analyses based on previous bill versions. The expectation would be that when Econ One updated its numbers to reflect CSSB 305, the numbers would be close to those presented by the Administration. Updating Econ One's information would not be a very cumbersome endeavor.

[10:02:01 AM](#)

Mr. Dickinson stated that, on numerous occasions, the Administration and Econ One reviewed each other's statistical modeling analyses. Both entities' modeling results were close when identical information was utilized. Oftentimes, however, graphs would differ because different variables were utilized.

Senator Stedman reiterated his recommendation that Econ One replace its previous modeling analyses with that reflecting CSSB 305. This request should not be misunderstood as questioning the material provided by the Administration; the intent would be to

have two modelings of the same bill version for comparison purposes.

[10:03:50 AM](#)

Page 7

#### Effect of Progressivity

Annual Oil Severance Tax (Millions of 2005 Dollars)  
Low Volume Scenario, \$50, \$60, and \$70 per bbl  
Governor's Bill as written, with House Progressivity, and  
with Senate Progressivity

[This graph provides nine low volume scenarios depicting how the Progressivity factors incorporated into the Senate and House PPT bills would compare to the Governor's bill as written, at ANS prices of \$50, \$60, and \$70 per barrel. The "Y" axis reflects the Severance Tax revenue and the "X" axis reflects the years 2007 through 2030.]

Mr. Dickinson explained that this graph depicted how the Progressivity factor, which becomes effective when ANS oil prices exceeded \$50 under CSHB 488 and \$40 under CSSB 305, would compare to the provisions of SB 305, which, as written, does not contain a Progressivity component. The bottom line on the chart represents the revenue for both the Governor's bill and the House bill at \$50 a barrel, as the House's progressivity factor would not generate any additional monies at that price. The second line from the bottom on the chart would reflect the revenue generated at \$50 a barrel under CSSB 305 and its Progressivity factor, which "kicks in" at a \$40 ANS price.

Mr. Dickinson noted that the lower of the next set of three lines was SB 305 at a \$60 ANS price with its flat 20 percent tax "regardless of the profits". Above it, in close proximity to each other, were graph lines depicting the revenues generated under CSHB 488 and CSSB 305. It is apparent that at \$60 ANS, the House and Senate bills and their progressivity elements would generate "quite a bit more money" than the Governor's bill at that price.

Mr. Dickinson noted that the top two lines of the chart represented the revenues generated by CSSB 305 and CSHB 488 with their progressivity elements at \$70 ANS. The line representing

the Governor's bill at \$70 ANS rests on top of the graph line depicting the revenue generated by CSHB 488 at \$60 ANS with progressivity. "In other words", the revenue generated by SB 305 at \$70 ANS without progressivity would equate to the revenue generated by CSHB 488 at \$60 ANS with Progressivity.

Mr. Dickinson noted that while the revenue generated by the Governor's bill would rise and fall with the price of ANS oil; the progressivity features of the House and Senate bill, while different and triggered at different ANS prices, would generate substantially more revenue.

[10:09:26 AM](#)

Page 8

WTI & ANC Crude Prices: Jan 1988 - Feb 2006

[This chart compares the WTI price, which averages \$25.01/barrel, to the ANS price which averages \$22.70/barrel. The vertical axis represents the price per barrel for the time frame of January 1988 through January 2006 in two year increments as depicted on the horizontal axis. While WTI prices are consistently slightly higher than ANS prices, the markets mirror each other's rises and falls.]

Mr. Dickinson advised the Committee that the House Progressivity feature was triggered by the West Coast Intermediate (WTI) price of oil rather than the ANS price utilized as "the key driver" of the Senate's Progressivity feature.

Mr. Dickinson stated that, regardless of whether the Progressivity feature was good or bad, either of these two markets would be "viable broad indicators" of price as they reacted to the same market influences, and, as indices, they tend to trend together.

Mr. Dickinson compared the WTI and ANS oil trading markets. WTI "is widely traded". The general sense is that the WTI market is "immune from any kind of manipulation" as it is a "very transparent widely reported figure. ANS, on the other hand, is just this one stream of oil, there are literally on average maybe two or three sales a month", some months go without a sale. While the ANS price is reported daily, that price is

simply the "WTI price adjusted at the market differential". The market differential is the last ANS sale as compared to the WTI.

Mr. Dickinson stated that the two markets might move together with a WTI price two dollars higher than the ANS price. An ANS sale is made at a price \$1.50 less than the WTI price. This would result in an ANS market adjustment of 50 cents to align the two markets going forward. Because the ANS price is based on the WTI, the recommendation would be to utilize WTI as the long term market marker.

[NOTE: The "Schematic Comparison of Tax of Gross Prior to netting out costs at various (INCLUDING VERY HIGH!!!) Oil Prices" chart on page 9 is discussed at Time Stamp [10:17:36 AM](#).]

Page 10

WTI - ANS Differential: Jan 1988 - Feb 2006

[This chart indicates that, during times of falling oil prices, ANS oil prices often experience a steeper fall than the WTI price.]

Mr. Dickinson informed the Committee that at times when the WTI price dropped, the ANS price might drop further due to a lower confidence factor. This would increase the price differential between WTI and ANS. At one point in the past year, these differences reached an "unprecedented" level which was worrisome to some individuals. These situations could be built into the modeling; however, the overriding issue is that "generally", the ANS price would continue to be approximately two dollars lower than the WTI price. The "features" of the WTI would make it a better marker of the index. On the other hand, in terms of "calculating the wellhead value", ANS should be utilized.

[10:13:47 AM](#)

Senator Stedman stressed the importance of this information in the discussion about the Progressivity trigger. The Senate Resources Committee amended the bill to change the trigger from WTI to ANS West Coast. The issues associated with using ANS West Coast should be recognized. WTI, being more fluid and having higher volumes, would be "less likely to be manipulated". It is also commonly utilized in the global financial market.

Senator Stedman shared the belief that the use of ANS would include some inherent risks to the State. Further discussion on this issue should occur.

Co-Chair Green asked whether utilizing ANS would require an adjustment to be made to the Progressivity trigger point.

Senator Stedman declared that consideration should be given to adjusting the \$40 trigger point to account for the two dollar difference between WTI and ANS.

10:15:14 AM

Senator Stedman referred the Committee back to the "Effect of Progressivity" chart on page 7 which reflected the differences between the Progressivity factors included in the House and Senate bills as compared to SB 305 which does not contain a Progressivity factor. He suggested that the information pertaining to the Senate and House bills be "rechecked" as the differences were not what he had expected. In addition, he asked that the chart be reformatted to consistently depict the different pricing scenarios for the Senate in one color, the House in another color, and the Governor's bill at another color.

Senator Stedman reiterated that once Econ One revised its information comparing the Progressivity relationship between the House bill and the current version of the Senate bill, any needed modifications or errors in either bill might become more evident.

10:16:31 AM

Co-Chair Wilken asked whether the differences between the House's Progressivity rate being based on WTI and the Senate's being based on ANS might be evident on the April 3, 2006 "Comparison of PPT Bill Versions - Highlights" summary sheet [copy on file] provided by the Department of Revenue.

Mr. Dickinson stated that the differing Progressivity factors are depicted on the fourth line item on the sheet, titled "progressivity surcharge."

Co-Chair Wilken acknowledged.

Mr. Dickinson agreed that the color coding suggested by Senator Stedman made good sense. Several of the Department of Revenue's material incorporated that approach.

[10:17:36 AM](#)

Page 9

Schematic Comparison of Tax on Gross Prior to netting out costs at various (INCLUDING VERY HIGH!!!) Oil Prices

[This chart depicts how the tax on gross revenue would look under the House, Senate, and Governor's PPT bill proposals at prices ranging from \$10 a barrel to \$170 per barrel.]

Mr. Dickinson stated this graph depicted how "truly extraordinary" high prices would affect the tax on gross revenue under the House, Senate, and Governor's bills.

Mr. Dickinson specified that, at "very high prices", the difference between basing the tax on net and gross revenue would be immaterial. The revenue generated by a \$160 barrel price gross, which would equate to a net of approximately \$150, as "a percentage, is very close". He pointed out that rather than the focus being on the outcome of barrel prices at the lower end of the chart, the focus should be on the outcome of prices exceeding \$100 per barrel. While oil might not achieve that price, people should be aware of what might happen were prices to escalate to that level.

Mr. Dickinson continued that, regardless of price, SB 305 with no Progressivity element would simply apply a 20 percent tax on a company's profits. At \$100, the rate of tax charged under the CSHB 488 with its 20 percent tax rate and a \$50 Progressivity component, would "essentially double" and then stay relatively flat. At \$110 per barrel, CSHB 488 would basically collect "50 percent of the value". The producer would be required to pay royalty, federal taxes, and other obligations with the 50 percent they garnered.

Mr. Dickinson stated that CSSB 305 with its 25 percent tax and \$40 Progressivity factor would impose a slightly higher tax rate until approximately the \$85 to \$110 price range when both the House and Senate tax percent takes would be approximately the same. However, it should be noted that at approximately \$110 a

barrel, some feature in the House bill would cause that tax rate to climb dramatically while the Senate tax percentage would continue a steady upward climb. The trends depicted on the graph would be expected to continue through the \$200 per barrel price range.

Mr. Dickinson exemplified how the tax rates that would be imposed under CSSB 305 and CSHB 488 and SB 305 were oil prices \$200 a barrel. At that price, deductions for expenses would be "a fairly minimal percentage". The 20 percent tax on oil priced at \$200 a barrel under SB 305 would equate to a total tax of \$40. The tax collected under CSHB 488 would be approximately 50 percent or \$100. The tax collected under CSSB 305 would be approximately 45 percent or \$90. "Real differences" in the tax collected would surface when prices exceeded approximately \$100 per barrel.

[10:21:19 AM](#)

Co-Chair Wilken stated that the price range depicted on the horizontal axis might appear "absurd" but there might be "short periods of time" when they could be realistic. To that point, he asked whether the Senate Resources Committee had discussed the Progressivity factor in consideration "of the cost of getting that oil out of the ground", for, when oil prices increase from \$40 a barrel to \$120 a barrel, the cost of extracting that oil and shipping it to market does not triple. Therefore, he queried as to whether a study has been conducted that would specify how much it would cost to extract oil when prices were, for example, \$40 a barrel or \$120 a barrel.

Mr. Dickinson understood that Roger Marks, Petroleum Economist, Department of Revenue has touched on this issue when he presented to the Committee. When oil prices were \$120 per barrel, producers would extract oil they previously would not have. For instance, the cost to extract oil in an area might amount to \$30 a barrel. While a producer would not extract that oil when barrel prices were \$40, he might extract it when prices increased to \$120 a barrel. The reason that extraction costs increase "as the long term forecasted price goes up is because" oil that is more expensive to extract would be extracted. There is also the "direct effect" on fuel costs and other expenses which might increase as prices do. "At low prices, you pick the low hanging fruit, and as prices get higher, you get more and

more complex arrangements, more and more expensive arrangements to get the oil out of the ground."

Mr. Dickinson stated that heavy oil had an eight dollar development cost as compared to a five dollar development cost for regular oil. A graph depicting this information could be developed. While this is a viable point, a limited amount of data was available.

Mr. Dickinson noted that, although there have been "five years of relatively high prices" including two years of very high prices, few "investments to extract more challenging barrels have occurred on the North Slope.

Co-Chair Wilken qualified that his question regarding the cost of extraction relative to the price of oil per barrel pertained to extracting oil in existing fields rather than fields which are more expensive to develop.

Co-Chair Wilken voiced being comfortable with the prospect of the State being able to share in profits as they increased, as would be allowed by the Progressivity element. Revenue generated under SB 305, without a Progressivity element, does not allow that. Further discussion on the incremental costs to the producers as oil prices increase would be appreciated.

Mr. Dickinson responded that the extraction costs relative to the price of oil in existing fields could be provided "fairly easily".

[10:25:22 AM](#)

Senator Dyson stated that he had previously asked the same question. "It seemed intuitive to me that production costs would not go up lock step with the price..." Another factor presented by one of the major oil producers was that "at the higher prices, not only are you going after more expensive deposits, but the competition for resources goes up". Rig day rates and labor costs would increase because of supply and demand. While he had considered increased costs associated with higher fuel costs and the extraction expenses of the "more difficult" oil, he had not considered the effect of supply and demand. Nonetheless, the increased costs percentages should not match the increase in barrel price percentages.

[10:26:13 AM](#)

Senator Stedman, when comparing the House, Senate and Governor's PPT bills' tax percentages at high oil prices as depicted on page 9 to the Low volume Progressivity chart on page 7, noted that the House take depicted on page 7 at \$70 a barrel was higher than the Senate take, but the Senate take was higher than the House at that price on the page 9 chart. These calculations should be rechecked.

Senator Stedman, referring to the chart on page 9, understood that during "their economic planning", the industry included projections based on high, medium and low prices. The high price scenarios would include mechanisms allowing those scenarios to be viewed in terms of today's dollars. To that point, the hefty increase in the House percentage take, as reflected on the chart at prices near the \$100 range, might be "problematic in the impact on the economic modeling"; specifically when compared to the "fairly predictable incline going forward" that would be incurred under CSSB 305. Its impact would be easier to factor into the industry's economic modeling analyses. This question should be posed to the industry economists who would be testifying before the Committee in a few days.

[10:28:05 AM](#)

Mr. Dickinson appreciated the point being made by Senator Stedman. "This slide is very schematic" and was meant to emphasize how the three versions of the PPT would be affected by high prices. The information was based on gross dollars without consideration of expenses. The Committee should not place "too much emphasis" on the lower barrel price schematics.

Senator Stedman also expected the industry to argue that the Progressivity element would remove some of the industries' "windfall or unexpected upside, and indirectly ... that's true". However, the Progressivity factor would serve to maintain a balance "going forward so that one side doesn't advantage or disadvantage the other".

[10:29:33 AM](#)

Page 11

Transition Provision

Governor's bill

\* 5 year lookback, deductible over 6 years

House CS

\* 3 months of capex and opex

Senate COMMITTEE SUBSTITUTE

\* 5 year lookback, 2 for 1 recoupment

ROBYNN WILSON, CPA, Director, Tax Division, Department of Revenue, testified via teleconference from Anchorage and reviewed the transition provisions in the bills.

[10:31:20 AM](#)

Page 12

Transition Treatment

- Governor's bill
  - \*Allowable deduction if oil > \$40/bbl
- House CS
  - \*Deduction over 9 months
  - \*No oil price test
- Senate CS
  - \*Credit-no oil price test
  - \*Sunsets 31/31/2013

Ms. Wilson noted there would be "no oil price test" under the provisions of either the House or Senate bills. CSSB 305 would terminate the transitional deductions on March 31, 2013.

[10:32:13 AM](#)

Page 13

Transition Provision

Annual Oil Severance Tax (Millions of 2005 Dollars)

Low Volume Scenario, \$40, \$60, and \$80 per bbl

Governor's Bill, with House Transition, and with Senate Transition

[This graph compares the severance tax revenues the State would receive from SB 305, CSHB 488 with its transition

provisions and CSSB 305 with its transition provisions, at \$40, \$60 and \$80 per barrel oil prices. The vertical axis depicted projected severance tax revenues for the years 2007 to 2014 as depicted on the horizontal axis.]

Ms. Wilson noted that the revenue graph lines within each price set were fairly close together. Most importantly, this graph impressed the point that "the difference between specific transition provisions matters some, but it doesn't matter nearly as much as the price of oil".

Ms. Wilson noted that only two lines appeared on the graph at the \$40 per barrel price, as the severance tax revenues garnered under SB 305 and CSHB 488 would be the same and thus were reflected as one line. The other line would represent the tax garnered under CSSB 305 at that price.

[10:33:49 AM](#)

Ms. Nienhuis informed the Committee that the House transition provision time frame was nine months and thus would occur in both fiscal year (FY) 2006 and 2007. Since this analysis began with the year 2007, the House FY 2006 revenue was included in the 2007 revenue.

Ms. Nienhuis noted that this information was also depicted in the table titled "Slide 13, Transition: Governor's Bill as written, with House Transition, and with Senate Transition, Low Volume" on page 3 of the handout she had earlier provided. She reminded that the transition credit provisions would terminate in 2013.

[10:35:05 AM](#)

Mr. Dickinson, referring to a table on Slide 16, pointed out that because "the Senate bill has no dollar floor" on the price of oil, credits would be allowed "in a lower price environment". Therefore, in a low price scenario, CSSB 305 would generate less revenue than either SB 305 which does not allow deductions to occur until oil prices exceeded \$40 a barrel or CSHB 488 which does not provide "any transition expenditures". The "relationships would flip" at higher prices because while CSSB 305 would allow a credit, it would be less than that allowed under SB 305 because "it would be tied" to the two for one investment reimbursement. The belief is that "not every company

will be spending twice as much in that future period as they did in the past". As reflected in the chart on page 13, while CSSB 305 would yield higher revenue than SB 305, the revenue generated by CSHB 488 would exceed both those because it does not contain a transitional investment expenditure allowance.

[10:36:48 AM](#)

Mr. Dickinson reiterated that the transition provisions would expire by the year 2014. However, the transitional provisions included in SB 305 could extend beyond that date, were prices to fluctuate above and below \$40 a barrel.

Senator Stedman asked for further information about "how to handle the impact of the two for one as far as expectations of use".

[10:37:30 AM](#)

Mr. Dickinson understood the modeling included an estimate that "70-percent of the amount of the investment would be reclaimed".

Senator Stedman asked therefore whether a 40 percent or 90 percent usage would significantly impact the modeling. The two for one recoupment language was suggested by Dr. Pedro van Meurs, a consultant to the Governor, and added to the Senate Resources bill "late in the day". While it was considered to be "a well crafted concept", its impacts have not been thoroughly discussed.

Mr. Dickinson replied that "sensitivity figures" in this regard could be developed.

[10:38:38 AM](#)

Page 14

Base Allowance

- Governor's bill
  - \*Up to \$73M standard deduction
  
- House CS
  - \*Up to \$12M credit (= \$60M deduction)

- Senate CS  
\*5000 barrel plan

Ms. Wilson stated that the base allowance formula in CSSB 305 was referred to as the 5,000 barrel plan. The bill included a production per day formula, factored at 20 percent. As a result of this formula, a percentage of each day's production would be tax free until production exceeded 30,000 barrels. On low production days, the allowance percent would be higher than that of high production days.

Ms. Wilson noted that the bill incorrectly specified an allowance for up to 55,000 barrels a day. The correct amount would be 30,000 barrels a day. That would be the point at which the deduction would be disallowed. The Senate Resources Committee adopted an amendment that lowered the amount from 55,000 to 30,000 barrels; however, the change had, inadvertently, not been reflected in the committee substitute.

Ms. Wilson communicated that the maximum 100 percent deduction would be allowable at a 5,000 barrel per day or less production level, as depicted in the "Illustration of base allowance at various production levels" graph on page 16.

Ms. Wilson stated that while CSSB 305 "provides a deduction based on production", SB 305 would provide a \$73 million dollar standard deduction. The House followed SB 305's lead, but substituted a credit for the specified dollar standard deduction. Thus, the 20 percent credit rate included CSHB 488 would allow a maximum credit of \$12 million or approximately \$60 million in standard deductions.

Co-Chair Green understood that the allowance language should be corrected to 30,000 barrels rather than 55,000 in CSSB 305.

Ms. Wilson affirmed a correction would be required.

Co-Chair Green understood that this change was the result of an amendment adopted by the Senate Resources Committee.

Ms. Wilson affirmed.

Mr. Dickinson noted that the reason for the barrel reduction was that, under the formula, any amount between 30,000 and 55,000 barrels a day would result in "a nonsense formulation".

[10:41:41 AM](#)

Page 15

Base Allowance Sunset

- Governor's bill  
\*No sunset
- House CS  
\*Sunsets 3/31/2016
- Senate CS  
\*Sunsets 12/31/2013

Ms. Wilson reviewed the base allowance terminate dates.

[10:42:17 AM](#)

Page 16

Illustration of base allowance at various production levels

[This graph depicted the percentage of allowance provided at various daily barrel production volumes under CSSB 305. A 100 percent deduction would be allowed on a 5,000 barrel or less per day production. No allowance would be provided when production exceeded 30,000 barrels a day.]

Ms. Wilson reviewed the graph.

[10:42:52 AM](#)

Page 17

Base Allowance, or Credit  
Annual Oil Severance Tax (Millions of 2005 Dollars)  
Low Volume Scenario, \$20, \$40, and \$60 per bbl  
Governor's Bill as Written, with House Credit, and with  
Senate Deduction Provisions

[This chart depicted how the base allowances and credits included in SB 305, CSHB 488, and CSSB 305 would affect the

Severance Tax paid to the State at \$20, \$40, and \$60 per barrel prices for the years 2005 through 2030.]

Ms. Wilson stated that this graph depicted the affect of the base allowance/credits on the Severance Tax under the provisions of the bills at three different price levels. At all three price ranges SB 305 would provide the lowest Severance Tax revenue. The Senate and House bill revenues would be aligned after the year 2016 because the base allowance provisions would terminate at that time.

[10:43:41 AM](#)

Ms. Nienhuis noted that at \$20 a barrel the impact of the allowances would be insignificant. However at \$40, the House credit would increase revenues by 13 percent and the Senate's deductions would increase revenues by 18 percent over that resulting from SB 305, which does not include any of these provisions. At \$60, the House credit would be six percent more and the Senate deduction would be eight percent more.

[10:44:12 AM](#)

Senator Stedman suggested that a table be provided which did not include other things such as SB 305's "\$14.6 million per year into perpetuity" credit or the House or Senate bill's deductions or credits. For example, one of the concerns raised is that, under CSSB 305, capping the barrel allowance at 30,000 barrels per day as opposed to the original 55,000 barrels per day might have "created more of an impact on industry than was anticipated".

Mr. Dickinson thought that the chart on page 17 might address Senator Stedman's concerns. As depicted on the chart, the provisions of CSHB 488 appear to have the same effect on the severance tax as SB 305; however, when the House provisions expired in the year 2016, the affect would resemble that of CSSB 305. "The point is that the effect of the Senate's provisions is very very small." When the House credits expired and "basically no deductions at all" were to occur, the dollar volumes at that point would be very close to those of CSSB 305. Only a "handful of very small companies" producing less than 5,000 barrels a day would benefit from CSSB 305's 5,000 barrel a day deduction. "The dollar amount of that" deduction is fairly small." This might be more apparent were the graph designed differently.

[10:46:57 AM](#)

Senator Stedman acknowledged that after the year 2017 when the allowance provisions of both the House and Senate committee substitutes expired, the two graph lines would trend together. At that point this would be "a null issue". However, the concern is that perhaps CSSB 305 "took too much off the table in this particular area". This Committee should further review this issue.

[10:47:41 AM](#)

Co-Chair Green understood therefore that the concern was whether 30,000 barrels or 55,000 barrels would be the appropriate number.

Senator Stedman affirmed. The concern was that this change "took too much off the table". There might not be much difference between the impacts of CSSB 305's barrel allowance and there being "no allowance at all".

[10:48:21 AM](#)

Senator Stedman stated that having this information would assist in determining whether including an allowance was necessary.

Mr. Dickinson acknowledged that the information being reviewed does not provide that information. Such information would provide a good visual comparison.

Page 18

Payment Safe Harbor

- Governor's bill
  - \*90% with annual true-up
  - \*No interest if 90% test met
- House CS
  - \*90% with annual true-up
  - \*Interest due on true-up amount
  - \*Penalty if 90% not met
- Senate CS
  - \*95% with quarterly true-up

\*No interest if 95% test met

Ms. Wilson stated that unlike current production law which required producers to pay 100 percent of the tax, the PPT would provide producers the option to estimate such things as capital expenditures. CSSB 305 would allow a producer to pay 95 percent of his tax each month with a calendar quarterly true up. No interest would be due were those conditions met.

Ms Wilson stated that both SB 305 and CSHB 488 would require a 90 percent safe harbor monthly payment. However, CSHB 488 would impose penalties if less than 90 percent was paid and it would charge interest on the annual true up amount. SB 305 would not impose interest if less than a 90 percent safe harbor was paid.

[10:51:02 AM](#)

Page 19

Spill Surcharges  
AS 43.55.201, AS 43.55.300

- Governor's bill
  - \* No change to total 5 cents
  - \* No change to split (2/3)
- House CS
  - \* No change to total 5 cents
  - \* Changes split to 1/4
- Senate CS
  - \* Increases total to 6 cents
  - \* Changes split to 1/5

Ms. Wilson stated that while SB 305 would continue existing spill surcharges, the House and Senate committee substitutes made changes in that regard. CSSB 305 would increase the current five cent per barrel fee to six cents per barrel. In addition, it would change the current split, which was three cents payable and two cents suspended, to five cents payable and one cent suspended. CSHB 488 would continue the five cent per barrel fee but would change the split to four cents payable and one cent suspended.

Senator Bunde asked Senator Stedman, who was a member of the Senate Resources Committee, what prompted the decision to change the split.

Senator Stedman deferred to Co-Chair Wilken who had more historical knowledge about the spill surcharge fee split.

Co-Chair Wilken explained that the five cents per barrel currently collected was deposited "into a pot": three of the five cents was utilized to support department operations and the remaining two cents supported clean-up activities. When the fund balance reached \$50 million in 1995, "the two cent infusion was halted". Since that time, the Department has "whittled" the money down and the pot is currently empty. This effort would assist in reconstituting the spill mitigation fund and provide money to the Department to support prevention, education, and response efforts. These funds have commonly been referred to as "4/70" funds.

Co-Chair Wilken was unsure why the decision was made to increase the fee to six cents.

Mr. Dickinson communicated that the Senate Resources Committee made that decision.

Senator Bunde understood the mechanism, but was seeking an explanation for the increase to six cents.

Senator Dyson, also a member of the Senate Resources Committee, added that this money was reflected in the State's Operating Budget. Several departments which had utilized the 4/70 fund in the past, were now seeking general fund money to support operations the 4/70 fund had previously supported. The reconstitution of this account would support a variety of funding needs.

Senator Stedman stated that further information on the decision to increase the fee to six cents could be provided.

[10:55:26 AM](#)

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Spill Fees

[This graph depicts the affect of the one penny change in the collected Spill Prevention Fee amount under the Low Volume scenario and the High Volume Scenarios.]

Ms. Wilson stated that the collection of one penny a barrel would equate to approximately three million dollars a year. Under the Low Volume scenario, the one penny fee would end in the year 2030. The High Volume scenario fee collection would continue. She noted that the rises in the High Volume scenario line depicted small new fields coming on line.

Senator Stedman noted that even though the PPT discussion has concentrated on billions of dollars, it should be noted that the impact of this penny a barrel should not be discounted as the money generated would really add up.

Mr. Dickinson defined the Spill Fees chart as being "multi-use", as it could represent the affect of any one penny movement in price.

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Other differences

- Credits refundable?
  - \* Up to \$10M in House CS only
- Abandonment
  - \* Governor's bill: no specific provision
  - \* House CS: No credit available
  - \* Senate CS: No credit available for old production
- Catastrophic oil spill expenses not deductible under House CS
- SB 185 credits: extended 10 years in House CS

Ms. Wilson state that this information identified notable differences between the three bill versions. It also addressed questions that have been raised such as which bill(s) would refund credits and how they addressed abandonment, catastrophic oil spill expenses and previous petroleum tax legislation credits.

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Private Royalties

- State and federal royalty interests are tax free so a producer typically pays tax on 7/8ths of its production from these leases.
- Private royalty interests are not tax free, so producer typically pays tax on 8/8ths of its production from these leases.

Mr. Dickinson stated that State and federal royalty interests were tax exempt under the current production tax statute. Thus, a producer would pay tax on, for instance, 7/8ths of their production from a State or federal lease.

Mr. Dickinson communicated however that "private royalty interests are not tax free". Therefore, a producer having a private royalty they must pay a production tax on 8/8ths of their production. Therefore, the issue is that the law specified an exception for State and federal leases but not for private leases.

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#### Private Royalties

- Existing law authorizes producer to pass production on to royalty owner
  - \* Royalty owner bears no responsibility as a tax payer.
  - \* More difficult to calculate under PPT
- CS establishes new tax rate on existing private royalty leases, (excludes private lessor's royalty interests from PPT)

Mr. Dickinson pointed out that existing law, which is a matter of public policy and does not affect the State's actual take, specified that "when in a private royalty situation, the lessee is settling up with a lessor and paying their royalties, they can deduct severance taxes that they pay. The producer is responsible for the severance tax but they can deduct it from the settlement they make to the royalty owner ... The royalty owner bears no responsibility" to the State as a tax payer, as the production tax was applicable only to the producer. The problem is that under the provisions of the PPT, the tax would

be on net value rather than the gross value at "the point of production at each point". Thus, the tax on a lease specific private royalty value would be more difficult to calculate, as all "exploration interests" of the producer would be factored in.

Mr. Dickinson also noted that currently, "the royalty owner gets their settlement free and clear of any costs". However, under the PPT, upstream costs would be deductible. So, what was "a relatively simple matter" under existing production laws would be "controversial" under the PPT.

Mr. Dickinson emphasized however, that, even though this issue is of importance to private royalty owners, it does not "have a large affect on State revenues". Even though the number of private royalty leases might increase, "statistically" the number of private leases would continue to be a small segment overall. However, in order to address this issue, "the amount of the pass through" could be adjusted to address the impact the PPT would have on private royalty leases.

Mr. Dickinson stated that in response to this concern, CSSB 305 incorporated "a new rate on existing private royalty leases". Because the PPT would be based on gross value at the point of production instead of net, CSSB 305 decreased the private royalty tax rate to five percent on all existing leases with the exception of Cook Inlet where the rate would be 1.5 percent. This new tax rate would be easy to calculate and should address industry concerns.

Mr. Dickinson advised however, that two issues remained. The first being that "private royalty owners are excluded from the PPT", and the second being that the PPT does not "address what would happen" with future private royalty leases. While CSSB 305 included language requesting that the Commissioner of the Department of Revenue issue a recommendation in this regard, "it doesn't say how that would become law". The uncertainty as to what the tax rate would be would be of concern to someone holding a private royalty interest or when a lease was being renegotiated. Currently the tax in these cases is zero.

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Co-Chair Wilken asked that a "real world example" of this issue be provided in a subsequent meeting.

Mr. Dickinson agreed.

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Private Royalties - Settlement

- New Formula for Settlement in Gov's Bill:
  - \*  $\frac{\text{Total tax paid by producer}}{\text{Total non-royalty bbls}} \times \text{Private royalty bbls}$
  
- New Formula for Settlement in CS:
  - \*  $\frac{\text{Total tax paid by producer}}{\text{total gross value at the point of production}} \times \text{Private royalty bbls}$

Mr. Dickinson stated that another private royalty concern would be to cement a formula on other things such as "overriding royalty interests" and situations in which the royalty tax might be unclear. SB 305 addressed this issue by including "a formula for allocating this share". After working with the Alaska Oil and Gas Association (AOGA), a new formula was included in both the House and Senate committee substitutes. This formula was acceptable to AOGA and to the Administration. The formula, which would be a "fair allocation" based upon the total tax and the royalty and non-royalty variables, "would allow the lessee to pass on to the lessor a fair amount of the tax". Further details in this regard could be provided.

[11:05:19 AM](#)

Mr. Dickinson distributed a three page handout [copy on file] which updated information regarding the current and proposed Point of Production process in Prudhoe Bay as discussed during the April first PPT hearing. The diagram on the first page of the handout depicted the current point of production in Prudhoe Bay. Well fluids were sent to a separation facility, referred to as a flow station or gathering center. One of the "streams of oil" emitting from that facility flowed through a Lease Automatic Custody Transfer (LACT) Meter into the Trans Alaska Pipeline (TAPS). The point at which the oil moved from the LACT Meter to TAPS is currently recognized as the point of production for the oil tax as well as the point of production for royalty. The handwritten notation on the diagram "COTP Point of

Production for Oil" was added between the Separation Facility and the LACT Meter point to specify where oil utilized on the North Slope for production purposes was taxed. This would address the crude oil topping plant (COTP) process that "takes and refines oil" and, like a gas station, provided it to trucks working on the North Slope. The COTP is currently defined in statute as a point of production because the oil was processed and transited through a metered sales line.

Mr. Dickinson continued. The fluids flowing from the separation facility also flow to a Central Gas Facility (CGF). Currently the inlet to the CGF is considered to be the Point of Production for gas. A "series of processes" occur within the CGF, and all products processed in the CGF are considered gas. One stream of gas emitting from the CGF is referred to natural gas liquids (NGLS). NGL is transited to the LACT Meter and is added to the oil stream which is sent through TAPS. "Those NGLS are currently defined as gas even though, in other many respects they are treated as oil."

Mr. Dickinson stated that another stream of gas emitting from the CGF could be divided into two streams. One of those streams, amounting to approximately 8.5 billion cubic feet a day, is re-injected into the ground and as "a consequence" is considered "to never have been produced". It is viewed as residual gas. The other stream is "the gas that is sold". There are currently only a limited number of uses for that gas on the North Slope: some is used at nearby TAPS pump stations and some is used by industry on the North Slope.

Mr. Dickinson reviewed the Point of Production proposed in the PPT. Three changes would occur to the current process. The first would be that oil used on the North Slope would no longer be taxed. "Practically all" of the 20 oil and gas producing states in the United States do not tax gas used to the process of producing oil and approximately one third of those states do not tax oil used to produce oil. The decision to not tax this oil was made in consideration of the overall profit the State would realize under the PPT. In summary, the COTP point of production for Oil was eliminated.

Mr. Dickinson communicated that the second difference in the Point of Production process, as proposed in the PPT, would be the elimination of the point of production before gas entered the CGF. "That point would be after the fluids have moved"

through the CGF. The new point of production for NGLS added to oil and moving through TAPS would be the LACT Meter. Under the PPT, those NGLS would be defined as oil. This would not be an issue, as the PPT would simplify the tax system by taxing both oil and gas at the same rate.

Mr. Dickinson pointed out that under the PPT, the point of production for Gas would be downstream of the CGF. It is important to note that other new facilities like the CGF that smaller producers might build would be upstream of the point of production. Those expenses would be considered qualified capital expenditures which would qualify for a 20 percent credit. Under CSSB 305, every dollar spent to operate those facilities "would be reduced 25 cents". The effort would be to treat processing activities occurring on the North Slope like other activities that are "important for finding, developing and producing gas".

Mr. Dickinson reiterated that the point of production of gas would be upstream of the gas treatment plant, as that activity was viewed to be a component of the transportation and sale of gas associated with a gas pipeline.

Mr. Dickinson addressed the Goal information on the last page of the three page handout. The PPT endeavored to support two goals. One was "to simplify definitions so we won't have low value-added conflicts" over such things as what would be considered gas and what would be considered oil and what would be considered a gas processing plant. The second goal was to "incentivize all production activity" through such things as moving processing activities upstream of the point of production. One area in which new conflict might arise would be the situation where a single plant might be built which had "both gas treatment and gas processing in it". The conflict could arise in determining "where one process stops and the other begins". However, the belief is that the PPT definitions would address that and other situations. Overall, the process would be simplified and production would be incentivized.

Senator Stedman asked that the concept of making credits available on gas processing be further addressed.

Co-Chair Green reviewed the schedule for future PPT hearings.

The bill was HELD in Committee.

#

**ADJOURNMENT**

Co-Chair Lyda Green adjourned the meeting at [11:14:03 AM](#).