

MINUTES
SENATE FINANCE COMMITTEE
April 21, 2006
1:20 p.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [1:20:50 PM](#).

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

Also Attending: SENATOR BEN STEVENS; SENATOR TOM WAGONER; DARWIN PETERSON, Staff to Co-Chair Green; DAN DICKINSON, CPA, and consultant to the Department of Revenue; MARK HANLEY, Public Affairs Manager, Anadarko Petroleum Corporation;

Attending via Teleconference: From an offnet location: ROB MINTZ, Assistant Attorney General, Oil, Gas and Mining Section, Civil Division, Department of Law

SUMMARY INFORMATION

SB 305-OIL AND GAS PRODUCTION TAX

The Committee heard from a consultant to the Department of Revenue, from the Department of Law, and from a representative of the oil and gas industry. Five amendments to the committee substitute were considered and four were adopted. The bill was held in Committee.

#SB305
[1:20:59 PM](#)

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 15th hearing for this bill in the Senate Finance Committee. During a previous hearing, CS SB 305 (FIN), 24-GS2052\P, was adopted as a working document. The amendments considered at this hearing are to the committee substitute, Version "P".

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Amendment #1: This amendment deletes "tax for certain expenditures and losses" and inserts "production tax on oil and gas" in the title of the bill on page 1, lines 4 and 5. The amended language of the bill title reads as follows.

An Act repealing the oil production tax and the gas production tax and providing for a production tax on oil and gas; relating to the calculation of the gross value at the point of production of oil and 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 production tax on oil and gas; 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 and 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 amendment also deletes "during" and inserts "for" to the language of AS 43.55.011(g), added through Section 5 on page 4, line 7. The amended language reads as follows.

In addition to the taxes levied under (e) and (f) of this section, for each month for which the price index determined under (h) of this section is greater than zero, there is levied on the producer of oil or gas a tax for all oil and gas produced during that month from each lease or property in the state...

This amendment also inserts "tax" following "may take a" in subsection (a) of Sec. 43.55.170. Additional nontransferable tax credit., added by Section 26 on page 23, line 29. The amended language reads as follows.

(a) For a month that ends before July 1, 2016, and for which a producer's tax liability under AS 43.55.011(e) exceeds zero before application of an credits under this chapter, a producer that qualifies under (c) of this section may take a tax credit under this section. ...

This amendment also deletes "credit applied" and inserts "credits applied by the producer" to the language of Sec. 43.55.170(b)(4) and (5) on page 24, line 13 and lines 15 and 16. The amended language reads as follows.

(4) except as provided in (5) of this subsection, may not be applied if it would cause the total of the tax credits applied by the producer under this section during a calendar year to exceed \$14,000,000; and

(5) may not be applied if it would cause the total of the tax credits applied by the producer under this section during 2016 to exceed \$7,000,000.

This amendment also makes a technical correction to the new paragraphs added to AS 43.55.900 in Section 34 on page 27, line 30. The paragraph was numbered as (2). This amendment numbers the paragraph as (20).

Co-Chair Green moved for adoption of the amendment and objected to provide an explanation.

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DARWIN PETERSON, Staff to Co-Chair Green, testified that the amendment to the title language is necessary to conform to the addition of a new bill section that provides for a tax exemption on the first 5,000 barrels of oil produced. Credits would no longer be limited to expenses and losses.

Mr. Peterson outlined the other changes made in this amendment to provide conformity or clarity.

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Co-Chair Green withdrew her objection to the adoption of the amendment.

The amendment was ADOPTED without further objection.

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Amendment #2: This amendment includes the provisions of AS 43.55.011(g) under which the provisions of AS 43.55.020(d) is subject. The amended language of AS 43.55.020(d), amended by Section 9 on page 5, line 19 through page 6, line 2, reads as follows.

(d) In making settlement with the royalty owner for oil and gas that is taxable under AS 43.55.011, the producer may deduct the amount of the tax paid on taxable royalty oil and [OR] gas, or may deduct taxable royalty oil or gas equivalent in value at the time the tax becomes due to the amount of the tax paid. Unless otherwise agreed between the producer and the royalty owner, the amount of the tax paid under AS 43.55.011(e) and (g) on taxable royalty oil and gas for a month other than oil and gas the ownership or right to which constitutes a lessor's royalty interest under an oil and gas lease is considered to be the gross value at the point of production of the taxable royalty oil and gas produced during the month multiplied by a figure that is a quotient, in which

(1) the numerator is the producer's total tax liability under AS 43.55.011(e) and (g) for the month of production; and

(2) the denominator is the total gross value at the point of production of the oil and gas taxable under AS 43.55.011(e) and (g) produced by the producer from all leases and properties in the state during the month.

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This amendment also inserts "is claimed" following "credit", in subsection (d) of Sec. 43.55.024. Tax credits for certain losses and expenditures., added by Section 12 on page 8, line 18. The amended language reads as follows.

...(2) if the applicant is required under AS 43.55.030(a) and (e) to file a statement on or before March 31 of the year following the calendar year in which the

qualified capital expenditures or carried-forward annual loss for which the credit is claimed was incurred, the date the statement was filed; ...

This amendment also inserts three statutory references following "AS 43.55.025" to the language of to AS 43.55.024(i)(3)(C) in Section 5 on page 10 line 17 to read as follows.

(C) if a credit for that expenditure was taken under AS 38.05.180(i), AS 41.09.010, AS 43.20.043, or AS 43.55.025;

This amendment also deletes "5,000 or more" and inserts "more than 5,000" to the language of Sec. 43.55.170(a)(2) on page 24, line 3. The amended language reads as follows.

(2) more than 5,000, the amount of the credit is 22.5 percent of the producer's production tax value for that month under AS 43.55.160(a) multiplied by the quotient of 5,000 divided by the average number of barrels of oil equivalent produced a day during that month and taxable under AS 43.55.011(e).

This amendment also inserts a new section to AS 43.55 in Section 26 on page 24, following line 26 to read as follows.

Sec. 43.55.180. Required reports. (a) The Department of Revenue shall

(1) study

(A) the effects of the tax rates under AS 43.55.011(f) and of potential changes in those tax rates on state revenue and on oil and gas exploration, development, and production on private land; and

(B) the fairness of the tax rates under AS 43.55.011(f) and of potential changes in those tax rates for private landowners; and

(2) prepare a report on or before the first day of the 2013 regular session of the legislature on the results of the study made under (1) of this subsection, including a recommendation as to whether those tax rates should be changed; the department shall notify the legislature that the report prepared under this paragraph is available.

(b) the Department of Revenue shall

(1) study the effects of the credits authorized by AS 43.55.025 and 43.55.170 on state revenue, on the encouragement of exploration, development, and production of oil and gas deposits located in the state, and on the encouragement of new entrants into the oil and gas industry in the state; and

(2) prepare a report on or before the first day of the 2015 regular session of the legislature on the results of the study made under (1) of this subsection, and shall include with the report a recommendation as to whether the legislature should extend the availability of the credits under AS 43.55.025 and 43.55.170 beyond June 30, 2016; the department shall notify the legislature that the report prepared under this paragraph is available.

This amendment also deletes the language of Section 36 on page 28, lines 4 through 27, which reads as follows.

Sec. 36. The uncodified law of the State of Alaska is amended by adding a new section to read:

REQUIRED REPORTS. (a) The Department of Revenue shall

(1) study

(A) the effects of tax rates under AS 43.55.011(f) and of potential changes in those tax rates on state revenue and on oil and gas exploration, development and production on private land; and

(B) the fairness of the tax rates under AS 43.55.011(f) and of potential changes in those tax rates with respect to private landowners; and

(2) prepare a report on or before the first day of the 2013 regular session of the legislature on the results of the study made under (1) of this subsection, including a recommendation as to whether those tax rates should be changed; the department shall notify the legislature that the report prepared under this paragraph is available.

(b) the Department of Revenue shall

(1) study the effects of the credit authorized by AS 43.55.170, added by sec. 26 of this Act, on state revenue, on the encouragement of exploration, development, and production of oil and gas deposits located in the state, and on the encouragement of new entrants into the oil and gas industry in the state; and

(2) prepare a report on or before the first day of the 2015 regular session of the legislature on the

results of the study made under (1) of this subsection, and shall include with the report a recommendation as to whether the legislature should extend the availability of the credit under AS 43.55.170, added by sec. 26 of this Act, beyond June 30, 2016; the department shall notify the legislature that the report prepared under this paragraph is available.

This amendment also makes numerous conforming changes to the bill to accommodate the provisions of this amendment.

Co-Chair Green moved for adoption and objected to provide an explanation.

Mr. Peterson informed that AS 43.55.011(g) under which the provisions of AS 43.55.020(d) would be subject, relates to progressivity. AS 43.55.020(d) stipulates the formula utilized to calculate the royalty share of the production tax for overriding royalties, i.e. royalties other than lessor royalties. This amendment would include the progressivity tax in the calculation.

Mr. Peterson noted the addition of language to AS 43.55.024(d) was to correct an omission made in the drafting process.

Mr. Peterson stated the additional statutory references included in AS 43.55.024(i)(3)(C) relate to information provided to the Committee by the Department of Revenue and provides that producers could not "double dip" and receive credit under this subsection if credit was taken under the provisions of the Petroleum Production Tax (PPT).

Mr. Peterson explained this amendment would also codify the reporting requirements of the Department of Revenue to the legislature and make conforming changes to the bill to accommodate the addition of Sec. 43.55.180. In addition the "credit extension language" enacted through SB 185 of a previous legislative session, was included in this section. Subsequently, three reports would be received by the legislature from the Department of Revenue and relate to private royalty, the lapse of the base allowance of 5,000 barrels of oil per day, and the lapse date of the credits provided in SB 185.

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Senator Hoffman asked the relation of the "double dipping" prohibition inserted to AS 43.55.024(i)(3)(C) to the similar language of AS 43.55.024(a)(1).

Mr. Peterson replied that the statutory references in subsection (a) refer to the 25 percent tax credit against capital expenditures. A producer could not take a tax credit under the provision of subsection (i), if a credit was taken under the provision of (a). The intent is to ensure consistency.

Senator Hoffman clarified that the inclusion of the statutory references was omitted in error from the language of subsection (i) of the committee substitute.

Mr. Peterson affirmed.

Mr. Peterson continued that the remaining changes included in this amendment are conforming and technical to the sectional changes made in this amendment.

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Senator Stedman assumed the purpose of codifying the reporting requirement is to prevent the task from being "overlooked".

Co-Chair Green affirmed.

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Co-Chair Green removed her objection to the adoption of the amendment.

There was no further objection and the amendment was ADOPTED.

Amendment #3: This amendment deletes the language of subsection (d)(2)(B) of Sec. 43.55.160. Determination of production tax value of oil and gas., added by Section 26 on page 20, line 25, and inserts new language to read as follows.

(B) oil or gas royalties, production payments, lease profit shares, or other payments or distributions of a share of oil or gas production, profit, or revenue;

This amendment also inserts "in a gas processing plant" following "processing" to AS 43.55.900(6)(B)(i) and (ii), repealed and reenacted by Section 31, on page 26, line 4 and line 6. The amended language reads as follows.

(i) are recovered by mechanical separation of well fluids by gas processing in a gas processing plant; and

(ii) exist in a gaseous phase at the completion of mechanical separation and any gas processing in a gas processing plant; and

This amendment to AS 43.55.900(7)(B)(i),(ii) and (iii), and (C) repealed and reenacted by Section 32 on page 26, also deletes "gas processing" and inserts "run through a gas processing plant" on lines 23 and 26, deletes "subjected to or recovered by gas processing" and inserts "run through a gas processing plant" on line 28, deletes "after completion of gas processing" and inserts "downstream of the plant" on line 30, and inserts "plant" following "processing" on line 31. The amended language reads as follows.

(B) for gas, other than gas described in (C) of this paragraph, that is

(i) not subjected to or recovered by mechanical separation or run through a gas processing plant, the value of the gas at the first point where the gas is accurately metered;

(ii) subjected to or recovered by mechanical separation but not run through a gas processing plant, the value of the gas at the first point where the gas is accurately metered after completion of mechanical separation;

(iii) run through a gas processing plant, the value of the gas at the first point where the gas is accurately metered downstream of the plant;

(C) for gas run through an integrated gas processing plant and gas treatment facility that does not accurately meter the gas after the gas processing and before the gas treatment, the value of the gas at the first point where gas processing is completed or where gas treatment begins, whichever is further upstream;

This amendment also inserts "in a gas processing plant" following "processing" to AS 43.55.900(10) repealed and reenacted by Section 33 on page 27, line 9. The amended language reads as follows.

- (10) "oil" means
 - (A) crude petroleum oil; and
 - (B) all liquid hydrocarbons that are recovered by mechanical separation of well fluids or by gas processing in a gas processing plant;

This amendment also deletes the language of AS 43.55.900(18)(A)(iii) on page 27 lines 21 and 22 and makes necessary technical conforming changes. The deleted language reads as follows.

- (iii) upstream of any gas treatment and upstream of the inlet of any gas pipeline system transporting gas to a market;

This amendment also adds a new paragraph to AS 43.55.900 amended by Section 34 on page 27 following line 23 and makes necessary technical conforming changes to read as follows.

- (19) "gas processing plant" means a facility that
 - (A) extracts and recovers liquid hydrocarbons from a gaseous mixture of hydrocarbons by gas processing; and
 - (B) is located upstream of any gas treatment and upstream of the inlet of any gas pipeline system transporting gas to a market;
- (20)...

This amendment also inserts a new subparagraph to AS 43.55.900(19) [renumbered (20) by the preceding portion of this amendment] amended by Section 34 on page 27, following line 29 to read as follows.

- (C) does not include
 - (i) dehydration required to facilitate the movement of gas from the well to the point where gas processing takes place;
 - (ii) the scrubbing of liquids from gas to facilitate gas processing;

This amendment was NOT OFFERED.

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Amendment #4: This amendment deletes "INTENT OF SEC. 11 OF THIS ACT.", and inserts "LEGISLATIVE INTENT. (a)" and adds a new subsection (b) to Section 1 on page 2, line 13. The amended language reads as follows.

Section 1. The uncodified law of the State of Alaska is amended by adding a new section to read:

LEGISLATIVE INTENT. (a) It is the intent of the legislature through sec. 11 of this Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by the Department of Revenue.

(b) It is the intent of the legislature that the division or other unit of the Department of Environmental Conservation assigned responsibility for administration of the programs under AS 46.08 that are principally supported by the conservation surcharges on oil levied under AS 43.55.201 - 43.55.299 and 43.55.300 - 43.55.310

(1) reduce program costs, including personnel costs, as necessary to operate within the revenue anticipated to be generated by those surcharges, in the amounts of those surcharges as amended by secs. 27 and 29 of this Act; and

(2) request appropriations for exceptional program needs and expansions beyond what can be provided from the estimated amounts collected from those surcharges from alternative funding sources.

This amendment also deletes "\$.04" and inserts "\$.05" to subsection (a) of Sec. 43.55.300. Surcharge levied., amended by Section 29 on page 25, line 15. The amended language reads as follows.

(a) every producer of oil shall pay a surcharge of \$.05 [\$.03] per barrel of oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation.

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Co-Chair Wilken offered a motion to adopt the amendment and objected to provide an explanation.

Co-Chair Wilken identified this amendment as pertaining to "the old split nickel fund", which currently levies six cents per barrel of oil. The three-cent per barrel surcharge specified in the original language of this statute is appropriated to the Department of Environmental Conservation for oil spill prevention and education activities. The additional two-cent per barrel surcharge was levied and deposited into a fund dedicated to addressing a potential catastrophic oil spill until the balance of that fund reached \$50 million, at which time collection of the surcharge was suspended. This amendment would increase the current three-cent surcharge for administration of spill prevention and education to five cents and would decrease the two-cent surcharge for spill response to one cent. The spill response fund would subsequently grow at one-half the current rate in the event monies were withdrawn from that fund. However, withdrawals from the fund had not been necessary.

Co-Chair Wilken referenced supporting documentation for this amendment [copy on file], which includes a spreadsheet titled, "Department of Environmental Conservation Response Fund - Balance Projection, Change Nickel Split from 2¢/3¢ to 1¢/5¢, Minimum Capital Cleanup, Known PS Cost Increases and 1.8 mil Transfer from CPVF" and a line graph titled, "Response Fund Balance". These utilize information he requested of the Department of Environmental Conservation.

[Note: The line graph estimates the fund balance for FY 06 at \$4.5 million, FY 07 at \$2.5 million, FY 08 at \$3.5 million, FY 09 at \$4 million, and FY 10 at \$4 million.

The spreadsheet details Revenues from the three-cent surcharge, Cost Recovery/Fines/Penalties, Interest, FY 07 Transfer 1.8 million from DPVF to RF (Language), and Change Nickel Split to 1¢/5¢; Total Expenditures categorized as DEC + annual Salary Increases - FY 2008 and Out Years, DMVA - Continue Annual Approp. from RF, and DOT - Continue Annual Approp.; Expenditures in Excess of Revenue; Capital Expenditures; and Estimated Fund Balance for the fiscal years 2006 through 2010.]

Co-Chair Wilken remarked that "the bureaucracy has grown through the funding." Decrease in oil production and increase in bureaucracy has culminated and the program would have insufficient revenues to cover its costs for FY 06. Future legislatures should not be required to address this same problem and therefore an increase in the surcharge from three cents to

five cents has been proposed. However, the program would again have insufficient funds to cover expenses beginning in FY 10.

Co-Chair Wilken cited this as the reason the intent language is proposed; to direct the Department to take necessary actions to ensure that the program is operated within its budget.

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Senator Stedman asked the status of the deductibility of the surcharge.

Co-Chair Wilken responded that this issue was not addressed in this amendment.

Co-Chair Green announced that the surcharge would not be creditable or deductible. The original version of the bill allowed for a credit against the PPT; however, all committee substitute versions stipulate otherwise.

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Senator Bunde assumed that as revenue decreased as a result of lower oil production, the workload of the program would also decrease. He asked if this was the reason for the intent language directing the Department to "live within their means."

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Co-Chair Wilken affirmed that decreased production would decrease the workload to some extent; however, the exposure to the possibility of a major oil spill would remain. More importantly, the intent is to "restrain and not grow the Department given the funding available."

Co-Chair Wilken withdrew his objection to the adoption of the amendment.

The amendment was ADOPTED with no further objection.

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Amendment #5: This amendment changes the effective date of most provisions of the legislation from July 1, 2006 to April 1, 2006.

Senator Bunde moved for adoption.

Co-Chair Green objected.

Senator Bunde stated that at the current oil price of approximately \$60 per barrel, the State would generate an additional \$400 million by implementing the PPT structure three months earlier than proposed in the Senate Finance Committee substitute. Future prices are unknown and therefore the legislature should not forgo collection of this revenue.

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Senator Hoffman noted he had an amendment drafted by the Division of Legal and Research Services to accomplish the same change in the effective date, although that amendment covers four pages. He asked if the amendment before the Committee was also drafted by the Division of Legal and Research Services and if so, the substantive differences between the amendments.

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Senator Bunde responded that this amendment was not drafted by the Division of Legal and Research Services and its only intent is to reinsert the effective date of the PPT structure as adopted by the Senate Resources Committee.

Co-Chair Green suggested the Committee defer to the longer amendment, as it includes all necessary conforming changes.

Senator Bunde WITHDREW his motion to adopt the amendment to defer to the forthcoming amendment sponsored by Senator Hoffman.

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[1:48:33 PM](#)

Amendment #6: This amendment deletes "July 1, 2006" and inserts "April 1, 2006" where it appears in subsections (h) and (i) of Sec. 43.55.024. Tax Credits., added by Section 12 on page 9, lines 21, 29-30 and 30-31, and page 10, line 3. This amendment also deletes "July 1, 2001, and before July 1, 2006" and inserts "April 1, 2001, and before April 1, 2006" to subsection (i) on page 9 line 28. The amended language reads as follows.

(h) A person may not elect to take a tax credit under (a) of this section for an expenditure incurred to acquire an asset (1) the cost of previously acquiring which was a lease expenditure under AS 43.55.160(c) or would have been a lease expenditure under AS 43.55.160(c) if it had been incurred on or after April 1, 2006; or (2) that has previously been placed in service in the state. An expenditure to acquire an asset is not excluded under this subsection if not more than an immaterial portion of the asset meets a description under (1) or (2) of this subsection. For purposes of this subsection, "asset" includes geological, geophysical, and well data and interpretations.

(i) For the purposes of this section,

(1) a producer's transitional investment expenditures are the sum of the expenditures the producer incurred on or after April 1, 2001, and before April 1, 2006, that would be qualified capital expenditures if they were incurred on or after April 1, 2006, less the sum of the payments or credits the producer received before April 1, 2006, for the sale or other transfer of assets, including geological, geophysical, or well data interpretations, acquired by the producer as a result of expenditures the producer incurred before April 1, 2006, that would be qualified capital expenditures, if they were incurred on or after April 1, 2006;

This amendment also deletes "June 30, 2013" and inserts "March 13, 2013" to Sec. 43.55.024 (i)(3)(A) on page 10, line 15. The amended language reads as follows.

(3) a producer may not take a tax credit for transitional investment expenditure

(A) in any month that ends after March 21,
2013

...

This amendment also deletes "July 1, 2006" and inserts "April 1, 2006" to subsection (c)(1) of Sec. 43.55.160. Determination of production tax value of oil and gas., added to AS 43.55 by Section 26 on page 19, lines 7 - 8. The amended language reads as follows.

(c) for the purposes of this section,

(1) a producer's lease expenditures for a period are the total costs upstream of the point of production of oil and gas that are incurred on or after April 1, 2006, by the producer during the period and that are direct, ordinary, and necessary costs of exploring for, developing, or producing oil or gas deposits...

This amendment also deletes "July 1, 2006" and inserts "April 1, 2006" to Sec. 43.55.160(g)(2)(A) on page 22, line 15. The amended language reads as follows.

(3) the sale or other transfer of
(A) an asset, including geological, geophysical, or well data or interpretations, acquired by the producer as a result of a lease expenditure on an expenditure that would be a lease expenditure if it were incurred on or after April 1, 2006; ...

This amendment also deletes "July 1, 2016" and inserts "April 1, 2016" to subsection (a) of Sec. 43.55.170. Additional nontransferable tax credit., added to AS 43.55 by Section 26 on page 23, line 27. The amended language reads as follows.

(a) For a month that ends before April 1, 2016, and for which a producer's tax liability under AS 43.55.011(e) exceeds zero before application of any credits under this chapter, a producer that qualified under (c) of this section may take a credit under this section...

This amendment also deletes "\$7,000,000" and inserts "\$3,500,000" to Sec. 43.55.170(b)(5) on page 24, line 16. The amended language reads as follows.

(b) A tax credit under this section
...
(5) may not be applied if it would cause the total of the tax credit applied under this section during 2016 to exceed \$3,500,000.

This amendment also deletes "June 30, 2016" and inserts "March 31, 2016" to subsection (b)(2) of REQUIRED REPORTS., added to the uncodified law of the State of Alaska by Section 36 on page 28, line 25. The amended language reads as follows.

(b) the Department of Revenue shall

...

(2) prepare a report on or before the first day of the 2015 regular session of the legislature on the results of the study made under (1) of this subsection, and shall include with the report a recommendation as to whether the legislature should extend the availability of the credit under AS 43.55.170, added by sec. 26 of this Act, beyond March 31, 2016; ...

This amendment also deletes "July 1, 2006" and inserts "April 1, 2006" to subsection (a) of APPLICABILITY., added to the uncodified law of the State of Alaska by Section 37 on page 28, line 31. The amended language reads as follows.

(a) Sections 5, 7 -10, 12, 13, 15 - 18, 20, and 24 - 35 of this Act apply to oil and gas produced on or after April 1, 2006.

This amendment also deletes "July 1, 2006" and inserts "April 1, 2006" where it appears on page 29, lines 6-7, 9, 12, 16, 22, 28 and 31 and page 30, lines 1, 4, and 17; deletes "4 1/16 percent" and inserts "2 7/9 percent" on page 29, line 10; deletes "last six months" and inserts "last nine months" on page 29, line 14 and 20; deletes "1/12" and inserts "1/18" on page 29, line 18; deletes "for each of the last six months of 2006, one-sixth of the producer's adjusted lease expenditures for that six-month period" and inserts "fore each of the last nine months of 2006, one-ninth of the producer's adjusted lease expenditures for that nine-month period" on page 29, lines 25 and 26; deletes "\$7,000,000" and inserts "\$10,500,000" on page 29, line 30; deletes "June 30, 2006" and inserts "March 31, 2006" on page 30, lines 8, 22, and 27-28; to TRANSITIONAL PROVISIONS., added to the uncodified law of the State of Alaska by Section 38. The amended language reads as follows.

TRANSITIONAL PROVISIONS. (a) Notwithstanding any contrary provision of AS 43.55.024(a), enacted by sec. 12 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an amount equal to 2 1/12 percent" in AS 43.55.024(a)(1), enacted by sec. 12 of this Act, shall be replaced by the phrase "every month during the period April 1, 2006, through December 31, 2006, and annualized tax credit in an amount equal to 2 7/9 percent."

(b) Notwithstanding any contrary provision of AS 43.55.024(e), enacted by sec. 12 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the phrase "calendar year" in AS 43.55.024(e), enacted by sec. 13 of this Act, shall be replaced by the phrase "the last nine months of the calendar year."

(c) Notwithstanding any contrary provision of AS 43.55.024(i)(2), enacted by sec. 12 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007,

(1) the number "1/24" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of this Act, shall be replaced by the number "1/18";

(2) the phrase "calendar year" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of this Act shall be replaced by the phrase "last nine months of the calendar year."

(d) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 26 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the phrase "for every month of a calendar year, 1/12 of the producer's adjusted lease expenditures for the calendar year" in AS 43.55.160(f), enacted by sec. 26 of this Act, shall be replaced by the phrase "for each of the last nine months of 2006, one-ninth of the producer's adjusted lease expenditures for that nine-month period."

(e) Notwithstanding any contrary provision of AS 43.55.170(b), enacted by sec. 26 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the amount of "\$14,000,000" in AS 43.55.170(b)(4), enacted by sec. 26 of this Act, shall be replaced by "\$10,500,000."

(f) For oil and gas produced before April 1, 2006, the provisions of AS 43.55, and regulations adopted under AS 43.55, that were in effect before April 1, 2006, and that were applicable to the oil and gas continue to apply to that oil and gas.

(g) Notwithstanding any contrary provision of AS 43.55.020(a), as repealed and reenacted by sec. 7 of this Act, for oil and gas produced on or after April 1, 2006, and before the first day of the first month that begins at least 180 days after the effective date of sec. 7 of this Act,

(1) the amount of the taxes that would have been levied on the producer under AS 43.55, as the provisions of

that chapter read on March 31, 2006, is due on the last day of each calendar month on the oil and gas that was produced from each lease or property during the preceding month;

(2) the portion, if any, of the taxes levied under AS 43.55.011(e)-(g), enacted by sec. 5 of this Act, that is due under AS 43.55.020(a), as repealed and reenacted by sec. 7 of this Act, and that remains unpaid, net of any credits applied as allowed by law, is due on the last day of the first month that begins at least 180 days after the effective date of sec. 5 of this Act.

(h) Notwithstanding any contrary provision of AS 43.55.030(a), as amended by sec. 18 of this Act, for oil and gas produced on or after April 1, 2006, and before the first day of the first month that begins at least 180 days after the effective date of sec. 18 of this Act, the person paying the tax shall file with the Department of Revenue, at the time an amount of tax is due

(1) under (g)(1) of this section, the statement required under former AS 43.55.030(a), as that subsection read on March 31, 2006; and

(2) under (g)(2) of this section, the statements required under AS 43.55.030(a), as amended by sec. 18 of this Act.

(i) For purposes of taxes to be calculated and due under (g)(1) of this section and statements to be filed under (h)(1) of this section, regulations that were adopted by the Department of Revenue under AS 43.55, as the provisions of that chapter read on March 31, 2006, and that were in effect on that date apply to those taxes and statements.

This amendment also deletes the language of Section 41 and Section 42, on page 31, lines 22 - 29, and inserts new language to read as follows.

Section 41. The uncodified law of the State of Alaska is amended by adding a new section to read:

RETROACTIVITY OF PROVISIONS OF ACT. Sections 5, 7 - 10, 12, 13, 15 - 18, 20, 24 - 35, 37, and 38 of this Act apply retroactively to April 1, 2006, and apply to oil and gas produced after March 31, 2006.

Section 42. This Act takes effect immediately under AS 01.10.070(c).

Senator Hoffman offered a motion to adopt the amendment.

Co-Chair Green objected.

Senator Hoffman pointed out this amendment would accomplish the same goal as proposed in Amendment #5 in generating for the State approximately \$140 million a month for the period of April through June of 2006.

Senator Bunde asked about the additional changes to the committee substitute contained in this amendment compared to the previous amendment.

Senator Hoffman assured that his request to the bill drafter was limited to the change in the effective date.

[1:50:21 PM](#)

Senator Wagoner asked why the dollar amount contained in subsection (e) of TRANSITIONAL PROVISIONS., would be different for the year 2006 than for future years.

Co-Chair Green surmised the amount would be less for 2006 than the \$14 million provided for each year following 2006 because the new tax structure would not be in effect for all 12 months of 2006. The original language of the committee substitute provided for \$7 million for 2006 and the amendment would increase that amount to \$10.5 million to account for the additional three months in which the PPT system would be in effect.

Co-Chair Green assumed the language of this amendment would be conformed to the changes adopted in the previous amendments.

A roll call was taken on the motion.

IN FAVOR: Senator Dyson, Senator Hoffman, Senator Olson, Senator Bunde and Co-Chair Wilken

OPPOSED: Senator B. Stevens and Co-Chair Green

The motion PASSED (5-2)

The amendment was ADOPTED.

[1:52:42 PM](#)

Co-Chair Wilken referenced AS 43.55.011(f), added by Section 5, on page 3, beginning on line 20 and asked how the language of this subsection is guaranteed to only pertain to private royalty.

[1:53:20 PM](#)

DAN DICKINSON, CPA, and consultant to the Department of Revenue, directed attention to lines 22 and the language "a lessor's royalty interest under an oil and gas lease, except for oil and gas the ownership or right to which is exempt from taxation." This limits the provision of this subsection to not apply to leases in which the State or federal government is the lessor.

[1:54:04 PM](#)

Co-Chair Wilken asked why this matter could not be addressed in a manner similar to the provisions governing royalty relief. Under those provisions, the producer petitions the Department of Natural Resources, and the Department makes a decision, which is validated by the legislature.

[1:54:35 PM](#)

Mr. Dickinson responded that tax rates are typically set by the legislature and the executive branch is charged with ensuring the payment is made. Similarly, the legislature sets the general terms of a lease, including the right for the commissioner of the Department to negotiate royalty reductions within the context of the lease. The commissioner then executes the contract and presents it to the legislature for approval. Therefore the "rules" for the "tax function" and the "royalty function" are different. He knew of no other instances in which a tax rate is set by an administrator of the executive branch.

[1:55:45 PM](#)

Co-Chair Wilken requested the Department of Law comment to this.

[1:55:55 PM](#)

ROB MINTZ, Assistant Attorney General, Oil, Gas and Mining Section, Civil Division, Department of Law, testified via teleconference from an offnet location, that in addition to the

differences between royalty and tax functions, tax on the royalty share does not directly affect the producer's economics. Rather this is a tax on the share, "that goes without deductions for cost, to the landowner". The producer retains the right to charge back this expense to the landowner and the amount of the royalty has already been established by agreement between the private landowner and the producer. Royalty relief, by contrast, pertains to the amount of royalty that the lessor producer must pay to the State and this does affect the economics of the producer.

[1:57:04 PM](#)

Co-Chair Wilken referenced paragraph (1) of subsection (f) following line 24, "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". He asked how the five percent figure was determined and how it was determined that five percent would be the appropriate amount for future years.

[1:57:25 PM](#)

Mr. Dickinson answered, "I guess I would ask that the same question about the 22.5 or the 15 that's in current existing statute." Research of how the five percent amount correlates to other taxes and potential impacts on private royalty shares could be conducted. He remarked, "How do we know that the right numbers are the right numbers, and obviously you are asking... The fact that this bill has made it through several committees suggests that the current numbers aren't the right numbers." This is the reason the establishment of the amounts is a legislative function, as it does not involve a "mechanical calculation of correct tax rate."

[1:58:05 PM](#)

Mr. Mintz added that the five percent figure is near the average effective tax rate in "recent times" under the current economic limit factor (ELF) system.

[1:58:29 PM](#)

Mr. Dickinson indicated that Mr. Mintz's statement was "close" to being correct.

[1:58:34 PM](#)

Co-Chair Wilken asked the possibility of establishing a system in which the commissioner would recommend a tax rate for companies with private royalty interest and the legislature would validate that rate on a lease by lease basis. He asked if this would be allowable under the Alaska Constitution.

Mr. Mintz replied that a method in which the legislature ratified a particular administrative action in a manner other than by enacting a statute through the legislative process would encounter constitutional "issues" that must be addressed before such a system were adopted. This matter has been discussed in the past in the context of legislative ratification of administrative regulations, although he was not familiar with all provisions of the current law pertaining to this.

[1:59:58 PM](#)

Co-Chair Wilken understood that the original version of this bill did not stipulate a fixed rate, which he has learned was not "correct under existing law" as an "abrogation of responsibility". He asked if this is the reason "we moved to the new system." He asked if the "expertise available" of the Department could be utilized to make recommendations to the legislature as to whether the provisions of the new system were too "generous" or too "punitive" to a company starting to do business in the state. He asked if such a system would be "appropriate" and constitutional.

Mr. Mintz stated that he would research this.

[2:01:25 PM](#)

Senator Bunde furthered on this issue, expressing his understanding that private royalty payers would not be subject to the "certainty provisions" under consideration for inclusion in the natural gas pipeline contract. He agreed that the proposed 20, 25 and 22.5 percentages for the PPT structure are policy decisions. He asked that if the percentage were deemed too high or low whether the legislature could change the percent without violating the certainty provision of the PPT system.

[2:02:24 PM](#)

Mr. Dickinson affirmed that the three "applicants, sponsors under the Stranded Gas Act", ExxonMobil, BP Exploration and ConocoPhillips "would be the signators to a contract that's eventually negotiated and that contract will bind no one else." The legislature would have the ability to change rates if deemed appropriate.

Mr. Mintz excused himself, as he had a previous commitment.

[2:03:32 PM](#)

Senator Hoffman requested participation of Anadarko Petroleum Corporation to address questions raised about the definition of point of production at the Point Thompson, Foothills, Nevada Basin, and Bristol Bay fields.

[2:04:13 PM](#)

Senator Hoffman recalled concerns regarding point of production that were raised by Anadarko in testimony presented at a previous hearing. The point of production definition would not apply to the Foothills, Nevada Basin and other fields located on the North Slope, but would be applicable the remainder of the fields. He asked if the changes made in the committee substitute, "Version P", addressed those concerns.

[2:04:50 PM](#)

MARK HANLEY, Public Affairs Manager, Anadarko Petroleum Corporation, testified that the issue had not been resolved in the committee substitute. He was collaborating with the Murkowski Administration to draft language that would resolve the matter. The provisions included in Amendment #3, which was not offered, would have partially achieved this but required further discussion.

[2:05:18 PM](#)

Senator Hoffman, referencing the proposed ten year extension on credits to the year 2017, pointed out that many exploration activities that would occur in the Nenana Basin, in Bristol Bay and possibly the Foothills locations would not have begun by the lapse date of the extension provision. He asked if this would be problematic and whether the witness recommended a solution.

[2:05:54 PM](#)

Mr. Hanley noted two different types of credits. The exploration incentive credits in existing statute would be extended for ten years under the provisions of the committee substitute and the corporation supported this "approach."

Mr. Hanley identified the challenge as the development credits, also referenced as "allowance" and "the 5,000 barrels per day with a \$14 million credit cap." These credits would not be transferable and could only be utilized against existing production. Therefore any credits earned by an operator new to the State or an operator with no production by the expiration of the provision would be unable to benefit from the credits. These credits would have no value to a "new player" and he predicted that companies would not "plan their economics" on an assumption that the legislature would extend this provision in the future. He suggested the provision either be extended for more than ten years, or the lapse date be eliminated.

Mr. Hanley pointed out that the "\$73 million allocation" provision in the original version of the bill did not contain a lapse date.

[2:08:03 PM](#)

Co-Chair Green stated that the development credit includes a provision to allow for review and possible extension.

Mr. Hanley agreed, but reiterated that most companies would not base decisions for future activities on the possibility that the credit would be extended.

[2:08:41 PM](#)

Senator Hoffman had similar concerns and indicated he would propose amendments to address this issue.

Co-Chair Green also intended to address the matter.

[2:09:10 PM](#)

Mr. Dickinson began a presentation utilizing an untitled packet of documents [copy on file].

[2:09:56 PM](#)

Page 1

Sale at Market

[Bar graph stating the following:

- \$14.5 Billion North Slope Oil - 334 million barrels (boe) - \$43.43/bbl
- \$300 million Cook Inlet Oil - 7 million barrels
- \$700 million Cook Inlet Gas - 30 million barrels - \$22.00 (3.7 per mcf)
- \$40 million North Slope Gas - 2 million barrels]

Mr. Dickinson outlined the information contained on this graph. He indicated that \$43.43/bbl represents an estimated price per barrel of oil and \$22.00 represents an estimated price per barrel of gas.

[2:10:39 PM](#)

Co-Chair Wilken asked what question this information was intended to answer.

[2:10:54 PM](#)

Mr. Dickinson replied that this graph demonstrates the amounts and sources of oil and gas revenues.

[2:12:36 PM](#)

Page 2

Gross Value at Point of Production

[Bar graph containing the information of Page 1 and adds "Transportation to Market = \$1.7 billion" for all items. The dollar amounts listed on Page 1 are not recalculated.]

Mr. Dickinson stated this shows the relationship of downstream costs to the total value of the product.

[2:13:18 PM](#)

Page 3

Net Value or Production Tax Value

[Bar graph containing the information of Pages 1 and 2, plus "\$1.7 Capital Costs" and "\$1.1 billion Operating Costs" to North Slope and Cook Inlet Oil items, and highlights a portion of the bars depicting North Slope and Cook Inlet gas. The purpose of the highlight is not identified. The dollar amounts listed on Pages 1 and 2 are not recalculated.]

Mr. Dickinson explained that this information does not pertain to a specific point, although it demonstrates "relative size". The amount remaining after deduction of the operating, capital and transportation to market amounts would be subject to taxation.

[2:14:40 PM](#)

Page 4

Net Value or Production Tax Value

[Bar graph containing the information of Pages 1 through 3 and adds highlights to each bar to represent 22.5 percent tax. The dollar amounts listed on Pages 1 through 3 are not recalculated.]

Mr. Dickinson described how this graph demonstrates the amount of tax at a rate of 22.5 percent in comparison to the operating, capital and transportation to market amounts. Because the per barrel price of \$43.43 is utilized in this demonstration, no progressivity tax would be levied under the provisions of the Senate Finance Committee substitute, although a "small" progressivity tax would be levied under the provisions of the Senate Resources Committee substitute.

Mr. Dickinson stated that State royalty, property taxes and income taxes, and federal taxes would be paid from the amount remaining after deduction of the PPT tax, operating, capital and transportation to market costs. The producer would retain the remainder as profit.

[2:15:54 PM](#)

Page 5

Tax Before Credits

2.4 billion

Mr. Dickinson remarked that this page "translates that into dollar terms."

[2:16:09 PM](#)

Page 6

Tax After Credits

[Bar graph listing the following:

- Tax After Credits 1.7 billion
- 3,000 bbl equivalent credit 8 users at max of 14 million = 112 million
- TIE credit $1.7 \times .5 \times .2 = 170$ million
- $1.7b \times .25 + 425$ million Qualified Capital Expenditure Credits

Mr. Dickinson outlined this information demonstrating "the application of three credits that would apply here" and presents the "order of magnitude". He defined TIE as "transitional investment credit". He detailed the calculations of the credits.

[2:18:49 PM](#)

Page 7

Tax After Credits

[Bar graph listing the information of Page 6 plus a separate bar graph labeled, "Tax Under Status Quo ~ .9 billion.]

Mr. Dickinson compared the difference in the amount of tax under the current structure to the amount of tax under the proposed PPT structure. The new tax would be almost double the current tax.

[2:19:39 PM](#)

Senator Olson asked if highlighted portions of the bar graph on Page 4 that represent the 22.5 percent tax are the \$2.4 billion amount Tax Before Credits shown on Page 5 and whether this amount includes tax on both oil and gas.

Mr. Dickinson affirmed.

AT EASE to [2:21:29 PM](#)

#

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [2:22:02 PM](#)