

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 17, 2006

3:38 p.m.

MEMBERS PRESENT

Senator Thomas Wagoner, Chair
Senator Ralph Seekins, Vice Chair
Senator Ben Stevens
Senator Bert Stedman
Senator Kim Elton
Senator Fred Dyson - via teleconference

MEMBERS ABSENT

Senator Albert Kookesh

OTHER MEMBERS PRESENT

Senator Gretchen Guess
Senator Gene Therriault
Senator Lyda Green

COMMITTEE CALENDAR

SENATE BILL NO. 305

"An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of

money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 305

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

| | | |
|----------|-----|------------------------------------|
| 02/21/06 | (S) | READ THE FIRST TIME - REFERRALS |
| 02/21/06 | (S) | RES, FIN |
| 02/22/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/22/06 | (S) | Heard & Held |
| 02/22/06 | (S) | MINUTE(RES) |
| 02/23/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/23/06 | (S) | Heard & Held |
| 02/23/06 | (S) | MINUTE(RES) |
| 02/24/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/24/06 | (S) | Heard & Held |
| 02/24/06 | (S) | MINUTE(RES) |
| 02/25/06 | (S) | RES AT 9:00 AM BUTROVICH 205 |
| 02/25/06 | (S) | -- Reconvene from 02/24/06 -- |
| 02/25/06 | (H) | RES AT 10:00 AM SENATE FINANCE 532 |
| 02/25/06 | (S) | Heard & Held |
| 02/25/06 | (S) | MINUTE(RES) |
| 02/27/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/27/06 | (S) | Heard & Held |
| 02/27/06 | (S) | MINUTE(RES) |
| 02/28/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/28/06 | (S) | Heard & Held |
| 02/28/06 | (S) | MINUTE(RES) |
| 03/01/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 03/01/06 | (S) | Heard & Held |
| 03/01/06 | (S) | MINUTE(RES) |
| 03/02/06 | (S) | RES AT 1:30 PM BUTROVICH 205 |
| 03/02/06 | (S) | Heard & Held |
| 03/02/06 | (S) | MINUTE(RES) |
| 03/02/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 03/02/06 | (S) | Heard & Held |
| 03/02/06 | (S) | MINUTE(RES) |

03/03/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/03/06 (S) -- Meeting Canceled --
 03/04/06 (S) RES AT 10:00 AM SENATE FINANCE 532
 03/04/06 (S) Presentation by Legislative Consultants
 03/06/06 (S) RES AT 3:30 PM SENATE FINANCE 532
 03/06/06 (S) Heard & Held
 03/06/06 (S) MINUTE(RES)
 03/07/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/07/06 (S) Heard & Held
 03/07/06 (S) MINUTE(RES)
 03/08/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/08/06 (S) -- Meeting Canceled --
 03/09/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/09/06 (S) -- Meeting Canceled --
 03/10/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/10/06 (S) -- Meeting Canceled --
 03/11/06 (H) RES AT 10:00 AM CAPITOL 106
 03/11/06 (H) -- Meeting Canceled --
 03/13/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/13/06 (S) Heard & Held
 03/13/06 (S) MINUTE(RES)
 03/14/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/14/06 (S) Heard & Held
 03/14/06 (S) MINUTE(RES)
 03/15/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/15/06 (S) -- Testimony <Invitation Only> --
 03/16/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/16/06 (S) -- Meeting Canceled --
 03/17/06 (S) RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

MARY JACKSON

Staff to Senator Wagoner

Alaska State Capitol

Juneau, AK 99801-1182

POSITION STATEMENT: Presented CSSB 305(RES), version Y, for the sponsor.

ACTION NARRATIVE

CHAIR THOMAS WAGONER called the Senate Resources Standing Committee meeting to order at [3:38:59 PM](#). Present were Senators Elton, Seekins, Stedman, Ben Stevens and Chair Wagoner.

SB 305-OIL AND GAS PRODUCTION TAX

CHAIR THOMAS WAGONER announced SB 305 to be up for consideration.

SENATOR SEEKINS moved to adopt CSSB 305(RES), version Y, as the working document.

CHAIR WAGONER objected for an explanation.

MARY JACKSON, Staff to Senator Wagoner, who introduced the CS said it was worked on by the LB&A Committee, the legislative consultants - Jim Eason and Bonnie Robson - Don Shepler and Marvin Kirchner from Greenberg Traurig LLC (specializing in FERC and tax law issues) - and Econ One. She said that Senator Wagoner had asked the producers to suggest language for definitions and they had conferred on that with Alaska Oil and Gas Association (AOGA). He worked with Dan Dickinson, Consultant to the Department of Revenue and Robynn Wilson, Director of the Tax Division; Rob Mince, Assistant Attorney General; Roger Marks, Economist, and Dr. Pedro Van Meurs, both consultants for the Administration.

[3:42:42 PM](#)

MS. JACKSON started the review by saying the title had some changes and the first was that "net value" was inserted at the request of AOGA. Other changes reflected the new Cook Inlet sections, the new surcharges in Sections 27 - 30, and the cross-reference definition to the Stranded Gas Development Act in Section 31.

She continued explaining that Sections 1, 2 (old Section 4), 3 (old Section 2), and 4 (old Section 3) had no changes. Sections 5 and 6 were new and had language that provided for the Cook Inlet Basin. Section 7 had several sections of new language requested by AOGA and ASRC [Arctic Slope Regional Corporation]. The term "gas" was inserted on page 5, line 7. Also page 5, line 27, had revisions to reflect that there is a tax on the royalty. Section 8 had language that maintained the status quo in Cook Inlet. Section 9 changed "upon" to "on". Section 10 (old Section 7) had a 95 percent "true up" per quarter that was originally 90 percent annually. Section 11 (old Section 8) had no changes. Section 12 (old Section 9) had changes requested by AOGA. Section 13 (old Section 10) had no changes. Section 14 had a new phrase to replace "produce, but" with "produced, but either not sold or if gas is sold". Section 15 had references for the Cook Inlet Basin. Section 16 (old Section 12) was lumped together with Section 17 to replace the \$73 million standard deduction

language. On page 10, line 11, percentage language was underlined that the committee needed to consider.

On page 12, line 11 (and throughout the bill), the effective date of "July 1, 2006" was changed to "April 1, 2006". On page 12, line 21, 3(a) and 3(b) were new and was a clarification as to what would be the ownership interest, a concern of the administration's.

[3:49:52 PM](#)

SENATOR BEN STEVENS asked if Section (f) on page 11, line 14, was new.

MS. JACKSON replied yes.

[3:51:37 PM](#)

SENATOR STEDMAN wondered if language starting on page 11, line 24 (g), about the commissioner repurchasing the transferable tax credits was new.

MS. JACKSON responded that she didn't have that language in any of her revisions and suggested that it might have been picked up from the House version by the drafter.

SENATOR STEDMAN noted that language on page 10, line 18, talked about a "person's" tax liability and he thought it should refer to "corporate" tax liability.

SENATOR SEEKINS responded that "person" covers all entities.

[3:53:13 PM](#)

SENATOR BEN STEVENS noticed that language on page 12, starting on line 16, dealing with abandonment, was new also.

[3:57:41 PM](#)

SENATOR STEDMAN asked for a more complete explanation of the CS so people at home could follow what the committee was talking about.

MS. JACKSON said she could do that and she also noted that the PDF files were available on the Internet. She said the committee would not take action on this bill until next Tuesday to give people ample time to review it.

She said that the abandonment section was under the subsection where the producer or explorer may not take a tax credit

[starting on page 12, line 7] and read [starting on page 12, line 22]:

- (A) a pipeline facility, other assets or service regulated as to tariffs, fees, or charges by the Federal Energy Regulatory Commission, Regulatory Commission of Alaska, or a similar regulatory body; (Ms. Jackson said concern had been raised that the term "similar regulatory body" needed to be more specific and she was working with the administration on that now.)
- (B) an asset in which the state, directly or indirectly, holds an ownership interest equal to or greater than 5 percent; for the purpose of making a determination of ownership interest under this subparagraph, the state's ownership of an interest in the land on which the asset is located shall be excluded.

SENATOR STEDMAN asked if section (B) would be discussed further.

CHAIR WAGONER responded that the bill was just being introduced today and the administration would address it tomorrow.

SENATOR BEN STEVENS asked if they could hear who originated the changes.

MS. JACKSON noted she would do that. She continued explaining the CS saying language on page 13 in Section 17 replaced the proposed \$73 million allowance. It deleted "testing, stimulation, or completion" from the old statute that authorized exploration tax credits. The new \$73 million allowance provided for a lot more credits for exploration and these were not allowed in the CS. However, she said, "If the new proposal on \$73 million goes forward, this section will come out."

[4:01:14 PM](#)

SENATOR DYSON joined the committee via teleconference.

MS. JACKSON continued explaining on pages 14 - 15, Sections 18, 19, and 20 were old Sections 13, 14 and 15 and had no changes. Section 21 was old Section 16 and it had some changes in (ii). She didn't remember the source, but would get that for them. Sections 22, 23, 24 were old Sections 17, 18, 19. One word, "or", was added in Section 24 (page 16, line 26) and some concerns were raised by the administration about whether it was

needed since it referenced Subsection (a) and (b) of the same statute had a slightly different set of constrictions.

Section 25 on page 16 was old Section 20 and eliminated royalty settlement agreements as a method of valuation. That came from Ms. Robson and Mr. Eason, both legislative consultants. Section 26 on page 17 was old Section 21 and its Subsection (a) had some slight formatting changes done by the drafter.

4:04:01 PM

MS. JACKSON continued explaining that language on page 18, lines 2 and 20, now states "one-forty-eighth" and previously it stated "one-seventy-second". This referenced the claw back provisions that extended back six years; now it is four years. Line 26 on page 18 had the new effective date of April 1, 2006. Page 19, line 4, had a typo. Page 19, lines 16 - 17, said "including the operator or a working-interest owner" and AOGA asked for it to be revised to say: "include a producer that is the operator". On line 29, the administration recommended better definitions for capital assets and those were forthcoming. The administration also recommended deleting "capital assets" on page 20, line 6.

MS. JACKSON explained that AOGA requested "for oil and gas" to be inserted before "royalty payments" on page 20, line 7. It also asked for new indemnification language starting on line 22 that says:

(K) amounts paid to indemnify the state: the exclusion provided by this paragraph does not apply to the costs of obtaining insurance or a surety bond from a third-party insurer or surety;

This language was under the definition of "direct costs" which does not include amounts paid to indemnify the state.

4:06:50 PM

SENATOR STEDMAN said he remembered earlier conversations about large producers who are self-insured and some smaller companies that write a check and the guy that writes the check would like that recognized as a legitimate expense of doing business.

CHAIR WAGONER remembered that the amount of one check was \$370,000 and it came up in testimony from smaller independents. He thought this was a large amount of money to be put up front to not have any value given to it.

SENATOR STEDMAN agreed and asked where that language came from.

MS. JACKSON replied that suggestion came from AOGA and was supported by the administration. She thought there was another answer to his question, but she wanted to make sure before she said anything.

CHAIR WAGONER suggested considering other options like giving credits or setting up a state pool where 50 percent could be reimbursable, for instance.

[4:08:33 PM](#)

MS. JACKSON continued on to page 20, line 22, where new language said:

(L) surcharges levied under AS 48.55.201 or 43.55.300;

Those sections referenced the surcharges for the 470 Funds, which were not direct costs. Language on line 26 also indicated that costs of abandonment were not direct costs. The source of (L) and (N) were from Chair Wagoner working with Mr. Eason and Ms. Robson.

[4:10:39 PM](#)

Page 21, line 8, (N) and (O) had new language clarifying what costs are and that came from the tax consultant, Marvin Kirchner of Greenberg and Traurig LLC. It said:

(N) in a transaction that is not an arm's length transaction, amounts that have not been paid to the extent that those amounts exceed fair market value; the provisions of (l) of this section apply to a determination under this subparagraph.

[4:11:18 PM](#)

Language on page 21, lines 16 - 25, had slight formatting revisions. Line 20 had a new subsection (B) and she didn't remember its source. It now said:

(e) A producer's lease expenditures must be adjusted by subtracting any payment or credit the producers receives for

(1) the use by another person or a production facility

(A) in which the producer has an ownership interest; or

(B) that is subject to a management agreement that provides for the

producer to receive a management fee determined in whole or in part on the income or gross revenue earned by the production facility;

4:13:03 PM

Line 1 on page 22 had the new date, April 1, 2006. Line 11 contained the new section on transition expenditures, which were limited to a look back of three years instead of six years that were laid out in the following way: a 75 percent credit for expenditures incurred on or after January 1, 2005 and before April 1, 2006; a 50 percent for expenses incurred from January 1, 2004 to January 1, 2005; and a 25 percent for expenses incurred after January 1, 2003 through January 1, 2004 - payable in four-year terms. Subsection (2) still had the \$40-a barrel limitation, which was in the original bill.

4:14:26 PM

SENATOR STEDMAN asked the Chair if he wanted to bring up the other concept on this issue.

CHAIR WAGONER replied that he had talked to Dr. Van Meurs about his concept that rewards current producers for continued investment in production based on a formula that allows credits in a look-back format. It would stem the current decline in production.

SENATOR STEDMAN helped him explain saying the issue was aimed at doubling expenditures by the industry on the North Slope over the next five years from \$1 billion to \$2 billion.

4:16:54 PM

MS. JACKSON continued explaining that language on page 22, line 27, was the same as in the original bill. Language on page 23, line 4 had "the" instead of "such". The previous Subsection (i), which was the old \$73 million standard deduction, was deleted. The new (i) was the old (k); the new (j) was the old (l); the new (k) was the old (m); and page 23, line 29, had new sections (l), (m), and (n).

SENATOR BEN STEVENS asked to discuss the removal of Section (i).

4:18:39 PM

CHAIR WAGONER explained that the replacement for the \$73 million allowance allowed a holiday season for the first 4,000 barrels of oil produced each day for seven years to be exempted from taxes.

[4:20:16 PM](#)

SENATOR BEN STEVENS noted that it applied only to new fields brought into production after the effective date and had a seven-year sunset.

[4:21:15 PM](#)

MS. JACKSON continued on saying the new subsections inserted beginning on page 23 came from the tax consultants and dealt with Internal Revenue Code. New Section (o) was the old (n) and it had some revisions that were requested by AOGA and concurred with by the administration. Sections 27 through 30 on page 25 were requested by the Chairman and dealt with the surcharge.

[4:24:20 PM](#)

CHAIR WAGONER said that someone from DEC requested this language and before this bill goes to the Finance Committee, he wanted a report on how those funds had been used. People have told him they were being expended for items it wasn't intended for.

SENATOR BEN STEVENS asked if Sections (l), (m), and (n) on page 23 came from the tax consultants.

MS. JACKSON replied yes.

SENATOR BEN STEVENS asked if all the sections they referenced in terms of the arms length transactions and direct costs under (d)(2)(M) and (d)(2)(L) were inserted by Mr. Eason and Ms. Robson.

[4:27:07 PM](#)

MS. JACKSON replied that she would double-check that and identify the source of each change for him. She went to pages 25 and 26 where Sections 27 through 30 contained the new surcharge rates. She explained that the current surcharge rate is 3 cents and 2 cents. This bill drops the 2 cents to 1 cent and increases the 3 cents to 5 cents. The result is that instead of a nickel, it becomes 6 cents.

SENATOR STEDMAN asked what was the intended use of the 6 cents.

MS. JACKSON replied that it was intend for each of the 470 Funds.

[4:28:16 PM](#)

SENATOR SEEKINS said he wanted to investigate using some of those funds to reduce the cost for small companies by not having

tremendous up-front insurance fees as "sort of a defacto bonding fund."

CHAIR WAGONER continued on and said that last year he asked why oil and gas exploration couldn't be separated and he was told that it was because companies didn't know which they were going to get when they were exploring.

[4:29:21 PM](#)

MS. JACKSON went back to surcharges and pointed out that the original bill allowed for the 470 surcharge to be taken as an expense and this CS does not allow that. She noted that old Section 29 was deleted. Section 31 on page 26 was old Section 30 and Section 32 on page 27 was old Section 31 and had no changes. On page 28, Section 33 was old Section 32 and Section 34 was old Section 33 and had no changes. Section 35 was old Section 34 and had several changes because the repealer statutes had changed as a result of the CS. Section 36 was old Section 35 and changed the date to April 1, 2006. The rest was conforming language with new section numbers. Section 37 contained the transitional provisions and had the April 1, 2006 date change on lines 6 and 7. Another date change was on line 17 and line 19 was changed to nine months of the calendar year from six months. She thought this related to the change in the true up.

[4:32:37 PM](#)

SENATOR ELTON mentioned a correction on page 29, line 17, to April 1, 2006 instead of April, 2006.

MS. JACKSON thanked him for that and continued on to page 29, line 21, that had another date change. Line 25 had the nine-month instead of six-month time frame and (d) had the April 1 time change again. Section 38 on page 29 was old Section 37 and had no changes. Section 39 contained the revisor instructions, which reflected the CS changes. On the last page, Section 40 was old Section 39 with the effective dates of all the sections. Sections 41 and 42 were the effective dates.

[4:34:55 PM](#)

SENATOR ELTON expressed his appreciation for the summary sheet.

There being no further business to come before the committee, Chair Wagoner adjourned the meeting at [4:36:59 PM](#).