

MINUTES
SENATE FINANCE COMMITTEE
April 21, 2006
10:24 a.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [10:24:57 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 BEN STEVEN; SENATOR GARY STEVENS, SENATOR TOM WAGONER; DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor; CHERIE NIENHUIS, Petroleum Economist, Department of Revenue; Students from Academy Charter School, Palmer, Alaska.

Attending via Teleconference: From an Offnet Location: ROBERT MINTZ, Assistant Attorney General, Oil, Gas & Mining Section, Department of Law

SUMMARY INFORMATION

SB 305-OIL AND GAS PRODUCTION TAX

The Committee reviewed the Finance committee substitute with the assistance of the Department of Law, the Department of Revenue, and a consultant to the Office of the Governor. 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 fourteenth hearing for this bill in the Senate Finance Committee.

Finance committee substitute, Version 24-GS2052\P, was before the Committee.

Co-Chair Green acknowledged the attendance of students from Academy Charter School in Palmer, Alaska.

[10:25:58 AM](#)

Co-Chair Green stated that the first order of business would be to address a list of questions and concerns [copy on file], specific to Version "P" which were developed by Senator Dyson.

[10:27:35 AM](#)

DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant by the Office of the Governor, addressed the first question on Senator Dyson's list. The question "From what may the taxpayer deduct taxes paid under AS 43.55?" was in reference to language in Sec. 3 subsection (c) page 2 lines 20 through 23 of the Finance committee substitute.

Mr. Dickinson specified that language in Sec. 3(c) pertained to the State's income tax Statute, AS 43.20; specifically that in the "computing of the tax under this chapter, the taxpayer is not entitled to deduct any taxes based on or measured by net income. ... The taxpayer may deduct the tax paid and levied under AS 43.55", when calculating their worldwide income for purposes of AS 43.20.

[10:29:16 AM](#)

Mr. Dickinson next addressed the question of whether a comma should be included after the word "state" in Sec. 5 subsection (f) page 3 line 21. While doing so might be appropriate, he would advise allowing the bill drafters to make that determination.

[10:29:45 AM](#)

Mr. Dickinson advised that the "department" being referenced in Sec. 5 subsection (f)(1), page 3 line 29, was the Department of Revenue; specifically that discussions regarding AS 43.55 would involve the Department of Revenue. Typically, the full name of the Department of Natural Resources would be depicted when that department was being referred to in the bill. Another distinction would be that a lower case "d" in the word "department" would refer to the Department of Revenue and an upper case "D" would refer to the Department of Natural Resources.

[10:30:57 AM](#)

Senator Dyson questioned whether delineating a specific department by either a "d" or an "D" would suffice.

Co-Chair Green qualified that any reference to AS 43 would be specific to the Department of Revenue. The department referenced in relation to another Statute would be identified.

Mr. Dickinson affirmed. He also noted that this issue was further addressed in the Definition section of the bill.

Senator Dyson remarked that the objective was to be "consistent and clear" in these distinctions.

[10:31:58 AM](#)

Mr. Dickinson next addressed Senator Dyson's question specific to Sec. 5 subsection (f)(B) page 4 lines 5 and 6 of Version "P". The question reads as follows.

Increases the royalty tax on gas from Senate Resources version of 1.5% of the gross for Cook Inlet gas to 7.5% of gross production for gas anywhere in the state. For non-Cook Inlet the increase is from the previous 5% to 7.5%. Isn't that a pretty big increase for Cook Inlet gas? Especially when we want more Cook Inlet gas? It appears that this change increases the private royalty tax for gas. Do we really want to increase [the] tax on gas?

Mr. Dickinson first approached the question from a "technical" perspective, as the language in question should be viewed in the "context" of Sec. 5 subsection (f) which pertained to the special tax applied to private royalty interests in the State. "The department was concerned that, in those private royalty contracts between an oil company and a private lessor, you could create a situation where you would say, well, let's say we've always had a 12.5 percent interest, but instead, we're going to double it to a 25 percent interest, but then we'll have some mechanism here that we re-equalize when we calculate our costs." As a result, when it was time to pay the tax, "suddenly, instead of 12.5 percent receiving the lower rate, 25 percent would receive the lower rate".

[10:34:33 AM](#)

Mr. Dickinson explained that the language in Sec. 5 subsection (f)(3) page 3 line 29 through page 4 line 2, specified that the 7.5 percent gas rate depicted in Sec. 5 subsection (f)(B) would be levied were the State to determine there had been "collusion"

between a royalty owner and a lessee. Otherwise, the statewide tax on gas would be 1.667 percent of the gross value at the point of production of the gas as specified in Sec. 5 subsection (f)(2) page 3, lines 27 and 28.

Mr. Dickinson stated that the special tax rate applied to oil relative to private royalty interests would be five percent of the gross value at the point of production for oil as specified in Sec. 5 subsection (f)(1) page 3, lines 25 through 27. That rate would increase to 22.5 percent of the gross value at the point of production for oil, were collusion to occur in that regard.

Mr. Dickinson pointed out that while language in Sec. 5 subsection (e) page 3 lines 15 through 19 specified that the tax would be 22.5 percent of the production tax value of the taxable oil and gas, language in Sec. 26 subsection (a) page 18, lines 10 and 11 qualified that the tax calculation for gas could only consider "one-third of the gross value of the point of production of the gas that is taxable". One third of 22.5 percent would equate to approximately 7.5 percent.

Mr. Dickinson next addressed the question pertaining to Sec. 7, subsection (a) page 5 lines 7-14. The question was as follows:

Lines 7 & 8 say that overpayments can be applied to taxes due for a later month. Lines 13 & 14 indicate that interest is paid on overpayments are not refunded. Are we applying taxes to future liabilities or refunding them?

[10:37:00 AM](#)

Mr. Dickinson specified that the Version "P" would provide options to a taxpayer. Were an overpayment to occur one month, the overpaid amount could be applied to the following month's tax. The company would not receive interest on any overpayment during that 30 day period.

Mr. Dickinson noted however that, were the carried forward overpayment to exceed the tax obligation of the following month, the company could apply for a refund. Interest would be applied to that overpayment were the State unable to refund the money 90 days after the request was made.

[10:38:18 AM](#)

Senator Dyson concluded therefore that interest would not typically be paid on an overpayment.

[10:38:30 AM](#)

Mr. Dickinson affirmed. The State did not desire to act as "a bank" and provide interest on overpayments. Companies should estimate their tax to the best of their abilities.

Senator Dyson understood however that the State would levy an interest penalty were a company to underpay.

Mr. Dickinson clarified that no interest would be charged were a company to underpay by five percent. However, interest would be charged on any underpayment beyond that "95 percent threshold".

Senator Dyson asked Mr. Dickinson to further explain the process through which a company could request an overpayment be refunded.

[10:39:40 AM](#)

Mr. Dickinson stated that the State had 90 days in which to process a company's request for a refund, in the case where that overpayment exceeded the following month's tax obligation. Interest would be paid on that money after that timeframe. While refunds were typically paid in less than 90 days, extended time might be required to thoroughly review a company's tax calculation.

[10:40:36 AM](#)

In response to a question from Senator Bunde, Mr. Dickinson expressed that the State would not levy interest were a company to remit between 95 and 100 percent of their monthly tax. Were a company to remit 90 percent of the amount due, interest would only be charged on the five percent beyond the 95 percent. The outstanding tax and the interest on that five percent would be due by the annual true-up date.

[10:41:34 AM](#)

ROBERT MINTZ, Assistant Attorney General, Oil, Gas & Mining Section, Department of Law testified via teleconference from an

offnet location and disagreed with Mr. Dickinson on one aspect of his remarks pertaining to a company's request for an overpayment refund. Language in Sec. 7 subsection (a) page 5 lines 9 and 10 of Version "P" would indicate that interest would not be paid on that money unless the refund was paid more than 90 days after the annual March 31 true-up date.

Mr. Dickinson confirmed that Mr. Mintz was correct.

[10:43:05 AM](#)

Mr. Dickinson addressed the next issue raised by Senator Dyson. The question was whether a comma would be required after the word "gas" in Sec.9 subsection (d) page 5, line 25 or after the word "lease" on line 26 of that same subsection.

Co-Chair Green understood that the language in question would not require the addition of commas. Nonetheless, the issue would be further reviewed with the bill drafters.

[10:44:14 AM](#)

Mr. Dickinson disagreed with Senator Dyson's next conclusion that language in Sec. 10 subsection (e), page 6, line 3-10 of Version "P" would delete "the penalty currently found in AS 43.55.020(e) for wasteful flaring of gas".

Mr. Dickinson stated the both the Senate Resources committee substitute and Version "P" changed the existing three category approach to flared gas "to a much simpler structure" in that a tax would be levied on gas that the Alaska Oil and Gas Conservation Committee (AOGCC) considered "wasted". No tax would be levied on gas used to produce oil and gas. AOGCC could levy a separate tax in this regard, aside from this legislation.

Mr. Mintz concurred.

Senator Dyson understood that typically taxes had not been levied on gas flared in the case of an emergency such as equipment failures. He assumed that gas used in such situations would continue to be exempt from taxation. However, AOGCC would likely consider whether the operator should have addressed the source of the equipment failure in making that determination.

Mr. Mintz affirmed that AOGCC would review "several factors" when determining whether the flared gas was wasteful or not. Emergency situations would be evaluated by established guidelines on a case by case basis.

10:47:06 AM

Mr. Dickinson deferred to Mr. Mintz to address the question pertaining to language in Sec. 12 subsections (c),(d),(e) and (f) on page 8 of Version "P". The question was as follows.

The CS refers to "person" whereas elsewhere it refers to "taxpayer", "producer", or explorer. Are we confident that "person" is satisfactorily defined?

Mr. Dickinson noted that the person reference was used in the context of the entity which had purchased the tax credit to reduce their tax liability.

Mr. Mintz explained that the term "person" could serve several "functions". In this case it could be considered "shorthand" for referring to either an explorer or a producer. In addition, it would indicate there being no limit on who could purchase a transferable tax credit certificate. "It might not be a producer or an explorer", even though the certificate would have no value to anyone other than one of those entities because it could only be applied to the production tax.

Mr. Mintz would foresee however, there being "intermediary brokers" who might "buy and sell these certificates".

Co-Chair Green recalled a Senate Resources Committee hearing on this bill in which the definition of a person had been discussed. It could apply to a corporation or another entity. She was unsure whether the word defined in State Statute was a widely accepted definition.

Mr. Mintz communicated that the term "person" was included in the listing of general applications definitions under Alaska Statute, Title 1, Sec. 01.10.060. That Statute defined "person" as a "corporation, company, partnership, firm, association, organization, business, trust, or society as well as a natural person".

Senator Dyson acknowledged.

[10:49:48 AM](#)

Mr. Dickinson addressed the question of whether there should be "either an 'and' or 'or' after the semi-colon" in Sec. 12 subsection (i)(2)(B) page 10, line 9. He agreed that a correction to this language was in order as it was unclear whether both or one of the conditions listed would be required. To this point, he thought the word "and" would be appropriate.

Co-Chair Green stated that this issue would be further reviewed with the bill drafters.

[10:50:26 AM](#)

Mr. Dickinson characterized Senator Dyson's next suggestion to add the word "or" after the semi-colon in Sec. 24 subsection (a)(2) on page 17 line 6 as being "a substantive issue", which had also been discussed by the Senate Resources Committee.

Mr. Dickinson stated that Sec. 24 AS 43.55.150(a) had been amended, as specified on page 16 line 28 through page 17, line 8, to specify that the Department of Revenue would recognize that "the reasonable costs of transportation will be the actual costs except ... when" the three conditions specified in Sec. 24 subsection (a)(1)(2)and (3) were present. These conditions were "when the parties of the transportation of the oil or gas are affiliated; when the contract for transportation of oil or gas is not an arm's length transaction or is not representative of the market value of that transportation; or when the method of transportation of oil or gas is not reasonable in view of the existing alternative methods of transportation".

Mr. Dickinson stated that including the word "or", as suggested by Senator Dyson, would infer that only one of the three conditions must be experienced. The intent was that all three conditions must be present. Therefore, were a word required to clarify that intent, he would suggest that that word be "and".

Senator Dyson understood therefore that the intent was to require all three of the conditions to be met.

Mr. Dickinson affirmed. Were further clarity required, the word "and" could be inserted.

Senator Dyson suggested that the bill drafter review this language for clarity purposes.

Co-Chair Green concurred.

[10:52:31 AM](#)

Mr. Dickinson addressed the last of Senator Dyson's written observations.

Dan Dickinson's Presentation of April 20, 2006 re: 5,000 BOE allowance. In Dan Dickinson's first slide of April 20, 2006, related to Daily Production of Oil and Gas in Cook Inlet, the slide seems to indicate that producers of oil and gas get two allowances - one for oil and one for gas - while the producers of only oil or gas get only one allowance.

[10:54:38 AM](#)

Mr. Dickinson referred the Committee to the April 20, 2006 "PPT Studies" presentation (copy on file). He explained that the 5,000 Barrels of Oil Equivalency (BOE) allowance would allow a producer to exclude 5,000 BOE of their daily production. An entity producing only oil would be able to exclude 5,000 barrels. An entity producing only gas would be able to exclude 30,000 cubic feet of gas daily which was the equivalent of 5,000 barrels of oil.

Mr. Dickinson agreed that in the effort to simplify the material, the chart was misleading. A producer producing both oil and gas would not be allowed a 5,000 BOE exclusion for each. The oil and gas production would be combined for a total 5,000 BOE exclusion.

Senator Dyson concluded therefore that "the energy content" of the production would be measured.

Mr. Dickinson affirmed that the measurement would be the total barrel of oil equivalent. He noted that producer "f" on the aforementioned chart exemplified a combined production scenario.

In response to a remark by Co-Chair Green, Senator Dyson credited his staff for developing the list of questions.

10:55:50 AM

PPT Revenue Studies

Senate Finance Committee

April 21, 2006

10:56:37 AM

CHERIE NIENHUIS, Petroleum Economist, Department of Revenue, reviewed the Department's handout titled "PPT Revenue Studies" [copy on file] dated April 21, 2006. The presentation was designed to address questions or requests that arose during the April 20th hearing on this bill.

[Note: The pages in this document are not numbered and thus, the Senate Finance Committee Secretary made a notation on each page of the corresponding timestamp in which that page was addressed in this hearing. General descriptive information of each page is provided in the body of these minutes when feasible. A copy of the handout can be obtained by contacting the Legislative Research Library at (907)465-3808.]

Ms. Nienhuis stated that for comparison purposes, revenues that would be expected under the status quo tax regime, the Economic Limit Factor (ELF), were added for comparison purposes to the graph titled "Effect of Tax Rate: Annual Oil Severance Tax (\$Millions) Status Quo and Senate Finance CS with 22.5% and 25% Tax Rate at \$20, \$40, and \$60 per bbl, Low Volume Scenario" for the years 2007 through 2030.

Ms. Nienhuis "cautioned" the Committee against focusing on actual revenues. Instead the focus should be on the trends depicted on the graph.

10:58:55 AM

Mr. Dickinson pointed out that at a \$20 per barrel oil price, the revenue generated by ELF would exceed that generated by either the 22.5 Petroleum Production Tax (PPT) proposed in Version "P" or the 25 percent PPT rate proposed in CSSB 305(RES).

Senator Bunde asked for re-verification that ELF would generate more revenue at a \$20 barrel price than the 22.5 percent proposed in Version "P".

Ms. Nienhuis concurred.

Senator Bunde observed however, that at the "more predicted" price of \$40 a barrel, the PPT terms in Version "P" would produce "a net gain" over ELF.

Ms. Nienhuis agreed. The revenue that would be generated in a single year at higher prices under the PPT would more than offset the revenue generated over a number of years at lower prices.

[11:00:02 AM](#)

Senator Bunde addressed the argument that lowering taxes would provide a company "more money to invest". This in turn would encourage "more production". However, no one has been able to provide a definitive answer to his question about the sort of production levels that could be guaranteed in that case. Thus, he was curious to the production level the Department of Revenue utilized in its modeling scenarios; specifically whether it was based on the theory there would be a production increase due to increased investment or based on no new investment.

Ms. Nienhuis responded that the Department utilized a variety of different volume scenarios. The information depicted in this chart was based on the Department's Spring 2006 Revenue Production Forecast book. That forecast was adjusted frequently with an official forecast was typically published in the fall and spring of each year. A low volume scenario would indicate that the "forecast doesn't take into account any kind of incentives". While the belief was that incentives would provide additional production, the Department avoided modeling that. It instead attempted "to show the effect of the tax" without "the influence of these other factors that could change".

[11:01:35 AM](#)

Senator Bunde understood therefore that the information depicted on the Department's chart could be viewed as "worst case scenarios". Continuing, he asked how the modeling would appear

were no increased investment to occur under the PPT regardless of the tax rate.

Ms. Nienhuis noted that economists would argue that increased taxes would decrease production. Conversely, the hope was that increased incentives would increase production. The Department attempted to avoid modeling "any of those things" as the effect was to reflect "the effect of the tax and how the tax and credits work". Thus, a low volume scenario would not include such affects.

Ms. Nienhuis continued however that "in the high volume scenario, we do include additional volumes we believe will be discovered and produced" in conjunction with the development of a gasline on the North Slope.

Ns. Nienhuis stated that the majority of the Department's efforts were to the low volume scenario, as it aligned with the data historically depicted in the Revenue Forecast book. In addition, a low volume scenario to be one the Department was "more certain of" at this time.

[11:02:49 AM](#)

Senator Bunde asserted that since that producers were unable to provide "a guarantee of future investment. ... Certainty is only coming from our side, not from the other side".

[11:03:05 AM](#)

Mr. Dickinson noted that had the 20 percent tax, 20 percent credit (20/20 tax/credit) PPT terms proposed in the original bill, SB 305, been depicted on the chart, its revenue would also have been higher than that generated by ELF at \$40, and lower than that generated by ELF at a \$20 per barrel price.

Co-Chair Green voiced concern that the modeling did not reflect either the negative or positive impact of the PPT on future investment in the State.

[11:03:53 AM](#)

Mr. Dickinson responded that the effort behind the charts "was to show the mechanical effect" of the PPT. While the relationship between the amount of the investment and the amount

of production was undeniable, the exact level of that relationship was unknown.

Mr. Dickinson specified that a high volume modeling scenario would reflect the investment, production, and revenue situation were the PPT incentives to work. The low volume scenario might not reflect the worst case scenario, as even those forecasts would be unobtainable were "investment to dry up"; continuing investment would be required to support the low volume modelings.

Mr. Dickinson reiterated that the effort was to reflect the "mechanical effects of the PPT" or how the "the macro-economic efforts of how this would play out, but directionally I think an economist would tell you if you incent behavior, you'll get more of it"; if you tax behavior, you'll get less of it". The hope was that this legislation would "strike a balance that will in fact create more investment". Hopefully, high prices would not result in "misbehavior" that has not been anticipated.

[11:05:21 AM](#)

Co-Chair Green understood that the expected decline in production had been factored into the modeling.

Mr. Dickinson affirmed. That decline, as projected in the Revenue Source book, was depicted on the chart.

[11:05:39 AM](#)

Senator Bunde agreed that it would be impossible to predict investment and production levels as "capital was a very fluid thing". There would be competition for capital in the global marketplace regardless "of what we do".

Mr. Dickinson stated that were the State to adopt a 20/20 tax/credit, and everyone else in the world to implement a 10 percent tax /20 percent credit tax (10/20 tax/credit) regime, business would go elsewhere.

[11:06:25 AM](#)

Ms. Nienhuis next addressed the chart titled "Distribution of Future Cash Flows Under SQ, Gov's Bill, House Res, Sen Res* and Proposed Sen Fin CS at 22.5/25 and at 25/25, FY 2007-2016". One

graph line on the chart reflected a hypothetical 25 percent tax/25 percent credit (25/25 tax/credit) scenario and another reflected the proposal being furthered in the House of Representatives committee substitute CSSB 488(RES). Due to its Progressivity provisions, the House graph line markedly sloped upward and surpassed the Government Take ratio of Version "P"s 22.5 percent tax / 25 percent credit (22.5/25 tax/credit) at a \$50 barrel price, as well as the hypothetical 25/25 tax/credit at the \$70 barrel price level.

Ms. Nienhuis noted that the asterisk on the chart indicated that the Progressivity tax was deducted only once in the CSSB 304(RES) calculation depicted on this chart even though that bill allowed it to be deducted twice. The Progressivity tax would not be deductible under Version "P".

[11:08:28 AM](#)

Ms. Nienhuis stated that this chart was an extension of the previous chart; the exception being that the previous chart ended at the year 2016 while this chart continued to 2030. The result was "a little higher distribution of cash flow to the Government". The Government Take percentages relating to the original 20/20 tax/credit presented in SB 305 did not increase in alignment with the other PPT proposals because its transition and allowance time frame were "shorter term mechanisms. They lose their affect over time".

Ms. Nienhuis noted that SB 305's Government Share was also affected by the fact that the \$73 million standard deduction included in that bill would continue through 2030.

[11:10:05 AM](#)

Ms. Nienhuis next explained the chart titled "Cumulative Severance Tax Revenues under Governor's Bill as Written, and with 22.5/25, 22.5/20, and 25/20, Low Volume Scenario 2006 - 2030". This chart was updated to include in its Cumulative Revenue comparisons how the original bill would perform were a 22.5 tax and 25 percent credit applied to it at \$20, \$40, and \$60 per barrel prices. In addition, the cumulative revenues of ELF were also depicted.

[11:10:55 AM](#)

Ms. Nienhuis stated that the slide titled "Cumulative Severance Tax Revenues under Governor's Bill as Written, and with 22.5/25, 22.5/20, and 25/20, High Volume Scenario 2006 - 2050" depicted how the original bill, SB 305, would perform at alternative tax/credit rates under a high volume scenario. The volumes would be expected to double. She reiterated that since the High Volume scenario also assumed there would be a gas pipeline, the upstream costs of the gas pipeline were included in the calculations.

[11:11:23 AM](#)

Senator Bunde asked for confirmation that the high volume scenario would generate approximately twice the revenues generated in a low volume scenario.

Ms. Nienhuis affirmed.

Senator Bunde understood that the additional investment being sought by the PPT would serve "to slow the decline". To that point, a high volume scenario would slow the decline whereas a low volume scenario would depict "maximum decline".

Ms. Nienhuis reiterated that a number of things accompanied the high volume scenario forecast; the development of a gas pipeline would alter the production rate in Prudhoe Bay; while it would continue to decline, the life of the field would be "prolonged". In addition, the Point Thomson field would come online were there a gas pipeline. There would also be additional opportunities for oil exploration and thus it was likely that more oil would be discovered.

Senator Bunde asked whether the information depicted on the chart was limited to oil or reflected oil and gas BOE.

Ms. Nienhuis qualified that the chart solely reflected oil revenues.

Ms. Nienhuis also noted that the high volume scenario chart depicted cumulative revenues over a longer timeframe than the low volume scenario chart. The high volume scenario chart depicted revenues through the year 2050; 20 more years than the low volume chart.

[11:13:08 AM](#)

Mr. Dickinson qualified that a large percent of the additional revenue projected in the High Volume scenario was due to the "additional time period".

Senator Hoffman pointed out that in order to accurately gauge the revenue the State would receive under SB 305 at various tax/credit percents and barrel prices, the amount generated by ELF, which was also depicted on the graph, should be subtracted from each revenue scenario.

Mr. Dickinson affirmed.

Senator Hoffman noted that the cumulative revenues shown on the chart were for a 44 year period.

Ms. Nienhuis stated that was correct.

Senator Olson, noting the significant increase in revenues that occurred between the \$20 to \$40 barrel price and the \$40 to \$60 barrel price, asked whether that trend would be expected to continue as prices increased from \$60 to \$80 per barrel.

Mr. Dickinson pointed out that, in addition to the significant jump in revenue that was experienced as prices increased from \$20 to \$40 to \$60, the revenues within each price grouping increased as the tax/credit percents applied to SB 305 increased. It would be expected that the revenue trend at an \$80 per barrel price "would be dramatically higher" than that experienced between \$40 and \$60. The revenue relative to each tax/credit percent within the \$80 grouping would continue the trend experienced at the other price levels.

Mr. Dickinson stated that because the revenues depicted on this chart were based on the provisions of SB 305, there was no Progressivity element. The changes would be "even more dramatic" were the chart to reflect the Progressivity provisions included in the House and Senate bills.

[11:16:33 AM](#)

Ms. Nienhuis addressed the final chart titled "Cumulative Severance Tax with Estimated Capital Costs and with Double Est. Capital Costs (\$B) 2006-2030, Low Volume Scenario". She had taken the initiative to develop this chart because she thought

the information would be of interest to the Committee as it showed how increased capital costs could affect revenues.

Ms. Nienhuis explained that the Department's modeling forecast indicated that capital costs in 2007 would be approximately one billion dollars. The severance taxes that would be experienced under the provisions of SB 305, CSSB 305(RES), CSHB 488(RES), and Senate committee substitute Version "P" based on the one billion dollars in capital costs, were reflected on the chart.

Ms. Nienhuis noted that the severance tax that would be expected under the status quo ELF tax regime was also depicted on the chart.

Ms. Nienhuis explained that in order to view how increased capital might affect severance tax revenue, she "doubled those capital costs". Thus, the severance taxes associated at that level under the four bill versions were also depicted on the chart. She noted that while an increase in capital costs would likely result in an increase in production, the severance tax calculations on the chart were based on the production level expected at the one billion dollar capital cost level.

Ms. Nienhuis pointed out that the severance taxes paid under any of the PPT bill provisions would be higher than that experienced under ELF when barrel prices ventured beyond a \$40 price.

[11:18:53 AM](#)

Mr. Dickinson used the information depicted on the chart to respond to a question posed earlier by Senator Bunde. "The point is, if our forecast is wildly optimistic, and what is required is a huge influx of capital, and lets just say a doubling of the capital, then" hopefully the provisions of the bill would be successful in incentivizing companies to expend more capital. In that event, "revenue figures would shift" upwards as depicted in the chart. He noted that the chart only portrayed the effect of an increase in capital costs as the production levels that were considered were those that would accompany the one billion dollar capital cost level.

Mr. Dickinson noted that "the amount of investment a company makes is irrelevant to the taxes they pay under the status quo". The only affect investment would have under ELF would be in regards to how it might affect production.

[11:19:52 AM](#)

Senator Bunde understood therefore that, were this bill successful in creating "a successful reaction from the industry", ... there would be increased investment. This would "maintain current levels of production".

Senator Bunde thought that the severance tax revenues generated by the various bill versions at the forecasted one billion dollar capital cost level would be "the more realistic projections", as he doubted investments would double.

[11:20:28 AM](#)

Mr. Dickinson deemed the area between the projections for the one billion dollar capital cost level and the \$2.1 billion dollar capital cost area to be "the zone in which we'll actually be operating".

[11:20:39 AM](#)

Senator Bunde asked how a delay in the effective date of the bill would affect revenues.

[11:20:55 AM](#)

Mr. Dickinson referred the Committee to the "Effective Date Change From 04/01/2006 to 07/01/2006 at \$60 per Barrel Oil" chart that had been included in his April 20, 2006 "PPT Revenue Studies" presentation [copy on file].

[11:21:33 AM](#)

Mr. Dickinson concluded that the cost of delaying the bill by three months could be calculated by dividing the annual \$418 million revenue projection on that chart by one third. Noting that the price of oil on April 20, 2006 was \$70 a barrel, he noted that changing barrel prices would affect that revenue figure.

Senator Bunde calculated therefore that the loss would be approximately \$125 million each month the implementation of the bill was delayed.

Mr. Dickinson thought that the cost would likely be \$140 million per month.

[11:22:41 AM](#)

Co-Chair Wilken asked for further discussion about whether the cost of addressing oil spills would be deductible under Version "P". The language pertaining to Version "P" as presented on the "Comparison of PPT Bill Versions - Highlights" handout [copy on file] discussed on April 12, 2006 was confusing as it stated "yes, if on lease (not precluded)".

[11:23:16 AM](#)

Mr. Dickinson apologized that the information had been abbreviated to a point that caused confusion. Currently, the costs associated with a downstream catastrophic oil spill of 100,000 barrels or more or one that had been declared by the Governor as such due to such things as life/safety issues would not be deductible in the calculation of the gross value at the point of production.

Mr. Dickinson advised that this Statute specifically addressed marine or inland waterway spills such as the Exxon Valdez oil spill.

Mr. Dickinson stated that this language was incorporated into the deduction for net value in the CSHB 488(RES) PPT bill. Thus, a catastrophic oil spill that dumped more than 100,000 barrels of oil into an inland waterway would not be deductible. There would have been no prohibition on those spill expenses were it to occur on land.

Mr. Dickinson stated that the current prohibition was not included in either CSSB 305(RES) or Version "P". Therefore the costs associated with "reacting to an oil spill ... would be considered an ordinary and necessary cost of doing business".

[11:25:52 AM](#)

Co-Chair Wilken understood therefore that current Statute contained a "barrel limit and a geographic qualifier". Continuing, he directed attention to Sec. 26 subsection (d)(2)(F) beginning on page 20, line 31. This language reads as follows.

(F) costs arising from fraud, willful misconduct, or negligence;

Co-Chair Wilken asked whether the costs of addressing a catastrophic oil spill would be disallowed were the State to prove the spill resulted from willful misconduct or negligence.

Mr. Dickinson deferred to Mr. Mintz with the Department of Law.

Co-Chair Wilken stated that this question was prompted by a recent spill caused by a company's negligence.

[11:26:57 AM](#)

Mr. Mintz stated that one must consider that "the list of items that are expressly not deductible" under Sec. 26 subsection Sec. 43.55.160(d)(2) beginning on page 20 line 23 through page 21 line 20 "was not intended to be an exhaustive list". The listing included only "items that as a matter of policy a Legislature would be declaring are not deductible whether or not they might otherwise be direct costs, they would be deductible". Therefore, the exclusion of an item from that list "does not mean that it's necessarily deductible". The "general answer" would be that "the cost of cleaning up or other costs associated with a spill would be deductible if they are direct, ordinary, and necessary costs of exploring for, developing or producing oil or gas, and otherwise they are not deductible".

Mr. Mintz communicated that neither CSSB 305(RES) nor Version "P" addressed this issue "any more than that". Thus, the State would be required to address the issue on a case by case basis. Things such as "industry practices under joint operating agreements", as specified in the bill, would be considered in each determination. Were the issue not addressed in the bill, then the department would be required to "make its determination based ... on the meaning of direct, ordinary and necessary". Since this issue is not specifically addressed in Version "P", the outcome would be unpredictable.

[11:28:51 AM](#)

Co-Chair Wilken asked whether the inclusion of the word "negligence" in Sec. 26 subsection (d)(2)(F) would provide "the

latitude" that would be required for "the department to determine whether its deductible".

Mr. Mintz affirmed that that language would "definitely imply ... that if negligent conduct or omissions led to a spill which in turn led to costs, then that could be excluded".

There be no further questions, Co-Chair Green requested that Members submit their amendments today. The intent was to discuss members' and bill drafter amendments during the afternoon Committee hearing.

In response to a question from Senator Stedman, Co-Chair Green expressed the desire to finalize the bill tomorrow.

Co-Chair Wilken asked whether the Legislature's PPT consultant, Econ One Research, Inc, had provided any information pertinent to Version "P".

Co-Chair Green stated that no information had been received from Econ One.

The bill was HELD in Committee.

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ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [11:30:34 AM](#)