ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE
March 23, 2006
10:11 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Senator Albert Kookesh

OTHER MEMBERS PRESENT

Senator Lyda Green
Senator Lyman Hoffman

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 10:00 AM BUTROVICH 205
03/22/06	(S)	-- Testimony <Invitation Only> --
03/23/06	(S)	RES AT 10:00 AM BUTROVICH 205

WITNESS REGISTER

JOE BALASH
Staff to Legislative Budget and Audit Committee
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Commented on CSSB 305(RES).

MARVIN KIRSNER
Greenberg & Traurig LLC
Tax Counsel to the Governor
Office of the Governor
PO Box 110001
Juneau AK 99811-0001
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

CAROLYN FANAROFF
Greenberg Traurig LLC
Tax Counsel to the Governor
Office of the Governor
PO Box 110001
Juneau AK 99811-0001
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

DAN DICKINSON, CPA
Consultant to the Governor
Office of the Governor
PO Box 110001
Juneau AK 998811-0001
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

ROGER MARKS, Economist
Department of Revenue
PO Box 110400
Juneau AK 99811-0400
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

MARY JACKSON
Staff to Senate Resources Committee
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

ROBERT MINTZ, Assistant Attorney General
Department of Law
PO Box 110300
Juneau AK 99811-0300
POSITION STATEMENT: Commented on amendments to CSSB 305(RES).

ACTION NARRATIVE

CHAIR THOMAS WAGONER reconvened the Senate Resources Standing Committee meeting from March 22 at 10:11:37 AM. Present were Senators Ben Stevens, Stedman, Seekins, Dyson, Elton and Chair Wagoner.

SB 305-OIL AND GAS PRODUCTION TAX

CHAIR WAGONER announced CSSB 305(RES), Version Y, to be up for consideration. The committee began by taking up Administrative Amendment 1 again 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 appositive 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 moth 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

10:14:06 AM
JOE BALASH, staff to Legislative Budget and Audit Committee, said that language on page 4 of Administrative Amendment 1 [that applied to page 24, lines 12 – 13, of CSSB 305(RES), Version Y] related to items surrounding the penalty for failure to provide information requested by the department in connection with a Section 482-like audit - that determines whether or not a

fair value was assigned to the asset in a transaction that was not at arm's length.

10:15:19 AM
CHAIR WAGONER recapped that Senator Stedman had asked for a legal opinion and Jack Chenoweth was working on that. He invited Mr. Kirsner to testify.

MARVIN KIRSNER, Greenberg & Traurig LLC, Tax Counsel to the Governor, said his colleague, Carol Fanaroff, was with him.

SENATOR BEN STEVENS said the committee left off yesterday with Senator Stedman wanting to make all language after "Page 21, lines 18 – 22: delete all material, insert:" of Administrative Amendment 1 a substantive amendment. So, he now moved to do that and then objected for discussion purposes.

10:16:42 AM
He said the question was:

> If we're going to do that, I guess the question is do we continue to adopt the administrative amendment and then continue this discussion when we get all the information on the substantive amendment.

CHAIR WAGONER responded that attorneys are available now to discuss the language and they may not be available later.

SENATOR BEN STEVENS restated his motion with the understanding that the committee would act on the deleted language at a future date.

SENATOR ELTON wanted Mr. Kirsner to be available to discuss the substantive amendment when it was taken up.

10:18:24 AM
SENATOR BEN STEVENS removed his objection.

CHAIR WAGONER announced without further objection, the committee had Administrative Amendment 1 before it without the language on page 4.

10:18:49 AM
SENATOR BEN STEVENS said Mr. Kirsner's discussion would concern the material on page 4 of Administrative Amendment 1 through the end of the amendment – "(e)(3)(A)".

MR. BALASH explained that the penalty item on the last page of Amendment 1 [regarding page 24, lines 12 – 13 of the CS], was an issue by itself.

10:21:18 AM
SENATOR BEN STEVENS went to page 3 of Administrative Amendment 1 and said a lot of the pieces that refer to (d)(2)(L) and (d)(2)(M) related to the information at the bottom of page 4. He didn't disagree with Mr. Balash that the penalty was an item, but he was more concerned about including (L), (M), (N), and (e)(3)(A) – on page 3 of Administrative Amendment 1 that referred to page 22, line 1 of the CS.

MR. BALASH explained that replacing (n) with (m) was due to the deletion of material on page 24, lines 14 - 27. He explained that Mr. Kirsner wrote a memo dated February 27, 2006, that addressed a couple of potential constitutional issues, which were put aside, but he also identified a number of other concerns about capital expenditures such as how to treat the stock of companies, outlays for Capex, related party transactions, ownership interests, and how credits and reimbursement adjustments are made. All his concerns were embodied in Section 26, which he offered to explain to the committee.

10:24:56 AM
SENATOR BEN STEVENS clarified that the affected language in the CS started on page 23, line 29, and went through the top of page 24, line 13; he wanted to hear the reasoning behind the insertion of (*l*) on page 23, line 29.

MR. BALASH replied that the administration was not trying to affect a substantive issue in Subsection (*l*), which was beyond the scope of his charge; it was the legislature's policy call. However, he supported striking the penalty provision as the department requested.

CHAIR WAGONER identified that the section started on page 23, line 29, and went through page 24, line 13.

SENATOR BEN STEVENS suggested that it extended through page 25, line 6.

10:29:57 AM
SENATOR SEEKINS recalled that he moved the amendment and objected. So, he removed his objection.

MR. BALASH clarified that all that has been stricken from Administrative Amendment 1 was the penalty language, which would be dealt with as a separate amendment; the rest of the changes corrected references.

SENATOR BEN STEVENS further corrected that the conceptual substantive amendment referred to page 23, line 29, through page 25, line 11.

10:33:45 AM
SENATOR ELTON suggested deleting all language after page 3 of Administrative Amendment 1 starting with "Page 22, line 1:".

MR. BALASH said they must go one paragraph higher to capture the references the administration requested – on page 3 [of Administrative Amendment 1] starting at "Page 21, line 18-22:".

10:36:02 AM
CHAIR WAGONER added that deleted language could be changed into one substantive and one technical amendment. He clarified that that Administrative Amendment 1 dealt with items on pages 1, 2, and the first two lines on page 3 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 appositive 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 moth 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

There were no objections and Administrative Amendment 1 was adopted.

He said Mr. Kirsner would start his discussion on the deleted language of the amendment as follows:

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

MR. KIRSNER explained this provision dealt with a facility that was owned by the producer that leased it to a third party and received payments for it. The amounts received would be subtracted from his costs. However he thought there was still potential for abuse saying the producer might enter into a management agreement – like most franchised hotels do. In that case, an operator wouldn't need an ownership interest in order to receive fees for it and that then puts him in the same position as if it were leasing a facility.

10:40:49 AM
CHAIR WAGONER asked him to comment on changes to page 22, line 1.

MR. KIRSNER explained that the original bill had provisions dealing with deductions that were taken before a property was sold. He said that would avoid the potential abuse by a producer who purchased equipment just in order to generate a direct cost he would be able to deduct in order to determine the profit for each barrel of oil. For example, a company might buy a piece of equipment, ostensibly for use in Alaska, which would entitle it to a deduction from direct costs, but then instead of selling it, it would ship it out of Alaska for its own use or use by an affiliate in some other state or some other country - like Nigeria.

10:42:31 AM
SENATOR SEEKINS asked if the intent was to block a company from bringing an asset into Alaska to get the credit and then shipping it someplace else to use it within a short period of time.

MR. KIRSNER replied yes - that was a very big loophole.

He moved on saying the next technical change renumbered (d)(2)(L) with (d)(2)(N). The next changes were corrected references to the Internal Revenue Code as amended.

MR. KIRSNER said the next change dealt with what he thought was the "greatest area for abuse," which he would also let Ms. Fanaroff comment on. It covered transactions between related entities. For example, a producer could purchase items at an inflated cost. It could buy 10 drill bits that are worth $100,000 each, but it might pay $2 million for them from the related entity. This would generate an inflated direct cost deduction of $1 million.

He said Section 482 of the IRS Code allowed the IRS to reallocate income between related entities. The idea was to incorporate the IRS provisions or allow the Department of Revenue to promulgate regulations incorporating the provisions of Section 482. This is where the 20-percent penalty came from. He then let his colleague, Carolyn Fanaroff, address the transfer pricing issues since her background was with the IRS.

CAROLYN FANAROFF, Tax Counsel, Greenberg Traurig LLC, focused specifically on the penalties. She explained that Section 482 was started by the IRS to deal with companies that were using offshore entities to maximize their expenses and income in low-tax or no-tax areas. To enforce the transfer pricing rules, the IRS developed a penalty documentation rule, which she explained:

> So, it's always a two-step process, which is that first you have to set your prices at the right level; but then, step two is that you have to provide the IRS with a roadmap of how you did it. This is because the IRS agents would come in and try to figure out how the companies structured their transfer prices.... There is no way to know because it's just one company and they were out to get a lot of answers that had to do with smoke-filled rooms and private negotiations. So in order to avoid that, Congress enacted Section 6662(e), which we refer to here – which has two parts to it - the part that's the penalty and the part that is the documentation. When Congress enacted the rules, the clear intent was not to apply the penalty, but rather to encourage compliance with the law. So, the goal would be that when the IRS came to audit the company, they would be able to go to their stuff and pull out from their stuff prepared documentation that was contemporaneous at the time the tax return was filed, hand it to the IRS, and then the IRS would have a roadmap of the transaction. That's basically the model that we've tried to incorporate here, because it

is very difficult to enforce these principles without a roadmap.

CHAIR WAGONER asked for questions and indicated there were none at this point.

MS. FANAROFF continued saying the only difference is the IRS established the penalty for the valuation statement where a company would value its goods and services incorrectly. That is slightly different than language in the amendment that establishes a penalty for underpayment. She reiterated that the intent was not to have penalties, but rather to have compliance at the federal level.

MR. KIRSNER added that it would be to the state's benefit to piggyback on that body of federal law.

10:52:16 AM
CHAIR WAGONER indicated there were no further questions and thanked them for their testimony. He set that amendment aside.

10:53:40 AM
SENATOR SEEKINS moved to adopt Substantive Amendment 1.

SUBSTANTIVE AMENDMENT 1

OFFERED IN THE SENATE RESOURCES COMMITTEE BY SENATOR WAGONER
TO: CSSB 305(RES)(24-GS2052\Y)(3/26/06) Work Draft: Chenoweth)

Page 3, line 16, through page 4, line 23:
Deleted all material.

Renumber the following bill sections accordingly.

Page 6, lines 18 – 27:
Delete all material.

Renumber the following bill sections accordingly.

Page 13, line 11, through page 14, line 7:
Delete all material.

Renumber the following bill sections accordingly.

Make changes throughout the bill to conform to the deletions above.

Page 17, line 26, following “(f)”:
Insert “and (i)”

Page 21, line 10:
Delete “(*l*)”
Insert “(n)”

Page 21, line 14:
Delete “(*l*) and (m)”
Insert “(n) and (o)”

Page 22, line 1:
Delete “(*l*) and (n)”
Insert “(n) and (p)”

Page 23, following line 14 – insert the following material:

“(i) For a month for which (12) the production tax value of the taxable oil and gas produced during the month calculated under (a) of this section exceeds zero, and (2) the total quantity of oil and gas, including oil and gas the ownership or right to which is exempt from taxation, produced per day by the producer from all leases or properties in the state averages less than 55,000 barrels of oil equivalent, a producer that is qualified under (j) of this section may reduce the production tax value by deducting an allowance in an amount calculated under this subsection. For purposes of this subsection, a barrel of oil equivalent is a barrel of oil, in the case of oil, or 6, 000 cubic feet of gas, in the case of gas. The allowance is equal to the production tax value calculated under (a) of this section multiplied by the fraction that is yielded by the following formula, except that the value of the fraction may not be greater than one:

$$(5{,}000 - 0.1*[ADP-5{,}000])/ADP$$

where ADP is the average for the month of the number of barrels of oil equivalent of the total quantity of oil and gas, including oil and gas the ownership or right to which is exempt from taxation, produced per day by the producer from all leases or properties in the state.

(j) Upon written application by a producer, including any information the department may require, the department shall determine whether the producer qualifies under this subsection for a calendar year. To qualify under this subsection, a producer must demonstrate that its operation in the state or its ownership of an interest in a lease or property in the state as a distinct producer entity would

not result in the division among multiple producer entities or any production tax value of taxable oil and gas, as defined under (a) of this section, that would be reasonably expected to be attributed to a single producer entity if the allowance provision of (i) of this section did not exist."

Page 23, line 15:
Delete "(i)"
Insert "(k)"

Page 23, line 23:
Delete "(j)"
Insert "(*l*)"

Page 23, line 25:
Delete "(k)"
Insert "(m)"

Page 23, line 29:
Delete "(*l*)"
Insert "(n)"

Page 24, line 14:
Delete "(m)"
Insert "(o)"

Page 24, line 25:
Delete "(*l*)"
Insert "(n)"

Page 24, line 27:
Delete "(*l*)(1)"
Insert "(n)(1)"

Page 24, line 28:
Delete "(*l*)"
Insert "(n)"

Page 25, line 3:
Delete "(*l*)(1)"
Insert "(n)(1)"

Page 25, line 18:
Delete "(o)"
Inert "(q)"

Page 8, line 26:
Delete “AS 43.55.013(c),”
Insert “AS 43.55.011(a), 43.55.011(b), 43.55.013(c),”

Following: 43.55.013(i),”
Insert “43.55.013(j),”

Make changes throughout the bill to conform to the statute repeals added on page 28, line 26, above.

CHAIR WAGONER objected for discussion purposes. He said that Robert Mintz, Department of Law, wrote this amendment that dealt with the 5,000-barrel amendment and replaces the Cook Inlet tax structure and the $73 million standard deduction that was in the governor’s bill.

10:55:28 AM
MARY JACKSON, Staff to Senator Wagoner, added that the chair had worked with Dr. Pedro van Meurs on this issue and that Mr. Mintz was online to answer questions.

CHAIR WAGONER asked Mr. Mintz to review the concept.

ROBERT MINTZ, Assistant Attorney General, Department of Law, explained that material on page 1 of the amendment eliminated the component of the production tax for Cook Inlet and that the heart of the amendment implemented a concept of Dr. Van Meurs that was on page 2 through the top of page 3.

The concept basically has a tax-free allowance similar in magnitude to the $73 million allowance, but scaled to the amount of production a company has in Alaska. If the average daily production of a producer during a month were no more than 5,000 barrels per day, then there would be no production tax on its oil and gas. At the other end of the spectrum, it gave no allowance to producers with 55,000 barrels a day or more of oil and gas production. The intent was to target the allowance to smaller producers where it was really needed and it was designed to be calculated on a monthly basis.

10:59:39 AM
MR. MINTZ pointed out that line 17 referred to 55,000 barrels of oil being equivalent to 6,000 cf of gas. Subsection (j) [referenced on line 18] was language from the governor’s bill that tried to prevent abuse of the allowance. In looking over the amendment, he realized a couple of refinements in terminology were needed. He said lines 15 and 26 of page 2, have

a reference to "total quantity of oil and gas" and the production tax statute actually uses the term "amount" when it refers to how much oil and gas is produced. He suggested changing "quantity" to "amount" for consistency. Secondly, language on page 3, line 3 – the anti-splitting provision - talks about production tax value among multiple producer entities. In this case, because the allowance is based on the formula that in turn depends on the producer's total amount of oil against production, he suggested inserting "any amount of oil or gas production or" after "entities of" on page 3, line 3. So, it would read, "multiple producer entities of any amount of oil or gas production or any production tax value of taxable oil and gas,". He said the rest of the amendment had conforming changes.

CHAIR WAGONER said that converting 6,000 cf of gas to 55,000 barrels of oil was a pretty simplistic statement in looking at the volatility of pricing for both commodities. He thought they might want to look at a formula the DOR could use to change it as prices changed.

11:04:45 AM
DAN DICKINSON, CPA, supported his observation and said he was comfortable with using a rough approximation that could be modified.

11:06:00 AM
SENATOR STEDMAN said another issue of concern was the financial impact of the tier structure and he suggested they might want to cap it at $40 a barrel. However, since it was a different methodology from the original $73 million exemption, he thought the idea needed to be analyzed more thoroughly.

MR. DICKINSON said he had a graph that would help illustrate it. He explained that Roger Marks, a petroleum economist at the Department of Revenue, calculated that the break-even point between the $73 million exemption and the $40 cap, given the current distribution of barrels, was at about $30. "At more than $30, this would yield a higher allowance; at less than $30, this would yield a lower allowance."

CHAIR WAGONER observed that the 5,000-barrel equation could go quite high.

11:08:13 AM
SENATOR STEDMAN agreed and he also thought they should have a discussion on the scope of the exclusion since they were going

to have one. Econ One had come back with the $40 cap suggestion. “It’s controlling the size of it,” he said.

MR. DICKINSON pointed out that Econ One suggested a cap, not a break-even point.

11:09:21 AM
SENATOR BEN STEVENS said he didn’t see an issue with running the production up to a certain level, but he wanted an analysis done on “the impact of just essentially cutting off the tail.”

11:10:52 AM
SENATOR SEEKINS said he understood the intent was to encourage new development, but the effect is to encourage new development of people who already aren’t producing pretty well. He objected to that on an issue of fairness, because he wanted to also encourage those who are already producing to go out and do more.

11:12:07 AM
CHAIR WAGONER said he thought it treated both parties pretty well.

SENATOR BEN STEVENS said he agreed with using incentives to attract new producers, but questioned how far the state needed to go. If you’re going to keep incentives for the smaller players, you have to decide what is small and keep it small. This would raise the amount for every company except three.

11:15:04 AM
SENATOR STEDMAN thought maybe the formula could be tweaked so the tail accelerated at 5,000 until 30,000 or 25,000 or whatever barrel-equivalent was decided.

MR. DICKINSON said that changing the .001 to .002 would make that steeper.

11:17:10 AM
MR. MINTZ said he had additional points in explaining Substantive Amendment 1 in that language on page 1, line 16, said: “Make changes throughout the bill to conform to the deletions above.” He didn’t have enough time to put in all the conforming changes that were needed and suggested making this conceptual.

Secondly, he said the original allowance language in the governor’s bill said that any unused amount could not be carried forward or be used as a basis for a loss credit. That language

was not in this amendment and he explained the reason it was not necessary was because the allowance is calculated per month and, "There is never anything left over that couldn't and wouldn't be used in that month."

11:19:08 AM
SENATOR SEEKINS moved to adopt Amendment 1 to Substantive Amendment 1 to change "quantity" on lines 15 and 26, of page 2 to "amount". There were no objections and it was adopted.

SENATOR SEEKINS moved to adopt Amendment 2 to Substantive Amendment 1 to insert "any amount of oil or gas production or" after "entities of" on page 3, line 3. There were no objections and it was adopted.

11:21:47 AM
CHAIR WAGONER said he thought they were going to review how this provision had enticed small operators to Alaska in seven years.

11:22:14 AM
SENATOR SEEKINS moved to adopt conceptual Amendment 3 to Substantive Amendment 1 to sunset the provisions of this amendment seven years from the date of enactment.

CHAIR WAGONER said he would hold this amendment until he got further information this afternoon.

MR. DICKINSON recapped the three points they wanted to look at later were what happens if there's a cutoff at 30,000 BOE total or a combination of cutoff or rapid-slope decline from the full 5,000 BOE (instead of tailing it off); the fiscal impact that would have at various prices; and the 6:1 valuation formula for valuation of gas and oil.

CHAIR WAGONER asked if there were any objections to Senator Seekins' conceptual Amendment 3 [the sunset provision] to Substantive Amendment 1. There were no objections and it was adopted.

11:24:59 AM
CHAIR WAGONER announced Substantive Amendment 2 to be up for consideration. He asked Mr. Mintz to explain it for the committee.

24G-2
3/22/2006
(12:54 P.M.)

SUBSTANTIVE AMENDMENT 2

OFFERED IN THE SENATE RESOURCES COMMITTEE BY _____

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

Page 17, line 31, following "(2)", through Page 18, line 2:

Delete all material and insert "for a month that ends before April 1, 2013, and to the extent allowed under (g) of this section, less an amount of the producer's transitional investment expenditures that has not previously been deducted under this subsection."

Page 18, line 20:

Delete "(g)"

Insert "(g)(3)"

Delete ", but not more than 1/48 of a producer's transitional investment expenditures may be deducted in any month"

Page 22, line 13:

Delete "January 1, 2003"

Insert "April 1, 2001"

Page 22, lines 18 - 19:

Delete "on or after January 1, 2003, and"

Page 22, line 20:

Delete ", multiplied by"

Insert ";"

Page 22, lines 21 - 26:

Delete all material and insert the following:

"(2) an amount of a producer's transitional investment expenditures may be deducted under (a) of this section only to the extent that the amount does not exceed

(A) one-half of the producer's qualified capital expenditures, as defined in AS 43.55.024, that are incurred during the month, if the producer does not make an election under (f) of this section;

(B) 1/24 of the producer's qualified capital expenditures, as defined in AS 43.55.024, that are incurred during the calendar year, if the producer makes an election under (f) of this section;"

Page 22, line 27:
Delete "(2) notwithstanding (1)"
Insert "(3) notwithstanding (2)"

Page 29, following line 25:
Insert the following material:
"(d) Notwithstanding any contrary provision of AS 43.55.160(g)(2), enacted by sec. 26 of this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007,

(1) the number "1/24" in AS 43.55.160(g)(2(B), enacted by sec. 26 of this Act, shall be replaced by the number "1/18";

(2) the phrase "calendar year" in AS 43.55.160(g)(2)(B), enacted by sec. 26 of this Act, shall be replaced by the phrase "last nine months of the calendar year"."

Page 29, line 26:
Delete "(d)"
Insert "(e)"

11:25:49 AM
MR. MINTZ explained that this kind of transitional investment expenditure concept is sometimes referred to as the clawback provision. This language shortened the look back that originally started in 2003 and provided that only certain percentages of previous expenditures would qualify for the deduction in calculating taxable value. The concepts that would be changed by this amendment would be first, that the look back period would start on April 1, 2001 [page 1, lines 14-15 of Substantive Amendment 2]; second, that reducing the deductible expenditures to 25 percent, 50 percent or 75 percent depending on the year would be eliminated and it would all be potentially 100 percent [on page 2, lines 20-21 of Substantive Amendment 2]; and third, the new concept from Dr. Van Meurs referred to as the two-for-one concept [page 2, line 3 – 12 of Substantive Amendment 2]. This concept says the capital investments previously made in past years can only be deducted to the extent that there are new investment expenditures, referred to as “qualified capital expenditures,” in the month and they would have to be twice as much as the tax expenditure. Further, the amount of the producer’s traditional investment expenditures, the look back, could be deducted only to the extent that the amount does not exceed one-half of the producer’s qualified capital expenditures that are incurred during a month.

MR. MINTZ said that subparagraphs (A) and (B) have two options. He recalled that subsection (f) of Section 160 says when a producer calculates taxes on a monthly basis during a calendar year, it can be done on the basis of the actual monthly lease expenditures or it could be an annualized approach, which is to say you look at your lease expenditures over a calendar year and each month deduct one-twelfth of them. He went on to explain:

> Subparagraph (B) of the amendment says if a producer elects to do it on an annualized basis, when you compare your current capital expenditures to the look back or transitional investment expenditures, then you can deduct up to one-twenty-fourth of the annual current expenditures during a calendar year.
>
> And then the final part of amendment is simply a transitional provision that would be towards the end of the bill, not a codified part of the statute – because the first calendar year begins in April, that when you're doing an annualized approach to calculating your taxes, you are only looking at nine months of the calendar year and, therefore, on your deductible look back expenditures, one-half of the monthly expenditures over nine months, which is one-eighteenth rather than one-twenty-fourth.... There is a sunset on this provision, which is shown on line 2, of page 1. And the whole trigger for being able to deduct transitional investment expenditures is that it has to be per month and that's for April 1, 2013.

11:30:54 AM
SENATOR SEEKINS moved to adopt Substantive Amendment 2.

SENATOR BEN STEVENS objected for discussion purposes.

SENATOR ELTON said in a previous amendment, a sunset was described as seven years after enactment and he thought the committee might want to use that concept here for consistency.

SENATOR SEEKINS said this assumes the effective date of the tax would be April 1, 2006 and it was tied to that. He renewed his objection to both a retroactive tax and a retroactive credit.

11:32:26 AM
SENATOR STEDMAN reminded members that they were looking for a balance and clearly the bill would have retroactivity in tax collection and an impact on the industry.

SENATOR ELTON said one of the advantages of an effective date of April 1 or January 1, for that matter, is that it does extend credits for winter work that is being done this winter. So, there is advantage for some players to have an earlier effective date, because the credits are more important to them than the tax.

SENATOR STEDMAN said it is hard to estimate how quick the credits would be used up.

SENATOR STEVENS asked Mr. Mintz to explain again the one twenty-fourth he talked about earlier in section (B) on page 2, line 10, of Substantive Amendment 2.

MR. MINTZ explained that that section was trying to reconcile two concepts. The tax is paid on a monthly basis. But in calculating it, the producer is allowed to elect to take the annual lease expenditure and divide by twelve and each month deduct one-twelfth of the annual cost instead of deducting 100 percent of the actual monthly costs. He explained further:

> So, there is a one-twelfth that appears in subsection (f)[page 22, line 8 of CSSB 305(RES)]. In this look back for transitional investment expenditure concept, in any one month that the amount of the look back for transitional expenditures can be deducted is limited to one-half of the new capital investment. So, under (A) [page 24, line 21 of CSSB 305(RES)], that's just very direct and when you're doing it on a monthly basis, you look at your capital expenditures made that month and you can't deduct more than one-half of that amount in transitional investment expenditures. But when you're annualizing your deductions and deducting each month, one-twelfth of that year's lease expenditures, then again you're only allowed to deduct up to one-half of that month's capital expenditures and that's one twenty-fourth of the entire year's capital expenditures.

11:38:07 AM
SENATOR BEN STEVENS asked where the ability to accrue it to the deduction was in the amendment.

MR. MINTZ replied that the fundamental language that provides for a deduction of the transitional lease expenditures is on lines 2 – 4 on page 1.

SENATOR BEN STEVENS noted that language began on page 17, line 31 of the CS and he didn't see the mechanism equating it to the transitional expenditure.

MR. MINTZ said the existing CS doesn't allow more than one forty-eighth of the total in any month. That is getting replaced with a new limit, which compares to new capital investment for the month and no more than one-half of that amount can be deducted.

SENATOR BEN STEVENS asked if the fact that the transitional expenditure can't be used to bring the ratepayers' liability down to zero was not being addressed.

MR. MINTZ replied that language was still in the CS on page 18, lines 3 – 4.

11:40:43 AM Recess 11:41:35 AM

CHAIR WAGONER called the meeting back to order at 11:41:35 and announced that the committee had a motion to adopt Substantive Amendment 2 before it. Seeing no objections, he said it was adopted.

11:42:13 AM Recess 2:07:19 PM

CHAIR WAGONER called the meeting back to order at 2:07:24 PM. He announced that the committee would take up Substantive Amendment 1 am again. He recapped that it eliminated the separation of Cook Inlet and the $73 million standard deduction.

2:08:55 PM
SENATOR STEDMAN said further analysis had been brought to the committee on the way the formula was written. It excluded the first 5,000 barrels a day from PPT tax, but this exclusion would have slowly tapered down in an exponential fashion to 55,000 a day before it hit zero.

He moved to adopt Amendment 4 to Substantive Amendment 1 to change the multiple factor in the formula of .1 (or 10 percent) to .2, which would steepen that curve and would still exclude 5,000 barrels, but it would end at 30,000 barrels a day.

CHAIR WAGONER said that Roger Marks authored the analysis.

2:10:17 PM

ROGER MARKS, Petroleum Economist, Department of Revenue, explained that the first page of his power point, Producer 2005 Daily Production (BOE Equivalents), just showed the date-set for 2005. It showed each producer in the state and their barrel of oil equivalent. He commented, "What is shown here is that at the 55,000 barrel-limit, everyone except BP, ConocoPhillips, and ExxonMobil would get some tax free allowance."

He said the next page, Allowance Mechanisms, showed what the curve looked like in terms of allowance percentage depending on average daily production. The proposed amendment, with the 5,000 barrels and the .1 multiplier and no cut off, showed at 5,000 barrels a day, a producer would get a 100-percent allowance, but that dropped pretty rapidly to 50 percent up to a 9,000 barrels-a-day spectrum when it would decline at a slower rate. The proposed amendment tapered off to zero at 55,000 barrels a day. It also illustrated a cutting off at 30,000, where it just about dropped straight off the graph. The other idea was to substitute .2 for the .1 that would cause the allowance to go to zero in 30,000 barrels a day. He explained that it still dropped fast initially, but then kind of tapered off more quickly than before.

2:13:56 PM
MR. MARKS said his third graph, Amendments – Annual Cost to State ($millions), showed the effects in annual costs to the state. Chevron was the only company that had more than 30,000 and less than 55,000 barrels a day. At 45,000 barrels a day, its tax-free percentage was only about 2 percent. He explained:

> In terms of revenues, it doesn't make much of an impact.... the general slope of that line is for every $1 increase in prices, it's about $1.9 million of revenue less to the state.

The other approach, he said, would be to change the multiplier to .2 and having a more-rapid drop off. The costs to the state are reduced – the graph showing that for every $1 in price, it's about $1.2 million a year less to the state. He suspected the annual revenue numbers would drop with declining production each year.

2:16:03 PM
Finally, Mr. Marks pointed out how this compares with the $73 million in the governor's bill. He estimated seven companies would get full allowances originally, but thought about it more and changed that to nine full allowances. A $73 million

allowance with a 20 percent deduction would amount to about $130 million per year. He estimated that about 98 percent of the oil hits that $73 million peak at fairly low prices – of about $20 to $25 and higher.

2:17:30 PM
MR. MARKS corrected his earlier estimate reported by Mr. Dickinson for a crossover point at about $35 per barrel and he had mistakenly thought that the 5,000 barrels a day was a credit, not an allowance. When he realized it was an allowance, that made the crossover point go much higher – to about $85 a barrel.

2:17:59 PM
SENATOR BEN STEVENS asked if he assumed the $130 million would be the maximum loss to the state, because all the companies might not use the full deduction.

MR. MARKS replied that was the difference between the structure in the governor's bill and the structure of the amendment. Once the $73 million allowance is hit with the governor's bill, it stops; under the amendment it continues going up with the price.

MR. DICKINSON explained that $130 million was the estimate for nine full equivalents using all the credits. Fourteen companies were actually listed and six of those would get partial credit. It was an estimate of the aggregate.

SENATOR BEN STEVENS reiterated that was the point he was trying to make. The $130 million would be the maximum amount of loss to the state, but it would be an aggregate of the 14 companies.

SENATOR BEN STEVENS asked if Mr. Marks' calculations could be carried out on actual costs given the known BOE equivalents. He asked if the yellow line on page 3 was an estimate.

MR. MARKS replied that the yellow line was his estimate of what the revenues would be with the .2 multiplier. "The reason at $15 ANS, the amount is zero, is we estimate average cost of about $15 a barrel to get from the market to net income."

SENATOR BEN STEVENS asked if the assumptions on the input were taken from current production scales (on page 1 of the power point).

MR. MARKS replied yes.

SENATOR STEDMAN asked if altering the slope reduced the state's financial exposure by one-third at the high end.

MR. MARKS replied yes and that comes to about $1.2 million per $1 ANS price from $1.9 million - about 37 percent.

SENATOR STEDMAN asked if that would still give a 5,000-barrel a-day exclusion for the start up companies.

MR. MARKS replied yes. He said everybody on his list on page 1 that is producing 5,000 barrels or less would still get 100 percent of their production excluded. He reminded them that Kerr-McGhee and Pioneer were starting up with 20,000 barrels, so under that proposal, about 10 percent of their production would be excluded, or about 2,000 barrels.

2:24:10 PM
CHAIR WAGONER said it looked like at that level of production, a company was getting a relatively small credit.

2:26:00 PM
SENATOR STEDMAN objected to the amendment for discussion purposes and said that by changing the multiplier and dropping the slope and driving the allowance to zero barrels at 30,000 exponentially versus the cliffing-approach of the other style would be in the best interests of the state and still give benefit to the industry on the smaller producing fields. Even the larger producing fields get a little bit of a break in the beginning.

SENATOR BEN STEVENS asked what the average BOE equivalent of a satellite on the North Slope was.

MR. MARKS replied just in Prudhoe Bay there are five satellites currently producing an average of about 6,600 barrels per day - Midnight Sun, Polaris, Orion, Aurora, and Borealis.

SENATOR BEN STEVENS asked if that would put them at the seventieth percentile on their chart.

MR. MARKS replied that the satellites belong to the Prudhoe Bay producers and because this was a company-wide allowance, they would not get an allowance themselves.

SENATOR BEN STEVENS asked if the intent of the legislation and the in-field allowance was to promote development of small fields and satellites, (most recently Pioneer and Oooguruk at

about 20,000 barrel per day). He wondered if this would actually serve those it was designed for because it was a pretty slow mechanism for cost recovery.

MR. MARKS replied that even under the governor's proposal of $73 million that was company-wide, the satellites were small operations of the big three and probably wouldn't see a benefit. Part of the governor's goal was to attract small and new companies and he believed that should continue.

2:30:21 PM
SENATOR BEN STEVENS suggested that this provision allowed them to maintain that benefit, but in a different way.

MR. MARKS agreed.

SENATOR BEN STEVENS asked if this amendment replicated the result for the small operators.

MR. MARKS responded that the governor's bill was designed to replicate the result of the ELF and this amendment would not replicate that result.

SENATOR BEN STEVENS refined his question and asked if this amendment replicated the result for smaller independent operator.

MR. MARKS replied yes for those producing under 5,000 barrels a day.

SENATOR BEN STEVENS said it was recognized that the heartburn behind the $73 million allowance was that it was company-wide and he asked if this treated smaller companies differently than the bigger ones.

MR. MARKS replied that Kerr-McGhee and Pioneer would still pay a tax under the governor's bill once their $73 million was achieved, but they would start paying tax sooner under this amendment.

SENATOR BEN STEVENS asked, "At any form of the amendment? Not any of the three proposals that you have – the one that was in the original amendment, the 30,000 or the .2 multiplier?"

MR. MARKS replied, "That's correct."

SENATOR BEN STEVENS asked if he said they would pay sooner.

MR. MARKS replied, “I believe so.”

2:33:28 PM
SENATOR SEEKINS said the first $73 million based on 5,000 barrels a day at $40 a barrel under the governor’s bill was tax-free and applied to everyone.

CHAIR WAGONER agreed.

SENATOR SEEKINS continued saying that this amendment provided that once a company hits 30,000 barrels a day, it would get no tax relief all the way back to the first barrel. Only if it kept production under 5,000 barrels a day would it get 100 percent of the tax relief and that would quickly go down from there, so that at 20,000 barrels a day a company would have to pay 90 percent of the tax.

MR. DICKINSON replied under the governor’s proposal, at 20,000 barrels assuming a $40 price, a company would get 5,000 barrels tax-free. But because the amendment gives 10 percent credit to 20,000 barrels, that drops the tax-free barrels to 2,000.

2:35:15 PM
CHAIR WAGONER said he originally talked to Dr. Van Meurs about everyone getting the 5,000-barrel deduction under a 55,000-barrel ceiling and he came up with this formula that basically reduced more of the credit from the medium producers.

2:35:57 PM
SENATOR SEEKINS said his concern was that a big producer wouldn’t have incentive to open up a new field.

CHAIR WAGONER said he wanted to give an allowance to everyone for production under 55,000 barrels.

2:38:23 PM
CHAIR WAGONER reminded the committee that the amendment adopting the .2-multiplier was before it [Amendment 4 to Substantive Amendment 1]. A roll call vote was taken. Senators Dyson, Stedman, Elton, and Wagoner voted yea; Senator Ben Stevens and Seekins voted nay; so the amendment was adopted.

2:39:41 PM
SENATOR SEEKINS moved to adopt conceptual Amendment 5 to insert the equivalent value of $40 a barrel.

SENATOR STEDMAN objected for further discussion because he wasn't sure that was needed.

SENATOR ELTON agreed with Senator Stedman and reasoned that the one-third difference in revenue to the state seemed pretty constant with each of the values along the bottom axis and putting in a specific price would distort it.

2:41:25 PM
SENATOR SEEKINS pointed out that according to the graph, at $40 a barrel it would cost the state $30 million and under $60 a barrel, it would cost the state about $55 million. He noted that Robynn Wilson, Director of the Tax Division, was nodding her head yes.

2:42:48 PM
SENATOR BEN STEVENS said he thought this component in the original bill gave relief up to $14.3 million per taxpayer and that was it. He asked Senator Seekins to restate his motion.

2:43:41 PM
SENATOR SEEKINS stated that it was a conceptual amendment to limit the tax credit at an equivalent of $40 a barrel, in terms of dollars. "Either we go to a floating or a fixed somewhere. I'm not necessarily opposed to a floating barrel as long as we understand exactly the size of the credit we're looking at."

SENATOR STEDMAN pointed out that the credit had been reduced substantially from the governor's numbers.

CHAIR WAGONER added that it had nothing to do with the price of oil per barrel for anyone producing less than 5,000 barrels.

SENATOR SEEKINS said he wanted it on the record that their intent was to fix it at some range or to allow it to slide if this model were adopted.

2:45:38 PM
SENATOR STEDMAN said the graph was geared to barrels, not dollars, so the cost estimate line was in the future and could be skewed one way or the other.

2:45:59 PM
SENATOR ELTON said the way he understood Senator Seekins' amendment was that there would be a fourth line that would climb at the same rate the yellow line did, but when it reached $40 a barrel, it would flat-line across the rest of the graph.

SENATOR SEEKINS said he had accomplished getting this discussion on the record, which is what he wanted to do, and then he withdrew his amendment.

2:46:53 PM
CHAIR WAGONER thought they should look further at his amendment, because if a company were producing 5,000 barrels a day, it would get a certain credit at $40 a barrel. If the price was allowed to float at $60 a barrel, it would get one-third more credit. At $80 a barrel, it would get a double-credit.

2:47:38 PM
SENATOR BEN STEVENS said he objected to the motion. He elaborated that an infield allowance is not an unusual credit and the $73 million allowance was designed to address the new explorer to the North Slope and to the Alaska industry. He argued that both history and recent testimony indicate that a substantial amount of investment comes over six or seven years before there is any income. The smaller fields won't be ratepayers and this is designed for the small independent to get the capital cost recovery it needs to stay in business. He said the discussion was beginning to drift off the intent of the provision, which was towards attracting investment from new players and "putting parameters and constraints that just continually shrink and shrink and shrink on the incentive, it's not going to have any impact. So, therefore, I object to the $40 limit."

SENATOR SEEKINS said he already withdrew the amendment.

SENATOR BEN STEVENS said he thought it was brought back.

2:50:08 PM
SENATOR ELTON agreed that they must look at whom they were incentivizing.

2:51:20 PM
SENATOR SEEKINS moved to adopt Substantive Amendment 1 as amended. SENATOR BEN STEVENS objected because of the reduction of the multiplier. A roll call vote was taken; Senators Stedman, Elton, Dyson, and Wagoner voted yea; Senators Ben Stevens and Seekins voted nay; so Substantive Amendment 1 am was adopted.

2:54:53 PM at ease 2:56:19 PM

CHAIR WAGONER called the meeting back to order and announced the committee would take up deleted language on page 3, line 24, of Technical Amendment 1 that was divided into Substantive Amendment 5.

MS. JACKSON, staff to the Senate Resources Committee, said this language concerned how to calculate gross value at the point of production (POP). The governor's bill (page 11, line 1) authorized three methods of calculating gross value. One was using an RSA (royalty settlement agreement) between the state and a single producer; the second was using a royalty valuation that was acceptable to DNR or the Department of the Interior; and the third used a formula that was developed by the DOR that had estimates of values based on factors like published price indices, quality differentials, and transportations costs. She said flag on using RSAs for two counts. The first was an issue of equal protection – which is just a matter of fairness.

MS. JACKSON explained that courts generally require taxpayers to be treated similarly in similar situations. Now, Alaska has producers that have RSAs and those that don't. Moreover, the ones that have RSAs are not all the same. So, there are several sets of dissimilarities. The Department of Law raised that same question according to Dan Dickinson.

She said the second issue raised about using RSAs was that Econ identified as much as 40 cents a barrel difference in some cases that would amount to about $300 million over 10 years under a 25/20 plan, for instance.

3:01:32 PM
MS. JACKSON noted that RSAs were not allowed in language on pages 16 - 17 of the CS, but it unfortunately got twisted to allow RSAs for one methodology but not the other. So, the technical amendment that was before the committee yesterday, placed the phrase - "may not incorporate by reference a royalty value, royalty value methodology or royalty settlement agreement" - so that it applied to either the methodology developed by the DNR or by the Department of Interior or another formula that might be developed by the Department of Revenue.

3:03:21 PM
SENATOR BEN STEVENS said he appreciated the explanation, but he didn't agree with the outcome. He said SB 305 originally had three sections under AS 43.45.150 (d) [page 11, lines 1 – 26] that said roughly:

1. a royalty value determined under a royalty settlement agreement between a producer and the state, with adjustments if appropriate:
2. a formula prescribed by the Department of Revenue or Department of Interior; or
3. another formula described by the Department of Revenue which reasonably estimates a value for the oil or gas at a specific geological location such as a point of tender or point of delivery.

He went back to Mr. Puliam's presentation that had the best reasoning, which said half of the oil the state gets its revenue from is royalty oil and about half of that is under royalty settlement agreements. Then the other half is under the severance system; and in reality, there are three main severance payers and nine or 10 other little ones that operate under similar, but different agreements that aren't RSAs. So, he interpreted Mr. Puliam's presentation to say one of the reasons this is so complex is because the state has three ratepayers, one, which pays under an RSA under a tax valuation methodology. So, putting it all under a RSA methodology would be an effort to simplify the valuation calculation of liability owed whether it be an RSA or a severance agreement. He summarized that they are trying to simplify the proposed system, but the existing system is already complicated. He interpreted this section as giving the department the discretion to use the price established in a settlement agreement across the board for the same ratepayer and to get rid of the complications. He said the royalty payer has different payment streams depending on which field the oil came from. "So, there's all kinds of reasons for the 40-cent variation and where it's produced, who the partners are...."

He pointed out that the RSAs have been litigated and agreed to as a way to price oil that is coming out of the ground and he didn't understand why the proposers of this amendment were so opposed to giving the department the ability to use them when it came to calculating a production tax obligation.

3:08:09 PM
SENATOR ELTON said:

> The compelling argument is that we don't want to get ourselves into a position where two different companies operating in the same field may have two different tax rates based on royalty settlements that one has and one may not have or royalty settlements that both have that just provide a different value to

> the royalty oil. To me it adds complexity. That's my view of the language in the governor's bill. I do think the obvious solution is the solution that is part of this substantive amendment.

3:09:43 PM
SENATOR BEN STEVENS said that each taxpayer has different tax calculations, because they have different shipping costs, for one thing; and he restated his question:

> What is the reason why royalty settlement agreements that have been litigated in court, that have been agreed upon by the state, agreed upon by the ratepayer, what is the reasoning for not incorporating it? I haven't seen it.

SENATOR SEEKINS inserted that he understood the CS on page 17, lines 22 – 23 said: "(B) may not incorporate by reference a royalty value, royalty valuation methodology, or royalty settlement agreement." and that "incorporate by reference" meant to make a part of the agreement. He believed they were saying when this methodology was agreed to, it couldn't incorporate another agreement that was already in place somewhere. "In other words, it has to be new all to itself."

SENATOR BEN STEVENS agreed. But he said the original bill said previous agreements could be used "in whole or in part" and "or portions of it may be used".

SENATOR SEEKINS agreed with that, but said they way he understood it, the whole agreement couldn't be incorporated by reference.

SENATOR BEN STEVENS said he didn't read that in the substantive amendment.

SENATOR SEEKINS said he didn't either.

ROBYNN WILSON, Director, Tax Division, DOR, said she didn't have much experience with royalty agreements or rates. She thought Mr. Mintz might have more information on this point.

3:12:38 PM
CHAIR WAGONER asked if he was still online and said the debate was to keep the original language or keep the CS language because some companies don't have royalty settlement agreements.

MR. MINTZ advised that it was unlikely the courts would find equal protection problems in the tax arena under the administration's bill because of similar situations already in existence. He used Proposition 13 in California as an example where two people could live in identical houses next door to each other and one could be paying 10 times as much in property taxes than the other because the houses were purchased on different dates. However, he thought there might be other policy reasons why the legislature would not want to allow royalty settlement formulas to be used.

He said that Senator Ben Stevens had accurately characterized this is a way of simplifying calculations and avoiding duplication. However, he express some uncertainty about how the amendment would work because it said that a formula under (d) may not incorporate a reference to royalty value or methodology, but yet (d)(1) still referred to a royalty valuation methodology. The two seemed to contradict.

MS. JACKSON said all three pieces were before the committee. The governor's bill, the CS, which already eliminated royalty settlements as a method of valuation, and the amendment that was directed at the CS.

3:17:44 PM
SENATOR SEEKINS replied that he thought there was a conflict. The amendment says you can't even talk about RSAs in the agreement and he thought that would be a big mistake. He didn't object to an RSA being brought into the new agreement, but he objected to saying they should not be able to "refer to a royalty value, royalty valuation or royalty settlement agreement".

MS. JACKSON remarked that two attorney said you have a problem and two have said you don't.

SENATOR BEN STEVENS said public policy should not be designed around an entity with a tax liability that is trying intentionally to circumvent the law and stated further:

> With that said, the royalty settlement agreements are agreements between the state and the individuals who owe a liability under those royalty settlement agreements and they are in agreement on a valuation of the production that is being transferred at a point of value. To preempt the use of the agreement as it transfers into liabilities under other statutory rules

and obligations that we create as a legislature, to me, doesn't make sense. Why should we say we can do it here, but you can't use that method here. But if you want to use that method here and it works and it's a settlement agreement and there's been no litigation or violation, we'll take a look at it. It doesn't say the department "shall"; it just says the department "may".

The other thing is on the equal protection, under Blacks Law, on the definition of equal protection, it has a couple different rationale and basis tests. If I might, Mr. Chairman, it says: 'In all equal protection cases, the crucial question is whether there is an appropriate governmental interest suitably furthered by the differential treatment.' I believe there is a governmental interest suitable for differential treatment under this case as demonstrated. And with that, Mr. Chairman, I'm finished. Thank you very much for your patience.

3:21:52 PM
SENATOR ELTON said he supported the amendment, because it was counterintuitive to believe that a taxpayer wouldn't elect the lowest value because that would be in his best interest. But if they do that, in fact, based on a royalty settlement agreement, two companies could easily be operating in the same field and be paying two different tax rates creating a fairness issue. Without this amendment, companies would be encouraged to battle out royalty values.

3:23:22 PM
SENATOR ELTON moved to adopt Substantive Amendment 5.

SENATOR DYSON said he thought this amendment should be held until they get to another amendment that is already in their stack of amendments.

3:24:06 PM
SENATOR ELTON withdrew his motion.

CHAIR WAGONER said he would hold this amendment until the committee dealt with Section 20.

3:25:30 PM recess 3:39:04 PM

CHAIR WAGONER called the meeting back to order and announced Substantive Amendment 3 by Senator Stedman to be before the

committee. It consisted of two options – 3A and 3B; one would replace the progressivity issue. He suggested they discuss both options before adopting one of them.

24-GS2052\Y.39
Chenoweth
3/22/06

SUBSTANTIVE AMENDMENT 3A

OFFERED IN THE SENATE BY SENATOR STEDMAN

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

Page 5, line 30, through page 6, line 5:

Delete all material and insert:

"(g) In addition to the taxes levied under (e) and (f) of this section, there is levied upon the producer of oil a tax for oil produced during that month from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax levied under this subsection is equal to

((ANS wellhead price - $40) x .0025) x ANS wellhead price x (1 - PPT rate)

where

(1) "ANS wellhead price" means the prevailing value for oil produced in the Alaska North Slope area; and

(2) the PPT, or production property tax, rate is 25 percent."

Page 6, line 10:

Delete "West Texas Intermediate"

Insert "Alaska North Slope"

Page 6, lines 11 - 12:

Delete "West Texas Intermediate"

Insert "Alaska North Slope"

Page 6, lines 16 - 17:

Delete "United States Gulf Coast price of West Texas Intermediate"

Insert "price of Alaska North Slope"

AND

24-GS2052\Y.41
Chenoweth
9/6/06

SUBSTANTIVE AMENDMENT 3B

OFFERED IN THE SENATE BY SENATOR STEDMAN
TO: CSSB 305(RES), Draft Version "Y"

Page 5, line 30, through page 6, line 5:
Delete all material and insert:
"(g) In addition to the taxes levied under (e) and (f) of this section, there is levied upon the producer of oil or gas a tax for oil or gas produced during that month from each lease or property in the state, less any oil and gas the ownership or right to which is exempt from taxation. The tax levied under this subsection is equal to

((WTI price - $40) x .002) x ANS wellhead price x (1 - PPT rate)

where
(1) "WTI price" means the average price for the month of West Texas Intermediate crude oil;
(2) "ANS wellhead price" means the prevailing value for oil produced in the Alaska North Slope area; and
(3) the PPT, or production property tax, rate is 25 percent."

Page 6, lines 16 - 17:
Delete "United States Gulf Coast"

SENATOR STEDMAN noted a drafting error in the formula on the line 7 that says ".002". It should be ".2". He said there were two options, but one idea.

SENATOR BEN STEVENS asked, as a point of order, if the amendment was being edited now.

CHAIR WAGONER replied yes.

3:41:55 PM
SENATOR STEDMAN said the way to counter the declining government take figure at high prices was to modify the 25 percent PPT. He did this by adding a slight multiplier to the formula established by Econ One when the price of oil hit $40 WTI (West Texas Intermediate). That price was used for several reasons. One, the WTI is an actively traded market and, therefore, easily identified; and two, it is very difficult to artificially move. He said it was also possible to use the price of Alaska North Slope crude (ANS), which is $2 less. He argued that the advantage to the state of having a progressivity feature when

oil prices advance is that it provides stability because when the tax gets out of balance like ELF did, one side becomes disadvantaged and wants to reopen or renegotiate.

3:46:28 PM
SENATOR DYSON said using the consumer price index (CPI) had been discussed.

SENATOR STEDMAN responded that he didn't think using the CPI was a good idea because it didn't correlate with oil prices and the trigger point might need to be moved quickly to keep everything in balance.

SENATOR DYSON added that costs to the producers go up with rising labor, material, and fuel costs.

SENATOR ELTON said he understood the first half of the equation on line 7, but he didn't understand the rationale for the second half.

3:51:00 PM
SENATOR STEDMAN explained:

> This is a deductible tax that goes against the gross value instead of the net like the PPT does. It's deductible against the PPT. We have to work through the mathematics and look at the net effect.

3:52:14 PM
SENATOR SEEKINS said starting the multiplier at $40 a barrel without the rest of the formula, at the current price of oil being in the $60-range would emulate a 30/20 PPT. He didn't know if that was the intent of the amendment or not.

SENATOR STEDMAN replied that Econ One did quite a bit of chart work on this. He explained:

> When you take into account the state's royalties, property taxes and corporate income tax from the industry, that's when they get a true picture of the dynamics of what this is doing. The royalty and tax scenario the state uses is regressive in nature, so as the price of oil goes up, the state take declines. So, in order to counteract that without totally removing that system, we've got to make something that's progressive enough to outweigh that and to flatten it.

SENATOR BEN STEVENS said he opposed the amendment and explained why:

> And I question the reasoning why a tax is exempt from a tax. It is really just an attempt to separate a new revenue stream out of the existing equation we have. This could easily be in addition to subsection (e), which is the formula and the item that says there will be a rate – the tax is equal to a percent of production tax – it could be easily added on to - the whole amendment could just be added under (e) and not be a new subsection and, therefore, it wouldn't be exempt from taxation. I am questioning the reason why we need to segregate this additional revenue stream from the same formula, the same taxation. That's number one.
>
> Number two - I have issue with WTI as the trigger price mechanism and ANS wellhead as the valuation method for the taxation itself. I have issues with it for a number of reasons, but mainly the reason is is that we've heard throughout testimony, over the last couple of weeks, a whole variety of different costs deducted from WTI to ANS wellhead. We heard one economist say it's $7; we heard one economist say it's $6; we heard one say it's $4.25; and then we have $2. So what is the differentiation there? And as far as I'm concerned the WTI is a trigger-happy hunter, because it initiates the progressivity clause prior to the price that we're taxing all the other oil that's valued. So, as far as I'm concerned, I don't think we need to have the second half of the equation based on the fact that I don't think it needs to be exempt from the tax that they're already being taxed on and it should just be WTI. I think it would be a much simpler methodology - and without question - I oppose line 13, so I'll take the opportunity to say it again....

3:58:39 PM
SENATOR DYSON asked to see a WTI and an ANS price at $60.

SENATOR BEN STEVENS interrupted saying, "I did the math - 28 percent. The effective rate at $60 under this formula would be 28 percent. It would be a 3 percent increase or $1.67 a barrel."

SENATOR DYSON asked if he was referring to this paragraph by itself or in addition to the 25 percent.

SENATOR BEN STEVENS replied the $1.67 would be the result of the formula on line 7 at $60 would equate to a 28 percent PPT; and he used $4.25 as the difference between WTI and ANS.

4:00:13 PM
SENATOR STEDMAN said, "Econ One has calculated the effective rate at 25/20 without an escalator at $60 at 17.6 and with this escalator it would be moved from 17.6 to 20.6 – at $60; at $50, it would move from 15.9 percent to 17.4 percent; and then at $40, it's 13.6 and there's no effect at $30 other than the trigger point.

He added Econ One's rationale for using WTI was that it was a fluid market versus the relatively inactive market of ANS. The $40 trigger could be moved sometime later on.

4:02:03 PM
SENATOR STEDMAN discussed Substantive Amendment 3A and his concerns with the complexity of dealing with the tax deductibility. He asked Econ One to create the same slope from that $40 trigger with a multiplier and they inserted the ANS price, which moved the factor from .002 to a .025 factor. He thought using ANS would be easier conceptually, but the fluid market would be lost.

4:03:41 PM
SENATOR DYSON asked him to explain the process he went through with Econ One to decide on the $40-trigger.

SENATOR STEDMAN said he is comfortable with using $40-trigger because that is the top in a range of prices from $30 - $40 that industry uses for its economic modeling. The entire government take number generated by Econ One had a slight regressive bent; that's why he selected $40. It is also at the top end of the industry range and would have minimal effects on their long-term planning. It takes the belly out of the government take numbers.

> The intent here is not to get an excessively – put the state in a position of high oil prices where we take all the upside away from the industry. The idea here is just to keep the balance and give them the upside percentage along with the state's. If oil prices end up at $70 or $80, our percentage share doesn't decline, because there's a multiple effect that the industry gets by allowing that to happen. But in my

personal opinion, that shouldn't happen to either side.

SENATOR DYSON said he appreciated that and didn't want the state to suffer the dip.

SENATOR STEDMAN reiterated that $40 is good number.

SENATOR BEN STEVENS commented that the effective rates they are talking about are all based on assumptions.

> The only thing we should be calculating on, because the only thing everybody is looking at is that 20/25 and what the effect of the escalator is going to be. And the way I calculate it, this makes it under current prices to be at 28 percent and that's probably on the low side because I'm not a very good economist or mathematician. Thank you Mr. Chairman, and I'll maintain my objection.

4:10:31 PM
SENATOR STEDMAN said Econ One indicated that the total government take from 2007 to 2016 at $60 a barrel, with a 25/20 scenario, was about 60 percent (including the federal government) and 40 percent profit to the industry. With the .2-escalator on it, the government take goes to 61.8 percent, a 1.8 percent change.

SENATOR BEN STEVENS asked if that 1.8 referred to dollars.

SENATOR STEDMAN replied that it referred to a percent, but that figure could be moved into dollars, which would be figured on volume and price. "The bigger the volume, the bigger the dollars."

SENATOR BEN STEVENS said his figures indicated that it referred to dollars.

4:11:45 PM
SENATOR ELTON said he thought the difference Senator Stedman was talking about in going from $60 to $61.8 was total government take; Senator Ben Stevens was talking about what is the percentage of the state's take and he thought that might go up 3 percent under this formula.

4:12:31 PM

SENATOR STEDMAN reiterated that the combined effect of both state and federal government on the industry was 1.8 percent - using Econ One numbers.

4:16:10 PM
SENATOR STEDMAN moved Substantive Amendment 3B that used WTI in the formula.

CHAIR WAGONER and SENATOR BEN STEVENS both objected.

4:16:55 PM
SENATOR DYSON said he favored using this amendment with ANS in both places.

SENATOR STEDMAN withdrew his motion and moved to adopt Substantive Amendment 3A.

SENATOR DYSON moved to change the multiplier rate from ".0025" to ".0020" on line 7.

SENATOR STEDMAN said he had no objection to that.

SENATOR ELTON objected. He said that change resulted in two fairly significant changes. He elaborated:

> I mean we had before us two different ways of doing an amendment that produced two lines that were the same. And what we have done if we accept the amendment to the amendment is we now have two different lines, one of them flatter than the other. And so that's the reason for my objection. I prefer a steeper line, Mr. Chairman.

SENATOR DYSON defended his amendment to the amendment saying that ANS is a more stable price to use and more closely reflects what Alaska's product brings on the market. And further he said:

> The wider swings of WTI, I don't know that it gains us anything and I think the .002 multiplier accomplishes exactly what Senator Stedman wants, which is to take the dip out of the line in the out at the higher prices and so that was my reasoning.

SENATOR STEDMAN said that moving the multiplier down would not adversely affect taking the belly out of the line; it would move the government take numbers down slightly, but he was very comfortable with it.

4:20:02 PM
SENATOR BEN STEVENS said he didn't object to the amendment.

CHAIR WAGONER asked for a roll call vote. Senators Ben Stevens, Dyson, Stedman, and Wagoner voted yea; Senator Elton voted nay; and the Amendment 1 to Substantive Amendment 3A was adopted.

4:21:18 PM
SENATOR BEN STEVENS moved to place the tax in this amendment on top of the exiting tax in section (e) beginning on page 4, line 25, of CSSB 305(RES) and delete "or right to which is exempt from taxation" on page 4, lines 27 – 28. His intention was to take away the tax exemption and separation of the revenue streams and simply add to the production tax rate.

SENATOR STEDMAN said he knew if they tried to make it a tax on net instead of a tax on gross, the formula would be altered substantially and Substantive Amendment 3A would have to be rewritten.

4:24:10 PM
SENATOR BEN STEVENS removed his motion so it could be properly drafted.

4:25:19 PM
CHAIR WAGONER said the committee would go ahead and act on Substantive Amendment 3A am and allow Senator Stevens to come back with a redrafted amendment and consider it at that time.

SENATOR STEDMAN said he wanted Econ One to check the calculations to make sure they know the effect of what they are doing.

4:26:20 PM
Chair WAGONER said that could be done in the Finance Committee.

SENATOR BEN STEVENS said, "Not by me; I'm not on Finance."

CHAIR WAGONER announced that the committee had Substantive Amendment 3A amended before it. He asked for a roll call vote. Senators Elton, Seekins, Dyson, Stedman, and Wagoner voted yea; Senator Ben Stevens voted nay; so it was adopted.

4:28:15 PM
CHAIR WAGONER announced Substantive Amendment 4 to be up for consideration.

SUBSTANTIVE AMENDMENT 4

OFFERED IN THE SENATE RESOURCES COMMITTEE BY SENATOR WAGONER

Page 45, line 4, delete:

"the provision of this subsection apply for a lessor's royalty interest under an oil and gas lease as follows:

(1) the rate of tax levied on oil and gas produced
  (A) from the Cook Inlet basin, as that term is defined in (a) of this section, is 1.5 percent;
  (B) except as provided in (A) of this paragraph, is 5 percent;
(2) the rate of tax is applied to
  (A) the amount of royalty paid to the owner by the producer; or
  (B) the value, in the case of royalty oil or gas taken in kind by the royalty owner, of that royalty oil or gas determined
    (i) in accordance with the royalty valuation methodology in the lease or other governing agreement between the owner and the producer; and
    (ii) at the point of delivery of that royalty oil or gas to the owner;"

Page 5, line 4, following "taxation", insert:

For oil and gas produced from the Cook Inlet Sedimentary basin, the tax is equal to one and a half percent of the gross value at the point of production of the oil and gas. For all other oil and gas, the tax is equal to five percent of the gross value at the point of production of the oil and gas. However, if the department determines that, for purposes of reducing the producer's tax liability under this subsection, the producer has received or will receive consideration from the lessor offsetting all or a part of the producer's royalty obligation, other than a deduction under AS 43.55.020(d) of the amount of a tax paid, the tax under this subsection is equal to 20 percent of the gross value at the point of the production of the oil and gas.

MS. JACKSON explained that Substantive Amendment #4 dealt with private royalty on the committee's roadmap. She said, "The problem with the CS is that the language that was given did not match what ended up in the CS." So, that was the first thing that was worked out between members of AOGA and some private royalty owners. The department that came up with a number of small concerns. The reason this is a substantive amendment was

because it dealt with private royalty. She explained that the amendment kept the 1.5 percent tax in the Cook Inlet Sedimentary basin, but a 5 percent tax in all other areas. The addition is on page 2, line 2, where it reads:

> However, if the department determines that, for purposes of reducing the producer's tax liability under this subsection, the producer has received or will receive consideration from the lessor offsetting all or a part of the producer's royalty obligation, other than a deduction under AS 43.55.020(d) of the amount of a tax paid, the tax under this subsection is equal to 20 percent of the gross value at the point of the production of the oil and gas.

She said that this penalty provision of 20 percent applied essentially to situations when the producer and royalty owner entered into an agreement in an attempt to game the system.

4:31:20 PM
MS. JACKSON said the department is comfortable with the 5 percent language, but hasn't expressed anything one way or the other in terms of the 1.5 percent for the Cook Inlet basin. The chairman elected to put that into the bill. The current percentage tax rate in the Cook Inlet basin is approximately a 1.2 percent (on private royalty).

4:32:08 PM
SENATOR BEN STEVENS referenced page 5, line 7, of the CS that said "gas" was at 1.5 percent and all other was at 5 percent.

CHAIR WAGONER said he was not aware that there was any oil at the time, but he was asked to put it in.

MS. JACKSON added that she was told this insertion of "gas", which was requested initially by the department, was incorrect on the CS.

SENATOR BEN STEVENS asked if most of the private royalty ownership in the Inlet is currently gas.

CHAIR WAGONER replied yes and the majority of it is in the Kenai gas field.

SENATOR BEN STEVENS asked then if the other 5 percent would apply to mainly oil production on the Slope.

CHAIR WAGONER replied yes – that was his understanding.

SENATOR BEN STEVENS asked if they could agree to interpret the 1.5 percent as a gas tax and the 5 percent as an oil tax.

CHAIR WAGONER said he didn't know if they agreed upon it, but that's the way it was explained to him.

4:35:01 PM
SENATOR BEN STEVENS said this has huge impacts on state policy and he wanted people to know that as they move forward. They were essentially saying the state's tax on gas equals 30 percent of its tax on oil.

SENATOR SEEKINS asked if they are just looking at gas, why did the administration want to put oil into the equation.

MS. JACKSON replied that it didn't want to at first. The original CS had "oil and gas"; then the administration wanted to insert "gas"; then it came back and wanted "oil and gas", which is where they are now.

CHAIR WAGONER said he thought it was a matter of consistency more than anything else.

4:37:04 PM
SENATOR SEEKINS moved to adopt Substantive Amendment 4.

SENATOR STEDMAN pointed out that line 5 on page 1 of the amendment referred to "Cook Inlet basin" and line 20 referred to "Cook Inlet Sedimentary basin".

MS. JACKSON explained that line 5 was being deleted and "Sedimentary" was reinserted on line 20.

4:38:06 PM
SENATOR BEN STEVENS reiterated that this is a significant policy change and he wanted to be consistent.

SENATOR SEEKINS said he thought the tax would be applied to this one sedimentary basin and not anywhere else in the state.

4:41:33 PM
CHAIR WAGONER said he would get that question answered. He noted there were no further objections and Substantive Amendment 4 was adopted. He recessed the meeting until 10 a.m. tomorrow, March 24, at 4:42:39 PM.