

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 22, 2006

3:40 p.m.

MEMBERS PRESENT

Senator Thomas Wagoner, Chair
Senator Ralph Seekins, Vice Chair
Senator Ben Stevens
Senator Fred Dyson
Senator Bert Stedman
Senator Kim Elton
Senator Albert Kookesh

MEMBERS ABSENT

All members present

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
 03/17/06 (S) Heard & Held
 03/17/06 (S) MINUTE(RES)
 03/18/06 (H) RES AT 10:00 AM CAPITOL 124
 03/18/06 (H) -- Meeting Canceled --
 03/19/06 (S) RES AT 1:00 PM BUTROVICH 205
 03/19/06 (S) Heard & Held
 03/19/06 (S) MINUTE(RES)
 03/20/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/20/06 (S) Heard & Held
 03/20/06 (S) MINUTE(RES)
 03/21/06 (S) RES AT 3:30 PM BUTROVICH 205
 03/21/06 (S) -- Meeting Canceled --
 03/22/06 (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 amendments to SB 305.

JOE BALASH

Staff to the Legislative Budget and Audit Committee
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Commented on Administrative Amendments to
CSSB 305(RES), Version Y.

ROBERT MINTZ, Assistant Attorney General
Department of Law
PO Box 110300
Juneau, AK 99811-0300

POSITION STATEMENT: Commented on Administrative Amendments to
CSSB 305(RES), Version Y.

ROBYNN WILSON, Director
Tax Division
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Commented on Administrative Amendments to
CSSB 305(RES), Version Y.

ACTION NARRATIVE

CHAIR THOMAS WAGONER called the Senate Resources Standing
Committee meeting to order at [3:40:21 PM](#). Present were Senators
Ben Stevens, Stedman, Seekins, Kookesh, Elton and Chair Wagoner.

SB 305-OIL AND GAS PRODUCTION TAX

CHAIR THOMAS WAGONER announced SB 305 to be up for consideration
and that the committee would consider amendments. [In packets
and under discussion was a proposed committee substitute (CS),
Version Y, labeled 24-GS2052\Y, Chenoweth, 3/16/06. Hereafter it
will be referred to as "Version Y".]

[3:41:31 PM](#)

MARY JACKSON, Staff to Senator Wagoner, said she arranged the
amendments according to whether they were technical,
administrative, or substantive issues. She presented Technical
Amendment 1:

24-GS2052\Y.34
Chenoweth

TECHNICAL AMENDMENT 1

OFFERED IN THE SENATE

TO: CSSB 305(RES), Draft Version "Y"

Page 5, line 19, following "owner;":
Insert "and"

Page 5, line 20:
Delete "except as provided in (4) of this subsection,"

Page 5, line 26:
Delete "; and"
Insert "."

Page 5, lines 27 - 29:
Delete all material.

Page 7, lines 16 - 23:
Delete all material.
Insert "Notwithstanding any contrary provision of AS 43.05.280, interest on an overpayment is allowed only from a date that is 90 days after the last day of the third month following the calendar quarter of production, as described in this subsection, and interest is not allowed if the overpayment was refunded within the 90-day period. In addition, the producer shall comply with the requirements of AS 43.55.030(a) and 43.55.030(e). In this subsection, "calendar quarter" means each of the three-month periods ending March 31, June 30, September 30, and December 31."

Page 8, line 21, following "is":
Insert "produced and"

Page 11, lines 7 - 23:
Delete all material and insert:
"(e) A person to which a transferable tax credit certificate is issued under (d) of this section may transfer the certificate to another person, and a transferee may further transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and notwithstanding any action the department may take with respect to the applicant under (f) of this section, the owner of a certificate may apply the credit or a portion of the credit shown on the certificate only against a tax due under AS 43.55.011(e). However, a credit shown on a transferable tax credit certificate may not be applied to reduce a transferer's total tax due under AS 43.55.011(e) on oil and gas produced during a calendar year to less than 80 percent of the tax that would otherwise be due without

applying that credit. Any portion of a credit not used under this subsection may be applied in a later period."

Reletter the following subsections accordingly.

Page 12, line 21:
Delete "(A)"

Page 12, line 22, following "service":
Insert "economically"

Page 12, line 24:
Delete "similar"
Insert "any successor"
Delete "; or"
Insert "."

Page 12, lines 25 - 29:
Delete all material.

Page 13, line 2:
Delete "(i)"
Insert "(h)"

Page 15, lines 4 - 7:
Delete all material and insert:
 (e) In addition to other required information, the producer shall file a statement, on or before the last day of each calendar quarter of a year, showing any adjustments or corrections to the statements that were required under (a) of this section to be filed for the three months of the preceding calendar year during which the oil or gas was produced. In this subsection, "calendar quarter" means each of the three-month periods ending March 31, June 30, September 30, and December 31."

Page 16, line 26:
Delete "or"

Page 16, line 29:
Delete "a new subsection"
Insert "new subsections"

Page 17, line 19:
Delete "(A)"

Page 17, line 21:

Delete ";"
Insert "."

Page 17, lines 22 - 23:

Delete all material and insert:

"(e) A formula prescribed by the department under (d) of this section may not incorporate a reference to royalty value, royalty valuation methodology, or royalty settlement agreement."

Page 19, line 3:

Delete "an"

Page 19, line 17:

Delete "the operator or a working interest owner"

Insert "a producer that is an operator"

Page 20, line 6:

Delete "of capital assets"

Page 21, line 3, following "service":

Insert "economically"

Page 21, line 5, following "similar":

Insert "regulatory"

Page 24, line 4, following "Code),":

Insert "as amended,"

MS. JACKSON explained that Technical Amendment 1 had three notes to go with it:

1. Page 2 - to insert Technical Amendment 1 after the second "is"
2. Page 2 - line 13 - should read "transferee's" (not "transferers")
3. Page 3 - lines 8 - 15 - Administration is checking on whether it still needed this section (item 6)

MS. JACKSON also noted that "page 2, line 21", [of Technical Amendment 1] should read "page 12, line 21". Back to page 1 she said lines 1 - 12 pertained to Topic 4 of the committee's "Roadmap," which related to the deletion of tax on royalty language. She explained that the deleted language authorized the commissioner to establish the tax and the commissioner pointed out that tax creation was a legislative function. Lines 1 and 2

and lines 6 - 12 on page 1 were both technical changes; lines 4 and 5 deleted reference to the previous subsection. Lines 14 - 22 related to Item 6 of the committee's Roadmap regarding the safe harbor provision that was in the original bill. The original bill was set at 90 percent. This language was revised to read 95 percent with a true up on a quarterly basis.

On page 2 [of Technical Amendment 1], lines 1 - 2 related to Item 7 of the Roadmap regarding oil and gas sold and oil and gas not sold. "Produced" was put in front of one section, but that language was not followed through in the second section. This amendment does that by inserting language on page 8, line 21 [of Version Y] that would then read: "If oil or gas is produced, but not sold, or if oil or gas is produced and sold".

On page 2 [of Technical Amendment 1], lines 4 - 16, dealt with Item 9, an error in language suggested by AOGA. Specifically, line 13 on page 11 changed "transferer's" to "transferee's" in Version Y. It also corrected Item 10, which was an improper insertion of House language into the Senate bill. The subsections need to be renumbered accordingly.

[3:50:46 PM](#)

Page 2, line 20, [of Technical Amendment 1] referred to Items 13 and 22 of the Roadmap. The administration expressed concern that the term "similar regulatory" was overly-broad. So, "economically" was inserted in one area, which administration agreed with. A second change on line 26 [of Technical Amendment 1] deleted "similar" and inserted "any successor" on page 12, line 24, of Version Y. Ms. Jackson explained that Ms. Wilson, director of the Tax Division, said this language needed to be clarified to mean the successor body to the Regulatory Commission of Alaska (RCA).

[3:52:33 PM](#)

Page 3, lines 1 - 2, of Technical Amendment 1 related to Item 14 on the Roadmap. The Chairman recommended deleting lines 25 - 29 on page 12 of Version Y. Page 3, lines 4 - 6 [of Technical Amendment 1], were drafting insertions to correct deletions. Page 3, line 8 [of Technical Amendment 1], related to Item 6 on the Roadmap and the administration now supported it.

[3:55:03 PM](#)

SENATOR SEEKINS asked how a person filed the quarterly statements mentioned on page 3, line 13, of Technical Amendment 1.

[3:55:42 PM](#)

DAN DICKINSON, CPA, Consultant to the Governor, explained that a quarterly true up was required in the original bill and this language he addressed situations in which a person didn't have an actual tax obligation at the end of a quarter. He would still have to file for the true up, but the language imposed no additional obligation.

SENATOR SEEKINS pointed out that language on page 3, line 13, of Technical Amendment 1, required a quarterly true up and referred back to the previous calendar year, not to the previous quarter.

[3:58:01 PM](#)

MR. DICKINSON admitted that Senator Seekins caught a glitch. He suggested inserting "calendar quarter" and deleting "year" on page 3, line 13 of Technical Amendment 1.

CHAIR WAGONER said they would treat that as an editorial correction. There were no objections.

[3:59:23 PM](#)

MS. JACKSON said page 3, line 17, of Technical Amendment 1 related to Item 15 that deleted "or" on page 16, line 26, of Version Y. She said after considerable discussion, the administration persuaded the chairman to remove that word. Page 3, line 20, of Technical Amendment 1, was a drafting correction to page 16, line 29, of Version Y.

[4:00:46 PM](#)

Page 3, line 24, of Technical Amendment 1, related to Item 17 of the Roadmap that concerned how the valuation was established. She explained there was a lot of discussion on whether or not royalty settlement agreements should be a basis.

[4:01:46 PM](#)

SENATOR BEN STEVENS requested that this item be removed from the Technical Amendment category and be put into the Substantive Amendment category, because it concerned a substantive change in policy. There were no objections.

MS. JACKSON followed up that language on page 3, lines 24 - 31, and page 4, lines 1 - 4, of Technical Amendment 1 would become new Substantive Amendment 5.

[4:03:11 PM](#)

SENATOR BEN STEVENS asked to go back to page 17 of Version Y and remarked that two components refer to two different subchapters. One relates to AS 45.55.160 and the other relates to AS 45.55.150. One has to do with transition investments and the other has to do with valuation.

CHAIR WAGONER said he would check those references to make sure they were correct.

[4:05:27 PM](#)

MS. JACKSON went to page 19, lines 3 and 4, of Version Y, and read the end: "or producing an oil or gas from a deposit of oil or gas". Either "from a" or "an" needed to be removed. The drafter determined it would be appropriate to remove "an". The net result is that the line would read: "or producing oil or gas from a deposit of oil or gas".

[4:06:17 PM](#)

Page 4, line 9, of Technical Amendment 1 referenced Item 20 of the Roadmap that was requested by AOGA. The administration agreed. The changes delete: "the operator or a working interest owner" and insert "a producer that is an operator". The result of it would be on page 19, lines 16 and 17, of Version Y that would now read: "(2) the Department of Revenue may authorize a producer that is an operator to treat as its lease expenditures...."

[4:07:19 PM](#)

Page 4, line 13, of Technical Amendment 1 referenced Roadmap Item 21 and was requested by the administration. It deleted "of capital assets" on bill page 20, line 6, of Version Y.

[4:07:59 PM](#)

Page 4, lines 16 - 23, of Technical Amendment 1 was requested by the department and corrected conflicting language about the regulatory board on page 2, lines 23 - 31, of Technical Amendment 1.

[4:10:15 PM](#)

CHAIR WAGONER asked if definitions would be inserted on page 19, line 29, of Version Y.

MS. JACKSON replied yes; but those definitions would show up in the Administrative Amendments group.

[4:11:13 PM](#)

SENATOR SEEKINS moved to adopt Technical Amendment 1.

SENATOR BEN STEVENS objected for a point of order. The committee had not adopted the working draft yet.

[4:11:44 PM](#)

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

SENATOR BEN STEVENS objected saying he didn't agree with the rates that were proposed in CSSB 305(RES), Version Y.

[4:12:39 PM](#)

SENATOR SEEKINS pointed out that they needed to adopt the CS because the amendments wouldn't work with the original bill. He looked upon the bill as a work in process that was subject to amendment and not the final product of the committee.

[4:13:10 PM](#)

SENATOR STEDMAN added that the bills and amendments would all get ample debate the committee needed a forum to work from.

[4:13:36 PM](#)

SENATOR BEN STEVENS suggested that they could adopt the original bill and move the substantive amendments. He maintained his objection.

[4:14:13 PM](#)

SENATOR SEEKINS said if the committee adopted the CS, it would be subject to even further amendments.

CHAIR WAGONER agreed and asked for a roll call vote. Senators Stedman and Ben Stevens voted nay; Senators Elton, Kookesh, Seekins and Wagoner voted yea. Senator Stedman changed his vote from nay to yea; so, by a vote of five yeas and one nay, CSSB 305(RES), Version Y, was adopted.

[4:15:51 PM](#)

SENATOR SEEKINS moved to adopt Technical Amendment 1.

SENATOR BEN STEVENS objected. He acknowledged all the work that had gone into the amendment, but he stated that some of the changes in Technical Amendment 1 were substantive changes to policy. He had anticipated debate on the substantive policy changes as to why it was changed. With that statement, he removed his objection.

SENATOR SEEKINS said that he agreed with Senator Ben Stevens that some of the changes in Technical Amendment 1 may have crossed over into the substantive area, but his intent on making the motion was to come up with an integrated document that he could further consider.

[4:18:32 PM](#)

SENATOR STEDMAN agreed with that statement.

SENATOR BEN STEVENS withdrew his objection to adopting Technical Amendment 1 and without further objection, it was adopted.

[4:18:44 PM](#)

MS. JACKSON went on to present Technical Amendment 2 that was requested by the administration as follows:

24G-2
3/22/2006
(10:53 A.M.)

TECHNICAL AMENDMENT 2

OFFERED IN THE SENATE RESOURCES
COMMITTEE

TO: CSSB 305(RES) (24-GS2052\Y) (3/16/06 Work Draft: Chenoweth)

Page 29, following line 28:

Insert the following material:

"(e) Notwithstanding any contrary provision of AS 43.55.020(a), as repealed and reenacted by sec. 10 of this Act, or of AS 43.55.020(g), enacted by sec. 15 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 secs. 10 and 15 of this Act,

(1) the amount of the taxes that would have been levied upon 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(a), as amended by sec. 5 of this Act, and under AS 43.55.011(e), (f), and (g), enacted by sec. 7 of this Act, that remains unpaid, net of any credits applied as allowed by law, is due on the last day of the second month that begins at least 180 days after the effective date of secs. 5 and

7 of this Act.

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

(g) For purposes of taxes to be calculated and due under (e)(1) of this section and statements to be filed under (f)(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."

Page 29, line 31, following "REGULATIONS":

Delete "."

Insert "AND RETROACTIVITY OF REGULATIONS. (a)"

Page 30, following line 3:

Insert the following material:

"(b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by the Department of Revenue to implement, interpret, make specific, or otherwise carry out the provisions of secs. 5 - 8, 10 - 13, 15 - 18, 20, 24 - 35, and 37 of this Act may apply retroactively as of April 1, 2006, if the Department of Revenue expressly designates in the regulation that the regulation applies retroactively to that date."

MR. DICKINSON explained that Technical Amendment 2 was written because there wouldn't be enough time between when the bill was introduced and the time the first payments would have to be made for taxpayers to get their technical systems in order. Transition provisions were created on page 1, lines 1 - 14 [of Technical Amendment 2], that adjusted for the three-quarters of a year. The administration's bill had six months. Page 1, line 15 - page 2, line 9 [of Technical Amendment 2], said for the

first 180 days taxpayers can pay what they would have owed under existing statutes. In the seventh month they would have to true everything up. Finally, language on page 2, lines 11 - 17 [of Technical Amendment 2], granted the department authority to make regulations to enforce these provisions retroactive to the effective date of the bill, which was April 1.

CHAIR WAGONER asked if this gave the companies and the state enough time to set up their accounting procedures.

MR. DICKINSON replied that it compressed the timeframe, but it was adequate.

[4:22:46 PM](#)

SENATOR BEN STEVENS asked if the first six months carried any penalty.

MR. DICKINSON replied if taxpayers underpaid what they owed under the current rules, they could have a penalty or interest; but as long as they paid what was owed under current rules, they wouldn't have a penalty.

SENATOR SEEKINS moved to adopt Technical Amendment 2 and objected. He said that in his own code of ethics a retroactive tax is not fair. He would have a hard time voting for any tax that precedes the effective date of a bill.

[4:23:54 PM](#)

SENATOR STEDMAN said at first this tax was going to be in place as early as January 1 and now they were considering the end of the third quarter. He thought that would work out fairly well.

SENATOR SEEKINS removed his objection, but he said he might have a further amendment if this one was adopted. He renewed his objection for Senator Ben Stevens' comment.

SENATOR BEN STEVENS said he felt the same way as Senator Seekins. He removed his objection.

SENATOR SEEKINS removed his objection.

CHAIR WAGONER announced that without further objection, Technical Amendment 2 was adopted.

[4:25:34 PM](#)

CHAIR WAGONER announced Administrative Amendment 1 to be up for consideration as follows:

ADMINISTRATIVE AMENDMENT 1

OFFERED IN THE SENATE BY SENATOR WAGONER
TO: CSSB 305(RES), draft version 24-GS2052\Y

Page 18, line 4: insert after "than zero":

If a producer does not produce taxable oil or gas during a month, the producer is considered to have generated a positive production tax value if the calculation described in this subsection yields a positive number because the producer's adjusted lease expenditures for a month are less than zero as a result of the producer's receiving a payment or credit under (e) of this section or otherwise.

Page 18, line 23: insert new paragraph (3):

(3) an explorer that has taken a tax credit under AS 43.55.024(b) or that has obtained a transferable tax credit certificate under AS 43.55.024(d) for the amount of a tax credit under AS 43.55.024(b) is considered a producer, subject to the tax levied under AS 43.55.011(e), to the extent that the explorer generates a positive production tax value as the result of the explorer's receiving a payment or credit described in (e) of this section.

Page 19, line 29: replace (A) "outlays for capital assets" with:

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

Page 21, line 9: replace "amounts that have not been paid" with:

amounts incurred

Page 21, lines 14 - 15: after "business entity" delete all material and insert:

, whether or not the transaction is treated as an asset sale for federal income tax purposes.

Page 21, lines 16 - 17: replace "any payment of credit the producer receives for" with:

Certain payments or credits received by the producer, as provided in this subsection. If one or more payment or credits subject to this subsection are received by a producer during a month or, under (f) of this section, during a calendar year, and if either the total amount of the payments or credits exceeds the amount of the producer's lease expenditures or the producer has no lease expenditures, the producer shall nevertheless subtract those payments or credits from the lease expenditures or from zero, respectively, and the producer's adjusted lease expenditures for that month or calendar year are a negative number and shall be applied to the calculation under (a) of this section as a negative number. They payments or credits that a producer must subtract from the producer's lease expenditures, or from zero, under this subsection are payments or credits received by the producer for

Page 21, lines 18 - 22: delete all material, insert:

(1)the use by another person of a production facility in which the producer has an ownership interest or the management by the producer of a production facility under a management agreement providing for the producer to receive a management fee;

Page 22, line 1: replace (n) with (m) and after "2006;" insert:

For purposes of this subsection, if a producer removes from the state, for use outside the state, an asset described in this subparagraph, the value of the asset at the time it is removed is considered a payment received by the producer for the transfer of the asset;

Page 23, line 28: insert "(b)," at the beginning of the line

Page 23, lines 29 - 30: replace (d)(2)(L) with (d)(2)(N) and delete "or (d)(2)(M)"

Page 23, line 31: delete "(d)(2)(L) or (d)(2)(M)" and insert (e)(3)(A)

Page 24, line 10: delete "(d)(2)(L) and replace with (d)(2)(N)

Page 24, line 4: insert after "Revenue Code":

as amended

Page 24, lines 12 - 13: delete all material after "due" and insert:

If a producer fails to comply with a request under this paragraph, there shall be added to any underpayment determined by the department under this section a penalty in the amount of 20 percent of the underpayment.

Page 24, lines 14 - 27: delete all material and reorder

Page 24, lines 28 - 30: delete all material and insert:

(n) For purposes of determining the amount of the adjustment by subtraction that must be made to a producer's lease expenditures as a result of the producer's receiving a payment or credit under (e)(3)(A) of this section,

Page 25, lines 7 - 11: delete all material and reorder

CHAIR WAGONER explained that Ms. Wilson had questions in previous meetings about the taxes in this bill and Mr. Balash had been working with the administration on the disagreements.

JOE BALASH, staff to the Legislative Budget and Audit Committee, said that tax counsel, Mr. Kirchner of Greenberg & Traurig LLC, had recommendations for Section 26 that dealt with a number of tax base adjustments, determinations of value, credits and payments. The department now has a better understanding of what he was attempting to accomplish in crafting the language and was able to resolve a number of the issues that would allow the legislation to flow more efficiently. He said a number of references were mixed up in the drafting process and those were easy to correct. The department helped craft a provision on management fees, asset churning and removal of assets from the state. It also agreed to include the acquisition of a business entity in the list of (d)(2) items, which do not count as direct costs. He said the department would have drafted this amendment, but Robert Mintz, Assistant Attorney General, needed to focus

his attention on the additional provisions. The technical pieces of the amendment work and a note from Mr. Mintz indicates his agreement.

CHAIR WAGONER asked him to distribute that note to the committee.

MR. BALASH noted that one item was left unresolved in subsection (1), on page 23, line 29, through page 24, line 13. The department was not certain it needed the additional audit powers granted by this subsection. It seemed to be a substantive issue that was beyond its charge to resolve.

[4:31:12 PM](#)

SENATOR STEDMAN asked him to explain the second paragraph on the first page of Administrative Amendment 1 that began with "Is considered a producer".

MR. BALASH explained that was requested by the department.

CHAIR WAGONER announced an at ease from [4:32:03 PM](#) to [4:32:04 PM](#) to get further help from the Attorney General's office.

ROBERT MINTZ, Assistant Attorney General, explained that several of the amendments were intended to deal with a timing mismatch. One of the provisions in the bill said the main tax credits could be used by companies that are doing exploration even if they don't have any production and, therefore, wouldn't have a production tax to deduct them against. He explained:

One of the things you can get a credit for is lease expenditures should be actual net lease expenditures. Subsection (e) of new section 160 of the production tax statute provides that when a producer gets certain types of reimbursements for assets that were previously acquired, those reimbursements have to be netted against the expenditures so that you only get to deduct net expenditures.

He said the problem was that deductible expenditures might have been made in one period that didn't also have production and those might not be able to be recaptured in a later period. These several provisions say even if you don't have any oil or gas production in this period, if you get one of these reimbursements or similar payments during that period, that reimbursement or payment has to be treated as a negative lease expenditure, which leads to a positive production tax. So, they

came up with language stating, "For purposes of this kind of recapture provision, the explorer will be considered a producer and he will be subject to production tax."

[4:36:07 PM](#)

SENATOR BEN STEVENS said he was lost at the end of Mr. Mintz's explanation. He asked if an explorer has no production tax liability, what's the purpose of creating that entity as a production taxpayer.

MR. MINTZ went through the following example:

If an explorer in 2007 spends \$1 million on exploration and he is allowed to treat that as lease expenditures. Since there is no oil and gas production to generate positive value, he basically gets a loss of \$1 million. He could convert that into a credit at 25 percent under the CS and sell it for \$250,000. If during that year the explorer had sold the asset that he acquired for \$1 million, for \$500,000, he could only take a credit for the net outlay of \$500,000. But suppose the sale doesn't take place until 2008. It's no longer a \$1 million expense to net the half million-dollar revenue against. So, basically, the explorer would have received the benefit of the full \$1 million expense without having to net that revenue against it. This says in that second year, 2008, you're going to have to treat the half-million dollar revenue as a negative lease expenditure, which would create a tax liability. And that's why this provision...the explorer could be treated as a producer subject to the net production tax. Otherwise we wouldn't be able to follow through with the basic principal that only net expenses would be deductible and eligible for credit.

SENATOR BEN STEVENS thanked him for the explanation.

[4:39:01 PM](#)

SENATOR STEDMAN asked him to explain the first paragraph on page 2 that read:

Page 19, line 29: replace (A) "outlays for capital assets" with:

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a

direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

He wanted to make sure the credits applied to what the legislature intended them to.

MR. MINTZ answered that the reason the original the bill had the term "outlays for capital assets" was to make clear that expenditures for capital assets were being treated differently under the new production tax. Generally, there is a the distinction between operating expenses, which are fully deductible during the time period that they are incurred, and capital expenditures on the other hand, which because they last a long time, generally have to depreciated over time. This language says they are not following the general rule in the bill, but instead the full amount of money that is spent on a capital expenditure is deductible in the time period it was made.

He said that tax consultants for the committee raised concerns that the term "capital assets" could be interpreted to include the purchase of a company or stock. The proposed language more directly accomplishes what they are trying to do which is to say, if you spend money to acquire something, it should be treated as a direct cost - even if the normal capitalization rules under IRS or financial accounting rules would require that to be spread over time. In this case you can deduct the expenditure when it's incurred so the interpretation of "capital assets" isn't an issue.

[4:42:25 PM](#)

SENATOR SEEKINS asked if that same expenditure was treated as an expense in financial accounting or as a deductible for IRS tax purposes, would that item be deductible on state income tax.

MR. MINTZ replied that the intent was to not affect how items are handled for federal income tax purposes.

SENATOR SEEKINS said it wasn't the legislature's intent to create double-deductibles and he was wondering if this provision might do that.

MR. MINTZ responded that it was his understanding that an expenditure that would be treated as a capital expenditure for income tax purposes would continue to be treated that way. All

this is saying is that for production tax purposes, it would be deducted in the same way as an operating expense.

MR. DICKINSON agreed with Mr. Mintz and added that they were building on existing rules that apply to income tax so the department has less work to do and gets fewer arguments from taxpayers.

[4:44:42 PM](#)

SENATOR STEDMAN asked when a producer purchases an office building in Anchorage, could it get a credit to take against the PPT.

MR. DICKINSON replied generally no. He envisioned a set of direct costs that would be the kinds of things that partners agree to pay for when they have joint operating agreements - like in Prudhoe Bay where there are many owners. Typically an office building in Fairbanks would not qualify. But, you might see an overhead rate built in, which recognizes the fact that when you have employees working on the North Slope, you have to house them someplace rather than fly them back and forth to work.

[4:46:10 PM](#)

SENATOR STEDMAN asked if a bunkhouse were built in Prudhoe Bay versus a bunkhouse in Fairbanks, would either one of them be available for the PPT credit.

MR. DICKINSON replied if a producer were to build a bunkhouse and people who were working on that field rotated in and out, that could qualify as a direct cost.

[4:47:17 PM](#)

SENATOR STEDMAN asked if that could be interpreted to mean a bunkhouse in Dallas.

MR. DICKINSON replied no.

[4:48:29 PM](#)

SENATOR BEN STEVENS went to page 23, lines 29 - 31, of Version Y and asked which item was being deleted. He was confused about whether it was substantive or administrative.

MR. BALASH replied by reading the text: "for the purposes of making a determination of direct cost" referenced direct costs listed [on page 21, line 8 of Version Y] in "(d)(2)(N) in a transaction that is not at arm's length transaction,".

He explained that "amounts incurred" would be inserted before "to the extent those amounts exceed fair market value;" [on page 21, lines 9 - 10 of Version Y]. Those are not direct costs. He said that the reference to (d)(2)(M) was deleted on page 23.

BEN STEVENS asked why it was deleted.

MR. BALASH replied that it was a drafting error.

[4:56:53 PM](#)

MR. MINTZ added that all the references make sense, but they are confusing. Sometimes they are redundant.

[4:58:07 PM](#)

SENATOR DYSON arrived a few minutes earlier.

[4:58:59 PM](#)

SENATOR BEN STEVENS asked the purpose of the repetition.

MR. BALASH explained that (L) sets out how the department establishes whether or not the transaction occurred at arm's length; (N) establishes what sorts of occurrences they look for to determine (e)(3)(A), which is an adjustment to direct costs as lease expenditures.

SENATOR SEEKINS remarked that it appears to not be a circular non sequitur.

[5:00:57 PM](#)

SENATOR STEDMAN asked for an explanation of page 4 of Administrative Amendment 1 that referenced page 24, lines 12 - 13, of Version Y that inserted a 20-percent penalty for underpayment of a tax.

MR. BALASH replied that the 20-percent penalty for underpayment was determined by the department in its audit process. The 20 percent came from 26 USC 6662(e), that portion of tax code that sets out penalties that are a result of Section 482 audits. He noted that 6662 states that an egregious underpayment is subject to a 40-percent penalty.

[5:03:31 PM](#)

SENATOR SEEKINS asked if this penalty applied if the department requested documentation that didn't exist at the time the entity took the deduction.

ROBYNN WILSON, Director, Tax Division, Department of Revenue (DOR), replied yes.

SENATOR SEEKINS remarked, "So, it's almost tantamount to a penalty for committing fraud - or just not producing."

MS. WILSON responded that she didn't have an opinion on his comparison to fraud. It hones in on the fact that the production taxpayer needs to have contemporaneous documentation for transfer pricing issues. This would address the situation where either affiliated companies or non-affiliated companies make an arrangement to sell something for a non market price. She hesitated to use the word fraud, but it's not typically the result of a mistake.

[5:05:48 PM](#)

SENATOR BEN STEVENS asked what current methodologies are in place to audit these transactions and what is the existing recourse for violations of them.

MS. WILSON replied that generally, the state doesn't get into transfer pricing issues, particularly with oil and gas companies. The IRS may have a transfer issue between a domestic company and a foreign affiliate, but the state doesn't have those issues.

MR. DICKINSON said the department now has a standard of actual costs, which is sufficient to look to for transfer pricing transactions. A 5-percent civil penalty already exists for negligent or intentional disregard of the law.

SENATOR BEN STEVENS asked if that applied to transfer pricing.

MR. DICKINSON replied that the existing civil penalties apply to any statement on the tax return.

SENATOR BEN STEVENS asked if the statement could be about income, property or a production severance tax filing.

MR. DICKINSON replied that the 5-percent penalty applies to anything the department administers.

SENATOR BEN STEVENS questioned the fact that the department has existing civil penalties for any filer on any sort of transaction and asked why it would all of a sudden treat one as 5 percent and another as 20 percent.

MR. DICKINSON responded that fraud has a 50-percent penalty, but it has a much higher standard than negligence or intentional disregard.

5:09:56 PM

SENATOR SEEKINS asked why the amendment deletes the section that allows someone to prepare evidence of an arm's length transaction after the fact.

MR. DICKINSON replied that he should direct that question to the maker of the amendment, because the department had no problem with it and was just trying to make it fit. It normally looked at costs between the point of production and the point of sale, but now it would look at upstream costs and there may be new issues there. Legislative consultants thought the additional powers would be appropriate; but the administration did not seek them.

5:11:37 PM

SENATOR BEN STEVENS asked if the reason he was looking at the upstream costs was because the profit sharing tax goes towards the entire corporate income versus the cost of producing one barrel of oil.

MR. DICKINSON replied yes.

SENATOR BEN STEVENS asked if the state is now looking at the corporate profit of an entity that operates in the petroleum business the same way it looks at the corporate profit of an entity that operates in the fish business or any other business and the 5 percent penalty for intentional misfiling and the 50 percent penalty for fraud are already on the books.

MR. DICKINSON replied this is not an income tax and other industries would typically be paying an income tax. A production tax is different than income tax, but some income tax applications can be appropriately applied to transfer costs. He said the department's audits are brutal and one issue that arose was if documentation was contemporaneous or created after the fact. And this is what they determined.

SENATOR SEEKINS remarked that this is a new area of taxing power for the department and the penalty for not having contemporaneous evidence was eliminated in the amendment. It just says to produce it; it doesn't have to be in existence at the time of the deduction.

[5:15:22 PM](#)

SENATOR BEN STEVENS recapped that the current system audits transactions that occur on the downstream side and asked if they would now be looking at transfers of cost among affiliates on the upstream side. He asked if that meant that the downstream portions would also see a 20-percent penalty rather than 5 percent.

MR. DICKINSON replied this penalty was very specific and addressed not providing information for a 482 audit that would only apply to the upstream portions. The 20-percent penalty was not replacing any other penalty or taking the standards that apply to 5 percent and applying them on a 20 percent scale. "It's simply this one pinpointed item."

[5:16:55 PM](#)

SENATOR BEN STEVENS asked if there would still be a 5-percent penalty for using fraudulent information in corporate statute.

MR. DICKINSON responded:

I believe that if the penalties that are being sought in this amendment were applied, we would probably argue that there was also intentional disregard and ask for the 5 percent penalty on top of that.

[5:18:10 PM](#)

SENATOR BEN STEVENS remarked that it seemed to him that it was now double jeopardy and he wondered what the justification was for this section.

[5:19:24 PM](#)

SENATOR ELTON said this language was saying the department will make a determination and can ask for additional information. If the entity refused to provide any information, an additional penalty could be levied. It didn't seem unusual to him.

MS. WILSON added that she thought that was a fair representation.

SENATOR SEEKINS agreed with Senator Elton that it applied to the guy who refuses to substantiate their arm's length transaction with contemporaneous data.

SENATOR STEDMAN said he thought these were substantive changes rather than administrative.

[5:21:50 PM](#)

SENATOR STEDMAN asked why language on lines 7 - 11 on page 25 of Version Y was being deleted.

MS. WILSON replied that the issue was the fact that the language in those lines does not have a time limit. So, an asset could be 80 years old, it could be taken out of the state and all of a sudden it would require recapture of any benefit a company received from it - even though it was well past its useful life. The question was cured through page 3 of Administrative Amendment 1 regarding page 22, line 1 of Version Y that limits the recapture to the value that was received. If something is 80 years old and the salvage value is all that was received, that's all that is applicable.

[5:23:44 PM](#)

MR. DICKINSON added that nothing is received if an asset is taken out of the state. He explained:

Our objection was to using cost, because if you used it here for 10 years, probably costs isn't appropriate. So, what we're saying is that you look at the value of it when you remove it from the state and treat that as though for transaction purposes of an Alaska production.

[5:24:23 PM](#)

MS. WILSON added that the last line of that amendment says the value of the asset at the time it is removed is considered a payment received.

[5:25:17 PM](#)

SENATOR STEDMAN asked why book value wouldn't be used.

MR. DICKINSON answered that would be another way of looking at it, but this language met the administration's objection. He suggested asking that question of the maker of the amendment.

SENATOR SEEKINS asked what he meant by book value.

MR. DICKINSON added that there were a lot of values to choose from. Using book value would require financial accounting and all that entails.

What satisfied us is the value here recognized the fact that if such a thing occurs, the department and the taxpayer may disagree, but at least you're all

trying to get to the same thing - the value of the asset.

[5:26:21 PM](#)

SENATOR SEEKINS asked who assigned a value when an asset was removed.

MR. DICKINSON replied if it were sold, it would show up through accounting. This applies when an asset isn't sold.

SENATOR SEEKINS asked if the state would recapture the value under both the PPT and income tax when it was resold.

MR. DICKINSON replied that was correct. "Both transactions would show up, but removal from the state would not trigger an income tax obligation, but it would trigger a PPT obligation."

[5:28:45 PM](#)

SENATOR BEN STEVENS said he wanted Legislative Legal to explain why an extra layer of penalty was needed in civil, as well as criminal, statutes that have to do with transfer costs, fraud, and withholding of documents. He wasn't convinced this provision was needed.

[5:30:05 PM](#)

SENATOR STEDMAN said he didn't think getting the answer to that question would slow the committee's deliberations on this issue.

[5:30:36 PM](#)

SENATOR ELTON made a friendly suggestion to have the administration explain the provisions it wanted and to have Legislative Legal look at the penalty component.

[5:32:03 PM](#)

SENATOR SEEKINS stated that he wanted to see a percentage number as a penalty.

[5:32:31 PM](#)

MARY JACKSON said that Legislative Legal's involvement has been minimal and she would get a better explanation from the administration on its insertions. She added that she called the amendment administrative not because it wasn't substantive, but because these issues were raised predominantly by the administration.

CHAIR WAGONER recessed the Senate Resources Committee meeting until 10:00 a.m. tomorrow, March 23.

