

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**April 12, 2006**  
**1:12 p.m.**

**CALL TO ORDER**

Co-Chair Lyda Green convened the meeting at approximately [1:12:25 PM](#).

**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; DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor

**Attending via Teleconference:** There were no teleconference participants

**SUMMARY INFORMATION**

SB 305-OIL AND GAS PRODUCTION TAX

The Committee and the consultant hired by the Office of the Governor compared the provisions of the original Petroleum Profits tax legislation to the provisions of the committee substitutes being advanced by the Senate and the House of Representatives. 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."

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

Co-Chair Green explained that the purpose of this hearing was to review the Department of Revenue (DOR) April 3, 2006 "Comparison of PPT Bill Versions- Highlights" handout [copy on file], which outlined the differences between the provisions of the original Petroleum Profits Tax (PPT) bill proposed by the Governor Frank Murkowski Administration, SB 305, and the committee substitutes being considered by the Senate and House of Representatives, CSSB 305(RES) and CSHB 488(RES), respectively.

[Note: CSSB 305(RES) is referenced as CSSB 305 and CSHB 488(RES) is referenced as CSHB 488 in these minutes.]

Co-Chair Green asked Committee members to express their concern, alternate language suggestion, or support a particular bill's approach to each provision being discussed. This discussion would assist in developing a Finance committee substitute.

DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor, informed the Committee he was available to provide additional information as needed.

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Co-Chair Green thanked Mr. Dickinson for his efforts in developing the handout. Its format was very helpful. She also noted that the handout denoted page and section numbers pertinent to each provision presented.

Co-Chair Green directed attention to the "transition" provision section of the handout. SB 305 included a five year look back for capital expenses; CSHB 488 specified a three month look back of capital and operating expenses; and CSSB 305 included a five year look back with a two for one recoupment provision.

Co-Chair Green had heard "favorable comments" regarding the provisions specified in CSSB 305, and therefore considered its five year look back with a two for one recoupment provision the preferred approach.

Co-Chair Green next directed attention to the "transition treatment" subsection of the "transition" section.

Mr. Dickinson explained that SB 305 would prohibit "the recapturing" of transition dollars in a year in which when barrel prices fell below \$40; those deductions would be delayed and recaptured over six subsequent years in which prices exceeded \$40.

Mr. Dickinson stated that CSSB 305 would eliminate the "price test. ... Transitional investment expenditures would be allowed as a deduction" until the year 2013, regardless of the price of oil providing the company met additional investment "match criteria".

Mr. Dickinson noted that because of the year 2013 termination date and the investment criteria, a company might not be able to recoup 100 percent of their allowable transition deductions under CSSB 305; they could recoup 100 percent of their transition deductions under SB 305 because it did not limit the recoupment timeframe.

Co-Chair Green noted that the termination date specified in CSSB 305 was March 31, 2013.

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Senator Dyson favored the transition treatment provisions included in SB 305 as it would provide a company a longer period in which to recapture their investment expenditures.

Co-Chair Green asked Senator Dyson his stance on the \$40 per barrel price test contained in SB 305.

Senator Dyson desired more time to further analysis that provision.

Senator Stedman noted that the State's revenue would be "repressed" at barrel prices of less than \$40. The Senate Resources Committee had thoroughly discussed the price test issue and determined it "would be fairer to the industry" were they able to utilize their transition deductions regardless of the price of oil. "The sooner they use it the more valuable it is to them 'cause of just the time value of money."

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Co-Chair Green asked regarding the Senate Resources Committee's decision to apply a termination date to transition deductions.

Senator Stedman, a member of the Senate Resources Committee, stated that a termination date was included "to encourage use of the two for one credit". Using that deduction earlier rather than later would be beneficial to the State as it would assist in "stem[ming] the decline of production". The 2013 termination date was determined to be the timeframe that would provide the most benefits to the State; it was also a sufficient amount of time in which the industry could recoup their transition investment dollars.

Co-Chair Green understood that concerns had been raised in regards to another termination date, separate from this issue, in the bill.

Senator Stedman affirmed.

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Senator Bunde opined that a year 2013 transition deduction termination timeframe was too short a period. It would be difficult for the industry to utilize this deduction as projects in the State take more than seven years to develop. While he was supportive of the goal to halt the decline in oil production in the State and the two for one recoupment provision, he questioned whether the seven year timeframe would be sufficient. In other words, the State might "be giving them something they really can't use".

Senator Stedman acknowledged that a 2013 termination date might incur such "an adverse affect". The intent was to encourage the industry to utilize the deduction sooner rather than later. This provision was included "to benefit the three major producers" "who have a little easier time responding" to that timeframe. Another provision in the bill, the 5,000 barrel per day base allowance exemption provision, was included to benefit smaller producers.

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Senator Bunde understood that the seven year timeframe would accommodate "expanding existing production". However, getting a new initial exploration project "to actual production" would require a longer timeframe.

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Senator Stedman reiterated that the 2013 provision was "geared more for the major" producers. In contrast the 5,000 barrel per day exemption provision included in CSSB 305 or the consideration of providing a \$14.6 million annual credit would not "make that much difference to the major producers". They would benefit more from this two for one recoupment provision. They are the entities who would be the most impacted by the PPT; "they're the ones that are going to be paying it". The 5,000 barrel per day exemption would be "the incentive" for the

smaller producers. The 5,000 barrel per day exemption might be revised and redefined as "a field allowance" or a "barrel holiday". In order to accommodate the needs of the large and small producers, there was a "separation of intended use" for the seven year recoupment timeframe and the 5,000 barrel per day exemption.

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Mr. Dickinson stated that in order to benefit from the transition expenditure deduction, a company would be required to increase its investment expenditures 40 percent over the last several years' investment amounts. The desire would be to provide a sufficient amount of time to allow those who invested in the State to recapture their investment.

Mr. Dickinson noted that SB 305 addressed this goal by not including a termination date in its transition provisions. If the intent was to increase investment "behavior" then a termination date would be an incentive; however, it would be unrealistic to expect that companies would be able to increase their investment amounts as soon as the bill became effective.

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Co-Chair Green asked what Mr. Dickinson considered to be an "optimum length of time" in the endeavor to be fair to producers, encourage investment, and thereby halt declining oil production.

Mr. Dickinson responded that the determination of what would be a "fair time to recover" the transition investment would be a policy call. The approach taken in SB 305 was to allow "full recovery" of the transition investments but delay that deduction if barrel prices dropped below \$40. This would assist in not negatively impacting State revenue.

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Co-Chair Wilken concurred with Senator Bunde that the 2013 timeframe was too short a period to allow the industry to recover its transition deductions. Anadarko and another company had previously testified to this point. Thus, he would suggest a termination date extending the termination date out another three years to 2016. The time value of money would itself be an

encouragement for the industry to utilize their deductions and therefore encourage additional exploration and discovery in the State.

Co-Chair Green understood therefore that the desire would be to extend the transition termination date to 2016.

Co-Chair Wilken asked Mr. Dickinson whether a 12 year timeframe would be conceivable.

Mr. Dickinson reminded the Committee that the amount of a producer's transition deduction would be limited by the amount the company had invested in the lookback timeframe. The number of years over which their transition expenditure deduction could be applied would be a factor in determining the amount the producer would spend under CSSB 305.

To further that point, Mr. Dickinson provided Members several graphs [copies on file] reflecting the expenditure levels a company would be required to make under various scenarios. For example in a five year recovery scenario, a company that had spent \$35 during the five year lookback period would spend seven dollars a year, for a one to one recoupment. However, were the recovery period extended to seven years, the company would spend five dollars a year, which was less than the annual investment they made during the five year lookback period.

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Mr. Dickinson noted that the recovery of \$35 over a seven year period under the two for one recoupment provision included in CSSB 305 would require a company to spend ten dollars rather than five dollars a year. This would be an increase of 40 percent rather a doubling of the expenditure as the company had originally spent seven dollars in each of its five lookback years. Expanding the recovery period to ten years under the two for one recoupment provision would not require a company to increase its annual investment: it could spend seven dollars a year for ten years and meet the match requirement.

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Co-Chair Wilken asked whether this mathematical calculation would be characterized as linear. For example, the investment

that would be required under a 14 year recovery period would be half the lookback amount.

Mr. Dickinson nodded in affirmation.

Co-Chair Wilkin acknowledged.

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Senator Stedman pointed out that a drafting error might have occurred in CSSB 305 as the recoupment of the five year lookback transition language in SB 305 had been in the form of "a credit". The recoupment of the lookback provision in CSSB 305 was specified as "a deduction". This must be a drafting error because the Senate Resources Committee had not made any changes in that regard.

Co-Chair Green acknowledged.

Senator Stedman stressed the importance of correct terminology. Terminology differences might serve to benefit the industry rather than the State; specifically as the tax rate in CSSB 305 was 25 percent and its credit rate was 20 percent.

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Mr. Dickinson cited a comment previously made by Senator Bunde. "In general, people always prefer credits to deductions." The receipt of "a 100 percent credit is always better than getting a 100 percent deduction because one is multiplied by the tax rate and the other one isn't". However, the transition language in CSSB 305 indicated that a "credit would be limited to 20 percent of the transitional expense". Thus, each dollar spent would reduce an entity's tax by 20 cents rather than by one dollar.

Mr. Dickinson stressed that were the dollar expenditure to qualify as a deduction, the lookback expenditure provision would affect the State's "bottom line" as that one dollar expenditure would provide the entity a 25 cent break since the marginal tax rate in CSSB 305 was 25 percent.

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Mr. Dickinson clarified that utilizing the term "credit" in the transition language in CSSB 305 was correct as it would save the

State money. Were the credit amount specified in CSSB 305 changed to 25 percent to match its 25 percent tax rate, the affect of using the term deduction rather than credit "would be neutral". A 20 percent credit or 25 percent deduction would have a huge impact were it factored upon a one billion dollar a year lookback investment expenditure.

Senator Stedman recalled the discussion in the Senate Resources Committee to reference this provision as a deduction. Thus, he declared the decision to accept the term "credit" in this context to be a policy call this Committee should make.

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Co-Chair Wilken asked whether the term deduction or credit had been utilized in the modeling analyses presented to the Committee.

Senator Stedman thought that the modelings were based on the term "deduction" as the term "credit" had only appeared when CSSB 305 was drafted. Further research would be conducted in this regard.

Co-Chair Green understood therefore that there was no consensus on the transition provisions of the bill at this time.

Senator Stedman stressed that the one billion dollar a year expenditure example provided by Mr. Dickinson clearly indicated that the use of the term credit in this provision was preferred. The 20 percent credit on a one billion dollar investment would be \$200 million whereas a 25 percent tax deduction would equate to \$250 million. What might appear to be a "small verbiage" issue in reality would have a huge impact.

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Co-Chair Green remarked that further discussion would be required to address the credit/deduction issue and the termination date language in the transition section.

Co-Chair Green referred the Committee to the "base allowance" section depicted on the handout. SB 305 would allow a \$73 million deduction, CSHB 488 would allow a \$12 million credit which would be the equivalent of a \$60 million allowance, and CSSB 305 would provide a 5,000 barrel per day exemption plan.

Senator Stedman interrupted to note that recent modeling prepared by Econ One Research Inc., the economic research and consulting firm hired by the Legislature, depicted several "effective average tax rate at different levels" scenarios over a six year transition period. While the overall numbers would not be significantly altered, the modeling appeared to suggest that the impact on the dollars of the industry would be more than the impact on the government take.

Senator Stedman stated that this information would be helpful in the discussion about whether to specify that the transition provision would be in the terms of either a credit or a deduction. He again voiced being puzzled as to how the term credit replaced the term deduction in CSSB 305.

Co-Chair Green asked Mr. Dickinson whether replacing the term deduction with the term credit, as occurred in CSSB 305, would be a "harmless change" or "a substantive change".

Mr. Dickinson stated that changing the language to a credit would establish a 20 percent credit. On the other hand, the affect of each dollar deduction "would be whatever the tax rate is. ... As long as that number is set to the same rate as the tax, it is usually a harmless change."

Co-Chair Green understood therefore that were the bill to have a 20 percent tax rate and a 20 percent credit rate (20/20) the affect "would be neutral".

Mr. Dickinson affirmed. The concern with whether the term deduction or credit would be incorporated in the bill would be limited to its affect on the 25 percent tax rate and 20 percent credit (25/20). Other provisions of the bill, in its current form, would not be impacted.

Senator Stedman opined that under the 25/20 tax/credit provisions in CSSB 305, a deduction would "be more valuable" to the industry than a credit.

Mr. Dickinson agreed.

Co-Chair Green asked which approach would be preferred.

Senator Stedman supported reverting back to the term deduction, as it would "give the benefit to the industry". The tax rate in the bill might be altered as the bill advanced.

Co-Chair Green asked the Committee whether they supported the language in SB 305 which would delay providing the credit when barrel prices dropped below \$40.

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Senator Stedman understood the reason both Governor Murkowski and Mr. Dickinson supported that \$40 provision, as it would alleviate the impact on the State's revenue. However, he would prefer omitting that provision and allowing the industry to have the utmost "flexibility" to how they could respond to various barrel prices. The "quicker" the industry used their transition deductions would assist in stemming the decline in oil production. He acknowledged, however, that the State's revenue would be at risk were oil prices to drop to \$30 a barrel.

Co-Chair Green ascertained that the desire was to continue to exclude the price test from the transition provision.

Senator Stedman affirmed.

Co-Chair Green then asked whether the six year transition deduction timeframe that accompanied the \$40 price test should be further discussed.

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Mr. Dickinson pointed out that were CSSB 305 to have an effective date of April 1, 2006, it would provide a seven year transition period as it would terminate in 2013. He was confused to the reason that Econ One developed a six year transition modeling analyses.

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Co-Chair Green summarized the question to be whether the transition provisions should be time certain and if so, would the year 2013 be appropriate.

Mr. Dickinson communicated that Governor Murkowski would prefer language that would allow the industry to recover their

investments but only during times when the revenues were at sufficient levels. He agreed with Senator Stedman that when prices were very low, the provisions in CSSB 305 would make investing in the State "less attractive".

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Co-Chair Green returned the discussion to the base allowance provisions in the bill. There has been significant support for the \$12 million dollar credit language proposed in CSHB 488.

Senator Hoffman and other Members nodded in agreement.

Co-Chair Green ascertained therefore that furthering the base allowance provisions in CSHB 488 was the consensus of the committee.

Co-Chair Green understood that were the \$12 million credit allowance converted to the terms included in SB 305, it would equate to approximately \$14.6 million.

Mr. Dickinson affirmed.

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Co-Chair Green next addressed the termination date specific to the base allowance provisions in the bills. SB 305 had no termination date, CSHB 488 contained a March 31, 2016 termination date, and CSSB 305 specified a December 13, 2013 termination date. There has been support for the March 31, 2016 termination date.

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Mr. Dickinson voiced the Administration's support for there being no termination date on the base allowance provision. This would benefit small and new players in the industry. Were there overwhelming support for including a termination date in the PPT bill, then the Administration would suggest a study be conducted two years prior to the end date. The commissioner of the Department of Revenue would then compile a report of the findings of that study. The date could be reconsidered at that time were the findings to indicate that the transition provisions were beneficial. Continuing, he suggested that at a

minimum, the termination date be ten years. The study could be conducted in the eighth year.

Co-Chair Green asked whether the study would be akin to a Labor, Budget & Audit review.

Mr. Dickinson responded that that was a possibility, but that the study could be conducted a variety of ways.

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Senator Dyson was unsure whether he could concur with the House termination date provisions. The 5,000 barrel exemption plan proposed in CSSB 305 was attractive in that it was not based on price or the cost of doing business. In conclusion, he was undecided on this issue.

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Co-Chair Green asked whether Senator Dyson was comfortable with the fact that the 5,000 barrel plan might equate to a wide ranging value.

Senator Dyson affirmed he was.

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Mr. Dickinson opined that a company would fare better under the provisions of SB 305 than under those of CSHB 488. At times of high prices and high investment, the difference might be insignificant; however, there are "a range of investment and profit mixes" in which a company would fare worse under CSHB 488.

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Senator Stedman stated that when barrel prices are in the vicinity of \$40, the \$73 million deduction base allowance specified in SB 305 would equate to \$14.6 million per company coming out of the State's treasury. A price of \$60 per barrel would increase that amount. To that point, he asked that the \$12 million base allowance credit specified in CSHB 488 be presented in terms of dollars.

Senator Stedman voiced that the concern was to the impact the allowances presented in SB 305 and CSHB 488 would impact the State's treasury. The concern was compounded by the fact that the number of companies operating on the North Slope might increase and be subject to this allowance. This was the reason the Senate Resources Committee crafted the 5000 barrel provision.

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Co-Chair Green asked Senator Stedman which of the base allowance plans he preferred.

Senator Stedman responded that the Senate plan would only help certain companies and SB 305 could be very expensive as it would apply to a multitude of companies. He was unsure of the cost associated with CSHB 488.

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Mr. Dickinson expressed that CSHB 488 would provide the same incentives to many small companies as SB 305. That could be considered "a drawback to either one. Likewise, the 5,000 barrel allowance provided by CSSB 305 would benefit many small companies. Whenever "you reward lots of small entities, you are creating incentives towards lots of small entities". He determined that the at most price levels CSHB 488 and SB 305 "would be equivalent". There would however be situations in which SB 305 would be more generous than CSHB 488.

Mr. Dickinson allowed that sometimes the benefits from spending money outweigh the concern about that expense. He referred the Committee to a chart [copy on file] which depicted such "goldplating opportunities" as allowed under SB 305 and CSHB 488. SB 305, however, would provide the allowance to a company without requiring them to spend any money.

Mr. Dickinson explained the chart. A company exceeding either 60 million dollars in profits or a 12 million dollar investment level would be indifferent to either SB 305 or CSHB 488 because they would receive the "full benefit" provided by either plan. It would be anticipated that the entity of the major companies would fall in this category.

Mr. Dickinson communicated that the chart also indicated that a company would be indifferent to either bill had they invested enough dollars and received enough credits to "reduce their taxes to zero".

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Mr. Dickinson identified the "area of interest" on the chart to pertain to a company making between zero and, for example, 120 million dollars in profits and investing less than 12 million dollars a year. That company would prefer SB 305 because they would not pay taxes under that bill. They would pay some tax under CSHB 488.

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Mr. Dickinson concluded that a base allowance would affect each company differently. No "blanket statement" could be made in regards to which plan was "better or worse" as it was affected by how much profit and investment a company might make in a year.

Co-Chair Green understood that base allowance provisions were a common occurrence worldwide; particularly in areas where there were developers and explorers.

Mr. Dickinson acknowledged and noted that areas that practice such a "profit sharing plan" refer to it as "cost oil". Cost oil was oil an entity would receive to cover its costs.

Co-Chair Green asked the purpose of this practice.

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Mr. Dickinson responded that providing an allowance to a company would assist in avoiding "exact disputes" over what costs are or might be, as the allowance "should cover" costs. The allowance might also be used "to encourage small entrants" to a market; this was the case in Alaska. The allowance would provide initial coverage to an entity that was just starting up and experiencing small profits. Providing a specified dollar amount would also assist companies who are already operating in the market.

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Senator Stedman pointed out that a decision must be made as to whether to further the language in SB 305 and CSSB 305 which treat the allowance as a deduction or the language in CSHB 488 which treats it as a credit. He reiterated that a 25 percent tax deduction was worth more than a 20 percent credit to the industry.

Mr. Dickinson also noted that both the tax and credit rates in both SB 305 and CSHB 488 were 20 percent. Therefore, there would be no affect were the allowance a deduction or a credit "other than the mechanics of how it gets limited".

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Co-Chair Wilken understood that were all the tax and credit percentages the same, the field allowances would be revenue neutral. However, he spoke in favor of the 5,000 barrel plan because it would be difficult to explain to a constituent why the State would be providing \$73 million a year to an oil company. While an explanation could be provided, it would "get lost in the headline". On the other hand, a barrel allowance plan was simple: a barrel of oil today would be the same 42 gallons ten years from now. Thus, he would prefer some level of barrel discount, be it 2,000, 5,000, or 10,000 as it was "production oriented" rather than "a straight dollar giveback".

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Mr. Dickinson stated that the difficulty in explaining the dollar allowance was the reason the House switched to a \$12 million credit allowance. The \$73 million deduction proposed in SB 305 sounded like "a big number".

Mr. Dickinson stated that an entity producing more than 30,000 barrels a day would receive no benefit under the mechanics of the 5,000 barrel plan. While the allowance proposals in SB 305 and CSHB 488 would benefit everyone, the 5,000 barrel plan would benefit companies producing fewer than 30,000 barrels and only provides a complete holiday from taxes for those producing 5,000 barrels or less.

Co-Chair Wilken acknowledged.

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Co-Chair Green asked whether the 5,000 barrel plan would serve "to promote small producers".

Mr. Dickinson replied in the affirmative. However, he noted that all three of the proposals tended to share the problem of providing a benefit that would encourage "carving off from a larger entity". Furthermore, all three bills would require the commissioner of the Department of Revenue to review each situation to ensure that it was "not tax motivated behavior".

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Senator Stedman asked that the formula for the barrel plan be discussed. The Senate Resources Committee changed the multiplier in the formula from .01 to a .02 factor. .01 would terminate any benefit from this allowance after a barrel level of 50,000. The benefit of this allowance would terminate after a barrel level of 30,000 under the .02 factor. Thus, were the barrel plan advanced, he would recommend that the factor revert back to .01. The "magnitude of the change" made by the Senate Resources Committee has made several people "uncomfortable".

In response to a question from Co-Chair Green, Senator Stedman reiterated the desire to change the factor back to point one. This would allow the benefit to apply to a 50,000 barrel production level.

Co-Chair Green reviewed the affect of this change. She also noted that the language in the bill contained a drafting error as, while the factor was reflected at .02, the barrel allotment had not been adjusted.

Senator Stedman affirmed. A factor of .01 would equate to an upper limit of 30,000 barrels. A factor of .02 would provide a benefit up to a barrel count of 50,000.

Senator Hoffman stated that the problem with the barrel count was being "it isn't equal for all companies"; particularly those who might endeavor to "extract heavy oil. The per barrel profit on heavy oil is a lot lower." Thus, the barrel plan would result in "an uneven playing field for different companies and different fields".

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Senator Wilken asked whether the PPT legislation was intended to address the circumstances surrounding heavy oil bill or whether it would be contemplated that an entity seeking to extract heavy oil would be required to negotiate with the Legislature a separate heavy oil rate.

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Mr. Dickinson responded "neither". The PPT legislation does not focus on heavy oil. Oil costing an entity "eight or nine dollars of capital" rather than four or five dollars to extract would in effect double the amount of credits and double the amount of deductions. Thus, the belief is that this bill would "adequately" account for high cost oil.

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Senator Olson stated that the \$73 million deduction would be more advantageous to smaller companies than to larger ones. He concluded that it would be difficult to reach "a position" that would be equal to all companies.

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Senator Bunde, referencing the "goldplating chart" discussed earlier by Mr. Dickinson, understood that, at their profit and investment levels, the major oil companies would be indifferent to either allowances proposed in SB 305 and CSHB 488. The \$73 million deduction would have little impact on them.

Senator Olson countered that the \$73 million dollar deduction would have "major impact" on small producers. Those were the entities that needed such encouragement.

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Senator Bunde pointed out that a common thread among [unidentified] testifiers was that "80 percent of production and revenues" would be generated from existing fields operated by the major oil companies. Thus, "the thrust there would be development not exploration." Only "20 percent of new revenues would come from new participants on the North Slope".

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Mr. Dickinson provided a graph titled "Figure 2 Allowance" [copy on file], which depicted two graph lines. One reflected the affect of CSSB 305's allowance formula with a .02 percent factor and the other reflected the affect of the .01 percent factor. The chart indicated that the allowance would be more beneficial to smaller producers. The State's three largest producers easily exceed 55,000 barrels a day and thereby would not receive any allowance benefit.

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Co-Chair Wilken asked whether CSSB 305 contained a provision that would benefit larger companies and thereby serve as a counterbalance to the benefits the 5,000 barrel plan provided to smaller producers.

Mr. Dickinson replied in the affirmative. While the bill does contain many provisions that would benefit smaller companies, large companies would receive a benefit as a result of the gross dollar affect from their investment levels. Nonetheless, large companies would pay the majority of the additional dollars when barrel prices were high.

In response to a question from Co-Chair Green, Mr. Dickinson stated that at current prices, the three largest producers were paying approximately 90 to 93 percent of the State's severance tax under the State's existing tax regime, the Economic Limit Factor (ELF). At the current barrel price, the PPT would increase that amount to 98 percent. "They would really become the major payers of severance tax".

Co-Chair Wilken thought that the response was "the opposite" of his question. The question was whether some provision in the PPT would benefit larger companies as opposed to smaller companies in an effort to balance the 5,000 barrel plan that would benefit smaller companies.

Mr. Dickinson stated that the larger companies would receive substantially more credits than smaller companies under the PPT. While the credits would be higher, their taxes would also be higher. Thus, "the short answer is no".

Mr. Dickinson continued however, that the PPT was focused on the major producers in the State. It was meant to incentivize them

to invest more. As a result of their holdings in legacy fields, they would be paying more.

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Co-Chair Wilken observed that the larger players would benefit by the transition lookback provisions.

Mr. Dickinson responded that those entities that had been investing in the State for the past five years would benefit from the lookback provisions. The large producers, ConocoPhillips and British Petroleum, who had invested in new fields in addition to existing fields over the past five years, would receive a "great deal of benefit".

Mr. Dickinson also noted that small companies such as Pioneer Natural Resources could also substantially benefit from the lookback provision. Pioneer had been heavily investing in the State for the past year and a half.

Senator Bunde stated that 20 percent of 100 million dollars would be a lot more than 20 percent of one million dollars. Thus, larger companies would benefit from the credits simply due to volume.

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Senator Stedman addressed Co-Chair Wilken's question about whether the bill included a counterbalance to the 5,000 barrel plan noted that while the barrel allowance would primarily benefits small producers, the two for one recoupment provision would be more beneficial to larger companies.

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Senator Stedman distributed a handout titled "Producer 2005 Daily Production (BOE Equivalents)" [copy on file] which reflected that, of the 14 producers depicted, only the three major producers, BP with 354,670 barrels of oil equivalency (BOE), ExxonMobil with 182,117 BOE, and ConocoPhillips with 426,087 BOE, exceeded 30,000 BOE. Ten of the 11 remaining producers had a daily production of less than 30,000 BOE.

Senator Stedman stated that the Senate Resources Committee decided to lower the allowance formula factor from .02 to .01

after reviewing this information. That served to terminate the allowance benefit once a producer exceeded 30,000 BOE rather than the 50,000 BOE that a .02 factor had allowed.

Senator Stedman thought the Committee would appreciate having this handout as it depicted the production levels that were occurring in the State.

Co-Chair Green noted that, in addition to the three major producers who were substantially above the 30,000 BOE level, one other producer, Chevron with a 44,757 BOE, had a daily production above 30,000.

Senator Stedman affirmed and declared that the PPT tax was "a tax on the major producing companies".

[2:09:42 PM](#)

Mr. Dickinson communicated that while the entity with the fourth largest production changed from time to time as the result of market changes and things such as business mergers, the producers in first, second, and third place have remained constant, and would be expected to continue as such as long as Prudhoe Bay continued its "dominant position" in the marketplace.

Senator Olson asked whether the producer production chart provided by Senator Stedman was specific to North Slope production.

Senator Stedman clarified that the BOE information reflected statewide production.

Mr. Dickinson affirmed that the information represented statewide oil and gas BOE production. Marathon, for instance, only operated in Cook Inlet.

[2:10:32 PM](#)

Senator Bunde understood that none of the BOE resource modelings presented to the Committee reflected potential reserves in the Arctic National Wildlife Refuge (ANWR) or the National Petroleum Reserve-Alaska (NPR-A).

Mr. Dickinson replied that was correct. While high and low volume scenario modelings had been presented to the Committee, the source of the increased volume in the high volume scenarios had not been identified.

Senator Bunde concluded therefore that "the notion" that 80 percent of future production would be from known fields operated by large producers and that 20 percent would be from new exploration could change dramatically were new exploration in places such as NPR-A and ANWR included in the projections.

Mr. Dickinson allowed that it could; however, Prudhoe Bay would continue to be a dominant field even as its production declined.

[2:11:34 PM](#)

Co-Chair Green observed that three rather than a single opinion had been voiced regarding the base allowance provision. She reiterated hearing separate support favoring the \$12 million credit provision proposed in CSHB 488. To further clarify the position of the Committee, she asked whether there was support for the \$73 million deduction proposed in SB 305. There being no Committee response, Co-Chair Green asked whether there was any opposition to the \$12 million credit proposed in CSHB 488.

Senator Bunde spoke in favor of the \$12 million credit provision.

Senator Olson also supported that provision.

[2:12:29 PM](#)

Co-Chair Green directed the Committee to the safe harbor subsection of the transition provision. SB 305 would require a company to remit a minimum of 90 percent of the taxes owed to the State. Provided this condition was met, the company would be subject to a no interest annual true-up. CSHB 488 also specified a minimum 90 percent payment; however, interest would be charged were less than 100 percent paid.

Mr. Dickinson clarified that the definition of the term true-up did not include safe harbor conditions. Thus, under CSHB 488, a company could true-up at any time in order to reduce interest charges. The 90 percent requirement in CSHB 488 meant that a company should remit between 90 and 100 percent of the tax owed.

The balance on any payment less than 100 percent would be subject to interest. Furthermore, an automatic penalty would also be applied to a company paying less than 90 percent.

Co-Chair Green, stating that CSHB 488 would require quarterly payments, concluded that a payment less than 100 percent would be subject to interest fees.

Mr. Dickinson stated that would be correct under the conditions of CSHB 488.

Co-Chair Green understood that no interest would be charged under the conditions of SB 305.

Mr. Dickinson expressed that a company paying 90 to 100 percent of the tax due would not be subject to an interest penalty.

Co-Chair Green noted that CSSB 305 would require a 95 percent tax payment with a no-interest quarterly true-up.

Mr. Dickinson concurred but clarified that a company remitting 94 percent of the tax due would be subjected to interest penalties.

[2:13:49 PM](#)

Senator Hoffman asked why the decision was made not to charge interest in SB 305.

Mr. Dickinson clarified that the safe harbor provision in SB 305 meant that a company could remit a minimum of 90 percent and not be subject to an interest penalty. Interest would be applied to the balance due on any payment less than 90 percent.

[2:14:27 PM](#)

Senator Hoffman, observing that SB 305 specified an annual true-up, asked how much additional work would be required were SB 305 to require a quarterly true-up.

Mr. Dickinson responded that the "critical" factor was that some of the numbers used in determining the tax relied on a company's annual federal income tax filing and annual partnership filings. He noted that 100 percent of the units in Prudhoe Bay were partnerships. Thus, the Administration determined there was only

one time a year in which all the pertinent information was available. Such information would not be available on a quarterly true-up basis. The annual true-up period was deemed to be a method that "stops the interest clock running every 90 days".

[2:15:31 PM](#)

Senator Bunde, theoretically speaking, thought that, due to the time value of money, the annual interest free true-up with a 90 percent payment requirement proposed in SB 305 would serve to encourage companies to simply pay the minimum 90 percent. To that point, he asked for an estimate of the amount of money a company paying 90 percent might save annually in interest. He deemed this to be a cost to the State.

Mr. Dickinson stated that were a company endeavoring to "pinpoint and estimate 90 percent" to underpay, the interest charged would be 11 percent, compounded quarterly. Thus, a company would desire not to incur such interest debt. The hope would be that companies would "aim high" in order to avoid paying interest.

Mr. Dickinson then addressed Senator Bunde's question. Based on next year's projected severance tax revenues of \$1.6 billion, he calculated that the State could be "underpaid" by in excess of ten million dollars a month were no interest charged as specified in the safe harbor provision of SB 305.

Senator Bunde believed that "a modest four percent interest" fee would encourage a company to underpay.

[2:17:22 PM](#)

Mr. Dickinson qualified that the interest rate that would be levied would be 11 percent rather than four percent.

Senator Bunde explained that the four percent interest rate he had referenced regarded earnings that that money could generate.

Senator Bunde agreed that a company attempting only to pay 90 percent could miss their target; however, accountants' skills were sufficiently honed to safely target paying 92 percent.

Mr. Dickinson stated that the State would benefit were a company to overpay as the State would receive earnings on that money, without being obligated to repay the company.

[2:18:21 PM](#)

Senator Bunde thought that overpayments would be unlikely.

Senator Bunde asked for further discussion regarding whether the quarterly or annual true-up might impose an "inherent disadvantage for the industry".

[2:18:39 PM](#)

Mr. Dickinson reiterated support for the annual true-up as the information that would be available on a monthly basis would not offer anything new. The information provided in the annual federal income tax would be the most pertinent. "Those are the events that drive it." Even were a company to consistently obtain a 92 percent target, they would still be required to true-up every 90 days.

Co-Chair Green inquired as to whether the federal Internal Revenue Service (IRS) conducted its true-ups on an annual basis.

Mr. Dickinson affirmed that was correct. The IRS required some of its high end taxpayers to pay 110 percent of their estimated quarterly taxes. The IRS had "different thresholds" for different situations.

Co-Chair Green allowed that the IRS approach provided some "consistency as calculations are being made and filings are being filed".

Mr. Dickinson expressed that the quarterly estimated payments would not be based on prior year "capital verses expense decisions".

[2:20:08 PM](#)

Senator Stedman requested that a history of past practices in this regard be provided; specifically to include any problems that might have been encountered. He also asked that the information include any impact that past practices have incurred on the State's cash flow or budget.

[2:20:41 PM](#)

Mr. Dickinson reviewed how the current severance tax under ELF was applied. There was no allowance and the tax was due on a monthly basis. Interest was charged on any underpayment.

Mr. Dickinson communicated that companies attempt to accurately project their tax and pay it in its entirety. This, at times, has resulted in an overpayment. The endeavor has been to avoid constant re-estimations. "It has not been an area of abuse". He noted that Legislative actions have been appropriate as the low interest rate that had been applied in the 1980s had been re-adjusted.

Mr. Dickinson noted that the safe harbor method had been included in the PPT due to various complexities.

[2:22:24 PM](#)

Senator Stedman understood therefore that no major problems had been experienced under the ELF severance tax collection structure. However, the Administration continued to support the 90 percent annual true-up proposed in SB 305 as it deemed that the 95 percent quarterly true-up proposed in CSSB 305 might be "too restrictive".

Mr. Dickinson responded that was correct as no "compelling arguments" had been presented to support the 95 percent or quarterly true-up provisions. The Administration continued to support the provisions in SB 305.

[2:22:58 PM](#)

Senator Stedman assumed therefore that under the annual true-up proposed in SB 305, companies would remit payments monthly.

Mr. Dickinson remarked that even though the State typically had considerable cash outflow at the beginning of each fiscal year, the 90 percent of tax minimum requirement as opposed to the amount currently received under ELF would not be cause for alarm. "It would not create more volatility."

Co-Chair Green asked the Committee's safe harbor preference.

Senator Bunde suggested a compromise: since businesses were currently paying on a monthly basis, a quarterly true-up would not be "overly burdensome". Thus, a 90 percent minimum payment with a quarterly true-up could be considered.

Co-Chair Green remarked that the burden would in reality be on the State. A quarterly true-up would require the State to conduct a "perpetual paper" auditing stream.

Senator Bunde thought that an annual true-up might delay the State from receiving tens of millions of dollars that it could otherwise use for cash flow purposes.

[2:25:14 PM](#)

Senator Hoffman noted that while he would support the annual true up, a semi annual true-up could be a compromise.

Co-Chair Green spoke in support of an annual true-up. It would be akin to the current procedure and would be simpler to administer since federal filings would be available. This would place less of a burden on the State.

[2:25:49 PM](#)

Senator Bunde preferred that an annual true-up be accompanied by an interest provision. Otherwise, the tendency might be for the industry to pay 92 percent and use that money "as a float".

Chair Green understood that the interest penalty would not be triggered unless a company paid less than 90 percent of the tax due.

Mr. Dickinson stated that in CSHB 488, an automatic penalty was incurred were an entity to pay less than 90 percent. There was no such penalty in SB 305. The State had three standards through which it could apply up to a five percent a month penalty with a limit of a 25 percent penalty. While the penalties under ELF were not automatic, the State could assess a penalty on a company operating with "bad behavior". He referred that standard to one that would automatically impose a penalty.

Mr. Dickinson stated that were a company required to pay interest no matter what percent was paid, the true-up would have "no particular significance". In other words, it would dictate

that interest be applied on any underpayment. The 90 percent provision would allow a company to pay a minimum of 90 percent. 100 percent would be paid at the true-up. This Administration was not supportive of the "automatic penalty feature" in CSHB 488. "Some leeway" should be provided to a company "when it's estimating its tax".

In response to a question from Co-Chair Green, Mr. Dickinson affirmed that ELF did not include any true-up provision. Interest was imposed on any monthly underpayment. Any overpayment was carried forward to the next month.

[2:28:14 PM](#)

Senator Hoffman pointed out however, that the PPT was complicated due to the credit provisions resulting from investments and developments. Thus, in many cases, the tax owed would be a "guessimate". No actual true-up could occur until after the taxes were filed. Therefore, oil companies and the Department of Revenue would be placed in a "guessimate game". In consideration of these complexities, he was in support of an annual true-up approach.

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Co-Chair Green stated that the catastrophic oil spill deduction provision in the bills would now be addressed. This deduction would be permitted under SB 305 and CSSB 305. It would not be allowed under CSHB 488.

[8:08:42 AM](#)

Mr. Dickinson stated "that in the wake of the Exxon Valdez [oil] spill, the portion of the [State] Statute that deals with downstream costs was amended" to specify that such costs relating to a catastrophic oil spill "could not be deducted". CSHB 488 extended that language to also prohibit such costs from being deducted from lease costs, which are upstream costs. The Administration's position was that "the cost of doing business is the cost of doing business" and thus did not support expanding that prohibition.

Co-Chair Green understood that allowing that deduction on upstream costs would "encourage" such needed expenditures.

Mr. Dickinson agreed. It would be good public policy to encourage companies to expend the amount necessary to properly address a catastrophic oil spill were one to occur.

The Committee supported the language as proposed in CSSB 305.

Co-Chair Green then turned the Committee's attention to the "IRC sec. 482 as a tool" provision which was included in CSSB 305. She had heard this provision being characterized as "onerous".

[8:10:22 AM](#)

Mr. Dickinson expressed that the provision could be "potentially onerous". IRC sec. 482 was the section of the federal Internal Revenue Code (IRC) which ensured that internal business transfers were not "used to shift taxable value away from the United States (U.S.) where it's taxable". The concern was that companies with both U.S. and other country operations could shift their taxable income to offshore locales. This could result in their U.S. entity having no taxable income. For example a company that refined ore in the U.S. but imported the raw goods used in that act from outside of the U.S., might attempt to up-charge the market cost of those goods to reduce the U.S. based company's profits, and thereby reduce the company's taxable income.

Mr. Dickinson noted that shareholders in the company would not be affected by this action, as they would benefit by the overall financial health of the company.

Mr. Dickinson communicated that the audits pertinent to this IRC code were very extensive because proof must be shown that the price being charged for the raw goods, for example, was not the market price. "That could be a difficult thing to establish" as prices vary dramatically.

Mr. Dickinson suggested that rather than furthering the language proposed in CSSB 305, "simpler" language such as "direct costs do not include transactions above market value" should be considered. Thus, were some abuse observed, the State could address it without "creating the whole ... potentially onerous structure of a 482 audit".

Senator Stedman understood therefore that the suggestion would be to rewrite the language in the bill pertinent to this issue.

[8:13:26 AM](#)

Mr. Dickinson affirmed.

Senator Stedman and Mr. Dickinson discussed the appropriate wording that would provide the desired protection.

Mr. Dickinson stated that omitting the language in Sec. 22 subsection (k) on page 21 line 5 through page 6 line 21 would be appropriate. A simpler approach would be to address this issue by a minor rewriting of language in Sec. 17 subsection (d)(N) on page 18, lines 13 through 15. This would be sufficient. The State would be required to show that the transaction "was not an arm's length transaction; that there was some kind of collusion or intent there."

[8:15:55 AM](#)

Co-Chair Wilken asked how other states addressed this issue.

[8:16:14 AM](#)

Mr. Dickinson advised that the State "could invoke this section" currently via its State corporate income tax process. This option would be maintained.

Mr. Dickinson noted that other state's production taxes typically reflect the tax structure of ELF in that they assess a tax solely on gross value. Thus, many cost issues are avoided. However, in order to address income issues in which costs could be "manipulated", language such as that being discussed would be commonplace.

Co-Chair Wilken asked whether omitting this language from the PPT and allowing it to be addressed in another manner would result in shifting "the burden of proof from the companies to the State".

Mr. Dickinson stated that it is presumed that the taxpayer is correct in what they report. However, if the commissioner of the Department of Revenue issued a contrary assessment, then the burden would shift back to company.

Co-Chair Wilken understood therefore that the State would not be subject to the burden of proof.

Mr. Dickinson stated that further research on this issue would be conducted.

Co-Chair Wilken thought that the State would not bother with this issue were it not to involve a substantial amount of money; "tens or hundreds of millions" of dollars verses millions of dollars. Therefore his question was "even though this might be an onerous audit structure" would "the pain be worth the gain".

Mr. Dickinson believed "this would not be a major issue". Typically, this "transfer issue" has occurred with "resource companies that were bringing things into the U.S. before they were manufactured". This would not be a significant concern on the North Slope, as the types of costs associated with upstream expenses were "pretty straight forward". Therefore, in general, he could "not contemplate a situation in which this would be a big deal".

Mr. Dickinson recalled however that in the early 1980s, the large producers shared with the State the costs they paid to their shipping companies to transport their oil. The State informed the companies that it was not interested in that information as the desire was to know what the companies' actual costs were. Issues of internal transfer pricing were not dwelled upon. While a lot of energy was given at the time in making the decision not to dwell on "internal transfer pricing", it was deemed to have been "resolved" in the State's favor. The expectation was that this would not be "a big issue on the North Slope".

[8:19:55 AM](#)

Co-Chair Wilken stated that because the PPT might be a 30-year agreement, he was concerned that overtime, some in the industry might find ways to "game the system". This issue might provide such an opportunity. Thus, instilling an onerous process such as that proposed in CSSB 305 might be worth the effort.

[8:20:29 AM](#)

Mr. Dickinson understood Co-Chair Wilken's concern. Continuing, however, he thought that the simpler language he previously

suggested would provide "the tool that may in fact, in the long run, be more effectively wielded in having this whole structure that we'd have to write" such thing as regulations for.

Senator Hoffman asked what prompted the Senate Resources Committee to include this language in the bill. He also asked whether this issue had been addressed in Mr. Dickinson's April 1, 2006 presentation to the Committee.

[8:21:04 AM](#)

Mr. Dickinson responded that had this issue been addressed in that presentation, it would have been in the section titled "the rest of the story" which covered "non-apex items".

Mr. Dickinson noted that a former employee of the Internal Revenue System (IRS) who now worked for the [unspecified] consultants hired by the Legislature had written a memorandum [copy not provided] on the IRC sec. 482 audit. This woman, who had conducted 42 such audits when she was employed with the IRS, expressed how critical those audits were to the work conducted by the IRS. "There is no question" that there would "be situations" in which this code "would be an applicable and useful tax administration tool. My only question is whether this is one of them."

Co-Chair Green expressed that omitting this language from the bill would not prohibit its use.

Mr. Dickinson agreed. Even were the IRC code language omitted from the bill, were the State to question a transaction, the "simpler language being suggested would allow an audit to be conducted to determine whether it had been "an arm's length transaction". Furthermore, were BP, for example, to try "to use some transfer pricing to bring something into the Prudhoe Bay unit", other companies would refuse "to pay BP premium for that".

Co-Chair Green surmised that because of the Prudhoe Bay unit arrangement, companies tended "to monitor ... each others'" activities "closer than anyone else".

Mr. Dickinson concurred. ConocoPhillips and ExxonMobil were each paying 36 percent of the unit's costs. "They had no interest in transferring extra money to BP in that arrangement."

Senator Stedman informed the Committee that "the self patrolling of the producers" issue had been discussed numerous times, including being an issue of discussion during the Senate Resources Committee PPT hearings.

[8:23:42 AM](#)

Senator Bunde noted there being a letter [copy on file] from ConocoPhillips, dated April 12, 2006 that answered questions asked by Co-Chair Green. To that point, he asked whether ConocoPhillips was scheduled to re-testify before the Committee as he was interested in discussing their new radio advertisement which he viewed as being "a distortion of reality, personally insulting, and not any way conducive to carrying on a productive conversation".

Co-Chair Green was unsure whether there would be another opportunity for them to re-testify.

Co-Chair Green believed the consensus was that omitting the IRC code language from the bill would be acceptable, as other provisions in State Statute would suffice.

[8:24:47 AM](#)

Mr. Dickinson noted that the aforementioned changes proposed to language in Sec. 17 subsection (d)(N) on page 18, lines 13 through 15. Sec. 17 should specify that action could be taken to address any "internal transfer or other transaction that was not at arm's length.

Co-Chair Green concurred.

Co-Chair Wilken tentatively accepted the approach being suggested. Continuing, however, he spoke in concern to Senator Stedman's remark that the producers' self patrolling issue had been discussed numerous times. To that point, he asked that the Legislature's consultants or members of the Senate Resources Committee be provided an opportunity to weigh in on this issue before the IRC code language incorporated into the bill by the Senate Resources Committee be discounted.

Co-Chair Green asked Senator Stedman, who was a member of the Senate Resources Committee, to share that committee's

perspective on this issue. She reiterated hearing testimony that the language could be "potentially or particularly onerous".

Senator Stedman affirmed that that remark had been made. He recalled that the language had been initially suggested in a memorandum [copy not [provided] by one of the State's tax consultants.

Senator Stedman affirmed there to be a difference of opinion between the consultants to the Legislative Budget & Audit Committee and the Administration, including Mr. Dickinson as to the need for this language.

Senator Stedman voiced being concerned that "at the end of the day", would the State be able to address this via the audit process. The language change would be acceptable were Mr. Dickinson correct in that the audit tools would continue to be available even were the language proposed in CSSB 305 omitted. However, were he incorrect, the State must have "strong language", such as that in CSSB 305, available.

Co-Chair Wilken stated he would obtain a copy of the aforementioned memorandum for review.

[8:27:20 AM](#)

Co-Chair Green next directed attention to the "DNR royalty value" section on the comparison chart. All three versions of the PPT bill concurred on this point.

Senator Dyson asked how the Department of Natural Resources (DNR) definition of royalty value aligned with the provisions of the PPT bill pertaining to gross value.

Mr. Dickinson responded that the gross value at the point of production in the tax formula aligned with the royalty value with the exception that under the royalty value, field costs in Prudhoe Bay and Kuparuk are subtracted. This deduction typically would amount to approximately one dollar a barrel in Prudhoe Bay and 60 cents in Kuparuk. Those deductions would not be allowed when figuring taxes.

Senator Dyson understood the term royalty value to be the value of the State's 12.5 percent royalty share. Thus, DNR royalty value language being referenced would indicate that a company

could not "deduct from their taxes the money they charge the State for processing the State's royalty share".

[8:29:27 AM](#)

Mr. Dickinson clarified that the royalty share was not taxable, even under ELF. This language would continue unchanged in the PPT. The affect was that the State's tax role calculations "taxed on seven-eighths of the oil". This provision would address how much the cost of tankers and transporting the oil in the Trans Alaska Pipeline (TAPS) from Pump Station 1 to Los Angeles would be. The total cost of such expenses, once approved by the DNR would also be accepted by the Department of Revenue (DOR). That value would be deductible.

Co-Chair Green asked whether the language in all three versions of the bill was similar.

Mr. Dickinson responded that the language differed, but "the concepts" were equivalent. He could provide language suggestions that would encompass the overall intent. He noted that CSSB 305 included language that would require the commissioner of DOR to make a determination as to whether this procedure would be in the best interest of the State. The Administration would suggest a rewrite of that language to specify that "the commissioner's determination is a balance between efficiency of tax administration and a determination that there's no bias downward in using the DNR valuations".

[8:31:22 AM](#)

Co-Chair Green understood that the overall concept presented in "each bill was in sync".

Mr. Dickinson affirmed. The provision in the bill relating to the DOR commissioner's determination actually contained two parts in that the commissioner could either utilize "publicly reported values and public market information to establish a standard netback" or "the netbacks reported" to the DNR. CSSB 305 expanded that language to specify that the public market information could not contain royalty documents. This was not a specification in SB 305 and CSHB 488.

Mr. Dickinson noted that CSSB 305 also included language specifying that were the DOR commissioner "to complete a

detailed fiscal analyses and determines that an election by a producer under the subsection would serve the long term fiscal interest of the State, that allows us to go forward". This language was located in Sec. 21. AS 43.55.150(d) lines 4 through 6 on page 14 of CSSB 305.

8:33:21 AM

Mr. Dickinson suggested that this language be replaced with the following language.

...If the department determines that an election under this subsection would improve the efficiency and economy of tax administration and would result in calculations that represent value, actual cost of transportation with reasonable accuracy, and are not biased towards understating the producer's tax liability.

Mr. Dickinson stated that this would assure that the commissioner's actions would make sense.

Senator Hoffman asked whether this issue had been addressed in the April 1, 2006 overview of CSSB 305 that had been presented by Rob Mintz, Department of Law.

Mr. Dickinson stated that this issue had been addressed on pages 14 and 15 of that presentation [copy on file].

Mr. Dickinson noted that the arm's length transaction issue was addressed in the "Navigating CSSB 305" section on page 25 of that same presentation.

Senator Stedman asked Mr. Dickinson to explain the reasoning behind whether to include or exclude "royalty settlement agreements" in the PPT.

Mr. Dickinson stated that because oil has such importance to the State, it has been recommended that "two different sets of people" should review the process, and, "in a world of unconstrained resources", that argument would be valid. However, from the State's point of view, he would argue that "having two sets of auditors looking at the same set doesn't make sense". Thus, "if we've got there downstream costs and" auditors from one department or another were "going to scrutinize them carefully" then it would not be necessary for another

department's auditors to repeat that process. The recommendation therefore would be to "leverage that work done by DNR" and allow the DOR to utilize its resources to review upstream costs. Currently, these costs are not audited or reviewed.

[8:35:58 AM](#)

Senator Stedman understood therefore that royalty settlement agreements were not included in the PPT bill.

Mr. Dickinson understood that royalty settlement agreements "would be fully allowed" under the current versions of the PPT. Language in Sec. 21 subsection (d)(1)(A) page 14 lines 10 through 15 of CSSB 305 "would grant" the State "the authority to use a royalty settlement".

Mr. Dickinson noted that lines 16 through 22 of that same section "would simply allow us to do the same thing with the Department of Interior if and when there's development within NPR-A". The method that has been developed by the U.S. Minerals Management Service (MMS) to establish wellhead value could be utilized in the future.

Senator Stedman specified that he must review the history of this issue in the PPT, as, at various times, it has been included or excluded. The industry would be in favor of including it in the legislation. To that point, he asked for confirmation that the language in CSSB 305 "would facilitate that".

Mr. Dickinson affirmed. He recalled that the Senate Resources Committee entertained three amendments pertaining to this issue. The end result "was to end prohibition".

[8:37:56 AM](#)

Senator Dyson understood therefore while the Administration supported retaining the language in Sec. 21 subsection (d) of CSSB 305; it would also recommend that the language on lines 5 through 9 of that section be amended to allow "the commissioner to make the decision that the redundancy of the audit function isn't an absolute requirement". The "general rule" would be to use a single set of auditors "unless there is an unusual circumstance". Providing this flexibility "would save money and manpower".

Mr. Dickinson concurred. While the language is acceptable, the Administration would recommend that "in the long term fiscal interest of the State", the language should be further clarified.

Senator Dyson considered that reasonable and would support amending the language in Sec. 21(d) lines 5 through 0.

Co-Chair Green acknowledged.

[8:39:27 AM](#)

Co-Chair Green next addressed the point of production provision on the comparison handout. There was no objection from the Committee to the language in all three bills that recognized the point of production for gas as being an upstream process.

Mr. Dickinson alerted the Committee that the Administration, after having conversations with Anadarko and other producers, was developing a minor language change to this provision in order to accommodate the concern that small facilities built in remote areas would be treated in a similar manner as the primary Gas Treatment Plant (GTP) which would be considered a component proposed gas pipeline project.

Co-Chair Green acknowledged.

Senator Hoffman asked whether that language would accommodate such facilities in the Nenana Basin and Bristol Bay areas.

Mr. Dickinson affirmed it would. While Anadarko was primarily concerned about the Foothills area, other areas would be addressed.

Co-Chair Green concluded therefore that an amendment to this language would be forthcoming.

[8:41:03 AM](#)

Co-Chair Green specified the next area of discussion as the "credits for annual loss" provision of the bill. She asked whether the percentage rates depicted for each of the bills was based on that bill's tax rate as both SB 305 and CS HB 488

reflected a 20 percent credit and CSSB 305 reflected a 25 percent.

Mr. Dickinson affirmed.

Co-Chair Green asked whether other than a bill's particular tax rate, the remainder of the language in the section was the same.

Mr. Dickinson affirmed.

Co-Chair Green next turned the Committee's attention to the "credits refundable?" provision.

Senator Stedman reiterated that this was a complex bill. To that point, he directed attention to how the "credits for annual loss" provision would apply to language in Sec. 13 subsection (b) page 7 line 26 of CSSB 305. He noted that the first sentence in (b) specified that "a producer or explorer may elect to take a tax credit in the amount of 25 percent of the carry forward annual loss". The question was to why the word "credit" rather than "deduction" was specified in that language.

[8:42:55 AM](#)

Mr. Dickinson responded that were a producer to "simply carry it forward" it would be carried forward at 100 percent. Only 25 percent of that amount could be converted to into a credit.

In response to a comment [indisc] by Senator Stedman, Mr. Dickinson stated that "it should have the exact same effect".

Senator Stedman observed that keeping the language consistent in the bill would allow for easier following.

[8:43:43 AM](#)

Mr. Dickinson concurred. The language was intended to allow a company to carry forward a loss. The "true-up" definition would allow a producer "to elect to transform it into a tax credit if you wanted to sell it or transfer it or do something with it other than just carry it forward". This language would allow a producer to transform it into a credit. For example, a producer who had a loss in December might chose to simply apply their credit in January.

Senator Stedman stated that in the bill prior to CSSB 305, the language on page 7, line 29 had specified the word "deduction" whereas the language in CSSB 305 specified the word "credit". He was unsure whether this was the result of a drafting error or an intentional change. Such changes continued to be of concern to him, as he recalled that a similar situation had been discussed the previous day.

Co-Chair Green also questioned the language change pertaining to the "credits for annual loss" provision.

Senator Stedman stated that his concern was to whether this was a drafting error or a conformity revision.

Co-Chair Green asked "the affect" of that wording difference.

[8:46:07 AM](#)

Mr. Dickinson explained that the use of the words "credit" and "deduction" varied depending on what they were preferring to.

Senator Stedman had understood that the decision had been to make transition investment expenditures a deduction, as that would be of more value to the industry than a credit.

Mr. Dickinson stated that as the bill was currently presented the use of the term "credit" on page 29 was correct. Were the term credit "transformed back into a deduction" numerous provisions in the bill would require revisions.

Senator Stedman concluded therefore that unless this issue had "already been decided", the Committee would be required to make a policy call on this point.

[8:48:23 AM](#)

In response to a question from Co-Chair Green, Mr. Dickinson clarified that "no language change" would be required in respect to the credits for "annual loss issue"; however, a language change might be required to address the language question Senator Stedman had "correctly identified" in regards to how it might relate to the transitional investment expenditure provision. Four or five other areas of the bill might also be affected by this question.

8:49:11 AM

Co-Chair Green returned to the "credits refundable" provision. She noted that CSSB 305 was consistent with SB 305 in this regard. CSHB 488's provision differed.

Mr. Dickinson explained that CSHB 488 specified that were a producer to ask the State for a direct refund because they had a loss situation or their credits exceeded their tax, the State could issue them a check for up to ten million dollars. However, the House placed a condition on that refund that required that that money to be spent in the State within a 24 month timeframe on investments or leases in the State. The refund would be denied were the company to have outstanding tax liability. Any producer could apply for this refund.

Co-Chair Green asked whether monitoring the reinvestment requirement might be a cumbersome process.

Mr. Dickinson thought it could be, however, the effort was to provide an alternative for small producers who might have trouble monetizing their credits because they could not use them or sell them to larger entities. The burden that might be placed on the business was outweighed by the benefit of the refund.

Co-Chair Green clarified that her concern was whether monitoring the use of the refund would be burdensome to the State.

Mr. Dickinson affirmed that it would impose "additional auditing burden and confirmation burden" on the State.

8:51:56 AM

Senator Dyson assumed that this provision would benefit small explorers. Thus, he was interested in Mr. Dickinson's perspective of how the House provision might impact producers in Cook Inlet; particularly as the State was interested in incentivizing gas exploration.

Mr. Dickinson responded that ideally the three large producers would be the purchasers of these credits, as they would have taxes owed. Other producers, such as Anadarko, would be sellers of those credits. "This would make the credits more valuable to the sellers because" they would be redeemable, and the seller

would receive "100 cents on the dollar" rather than 90 cents on the dollar.

Mr. Dickinson continued, however, that were there 14 producers and a lot of investment occurring, the State might encounter refund requests amounting to \$140 million. Some would question why the State might write such checks were some of those checks written to any of the three largest companies.

Mr. Dickinson concluded that the dilemma was whether the State should assist small producers in this manner or has the State already "created enough value". There might be "some sensitivity" to the State writing checks in these amounts.

Senator Dyson asked whether the House provision might provide a further incentive to exploration in Cook Inlet.

Mr. Dickinson responded that the difference between receiving 100 percent or 90 percent on the dollar might ultimately be a huge deal; however, it would make a difference were there a time such as a market correction, in which selling one's credit might be difficult. The forecast indicated it to be unlikely that the credits could not be sold, as it was anticipated that producers would endeavor to purchase the credits to reduce their tax liability.

Senator Dyson stated that "the worst scenario" would be that the State would be "the buyer of last resort". The State would ultimately be "the guarantor" that the credits would have value. He acknowledged Mr. Dickinson's position that this would be "unlikely" to occur. However, he asked whether it would be "fair to infer that" this provision would provide small explorers "a chance to go out there and risk their exploration dollars knowing that regardless of the outcome of the effort, they could get a credit for that activity. The refund would allow them to expend a similar amount of money on further development.

Mr. Dickinson concurred with Senator Dyson's summary.

Senator Dyson would appreciate an opportunity to obtain feedback from small explorers and the State's consultants on this issue.

Co-Chair Green was hesitant to commit, as time was limited.

Senator Bunde spoke against the provision in CSHB 488. In addition to being cumbersome, the proposal might disadvantage companies as there is a gamble in the business of having an opportunity to receive large profits. The removal of the chance of loss would serve to conflict with the argument for large profits.

Senator Bunde cringed at the thought of the newspaper headlines were the State to write huge checks to the oil and gas industry.

Senator Dyson had understood Mr. Dickinson's comments to say that a company would only receive a refund were they to spend that money in the State within 24 months. Thus, the State would benefit as the company could not simply utilize that money for profits.

[8:57:44 AM](#)

Mr. Dickinson affirmed that a company would be required to spend the money in the State. However, a large company would already have that level of spending. The State could not require that the money be used to be "incremental spending" that they might not have done otherwise.

Senator Bunde had not intended to infer that the money would be applied to a company's profits, as his intent was to submit that the State would be "subsidizing" a company's exploration.

Co-Chair Green concluded therefore that Senator Bunde supported the language presented in CSSB 305.

Senator Bunde affirmed.

Senator Hoffman also supported the Senate language.

Senator Stedman informed the Committee that this issue was also the subject of extensive discussion. While larger companies would generate credits, it would be the smaller companies who would be selling their credits to the larger companies who would purchase them to reduce their PPT tax liability by 20 percent. The smaller companies' concern was that the credits might not be worth 100 percent, but instead would be worth 90 or 95 cents on the dollar. Over time, the small companies would use that "discounted portion when they calculate the value of it". In other words, were the State to issue them "a 20 percent credit

which was only worth 90 cents on the dollar, they'll be calculating it as an 18 percent credit for their value in their modeling". In turn, the big companies would purchase it for 90 cents on the dollar and reap a small benefit. It should also be noted that it was the big companies who paid 90 percent of the taxes.

Senator Stedman concluded that this was a fairness issue. While it was unlikely that there would be no market for these credits in the future, the State could revisit the issue and "create a market".

Co-Chair Green next addressed the "credits transferable" provision of the PPT bill. The three bills appeared to be similar in their approach to this provision.

Mr. Dickinson concurred.

Co-Chair Green then referred to the "credits usable" provision section on the comparison sheet. She asked the reason there was a question mark with the "against PPT only?" verbiage under CSSB 305.

Mr. Dickinson stated that during the final drafting of CSSB 305, questions similar to those being raised by Senator Stedman were identified. This was indication that this was one of those areas.

Mr. Dickinson continued that SB 305, CSHB 488, and CSSB 305 all agreed that the credits would not be "creditable against income tax. However, the question was whether the credits would be limited to the PPT or would they also apply to such things as "Progressivity or a special Cook Inlet or some other special thing" were they incorporated in the bill.

[9:01:02 AM](#)

In response to a question from Co-Chair Green, Mr. Dickinson stated that because Progressivity or the consideration of such things as a special rate for Cook Inlet had not been included in the original bill, the applicability of credits to such things had not been an issue. CSSB 305 proposed three separate rates: rates on private lease hold interests, Progressivity, and the base PPT. CSHB 488 had these plus a special Progressivity tax on

gas. This issue required further clarification now that these things were being considered.

Mr. Dickinson concluded that this would be a policy call. The Administration, which did not support these additional elements, would support allowing credits to be applied to them as doing so would "take some of the sting out of it".

Senator Stedman agreed that the Committee should address whether to allow the credits to be applicable to the Progressivity mechanism. He supported not allowing them to apply to Progressivity, "regardless of whether we go net or gross on its calculation". The four largest taxpayers would internally generate a significant amount of credits which could be applied toward their tax. In addition, they could purchase additional credits from others which they could also use to reduce their PPT tax by 20 percent; or by using their own credits against the PPT tax, they could apply the purchased credits toward the Progressivity tax were it allowed.

Senator Stedman stated that the Progressivity mechanism was developed to maintain a constant Government and industry share constant as prices increased.

Co-Chair Green asked whether a language change would be required to CSSB 305 to support Senator Stedman's position.

Senator Stedman stated that the determination in that regard would become evident as further discussion about the Progressivity occurred. In conclusion, the Committee would be required to make a policy call as to whether to allow or disallow credits from being applied to Progressivity.

[9:04:49 AM](#)

Mr. Dickinson agreed with Senator Stedman's remarks. In addition, the issue of whether to limit the use of internal or purchased credits must be further discussed. Currently there is no distinction between the usages of the two. To this point, the only language specific to such issue in CSSB 305 would allow both internal and purchased credits to be applied to the 20 percent limit.

Co-Chair Green referred to Committee to the "abandonment" section of the comparison sheet. SB 305 contained no provision

in this regard, CSHB 488 would allow no credit for it, and CSSB 305 would allow expenses to be "partially deductible; no credit abandonment on old production".

9:06:30 AM

Mr. Dickinson expressed that there was "less" of a difference between the provisions between CSHB 488 and SB 305 than appeared. Both would allow credits for capital expenses, which was money expended to benefit future periods. Abandonment costs are "a business expense"; the State should encourage abandonment activities to be "done well". Thus, the recommendation was that this expense be "fully deductible", and that were any of that that expense was creditable under federal tax law, "it should be creditable as well".

9:07:35 AM

Senator Stedman asked Mr. Dickinson to share information about how some abandonment efforts in Cook Inlet had resulted in some platforms being converted to lighthouses. There is a concern that abandonment efforts in Cook Inlet expenses might generate extremely large credits; particularly as the industry has already "planned for removal of those instillations".

Mr. Dickinson affirmed that several oil producing platforms which were shut down in Cook Inlet were converted to navigational aides. The industry has delayed abandonment efforts on shut down platforms until a critical mass of five was reached, as this would reduce the cost of bringing in the required specialized equipment needed to conduct abandonment efforts. Nonetheless, "it would be a considerable expense".

Mr. Dickinson stated that CSSB 305's approach to the abandonment issue was to "look at the total amount of production that occurred prior to the passage of this bill and the total amount that occurred after". The abandonment expenses for platforms shut down before the bill was passed "would not be allowed as a deduction". A platform shut down after the effective date of the PPT might have had 95 percent of its production occurring prior to that effective date. In that case, five percent of the abandonment expenses would be allowed.

Co-Chair Green asked whether this was considered a workable solution.

Mr. Dickinson qualified that while this language was workable other language in the provision was too vague. For instance, the meaning of the references to "extended periods of disuse" was unknown. This language is of concern, particularly in consideration of some of the original platforms in Prudhoe Bay. Many of those platforms had a lot of redundancy was built into them. For various reasons including a reconfiguration of a field, platforms could be mothballed or in a state of cold or warm shutdown. "There are numerous facilities in various stages of disuse" and different decisions have been made in regards to their status. Some have been maintained to a point where they could be restarted, while others might be targeted to be torn down.

Mr. Dickinson requested, therefore that "more guidance" be provided in this regard.

Co-Chair Green asked to the "typical rule of thumb" in regards to abandonment. She understood that 100 percent of the expense was the responsibility of the producer or explorer and that no credits were allowed for that expense.

Mr. Dickinson affirmed. Typically, the shut down expenses would be the responsibility of a lease holder. However, under the provisions of the PPT, "that would be borne by the existing oil, by the oil or gas that's still being produced at that point".

[9:12:08 AM](#)

Senator Bunde asked for confirmation that the Administration supported allowing shut down expenses to be deductible.

Mr. Dickinson affirmed.

Senator Bunde was concerned "about any encouragement" to abandon a platform. "One of the justifications for large profits is that they have to have this reserve for disassembling once" a facility was abandoned. The prospect that such a credit might result in "earlier abandonment" of a facility that otherwise might have operated until the last drop of oil was "squeezed" out of it.

Mr. Dickinson recognized that as a "valid observation". However, it was unclear as to how much influence this provision would

have on the overall decisions of a company operating several fields in the State. "At the margin, this would be part of their calculation, but I don't know how decisive it would be."

Senator Hoffman asked whether the Administration's desired to have the "a period of extended disuse" language eliminated "or further defined".

Mr. Dickinson stated that either would be acceptable; however, were it to remain in the bill, a clearer definition of the concept was requested. The Administration's attempt to develop clarifying language in this regard was unsuccessful due to confusion about its intent.

Co-Chair Green asked how abandonment would be treated under the terms of SB 305.

[9:14:22 AM](#)

Mr. Dickinson expressed that abandonment costs would be treated like any other business expense under SB 305.

Mr. Dickinson further addressed Senator Bunde's earlier concern by stating that in the last two years of a field's life, when "everything is being dismantled, there are no profits being made at that point under the PPT". It would be likely that "every company's going to end up with a net loss situation under the PPT for their final years" Since that would not be "reclaimable or refundable in any way, so in that sense, we may not bear some of those costs". In conclusion, the Administration would support allowing for the cost of sporadic abandonment of wells on a year to year basis to be deductible.

[9:15:14 AM](#)

Senator Dyson asked whether lease agreement abandonment terms required a lessee to salvage all equipment and leave the terrain in environmentally sound condition.

Mr. Dickinson replied in the affirmative.

Senator Dyson asked regarding the penalty for non-compliance.

Mr. Dickinson was unsure.

Senator Dyson assumed that regulations provided the State "reasonable protection" in that regard. Thus, the intent of the abandonment language being discussed was to provide a company "another investment benefit".

Mr. Dickinson affirmed.

Senator Dyson surmised that including abandonment incentives in the PPT had been deemed "unnecessary" when the Governor's bill, SB 305, had been introduced.

Mr. Dickinson countered this conclusion. While the Administration thought it "should be treated like any other business expense and so ... in general," thought it "should not be creditable. The Administration desired that the credit issue "stick as close as we can to the IRS guidelines". Whatever decision made by the IRS would be unquestionably accepted by the State.

Senator Dyson asked whether the language in the Governor would accomplish that intent.

Mr. Dickinson affirmed.

Co-Chair Green asked whether the Administration had identified any other areas in CSSB 305 that could be "simplified" by a reference to an IRS provision.

[9:17:08 AM](#)

Mr. Dickinson specified that the largest issue related to identifying the "line between what is a qualified capital expenditure and what is an operating cost". An example of a "clearly qualified capital expenditure" would be seismic exploration. Other issues might include further clarification of some safe harbor issues. IRS filings would be utilized to determine what would be considered "ordinary and necessary direct costs" in the joint billings of "contemporary business practice" partnerships on the North Slope.

[9:18:17 AM](#)

Co-Chair Green turned the discussion to the "SB 185 credit" section of the PPT.

[9:18:39 AM](#)

Mr. Dickinson explained that under CSHB 488, the credits allowed under SB 185 would be extended an additional ten years. SB 185 contained a "two tiered" credit structure" relating to wildcat activities. Those in remote areas would qualify for a 40 percent credit; those closer to infrastructure would qualify for a 20 percent credit. The provisions of that bill had recently been amended to allow a different set of credit provisions to be applied to such activities in Cook Inlet. The issue was whether SB 185's credits should continue "so true wildcat exploration gets credits above and beyond what are in the rest of the Governor's bill".

Mr. Dickinson noted that information garnered from these wildcat activities is shared with the Department of Natural Resources but is kept confidential for ten years before becoming public record. The question is whether only the confidentially of information gleaned from those activities earning the 20 percent credit should be required.

Mr. Dickinson noted that a third issue pertained to the credit provisions specific to Cook Inlet. That language was very "awkward" and allowed for some unintended consequences as it limited credits in Cook Inlet to a total of \$20 million. This issue should be readdressed as that was not the intent.

Co-Chair Green understood therefore that "clean up language" was required in that regard.

Mr. Dickinson concurred.

There was no objection to readdressing this issue.

Co-Chair Wilken understood that SB 185's credit provisions were due to expire soon.

Mr. Dickinson expressed that SB 185 would apply to "one more exploration season" on the North Slope. The terms applicable to other areas in the State, including Cook Inlet, were extended another ten years.

[9:21:07 AM](#)

Senator Stedman understood there was a "quirk" to the credits allowable under SB 185 in that no credits would be allowed to offset the cost of drilling a dry well. This was contrary to the dry well provisions of the PPT.

Mr. Dickinson stated that changes had been made in this regard; dry hole credits had been allowed for the past two years under SB 185.

Senator Stedman thought otherwise. He asked that further clarification of this be sought as otherwise this issue had been discussed under the wrong assumption.

Mr. Dickinson noted that a separate "ten percent income tax credit" bill applicable to Cook Inlet had been passed in the same timeframe as SB 185. That bill had pertained solely to successful drilling efforts. SB 185 offered credits to all drilling, regardless of their outcome.

In response to a question from Co-Chair Green, Mr. Dickinson clarified that such credits would be available statewide. The separate ten percent credit bill applied only to successful well efforts in Cook Inlet. That ten percent credit also applied to the entirety of development efforts "subsequent" to that effort.

[9:22:17 AM](#)

Senator Dyson supported the "SB 185 credit" language in CSHB 488, which extended those provisions ten years.

Co-Chair Green also supported that language with consideration given to amending the \$20 billion credit provisions specific to Cook Inlet.

Co-Chair Green next addressed the "spill surcharge total spill surcharge split (.201/.300) spill surcharge payable" section of the handout. The spill surcharge under CSSB 305 would be six cents per barrel.

Mr. Dickinson stated that three cents of the five cents surcharge fee currently specified in State Statute was payable on each barrel. The two cent balance was only payable when the funding level in the spill fund dropped below \$50 million. This practice is referred to as "the split nickel". The spill fund

balance has not dropped below \$50 million for approximately eight years.

Mr. Dickinson understood that CSSB 305 was increase the surcharge to six cents. Five cents instead of the current three cents would be collected. The one cent surcharge would only be collected to "replenish the fund".

In response to a question from Co-Chair Green, Mr. Dickinson stated that the five cents collected would be utilized to support remediation efforts.

Co-Chair Green understood that the efforts supported by that money were managed by the Department of Environmental Conservation.

Mr. Dickinson affirmed.

Co-Chair Green asked the Committee's perspective on the six percent surcharge fee proposed in CSSB 305.

Senator Hoffman asked the location of this issue in the April 1, 2006 presentation.

Mr. Dickinson responded that the issue was addressed on page 35 of the presentation. The page was titled "Navigating CSSB 305".

Senator Stedman stated that another issue pertinent to this surcharge was whether it should be deductible or creditable expense under the PPT.

Mr. Dickinson stated that each penny collected per barrel would equate to approximately three million dollars annually.

Co-Chair Wilken deferred to the determination of the Senate Resources Committee. However, under the current split nickel scenario, the two cents supported the spill clean up "response fund. The three cents funded the bureaucracy" of the Department administering the program. Reducing the response fund surcharge to one cent would half the funding requirement for replenishing that Fund while the funding for the bureaucracy would increase by 40 percent. He questioned how that additional funding would be utilized.

Senator Stedman responded that this issue was one of many that "did not rank high on [his] the priority list" when developing the overall PPT bill. Other Senate Resource committee members had more knowledge of this issue. His concern had been to whether this expense would be deemed deductible or creditable and whether the fund would be sustainable.

Mr. Dickinson stated that the affect of reducing the fund support to one cent per barrel would serve to require twice as much time to replenish the fund to a \$50 million were it reduced to zero.

Co-Chair Wilken asked therefore whether the bureaucracy amount should be specified as four cents and the fund portion two cents.

Mr. Dickinson expressed that the Administration preferred to leave the current split in place.

Co-Chair Wilken, the chair of the Finance budget subcommittee on the Department of Environmental Conservation, asked that he be allowed to report back on this issue after conferring with the Department.

Co-Chair Green thought that this change had been requested by the Department of Environmental Conservation.

Co-Chair Wilken communicated that the Department has had budget problems for three years. To that point, he affirmed that the subcommittee had presented this change as a manner through which to address the state of the Department's budget.

Mr. Dickinson qualified that while the Administration's original position was to support the status quo split, the funding of the account had not been thoroughly analyzed. That should be done before the Administration's official recommendation split be provided.

Senator Bunde stated that the split nickel issue had been addressed numerous times over the years. He understood that the current division had been the best solution. Thus, he considered the Department's request to be an "end run around budget limitations."

Co-Chair Wilken could not say whether an increase in the bureaucratic funding in this regard was warranted or not. His desire to discuss the issue with the Department was based on the fact that the subcommittee's decisions with the Department had been based on the three/two split rather than the five/one split being proposed in CSSB 305. He deemed the five/one split scenario to be a "significant change".

Co-Chair Green next addressed the "surcharge treatment" provision on the comparison sheet. SB 305 would allow it to be "creditable against the PPT" and neither CSHB 488 nor CSSB 305 would allow it to be creditable or deductible.

[9:30:50 AM](#)

Senator Stedman stated that allowing the surcharge expense to be deductible would have "shifted quite a bit of the cost onto the State".

[9:31:07 AM](#)

Mr. Dickinson explained that the Administration had proposed to allow the surcharge to be creditable was to promote "a single tax on the profit". The opinion was that "this money would have supported those funds but mechanically speaking," he agreed with Senator Stedman that that would result "in fewer dollars for the general fund". He reviewed the cost to the State were the surcharge deemed creditable or deductible.

[9:32:23 AM](#)

Co-Chair Green affirmed that Co-Chair Wilken would review the surcharge split with the Department of Environmental Conservation.

Co-Chair Wilken affirmed. He corrected his previous calculation that increasing the funding for administering the program from three to five percent would be a 66 percent rather than a 40 percent increase.

[9:33:03 AM](#)

Co-Chair Green concluded that disallowing the surcharge from being either creditable or deductible was the consensus.

[9:33:19 AM](#)

Co-Chair Green next addressed the proposed effective dates for the PPT. SB 305 would have an effective date of July 1, 2006. Both CSSB 305 and CSHB 488 would have an effective date of April 1, 2006.

[9:33:32 AM](#)

Co-Chair Wilken stated that he has heard arguments in support of either date; therefore he suggested leaving this item open for further negotiation.

Co-Chair Wilken opted to use the April 1, 2006 date as a placeholder since Co-Chair Green preferred not to have a "blank" in the committee substitute

Senator Bunde did not support retroactivity, thus he supported the July 1 date.

Senator Hoffman could accept the April first date.

Co-Chair Green concluded that a timeframe between April first and July first was the consensus.

[9:34:47 AM](#)

Co-Chair Green asked Mr. Dickinson to explain the "transition payment" provision depicted on the comparison sheet.

Mr. Dickinson stated that the Administration had not included a transition payment provision in SB 305 as the hope had been that the bill would have been adopted early in the Legislative session. That would have allowed sufficient time for the PPT tax calculations to be conducted and paid in July. This not being the case, the Administration was in support of the transition language proposed in CSSB 305 which would allow the first six months after the effective date of the bill to be based on the conditions of the existing ELF tax regime, without the accrual of any penalties or interest. A true up of the PPT taxes owed must be paid in the seventh month.

Co-Chair Green understood therefore that the transition payment provisions in CSSB 305 would be workable.

Mr. Dickinson affirmed.

Co-Chair Green stated that the true up month would be dependent on the effective date of the bill.

Mr. Dickinson affirmed that the true up would occur in the seventh month after the effective date of the bill. However, were the effective date to be retroactive, the Administration would seek a transition term longer than six months as a minimum of six months would be required "to get everything in place".

Co-Chair Green understood therefore that were the effective date of the bill April first, a nine month transition timeframe would be required at this point.

[9:36:30 AM](#)

Co-Chair Green next addressed the safe harbor provision of the bill. The discussion that had occurred earlier in the hearing on this issue would now continue.

Co-Chair Green stated that SB 305 would require a company to remit a minimum of 90 percent of the taxes owed to the State with a no interest annual true-up. CSHB 488 also specified a minimum 90 percent payment; however, interest would be charged were less than 100 percent paid. CSSB 305 would require a 95 percent quarterly true-up with no interest charged were that condition met.

[Note: The earlier discussion on this issue occurred at [2:12:29 PM](#).]

[9:36:49 AM](#)

Senator Bunde spoke in favor of the conditions specified in CSSB 305. Requiring less than a 95 percent payment would "encourage people to use at least eight percent of our money in some short term interest bearing account". A 95 percent payment would result in "more exact accounting and would less likely to encourage arbitrage".

Senator Stedman asked Mr. Dickinson whether the industry had attempted "to minimize their payment and maximize their float" under ELF.

Mr. Dickinson clarified that ELF did not contain any safe harbor provisions. Taxes are due monthly and interest is charged on any underpayment. No benefit would be provided to a company were they to overpay.

Mr. Dickinson shared that because the PPT would be a more complex tax, the Administration would request that "a buffer" be included to allow for accommodating the changes. 90 percent was considered to be the appropriate buffer.

Senator Stedman asked how difficult the implementation and monitoring of the various safe harbor provisions might be on both the industry and the State.

[9:38:50 AM](#)

Mr. Dickinson stated that the more variables included in the bill the more difficult it would be to implement. To that point, "a large buffer would be more appropriate than small one".

[9:39:36 AM](#)

Senator Bunde asked whether the consensus was to have a quarterly true-up. His concern with a 90 percent true-up would be lessened were there a quarterly rather than an annual true-up. Investors have been known to make as short as two day turnarounds on investments. He would recommend a 95 percent payment requirement were there to be an annual true up.

Senator Hoffman preferred an annual true-up and a 90 percent payment requirement.

Senator Dyson surmised that were a 90 percent payment specified, a company would strive to pay 90 percent. To that point, he asked the "delta" between a 90 and 100 percent payment with an annual true-up.

[9:41:38 AM](#)

Mr. Dickinson responded that, were the State to impose an 11 percent interest on the payment balance, a company would choose to "aim high" as they would prefer "to be a couple of dollars over" than under.

Mr. Dickinson calculated that in a "big year", the State might have \$90 million in taxes outstanding were the industry subject to a 90 percent payment with an annual true-up. An 11 interest could be applied to that. There was also the time value of money consideration.

[9:44:21 AM](#)

Senator Stedman suggested that it was likely that the industry "would probably float that in money market"; however, it was unlikely they would earn 11 percent interest.

Co-Chair Green inquired to Senator Stedman's safe harbor preference.

Senator Stedman understood Senator Hoffman's annual safe harbor position; however, due to the "sheer size of the dollar volume", he would support a quarterly true-up with a 90 percent payment. The 95 percent payment quarterly true-up might be "too onerous" due to the complexities of the bill. The quarterly plan could be changed to an annual plan were it found to be too burdensome.

Co-Chair Green supported the annual plan as it would be more consistent with other filing requirements.

Co-Chair Wilken deferred to Senator Stedman in this decision.

In response to a comment by Senator Bunde about the fact that the industry could withhold approximately \$90 million in outstanding taxes were there an annual true-up, stated that in that case the State would receive an annual "windfall" when the true-up occurred.

Senator Bunde stated that interest should be applicable to that outstanding amount.

Senator Dyson supported there being a quarterly true-up were the decision made to support a 90 percent payment requirement.

[9:47:01 AM](#)

Mr. Dickinson stated that the Administration's position was that companies would only have "good information once a year" via the federal income tax return. Little if any additional information for tax estimation purposes would be generated by having a

quarterly true-up timeframe. However, a quarterly true-up would assist "in stopping the interest clock" concern.

Senator Stedman asked Mr. Dickinson whether a 95 percent payment with an annual true up might address some of the concern about the float. This would also align the State with federal calculations.

Mr. Dickinson viewed that suggestion to be "a compromise".

[9:48:53 AM](#)

Senator Hoffman understood that current investment levels in the State were approximately \$1.5 billion. The hope was that the PPT would assist in increasing that level to \$2.5 billion. He thought that a 90 percent payment requirement would further that endeavor.

Senator Hoffman asked for further information about the reason it was believed that companies would err on the high side rather than the low side of the minimum payment amount required.

Mr. Dickinson echoed Senator Stedman's earlier remark that companies could not invest the money they withheld over a three month period and make more than the interest that would be due on the money. Thus they would strive to avoid underestimating their taxes because they would be charged 11 percent interest by the State.

Senator Hoffman recognized the 11 percent interest rate to be at a level that would also deter such behavior under a 90 percent annual true-up plan.

[9:50:44 AM](#)

Co-Chair Green then directed Committee attention to the "tax rate" provision of the bill. Both SB 305 and CSHB 488 supported a 20 percent tax; CSSB 305 proposed a 25 percent tax rate.

[9:51:20 AM](#)

Senator Stedman supported the 25 percent rate, particularly when considering the entirety of the bill's considerations; specifically the costs of doing business, royalties, and the corporate and State income tax. The magnitude of the provisions

of CSSB 305 on the government/industry takes "isn't 100 or 200 or 300 percent", but would level the government take off between 57 and 60 percent for an approximate two or three percent change. "Although the articles being published ... and the ads on the radio reference a substantial increase in tax, when we look at what substantial is", the effective change would only be two or three percent government percent change. The federal government would receive approximately half of that.

[9:53:13 AM](#)

Senator Stedman stressed that 25 percent would be the appropriate tax. Further work should be given to the Progressivity feature because its current structure, even at a 25 percent rate, the government share portion declines as oil prices go up. "That is unacceptable" regardless of what the tax rate might be. "The State should not be a smaller portion of the value of our resources as the price moves from \$50 per barrel to \$60 to \$70" and upwards. The government take should remain flat if not to increase slightly.

Senator Stedman stressed that the affect of the 20 percent credit rate on the 25 percent tax should be further analyzed as it might decrease the government take. Some estimates indicate that the rate would equate to the current government take level and would increase expenditures.

Senator Stedman also noted that "the analysis conducted by Econ One did not take into account the impact of the 20 percent credit on stimulating the producers to explore and develop more and increase their production". Thus, the effect of applying the credits to the 25 percent PPT tax would result in lowering the government take. It was imperative that the analysis take into consideration whether the credit would stimulate exploration and "stem" the production decline.

[9:55:11 AM](#)

Co-Chair Green did not support the argument that the PPT being proposed, whether it be 20 or 25 percent, would be a "minor increase; it is substantial" in terms of percentages particularly when including the Progressivity element. She would prefer the Legislature being more forthright and portraying the percentage increase as it should be portrayed; that it in reality might be a 30 percent increase overall.

Co-Chair Wilken stated that this was the most important component of the bill and should be thoroughly discussed. Continuing, he characterized it as a "who do you believe" issue. To that point, he voiced his confidence in the information presented by Mr. Dickinson. "His interests are in the best interests of the State of Alaska. ... You're one of the people I believe."

Co-Chair Wilken stated that when he asked a producer to explain their conclusion that the PPT would triple their tax rate, the response had been that that percentage rate was specific to production taxes. This surprised Co-Chair Wilken as it was difficult to believe that the industry's newspaper and radio advertising campaigns were solely focused "on one section of a 34 section bill". The industry affirmed that was correct and that they "had been very clear about just production taxes". However, that message has had vast influence on the people of the State.

Co-Chair Wilken understood that the overall government take under CSSB 305 would be a 3.6 percent increase at a \$50 per barrel price. He vehemently urged someone to correct him were his calculations incorrect. Were the bill in its entirety, rather than just the production tax component, considered, the result would be "a marginal increase in government take". Such an increase would not result in "the cataclysmic events" he had been told would happen were this bill adopted.

Co-Chair Wilken stressed that the tax increase would not be 300 percent. The information being presented to the public should be honest. He characterized the industry as "being devious" in how they were presenting information to the public. "That bothers me." The conversation should include all the provisions of the bill and not solely Section 5 which deals with the production tax. He was a strong supporter of the 25 percent tax rate.

[9:59:35 AM](#)

Senator Hoffman thought that the PPT tax rate should be one of the last decisions made. The appropriate rate would depend upon such things as Progressivity and the point at which that element would be triggered. He agreed with Co-Chair Wilken that the total picture should be considered in the final determination of "what would be a fair percentage" rate for the tax.

10:01:07 AM

Senator Bunde considered this to be the most important decision of his political career. He has been frustrated by the "dueling experts"; however, the industry had as much right as the State to protect their interests.

Senator Bunde did not think that industry investment in the State would stop were a 25 percent PPT rate adopted. However, he urged that the analysis process be conducted in a cautious and thorough manner that considered a variety of price and tax rate scenarios. "The political realities" of this were that regardless of Committee action on this issue, the conditions would be altered when the bill was before a conference committee.

10:03:10 AM

Mr. Dickinson verified Co-Chair Wilken's calculation that at a \$50 barrel price, there would be a 3.6 percent difference in the State's take between the 20 and 25 percent tax rate. However, "the net affect" of a 25 percent tax rate at high prices "will be a "substantial increase". Thus, the difference between the tax rate in CSSB 305 and the status quo would exceed 3.6 percent at current barrel prices. That would not be the case at low prices.

Senator Stedman stated that the comparison of the provisions in CSSB 305 to the status quo would result in an 18.5 percent change. While this sounded "fairly large"; however CSSB 305 only increased the tax 7.7 percent beyond that that would be imposed under the Governor's bill, SB 305. CSSB 305 was 3.4 percent above the tax rate that would be imposed under CSHB 488. Thus, the percentage magnitudes would be dependant on which comparison one chose. "Clearly, the delta, depending on the price of oil, was somewhere between ... 2.5 percent up to five percent, depending on if we stop at \$70 or \$80 per barrel.

In consideration of time, Co-Chair Green called a close to the hearing. She announced that a committee substitute would be developed based on the discussion to date.

The bill was HELD in Committee.

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**ADJOURNMENT**

Co-Chair Lyda Green adjourned the meeting at [10:05:00 AM](#)