

ALASKA STATE LEGISLATURE
SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT

August 8, 2006

9:15 a.m.

MEMBERS PRESENT

Senator Ralph Seekins, Chair
Senator Lyda Green
Senator Gary Wilken
Senator Con Bunde
Senator Fred Dyson
Senator Bert Stedman
Senator Lyman Hoffman
Senator Thomas Wagoner
Senator Ben Stevens
Senator Kim Elton

MEMBERS ABSENT

Senator Donny Olson
Senator Albert Kookesh

OTHER LEGISLATORS PRESENT

Senator Gary Stevens
Senator Gene Therriault
Representative Mike Kelly
Representative Ralph Samuels
Representative John Harris

COMMITTEE CALENDAR

CS FOR HOUSE BILL NO. 3001(FIN)

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 3001

SHORT TITLE: OIL/GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06 (H) READ THE FIRST TIME - REFERRALS
07/12/06 (H) FIN
07/26/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
07/26/06 (H) Heard & Held
07/26/06 (H) MINUTE(FIN)
07/27/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
07/27/06 (H) Heard & Held
07/27/06 (H) MINUTE(FIN)
07/31/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
07/31/06 (H) Heard & Held
07/31/06 (H) MINUTE(FIN)
08/01/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
08/01/06 (H) Heard & Held
08/01/06 (H) MINUTE(FIN)
08/02/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
08/02/06 (H) -- Testimony <Invitation Only> --
08/03/06 (H) FIN AT 10:00 AM HOUSE FINANCE 519
08/03/06 (H) Moved CSHB 3001(FIN) Out of Committee
08/03/06 (H) MINUTE(FIN)
08/04/06 (H) FIN RPT CS(FIN) 7DP 1NR 1AM
08/04/06 (H) DP: HAWKER, KELLY, WEYHRAUCH, STOLTZE,
FOSTER, MEYER, CHENAULT;
08/04/06 (H) NR: JOULE;
08/04/06 (H) AM: KERTTULA
08/06/06 (H) ENGROSSED
08/06/06 (S) NGD AT 1:30 PM SENATE FINANCE 532
08/06/06 (S) -- Meeting Canceled --
08/07/06 (H) TRANSMITTED TO (S)
08/07/06 (H) VERSION: CSHB 3001(FIN)
08/07/06 (S) READ THE FIRST TIME - REFERRALS
08/07/06 (S) NGD
08/07/06 (S) NGD AT 1:00 PM SENATE FINANCE 532
08/07/06 (S) Heard & Held
08/07/06 (S) MINUTE(NGD)
08/08/06 (S) NGD AT 9:00 AM SENATE FINANCE 532

WITNESS REGISTER

DR. PEDRO VAN MEURS
Consultant to the Governor
Office of the Governor
PO Box 110001
Juneau, AK 00911-0001

POSITION STATEMENT: Testified on CSHB 3001(FIN).

DAN DICKINSON, CPA
Consultant to the Governor
Office of the Governor
PO Box 110001
Juneau, AK 99811-0001
POSITION STATEMENT: Testified on CSHB 3001(FIN).

REPRESENTATIVE RALPH SAMUELS
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Recapped the discussions and decisions in the House that led to CSHB 3001(FIN).

REPRESENTATIVE MIKE KELLY
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Provided perspective on CSHB 3001(FIN)

BILL CORBUS, Commissioner
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400
POSITION STATEMENT: Testified on CSHB 3001(FIN).

ROBYNN WILSON, Director
Tax Division
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400
POSITION STATEMENT: Answered questions related to CSHB 3001(FIN).

ACTION NARRATIVE

CHAIR RALPH SEEKINS called the Senate Special Committee on Natural Gas Development meeting to order at [9:15:00 AM](#). Present at the call to order were Senators Fred Dyson, Lyda Green, Thomas Wagoner, Gary Wilken, Bert Stedman, Lyman Hoffman, Kim Elton, Con Bunde and Chair Ralph Seekins; Senator Ben Stevens arrived as the meeting was in progress. Also in attendance were Senators Gary Stevens and Gene Therriault, and Representatives Mike Kelly, Ralph Samuels and John Harris.

CSHB 3001(FIN)-OIL/GAS PROD. TAX

CHAIR SEEKINS announced CSHB 3001(FIN) to be up for consideration.

9:15:49 AM

DR. PEDRO VAN MEURS, Consultant to the Governor, provided an economic analysis of the variable PPT rate and noted that the conclusions are the same as those that were presented yesterday.

DR. VAN MEURS said the idea of "Invest or Pay" has already been well explained. It is a new concept for figuring the PPT rate whereby the higher of two alternative rates is selected:

- 1) based on the investment per barrel ("\$/barrel rate") or
- 2) based on the relationship between qualified investments and production tax value (the "R rate").

The dollar per barrel rate changes with the level of investment and it is very sensitive to the production decline curve and the level of investment measured in nominal dollars.

\$1 per barrel - 25%

\$6 per barrel - 20%

In between the rate is:

25% - 1% (IF-1)

IF = Qualified Capex/production

The first two graphs illustrate what happens with the PPT rate if production is maintained at current nominal levels. Dr. van Meurs said we know that production is declining at the current nominal levels of investment because that's what has been happening over the last 10 years.

The top blue line in the graph shows the level of investment and the bottom pink line indicates production decline. Because the dollar per barrel in nominal terms would increase over time, the PPT rate would automatically decline from 22.5 percent to 20 percent. If a business plan wants to get to 20 percent PPT rate, or if the plan is to continue the current level of investment in nominal term, then over time as production declines the PPT rate would be 20 percent.

In real terms the investment shows that in 2006 dollars, investment would decline to almost half of what it had been over 20 years, but the PPT rate would still be about 20 percent after 10 years.

DR. VAN MEURS said if the investments decline at the same nominal capex rate as the production, the PPT rate would remain constant. That is illustrated in the graphs on slides 8 and 9. In real terms the graphs show investment declining to about \$200 million per year for the next 20 years with the PPT rate staying

the same. He commented that that isn't a particularly strong incentive to increase investment.

9:20:14 AM

The next two graphs show a business plan whereby a company could accelerate certain capital investments so the PPT rate quickly declines to the 20 percent rate. After that the 20 percent rate can be maintained by declining investment at the same rate that production declines. In real terms that would be a dramatic decline of investment in Alaska and is consistent with what he said yesterday.

The R rate is based on the following formula:

$$[(R*QC)+(0.2*QC)+[(0.25-R)*PT]]*(1-IR)+(QC*IR)=0.75*QC$$

R=rate

QC=qualified capex

PT=production tax value

IR=US tax rate

In principle it links the qualified capex as a percentage of the production tax value. So if the production tax value and the tax rate value are constant, then there is a direct relationship between the qualified investment and the PPT rate.

With a zero reinvestment the rate is 25 percent, and with a reinvestment of 23.2 percent the PPT rate is 20 percent. A company that only reinvests 25 percent of its net revenues and transfers 75 percent to other jurisdictions could reasonably be considered a "harvester."

The R rate graph shows the reinvestment rate curve and illustrates that the R rate is directly linked to the percentage of net revenues that companies reinvest. If they reinvest 23 percent of net revenues the PPT rate is 20 percent. To maintain a 22.5 percent PPT rate, reinvestment of just 12.5 percent of net revenues is all that is required. The percentages that are shown are the qualified capital expenditures as percentage of the production tax value. The importance is that price is eliminated as a variable so it holds true whether the price per barrel is \$20 or \$100.

DR. VAN MEURS said the idea is to select whichever rate is higher between the dollar per barrel rate and the R rate so that gold plating is slowed. He explained that he used Mr. Dickinson's table, but he added color to illustrate that it is relatively easy to reach a 20 percent PPT rate as long as oil prices (net of royalties) are up to \$50 per barrel. Modest

increases in investment will quickly bring the rate down to 20 percent.

Under higher prices it's increasingly difficult to stick to the lower rates because 23.2 percent of net revenues must be reinvested and at \$100 per barrel that becomes significant. At \$50 to \$70 per barrel it is relatively easy to get to the 20 percent rate.

[9:26:58 AM](#)

The chart on slide 19 illustrates that Alaska contributes up to \$1.20 in PPT loss when a company increases investment by \$1.50 per barrel from \$3 per barrel. If the 2 for 1 feature is in the system, which he would support, the company would receive another \$0.15 per barrel so the state contribution would be \$1.35 per barrel and U.S. federal tax would result in a further reduction of \$0.05 per barrel. Thus, a company that increases investment by \$1.50 per barrel only contributes \$0.10 per barrel from "its own pocket" because the rest is tax deductions. Since government is really paying, it would be easy for companies to increase investment for a short while.

The chart on the next slide illustrates the same overall pattern if a company increases investment from \$3 per barrel to \$6 per barrel. When oil is at \$70 per barrel and after all the deductions - the base PPT, the 2 for 1 and the federal income tax - a company would spend about \$0.25 of the \$3 out of pocket. Again, government is paying and that is a concern because the reduction of the PPT rate is basically built in and Alaska's money is used to come down to twenty percent.

DR. VAN MEURS said the information is basically the same as what was presented the previous day, but the graphs are up to date and reflect the actual economic results. He reminded the committee of the virtue of a simple fiscal system and appealed to the Senate to take such an approach. He noted that all other nations in the world have successfully used a simple fiscal system to encourage investment and increase government revenues.

[9:31:16 AM](#)

SENATOR BERT STEDMAN referenced the bar charts on slides 19 and 21 and asked about computing percentages.

DR. VAN MEURS replied he could show the information as a percentage, but the idea is to show the result of the combination of the two formulas.

SENATOR STEDMAN asked if at \$70 per barrel Alaska would actually pay for \$1.20 of the \$1.50 per barrel increase in capex.

DR. VAN MEURS said yes; then there is the 2 for 1 feature that would add another \$0.15 and the federal income tax deduction. Increasing investment by \$1.50 per barrel would result in a company spending very little out of pocket.

[9:33:12 AM](#)

SENATOR CON BUNDE asked if using a fixed rate would reduce the "gold plating" problem.

DR. VAN MEURS replied that would eliminate it. Internationally it is recognized that it's a stimulus to reduce the net investment by about 40 percent, but for the state to pick up 80 to 90 percent of the cost is clearly over stimulating investment. A project's rate of return wouldn't matter because, on an incremental basis, everything would look good. That induces companies to do projects for the purpose of lowering taxes, which isn't typically seen as a healthy investment strategy.

[9:35:31 AM](#)

SENATOR GARY WILKEN referenced the issues left on the table yesterday and asked if they wouldn't all be taken care of if subsection (f) were replaced with a simple formula.

DR. VAN MEURS replied it is that simple.

SENATOR BUNDE thanked Dr. van Meurs for his contribution.

SENATOR STEDMAN noted that later in the meeting he would introduce amendments.

[9:37:47 AM](#)

DAN DICKINSON, CPA, Consultant to the Governor, said before he responded to questions that were asked yesterday he wanted to clarify that he agrees with Dr. van Meurs on the math. The difference is that they look at different aspects. Dr. van Meurs said a modest increase in investment will lead to a lower rate. That's correct; under this proposed mechanism there are situations in which increased increase investment will drive the tax rate down.

However, he said, the information on the chart labeled "Five Step Calculation of Tax Rate under Produce or Pay" provides a different and important perspective. It shows how much of the

production tax value is being reinvested. He noted that Dr. van Meurs suggested that 23 percent would be "harvesting" and the state ought to look for something higher. Mr. Dickinson said his observation is that at \$70 per barrel and \$1.2 billion in investment, about 8 percent would be reinvested into the state and if that could be raised to something closer to 23 percent, he would suggest that that would be a job that was extremely well done. He noted that the stair step across the chart shows the level of investment that the state would receive at any price if it did attain 23.5 percent reinvestment. He described the difference in perspective as the difference between the glass being half empty or half full.

[9:42:04 AM](#)

MR. DICKINSON began his presentation with the explanation that the first graph shows oil at \$20/bbl for the next 30 years. The severance tax is indicated under: the status quo, the Produce or Pay Plan (POP) with .25 percent Net \$40, the governor's 20/20 proposal, the conference committee 22.8/20 proposal with .175 percent Net \$35, and the Senate 22.5/20 proposal with .100 percent Net \$35.

Clearly, at very low prices the status quo is better than systems based on a net. For several years the POP rate under consideration today lines up with the conference committee version before falling away. By 2021, which is about the same time that there are zero revenues, it aligns with the governor's bill.

[9:44:53 AM](#)

The next graph shows \$40/bbl oil for 30 years and illustrates the tax rate starting in the 23 percent range and moving down to the 20 percent range.

The next graph shows \$60/bbl oil for 30 years and illustrates that POP starts midway between the conference committee and Senate versions, but over time as production declines it drops to 20/20.

[9:46:00 AM](#)

The next graph shows the Cumulative Severance Tax from 2007 to 2030 when oil is \$30/bbl to \$80/bbl. The status quo and the governor's bill are the least aggressive in terms of revenue. The current POP proposal is also low at \$30/bbb, but over time and particularly with progressivity, the POP plan begins to rise. When oil is in the \$65/bbl range, HB 3001 generates higher revenue than any of the other bills.

[9:46:50 AM](#)

The next two graphs deal with total take so the state share includes royalties, income taxes, and property taxes. Again the state share goes down as the price per barrel goes up under the status quo and it dips just slightly under the governor's bill. Because of the progressivity features, the percentage rises for the other three models, but it rises the most under HB 3001 when the dollar per barrel prices are at the highest levels. The last slide is essentially the same, but it includes federal income taxes so the percentages are higher. The percentages increase with progressivity and at \$80/bbl HB 3001 is seen to have the highest percentage take.

MR. DICKINSON warned that the modeling system is ill suited to differentiate between the incentives.

[9:49:16 AM](#)

MR. DICKINSON offered a matrix of the different bills under three price scenarios: \$30/bbl, \$50/bbl, and \$70/bbl.

Under the \$30/bbl scenario each of the three proposed net methods have a production tax value of \$13.37. At this price progressivity is not a factor. Under HB 3001 the base tax rate is 25 percent and then 3.63 percentage points are subtracted as investment adjustment for an actual tax rate of 21.3 percent. At this level the R rate does not become part of the equation and the effective rate on gross is 4.1 percent.

The final Senate bill has the same taxable value of \$13.37 per barrel. Again progressivity is not a factor so the actual tax rate is 22.5 percent. The only adjustment that is different is that all taxpayers qualify for the \$12 million rather than just those that fall below a certain barrel threshold. The net effect is that the rate on gross is 4.2 percent. The final House bill has a higher tax rate, but it is similar. The governor's bill would have the lowest rate on gross at 3.4 percent while the status quo would have the highest at 7.5 percent of gross.

[9:52:42 AM](#)

Under the \$50/bbl scenario the calculations are the same. Again, there is no progressivity. HB 3001 has a 0.5 percent gold plating correction so the actual tax rate is 21.88 percent and the effective rate on gross is 12.4 percent. He observed that Dr van Meurs is correct that the anti gold plating formula does not include transitional investment expenditures (TIE). For measuring purposes it would be appropriate to include those

expenditures and doing so would bring the reinvestment to the 75 percent cap.

The effective rate on gross for the different bills is: 12.4 percent under the current proposal, 12.5 percent under the final Senate bill, 13.3 percent under the final House bill, 10.9 percent under the original governor's bill, and 7.5 percent under the status quo. The slight difference in the effective rates for the final Senate version and the current bill reflects a difference in credits.

The final scenario starts at \$70/bbl and subtracts \$12 in operating and transportation costs and \$4.63 in capital investment costs for a production tax value of \$53.37/bbl. At this price the progressivity feature is factored. Under the current bill the base rate is 25 percent; 3.63 percent in investment adjustment is subtracted, 1.8 percent gold plating is added (if TIE is added it is a bit higher), and 3.34 percent progressivity is added for an actual tax rate of 26.5 percent.

The effective rate on gross for the different bills is: 19.2 percent under the current proposal, 17.2 percent under the final Senate bill, 20.3 percent under the final House bill, 13.8 percent under the original governor's bill, and 7.5 percent under the status quo.

[9:56:24 AM](#)

MR. DICKINSON observed that the charts show that as the prices rise, the effect of the anti gold plating feature becomes more important.

The committee took an at-ease from [9:58:00 AM](#) to [10:00:14 AM](#).

CHAIR RALPH SEEKINS recognized Representative Ralph Samuels and Representative Mike Kelly.

[10:02:50 AM](#)

REPRESENTATIVE RALPH SAMUELS reviewed the discussions and decisions that led to the current bill including: tying oil and gas together or keeping them separate; doing something with the investment; making the system practical for all parties; using gold plating; and going to actual production.

He commented that most people are looking at investment in terms of how it affects state revenues, but dollars to the state treasury aren't the only consideration; it's any way the money is spent into the economy. Sheet metal fabricators, the flow

line in Fairbanks, Doyon, ASRC Energy and many others are affected so the more money that is spent here the better it is for the economy statewide.

REPRESENTATIVE SAMUELS said some discussion centered on putting an inflation indexer on capital expenditures, but all the groups that have supported that notion have been told that they could petition the government if something isn't right. He said he stands by that philosophy although he understands there are practical concerns right now.

10:05:00 AM

Because some companies choose to invest here and some do not, the next decision was to reward companies that do. He emphasized that companies that are willing to spend more money here ought to be encouraged. He noted that he has argued with Mr. Dickinson that it isn't fair when investment is seen to increase greatly, but production does not. Clearly, gold plating is an issue, but that can be stopped. Although production may not increase in aggregate, it will increase more than if the investment were not made at all and certainly it will stop the production decline.

Heavy oil was the next issue. Representative Samuels said he firmly believes that is where the major increase in production in Alaska will come from so it's important to encourage investment for that to happen. Thus, the current bill is aimed more at the heavy oil investment than at some of the explorers. He noted there are separate programs for royalty reduction and exploration tax credits.

The House looked at different scenarios and found that getting to any of the barriers too quickly was problematic. If a company gets to the 25 percent rate too quickly then incentive is lost. The same problem exists if the 20 percent rate comes too quickly because additional investments won't do any good. Previous testimony indicated you get to the 20 percent rate in about 10 years so the House decided to have a study done in 2011. It would ask: how much investment there has been compared to what there is today, where the money was spent, what happened to production, what happened to heavy oil, what happened to investment, who invested, and who did not invest. He said the process is slow and it would probably take five years to get to the board level where investment decisions are made. In fact with Prudhoe and Kuparuk three boards must agree before moving forward on a capital expenditure. He expressed the view that hitting either of the barriers signifies failure, but the House believes that by 2011 there will still be incentive to move

within the range. In conclusion he said to pressure corporate behavior, you must keep the pressure on.

10:09:07 AM

REPRESENTATIVE MIKE KELLY described himself as a counterbalance to Representative Samuels. From the beginning he has favored: a higher tax rate, a robust progressivity feature, separation of oil and gas, elimination of the clawback, a January 1 effective date, and a floor. To that end he was heavily involved in developing the bill that passed the House. That bill had a 23.5 percent tax rate, a 2.5 percent progressivity with a \$35/bbl trigger, and a floor.

HB 3001 is an attempt to move forward after two failed attempts and get over the triple hurdle of satisfying the Senate, the House, and the Governor. When going over the bill several things were apparent. First, regardless of where you stand on the rate curve, the bill doesn't allow the rate to fall below 20 percent. Also, it has no new credits. The concept is simple and it would be easy to put into effect. In comparison, he said, the production-based concept that Dr. van Meurs discussed is much more complex.

REPRESENTATIVE KELLY said 30 House members passed this bill and he believes it is worth serious consideration in the Senate.

10:14:57 AM

SENATOR ELTON referenced a previous statement about rewarding new investment and said he was struck by Dr. van Meurs' testimony that the state is rewarding new investment and it is paying for it. He recapped that Dr. van Meurs said that with each \$1.50 in new investment, government is paying for all but \$0.10 and that the new investment can get the tax rate down to 20 percent very quickly. He asked for a response to Dr. van Meurs' point.

REPRESENTATIVE SAMUELS responded as follows:

I'll fall back on what Mr. Dickinson said. Right now we have 7 percent of the money gets reinvested in the state of Alaska. Some people - some companies do come here and reinvest and others do not reinvest. I believe that in a snapshot of today, that we tried to hit the middle ground at 22.5 today. Today's spending at \$3.50 per barrel - the goal was to hit 22.5. Exxon would be higher than that; they spend less per barrel. ... BP would be about at that and Conoco would be below that.

If you do increase - I wasn't involved in all the writing of the formula for the gold plate and if the 2 for 1 credits need to be included in there then that's fine, but let's do that.

The bill has a set rate. You're at 60 percent already that the government's paying. We set it at 75. At very high prices 75 kicks in. ... 75 percent is what the goal that we set in this gold plating formula was. We're at 60 right now. ... Counting the deduction, counting the credit, and counting the implications of the federal government you're at 60 percent right now anyway. Just with a set number. That hasn't changed. We did not add a credit. You're using the credit for another purpose - to set the rate. ... The criticisms were, 'We're giving them the 20 percent rate and they're not going to invest money anyway.' I heard it over and over again.

So we kind of flipped that on its head and said, 'Well, if you spend the money then we'll give you the 20 percent rate. But you've got to spend a lot.' ... I can't remember if it was Dr. van Meurs or Dickinson said it took ten years to get the aggregate over time. I think we need to look at the aggregate - you can't look at what's going to happen in one year because investments are going to go up and down. Every year you start over again at 25 - it's in the bill. ... If you don't invest this year, up you go.

The criticism of the small players ... you're going to have somebody come in here and go, 'We have these huge capital expenditures right now, but we don't have any production so we get to sell the credits forward and we get to do all of these things, but the minute we have production, we don't need to spend any more capex and our tax rate is going to go up.' Yea, because your risk is gone, your capital recovery has taken place, and we're going to raise the tax rate. If you just set a number you won't get that.

[10:20:21 AM](#)

SENATOR ELTON reiterated he was struggling with the concept of reinvestment because a company is only investing \$0.10 for every \$1.50 it puts back while government is paying the balance.

SENATOR ELTON changed topics and said that when he read the morning paper he realized there seems to be disagreement between what Representative Samuels believes is in the bill and what Director Wilson believes is in the bill in terms of credits that might apply to the current pipe issue in the Prudhoe Bay unit. Director Wilson suggests that the investment would be allowed under this bill and Representative Samuels suggests it would not be allowed. It's extremely unsettling to have two people who were fundamentally involved in crafting this proposal come to such different conclusions, he said.

REPRESENTATIVE SAMUELS responded he would defer to the tax division on tax issues.

SENATOR ELTON asked if he is suggesting that the tax division is correct in its characterization.

REPRESENTATIVE SAMUELS replied he did not know if the division would call it capital expenses or operating expenses.

CHAIR SEEKINS recognized that Senator Gene Therriault had joined the meeting.

10:22:10 AM

SENATOR DYSON said originally he was told that \$0.25 out of every dollar would come from the company's pocket and he was pleased to hear that. Now he hears that it might be just \$0.10 and he questioned what happened.

REPRESENTATIVE SAMUELS said if transition credits weren't included in the formula it was probably an inadvertent omission. They tried to look at every benefit the spending gives - the deductions, the credits, and the federal implications. They also looked at the TIE credits that are in the legislation.

REPRESENTATIVE KELLY said he wasn't sure how that got left out, but the point Senator Dyson raised is important considering how Senator Elton ended up on how much of the \$1.50 is being paid by the state and how much is being paid by the company. He asked members to keep in mind that the state isn't going to be writing checks; the money comes from the stack of cash that the companies bring and that point isn't being addressed. He emphasized that in all respects the credits on the table are the same ones that Dr. van Meurs has been looking at for half a year or longer. Furthermore, he is really bothered by the implication that there is a new round of credits in here and they've just

made this thing ridiculously tilted from former versions in favor of the companies.

SENATOR DYSON said he was not implying a thing, but he would like an explanation about keeping a company's investment down to a minimum of \$0.25 out of every dollar because he missed it the first time.

REPRESENTATIVE SAMUELS said that referred to the 2 for 1 clawback credit that were first introduced in Senate Resources.

[10:29:55 AM](#)

SENATOR STEDMAN said he just received an update from Econ One and the last page depicts sharing capital expenditures between the industry and the state. He asked for some time to distribute copies to the members.

The committee took an at-ease from [10:30:37 AM](#) to [10:45:07 AM](#).

SENATOR DYSON asked Dr. van Meurs about the concern that the House gold plating feature will drive investments up and tax rates down. He asked if the yellow line, which shows the produce or pay variable rate/20 with .25% Net 40, is the likely scenario.

DR. VAN MEURS clarified that is a DOR model that has a number of assumptions. His testimony was that an inherent tendency would be for companies to plan operations to lead to 20/20 or close to that. He suggested that the actual behavior of the oil industry is that a few years out the curve would be much lower than the yellow line indicates.

[10:48:22 AM](#)

DR. VAN MEURS highlighted that his first graph presented the scenario that even if investment continued at \$1 billion per year, production would decline by 6 percent and that is entirely consistent with testimony the oil industry made. The consequence is that over time that inevitably leads to a 20 percent rate. He noted that the problem is that the DOR model is standalone and the current discussion is about incremental decisions. There is nothing wrong with the standalone model, but it looks different than an incremental model.

SENATOR DYSON asked for an explanation of the difference.

DR. VAN MEURS explained that a standalone model makes assumptions about the future, but it doesn't analyze the

investment behavior. In comparison he used an incremental model to analyze gold plating and that looks at how behavior will change over time.

SENATOR DYSON asked if he said that the producers might tailor investments to be front end loaded to get to the 20 percent rate and then they could reduce investments and still hold on to that rate.

[10:51:52 AM](#)

DR. VAN MEURS replied that's correct. Once a company is at the 20 percent level the formula is reset every year, but it is set at a much lower level of production so the per barrel rate is inherently higher at the start. That leads to the conclusion that the 20 percent rate could be maintained.

SENATOR DYSON recapped the explanation.

CHAIR SEEKINS asked Commissioner Corbus to come forward.

[10:52:58 AM](#)

SENATOR WILKEN asked if the administration has a team working on the situation and if the legislature should do something to set a process in motion.

BILL CORBUS, Commissioner, Department of Administration, replied it would help if the legislature passed the PPT. He related that the administration is working diligently and is looking at the issue from a technical and a financial standpoint.

SENATOR WILKEN asked that the administration keep the legislature in the loop.

BILL CORBUS assured members that that is the intention.

[10:55:53 AM](#)

SENATOR ELTON asked if Director Wilson's comments were the definitive answer with regard to the application of credits to investments that are now required in the Prudhoe Bay unit.

BILL CORBUS deferred to Ms. Wilson.

ROBYNN WILSON, Director, Tax Division, Department of Revenue, said she was asked how the costs would be treated under the PPT and she tried to clarify that it would depend on the kind of costs. Briefly, they could take two forms. One would be repair and maintenance and the second would be capitalized

expenditures. For example roof repairs on a building would be routine maintenance and would not be capitalized. But if the entire structure of the roof and the roofing needed to be replaced, that would extend the life of the building and those expenses would be capitalized under the IRS code. That's the dividing line, she said, but it's not necessarily a clear line because of questions of magnitude. Generally though, maintenance and repair would be operating expenses and under the PPT those would be deductible if it's a lease expenditure. On the other hand, a major replacement that would be capitalized for federal purposes. Those would be a capex under the PPT and would be deductible and subject to credits.

SENATOR ELTON asked if her answer would be the same for HB 3001.

MS. WILSON replied yes; the variable tax rate that's based on capital investment is the same definition that is used for the capex credit.

SENATOR DYSON said there is a dilemma because the idea is to have incentives so that people keep up on maintenance. He commented that it's a worry that the inadvertent outcome might be that maintenance is allowed to slide until a project would qualify as a credit rather than a deduction. He said he would like assurance that the intention isn't distorted to the taxpayers' disadvantage.

COMMISSIONER CORBUS responded the administration will take that under consideration.

The committee was in recess from [11:00:06 AM](#) to [4:46:23 PM](#).

SENATOR GREEN reconvened the meeting and announced that the committee would meet again at 10 a.m. tomorrow, August 9, 2006.

There being no further business to come before the committee, Senator Green adjourned the Senate Special Committee on Natural Gas Development meeting at [4:46:31 PM](#).