

MINUTES
SENATE FINANCE COMMITTEE
April 19, 2006
9:06 a.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [9:06:51 AM](#).

PRESENT

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

Also Attending: SENATOR TOM WAGONER; DARWIN PETERSON, Staff to Senator Lyda Green; 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 reviewed and adopted a committee substitute. The bill was held in Committee.

#sb305

CS FOR SENATE BILL NO. 305(RES)

"An Act providing for a production tax on oil and gas; repealing the oil and gas production (severance) tax; relating to the calculation of the gross value at the point of production of oil or gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the tax for

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

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

Co-Chair Green moved to adopt committee substitute version 24-GS2052\P as the working document and objected for purposes of discussion. She anticipated that each person would find areas of the proposed Petroleum Production Tax (PPT) bill they could support and other areas they might wish to change. The desire was to produce a PPT bill that would generate widespread support in the effort to protect the State and promote additional industry investment.

Co-Chair Green, referencing a summary sheet of the provisions proposed in Version "P" [copy not on file], noted that many of its components aligned with those of CSSB 305(RES). These included the provisions pertaining to the private royalty tax rate; the special gas progressivity; the five year lookback transition period with a two for one recoupment for capital

expenditures; the interest only provision pertaining to the safe harbor outstanding tax balance; the allowance of a six month transition period in which the severance tax would be paid under the tax provisions of the current tax regime, Economic Limit Factor (ELF), with a seventh month PPT true-up; disallowing spill surcharge payments to be either creditable or deductible; the specification that the credits could only be applied to the PPT; allowing 20 percent of any transferred credits to be applied to the tax limit; disallowing any provision through which the State could refund a company for their credits; specifying that the point of production for gas would be upstream of the gas treatment facility; and allowing catastrophic oil spill expenses pertaining to leases to be a deductible expense.

Co-Chair Green expressed that the transition treatment "credit; and no oil price test" provision and the termination year of the transition period proposed in Version "P" were essentially the same as those of CSSB 305 (RES). While the termination year was the same, the date had been changed from March 31 to June 30 of 2013.

Co-Chair Green stated that minor revisions were made regarding the base allowance provision and the treatment of the Department of Natural Resources (DNR) royalty values in Version "P" as compared to CSSB 305(RES).

Co-Chair Green also noted that the safe harbor language in Version "P" specified a 95 percent monthly tax payment with an annual true-up rather than the quarterly true-up proposed in CSSB 305(RES).

[9:11:38 AM](#)

DARWIN PETERSON, Staff to Senator Lyda Green, clarified that Version "P" would apply a Progressivity element to both oil and gas. He noted however that the Gas Revenue Exclusion section of the bill would "lift the bar so high that Progressivity, in essence, was not applicable".

[9:12:14 AM](#)

Senator Bunde suggested that Version "P" would be easier to compare to other bills were it depicted as a fourth column on

the bill comparison sheet provided by the Department of Revenue and discussed on April 12, 2006.

9:12:47 AM

Co-Chair Green began to individually address the language changes in Version "P". The phrase "An Act repealing the oil production tax and the gas production tax" had been moved to the forefront of the bill's title on page 1 line 1 rather than being on line 3 of the title in CSSB 305(RES). In addition, the words "oil or gas" on line 3 and line 10 of the bill's title had been changed to "oil and gas".

9:13:31 AM

Senator Bunde asked whether this was the result of a drafting change or whether changing to word "or" to "and" could be considered a substantial change.

Co-Chair Green remarked that changing the language to "oil and gas" would "make a difference".

Mr. Peterson expressed that changing the word "or" to "and" would provide consistency in the bill as the phrase "oil and gas" was included in other sections of the bill.

Co-Chair Green communicated that moving the phrase "An Act repealing..." to the first line implied its importance.

Co-Chair Green noted that no changes were made on page 2 of Version "P" in respect to CSSB 305(RES).

Co-Chair Green specified that Version "P" decreased the production tax rate "of the taxable oil and gas as calculated under AS 43.55.160" from 25 percent to 22.5 percent. This change was located in Sec. 5 subsection (e) page 3 line 18.

Co-Chair Green stated that the private royalty tax rate on leases was addressed in Sec. 5 subsection (f)(1) and (2) page 3 lines 20 through 28 of Version "P" as follows.

(1) the rate of tax levied on oil produced from a lease is equal to five percent of the gross value at the point of production of the oil;

(2) the rate of tax levied on oil produced from a lease is equal to 1.667 percent of the gross value at the point of production of the gas";

Co-Chair Green added that the Sec. 5 subsection (f)(3) language depicted on page 3 line 29 through page 4 line 6 was added "to prevent gaming ... between an oil company and a private royalty owner" to reduce taxes. Were this to occur, the rate would revert to the standard 22.5 percent on oil and 7.5 percent on gas.

Mr. Peterson noted that the terms of the private royalty section in CSSB 305(RES) had "craved out Cook Inlet for oil and gas". Version "P" eliminated that provision and would apply a five percent a private royalty owner tax rate on oil and a 1.667 percent private royalty owner tax rate on gas statewide.

Senator Hoffman asked the percentage rates specified in CSSB 305(RES).

Mr. Peterson responded that the gas rate on private royalty leases in Version "P" was similar to that specified for Cook Inlet in CSSB 305(RES). Furthermore, Version "P" would allow other basins such as the Nenana Basin to be taxed at that rate. A single statewide tax on gas would be easier for the Division of Tax, Department of Revenue to calculate.

Senator Hoffman understood therefore that a single private royalty lease gas tax rate would apply to Cook Inlet, Bristol Bay, Nenana Basin, and the North Slope.

Co-Chair Green affirmed.

[9:17:22 AM](#)

Senator Stedman desired that the overall affect of the provisions in Version "P" on Cook Inlet be revisited after the bill in its entirety had been reviewed.

Co-Chair Green agreed, but noted that questions pertaining to Cook Inlet would be welcome at any time during the discussion.

Co-Chair Green next addressed the Progressivity element in the bill as depicted in Sec. 5 subsection (g) and (h) on page 4 lines 7 through 21. The Progressivity Trigger proposed in

Version "P" would be \$45 per barrel of oil after costs. That would be "equivalent to a higher" Alaska North Slope (ANS) West Coast price. This would be a "more proper calculation" since Progressivity would be based on net value.

Co-Chair Green specified that the \$40 ANS market price Progressivity trigger specified in CSSB 305(RES) would have been "a lower threshold" than that proposed in Version "P". She had been concerned about "the inequities" that might have occurred were the \$40 ANS price utilized as a trigger point as that rate might have increased several times before the effective date of the bill.

Co-Chair Green stated that the language in Sec. 5 subsection (g) and (h) also simplified language as it would apply "the same tax base for the Progressivity tax and the PPT".

Co-Chair Green pointed out that while the Progressivity element would also apply to gas, Version "P" added a gas revenue exclusion in Sec. 26 on page 18, beginning on line 6.

[9:19:45 AM](#)

Senator Bunde observed that the Progressivity rate would be 1/20th of one percent.

Co-Chair Green affirmed.

[9:19:57 AM](#)

Co-Chair Green stated that no change was made to Sec. 6 of the bill.

Co-Chair Green stated that the change from a 95 percent monthly tax payment safe harbor with a quarterly true-up to a 95 percent annual true-up was depicted in Sec. 7 subsection (a) on page 5 lines 1 through 10. She specified that 95 percent of the private royalty lease tax and 95 percent of the Progressivity tax would also be due monthly. The annual true up date would be March 31, of the year following the calendar year.

Senator Bunde asked the interest penalty rate that would be applied were the tax paid less than the 95 percent minimum.

Co-Chair Green stated that the interest penalty would be 11 percent. This mirrored the penalty levied in CSSB 304(RES).

Co-Chair Green identified Sec. 9 and Sec. 10 as being conforming language.

Co-Chair Green stated that the language "produced but not sold, or if oil or gas is produced and" was added to Sec. 11 subsection (f) page 6 line 12 to "more accurately reflect" State Statute and current practice.

[9:21:47 AM](#)

Co-Chair Green pointed out that Sec. 12. subsection Sec. 43.55.024 (a)(1)(A) on page 6 line 29 of Version "P" would increase the credit rate from 20 to 25 percent.

Co-Chair Green recalled hearing that "a one percent rise in the tax rate is equivalent to about a five or six percent" credit rate increase. The decision was made to increase the credit rate in Version "P" to a point that would "offset" the difference in the tax rate in SB 305 over the original 20 percent tax proposal.

[9:22:21 AM](#)

Co-Chair Green hoped that would incentivize further investment in the State. A company electing to take the credit provided under subsection (A) would be prohibited from utilizing other credit provisions in the bill and visa versa. In other words, "double dipping" would not be allowed.

Co-Chair Green also noted that language in Sec. 12 "restated" provisions included in SB 185, in that an entity receiving credits for geological or geophysical activities would be required to share that seismic data with the Department of Natural Resources. As specified in current State Statute, such data would be kept confidential for ten years.

Co-Chair Green pointed out that language in Sec. 12 subsection (a)(1)(B) specified the "loss carry forward rate at 22.5" percent. That would coincide with the tax rate.

[9:23:46 AM](#)

Co-Chair Green advised that no changes were made on page 8 of the Version "P" relative to CSSB 305(RES).

9:23:52 AM

Co-Chair Green stated that language in Sec. 12 subsection (h) and (i) on page 9 contained "conforming amendments to comply with the new [PPT] effective date" of July 1, 2006.

Co-Chair Green communicated that the phrase "extended period of disuse" had been deleted from Sec. 12 subsection (h)(2) because that language "was too vague".

Co-Chair Green also noted that language in Sec. 12 subsection (h) would maintain the current practice of excluding "ordinary and necessary business expenses" from qualifying for credits.

9:24:42 AM

Co-Chair Green communicated that conforming amendments were utilized in Sec. 12 subsection (j)(2) page 10 line 22 in order to simplify the reporting of expenditures. Such expenditures must qualify under federal income tax standards.

9:25:08 AM

Co-Chair Green informed the Committee that Sections 13 through 17 on pages 11 - 14 would extend the exploration provisions of SB 185 on a statewide basis for ten years. She pointed out that language in Sec. 15 subsection (f)(5), page 13 lines 24-26, would clarify existing language pertaining to the exploration expenditure limit of \$20,000,000 on exploration activities in Cook Inlet. This language reads as follows.

...after the end of the calendar year following the calendar year in which the total of production tax credit certificates issued by the department under this section based on exploration expenditures for Cook Inlet prospects reached \$20,000,000,

Co-Chair Green explained that this "clarifying" language would require the Department of Natural Resources (DNR) to review the program the year prior to the limit being reached. Any project conducted that final year that had Department approval would be

allowed even though the \$20,000,000 limit might be exceeded. At that point, this Cook Inlet provision would terminate.

[9:26:52 AM](#)

Senator Stedman asked how the 20 percent exploration credits referenced in Sec. 13 subsection (a)(1) page 11 lines 9 and 10 and the 40 percent credits referenced in Sec. 13 subsection (a) (3) and (4) on page 11 lines 13 through 16 would mesh with the 25 percent credit proposed in Sec. 12 subsection (a)(1)(A).

Co-Chair Green stated that the exploration credits in Sec. 13 referred to the credit provisions of SB 185.

[9:27:43 AM](#)

Senator Stedman asked why someone would choose a 20 percent credit when a 25 percent credit was available.

[9:28:14 AM](#)

DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant to the Office of the Governor, affirmed that Sec. 13 would extend current law enacted by SB 185. He understood that the question was why a person would elect the 20 percent credit when a 25 percent credit was available or why they would take a 25 percent credit when a 40 percent credit was available. The intention was to accommodate exploration project decisions that had been made under the provisions of SB 185. The desire was simply to "not change those rules". The language could be considered "superfluous" as it was likely that "people would apply for the new credits" that would be established by this bill.

[9:29:41 AM](#)

Senator Olson surmised therefore that extending the provisions of SB 185 would allow for a "smoother transition with the least amount of misunderstanding".

Mr. Dickinson affirmed.

Co-Chair Green noted that no changes had been made to the provisions depicted on page 15. She noted that Sec. 20 reflected a conforming amendment pertaining to the March 31 filing date

for adjustments or corrections relating to the prior year's reportings.

Co-Chair Green stated that no changes were made to Sec. 21. The changes in Sec. 22 on page 16 were conforming amendments.

[9:30:31 AM](#)

Co-Chair Green noted that Sec. 25 subsection (d) on page 17 lines 10 through 17 was new language.

[9:31:09 AM](#)

Co-Chair Green specified that Sec. 26, page 18 beginning on line 6, related to the new gas revenue exclusion. This section addressed "one of the dilemmas" with the proposed PPT; that being how "to determine the" costs of oil and gas "when they're together and in the same area and in the same pipe, etc." While the same PPT base would be applicable to both oil and gas, the effective tax rate for gas would be lowered in that only one of every three dollars of gas revenue would be subject to the 22.5 percent PPT rate. In other words, each dollar of gas revenue would be taxed at one-third the PPT rate or a 7.5 percent tax rate.

[9:33:02 AM](#)

Senator Stedman concluded that the intent was to apply the same tax structure statewide and then address the tax on gas in this manner.

Co-Chair Green affirmed.

Mr. Peterson agreed that the tax base would be uniform statewide. The gas revenue exclusion rate was specified in Sec. 26 subsection Sec. 43.55.160(a) on lines 10 and 11 of page 18.

[9:34:00 AM](#)

Mr. Dickinson reiterated how difficult it was to "parcel the costs between" oil and gas produced at a production facility. Imposing a separate tax on oil and gas would also be tedious. Thus, the decision to approach the issue from a gross value at point of production position was the preferred method.

[9:35:07 AM](#)

Senator Olson asked the reason why specifying a gas tax rate of 7.5 percent had not been preferred to the one-third of the gross value at the point of production of the gas language.

[9:35:21 AM](#)

Mr. Dickinson responded by exemplifying the activities associated with a platform producing both oil and gas in Cook Inlet. He noted that the costs of that production would qualify for a 22.5 percent deductible under the PPT under the conditions of Version "P".

Mr. Dickinson communicated that there had been no enthusiasm for applying a lower rate for gas at the platform level as other factors such as those experienced under a private lease situation, would come into play.

Senator Olson asked whether geographical differences would also be a consideration.

Mr. Dickinson clarified that Version "P" did not include any geographical considerations.

Senator Olson acknowledged.

Co-Chair Green noted that the intent was to simplify the calculation.

[9:37:00 AM](#)

Co-Chair Green referred the Committee to language in Sec. 26 subsection (c)(1)(B) page 19 lines 24 through 30. The intent of this language was to clarify that were there no existing or clear industry standards, "existing DNR standards may be used" in calculating costs.

Co-Chair Green noted that, in order to eliminate confusion, a listing of what would and would not be considered "direct costs" was provided in Sec. 26 subsection (d), page 20 line 11 through page 21 line 20.

Co-Chair Green noted that the term "1/12" was added to the language in Sec. 26 subsection (f) on page 22 lines 29 through 31. The language read as follows.

(f) In place of the adjusted lease expenditures for a month under (a) of this section, a producer may, at any time, elect to substitute, for every month of a calendar year, 1/12 of the producer's adjusted lease expenditures for the calendar year. ...

[9:39:34 AM](#)

Co-Chair Green directed attention to the "revised base allowance language in Sec. 26 subsection Sec. 43.55.170(b)(4), page 24, lines 12 through 14. The language in this subsection was similar to that of CSSB 305(RES), but "was somewhat enhanced". While each company would continue to receive a 5,000 per day barrel allowance, language specifying an annual maximum of 14 million barrels was added. In addition, the Department of Revenue (DOR) would be required to provide a report to the Legislature in 2015 "as to the effectiveness of this program" as well as a recommendation as to whether it should be extended.

Co-Chair Green next noted that the \$.01 surcharge and the \$.04 surcharge specified in Sec 27 subsection (a) page 24 line 29 and Sec. 29 subsection (a) page 25 line 15, respectfully, were included in the bill as placeholders until Co-Chair Wilken concluded his discussion with the Department of Environmental Conservation and provided his recommendation in this regard.

Co-Chair Green noted that no other changes were made to language on page 25. Furthermore, no changes were made on page 26 of the bill.

Co-Chair Green noted that the definition of "explorer" had been expanded for clarity purposes in Sec. 34 subsection (17), page 27 lines 11 and 12. References to oil and gas in this Section were also expanded to provide further clarity.

[9:41:53 AM](#)

Co-Chair Green noted that the repealer language in Sec. 35 page 28 lines 1 through 3 had been amended for conformity purposes.

Co-Chair Green anticipated that an amendment would be forthcoming regarding the reports to the Legislature specified in Sec. 36 of the bill. In order to prevent these reports from being "overlooked" the intent would be to place them in codified rather than uncodified law.

Co-Chair Green noted that the remainder of the bill contained conforming language and date changes. She concluded her overview.

[9:42:56 AM](#)

Senator Bunde asked that an estimate of the difference in revenue the State would receive as the result of changing the effective date from April 1 to July 1, 2006 be provided.

[9:43:26 AM](#)

Senator Bunde also asked that an estimate of the effect of other changes in the bill such as the change to a 25 percent credit be provided.

Co-Chair Green understood that increasing the tax rate from 20 to 25 percent had more impact on revenue than increasing the credit rate from 20 to 25 percent.

[9:44:09 AM](#)

Senator Stedman asked that the government take charts be updated to reflect the provisions of Version "P"; specifically the affect of the Progressivity element in the bill. For comparison purposes, he asked that the revised charts also reflect the provisions of CSSB 305(RES).

Mr. Dickinson acknowledged.

Mr. Dickinson stated that while the comparison charts could be provided in short order, generating the revenue estimates requested by Senator Bunde would take longer to compile.

[9:45:16 AM](#)

In response to a question from Co-Chair Wilken, Co-Chair Green revisited the Progressivity element specified in Sec. 4 subsection (g) page 4 lines 7 through 15. The Progressivity rate

of one-tenth of one percent would be triggered at a \$45 barrel price of oil after cost.

Co-Chair Wilken understood therefore that the Progressivity rate language specified in Version "P" had been changed to one-tenth of one percent.

Mr. Dickinson referred Co-Chair Wilken to Sec. 5 subsection (h) page 4 lines 16 through 21 for further details about the Progressivity element calculation.

Co-Chair Wilken asked whether the one-tenth of one percent language on lines 12, 13, and 14 of Sec. 5 subsection (g) would equate to the two percent Progressivity language provision included in CSSB 305(RES).

Mr. Dickinson affirmed they were "comparable".

[9:47:03 AM](#)

Co-Chair Wilken hoped there would be an opportunity for the Legislature's consultants to develop charts pertinent to Version "P"; specifically those pertaining to the government share percentages. Decisions were dependent on such information.

[9:47:34 AM](#)

Senator Stedman surmised that the affect of the Progressivity element in Version "P" would be substantially different to that of CSSB 305(RES). The Progressivity calculation had transitioned from being based on the West Texas Intermediate (WTI) price to the ANS West Coast, and now to the North Slope wellhead price. Having this in chart form would assist in understanding the affect.

[9:48:24 AM](#)

Mr. Dickinson stated that charts would be developed.

Senator Bunde understood that basing Progressivity on a net price differed from the approach taken in CSSB 305(RES).

Co-Chair Green affirmed that "consideration for cost" was included in the Progressivity component of Version "P" as it was deemed to be "more fair".

Senator Bunde noted that, while "considerable discussion" had occurred regarding conditions in Cook Inlet, specific language addressing that situation was not included in Version "P".

Co-Chair Green affirmed that the PPT provisions in Version "P" would be applied on a statewide basis. However, the rate had been adjusted to reflect the situation in Cook Inlet and other areas including the Nenana Basin and Bristol Bay.

Mr. Dickinson stated that the PPT rate specifications in Version "P" had taken into account smaller developments.

Co-Chair Green removed her objection to the adoption of Version "P".

Without further objection, Version "P" was ADOPTED as the working document.

[9:50:28 AM](#)

Senator Stedman asked whether Version "P" included language that would prevent an entity from getting both the 20-percent credit afforded by the extension of SB 185 as well as the 25 percent PPT credit. He also asked for further discussion as to how the credit associated with Progressivity would be applied.

[9:51:21 AM](#)

Mr. Peterson stated that the Statutes referenced in Sec. 12 page 6, lines 23 through 26, would prohibit an entity from "double dipping" credits.

[9:52:00 AM](#)

Senator Stedman asked that further analysis be conducted on this of this issue.

[9:52:32 AM](#)

Senator Stedman next addressed the two for one five-year look back provision in the bill; specifically whether Version "P" would allow those credits to be applied over a seven or ten year forward timeframe.

Mr. Dickinson responded that Version "P" specified a seven year forward timeframe.

Co-Chair Green mentioned that CSSB 305(RES) had also specified a seven year timeframe.

[9:53:06 AM](#)

Senator Dyson was impressed with the work conducted on the committee substitute. He was in agreement with some of it but would desire more time to thoroughly analysis it.

Co-Chair Green advised that the timeframe in which to address the bill was limited. The intent would be to further address questions this afternoon, receive amendments on Thursday, April 20, and act on them and report the bill from Committee on Friday, April 21.

Co-Chair Green stated that additional work to address such things as an alternate point of production for small companies on the North Slope would be required. Amendments would be required to address such things as incorporating the reporting requirements in codified law.

[9:55:00 AM](#)

Co-Chair Green requested the Committee to provide additional feedback on the bill as soon as possible as the timeframe was limited. The effort would be to develop a bill that would benefit Alaska and encourage the industry to keep investing and producing in the State.

AT EASE: [9:55:38 AM](#)/ [9:56:41 AM](#)

Senator Hoffman requested that a chart be developed that would reflect the Progressivity factor included in the House of Representatives PPT bill, CSHB 488(RES) as compared to that proposed in Version "P" and CSSB 305(RES).

Mr. Dickinson, Senator Hoffman, Senator Stedman, Co-Chair Wilken, and Co-Chair Green discussed the mechanics of the chart being requested.

[9:59:08 AM](#)

The bill was HELD in Committee.

#

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [9:59:38 AM](#).