

HOUSE FINANCE COMMITTEE
November 9, 2007
4:30 P.M.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [4:30:13 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Harry Crawford
Representative Richard Foster
Representative Les Gara
Representative Mike Hawker
Representative Reggie Joule
Representative Mike Kelly
Representative Mary Nelson
Representative Bill Thomas, Jr.

MEMBERS ABSENT

None

ALSO PRESENT

Representative Paul Seaton; Representative Lindsey Holmes;
Representative Kyle Johansen; Representative Craig Johnson;
Representative Bob Buch; Representative Peggy Wilson;
Representative Woodie Salmon; Dan Dickinson, Consultant,
Legislative Budget and Audit Committee; Pat Galvin,
Commissioner, Department of Revenue; Steve Porter,
Legislative Consultant, Legislative Budget and Audit
Committee

SUMMARY

HB 2001 An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production

tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date.

HB 2001 was HEARD & HELD in Committee for further consideration.

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HOUSE BILL NO. 2001

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date."

Co-Chair Chenault pointed out the revised fiscal note to the House Resources Committee version of the bill. (Copy on File).

Representative Stoltze MOVED to ADOPT work draft #25-GH0014\N, Finley/Bullock, 11/9/07, as the version of the bill before the committee. There being NO OBJECTION, it was adopted.

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Co-Chair Chenault referenced the "Summary Comparison between Various House Approaches to Production Tax". (Copy on File).

DAN DICKINSON, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, provided an overview of the handout. Those items not in current law are shown in red; yellow is the governor's original proposal; blue is from the House Resources Committee version.

Representative Gara asked about the white portion under current law. Mr. Dickinson replied that white items shown under current law did not show up in a later version.

Mr. Dickinson explained that the base rate is 25 percent; the progressivity reflects what was in the governor's proposal.

Under the Floor issues, there are no changes. Investment credits can be taken in the year made. If there is a loss that year, 25 percent can be carried forward. The TIE credits have been restricted to investments made between 2003 and 2006.

Representative Gara asked how the transitional TIE credits work. Mr. Dickinson related that there was a window created for new entrants.

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STEVE PORTER, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, further explained that the producers, producing oil at the time, took advantage of the credits in the current year. The advantage was 10 percent of whatever was spent that year per capex - around \$200 million dollars. It is the administration's intent for the parties that were unable to use the credits they would have earned, to be able to utilize them in the future.

Representative Gara understood that there was some additional benefit for new explorers. Mr. Porter did not know the exact language in the bill.

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Mr. Dickinson addressed exploration credits on page 2 of the handout, comparing the 20/40 percent credit to 30/40 percent credit. The proposed bill contains the same list of "bad acts" prohibited in both credits.

Approval by DNR is required in this bill, and the confidentiality of well data remains ten years, the same as it is under current law. The data provided by a seismic explorer is treated the same way as in current law. The pre-existing well issue provides for two consecutive drilling seasons. The DNR TIE credit remains at 5 percent.

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Mr. Dickinson addressed the State Purchase of Credits. "Appropriations made by law" does not include the creation of an oil and gas fund. The bill contains the option for the purchases to be made by the Alaska Retirement Board (ARM). There is a limit of \$25 million, except for purchases made by ARM.

Representative Kelly referenced the 5 percent credit on pre-2003 seismic work and asked if it was bilaterally

permissive. Mr. Dickinson thought so. The Department of Natural Resources must find that it in the state's best interest to do it.

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Mr. Dickinson addressed the Allowable Lease Expenditures portion of the bill - page 3. He clarified how producer audits are done. Dispute resolution was carved out to clarify regulations regarding payment. The public outreach costs have been moved down to the bottom of the list.

DR&R is not allowed and the corrosion issue remains the same disallowance of \$.30 per barrel.

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Representative Gara asked about the pipeline corrosion issue. Mr. Dickinson responded that SB 80 language had not been included and the unscheduled events disallowance was removed.

Representative Gara asked if the proposal would allow the write-off of shut down costs and repairs. Mr. Dickinson did not know if they would be disallowed. He pointed out that \$.30 per barrel would be disallowed.

Mr. Porter clarified that the \$.30 was taken out at the House Resources Committee version of the bill.

Representative Gara asked if there was additional language included for protection against pipeline corrosion costs. Mr. Dickinson understood that the phrase "criminal negligence" was in the "bad acts" language. The language in the governor's proposal and in SB 80 was not included in this bill.

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Mr. Dickinson addressed where costs are incurred and if off lease is allowed.

Representative Gara asked for further clarification on lease expenditures and the baseline. He asked if indirect costs were added as deductions. Mr. Dickinson explained that it went back to the PPT definition. The section was changed but the definition was not changed.

Mr. Dickinson continued to explain the information section of the bill. He pointed out that the proposed House Finance box should have been white, rather than yellow. On the forward-looking information, a phrase was inserted to say that before the \$1,000 a day penalty applies, the state has to give notice.

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Mr. Dickinson reported that the disclosure of tax information restores part of what is in current law. In the governor's proposal the rule that the data must be aggregated to prevent the identification of particular returns was removed. It places this language back under current statute. All other sections remain the same as prior versions of the bill.

Mr. Dickinson addressed page 4, the Statute of Limitations, which is four years in this bill and was changed from prior versions. Auditors from the Department of Revenue and the Department of Natural Resources remain exempt employees. The effective date is January 1, 2008. There is only one retroactive policy which refers to not-for-profit corporations selling credits.

Mr. Dickinson related that Downstream Costs has the same language as current law. Language regarding Gas Ceilings thru 2022 was adopted from the HRC version. The section on Additional Penalties maintained the same language used in the HRC version, however, when it applies to estimates, the taxpayer pays less than 90 percent of what is due in that period.

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Mr. Dickinson discussed page 5, the Intent Language. He pointed out that the piece that clarifies the long standing way of dealing with revisions by regulatory bodies remains in the bill. Monthly estimated payments are subject to monthly ceilings, as found in the governor's version of the bill.

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Representative Gara requested an EconOne revenue chart comparison. Co-Chair Chenault said he would attempt to do so.

Representative Gara asked about the \$60 dollar per barrel price comparison. Mr. Dickinson thought it would be the same as the governor's proposal.

Representative Gara inquired if, at \$80 dollars per barrel, this bill would raise \$1 billion less than the HRC version. Mr. Dickinson said yes.

Representative Gara asked about the deletion of the retroactivity provision and the fiscal impact of that. Mr. Dickinson did not know. He suggested asking the Department of Revenue.

Representative Gara mentioned the downstream costs listed on page 4. He asked for more information regarding the new proposal. Mr. Dickinson replied that the language is in existing statute and states that for the downstream tanker and pipelines, reasonable cost is actual cost except when certain conditions are met, such as when there is a more reasonable way of getting the oil to market.

Representative Gara asked, if actual costs were much higher than fair costs, what the independent shipper would be charged, and how taxes would be figured. Mr. Dickinson thought that the independent shipper would be charged the actual cost. He explained the method used for the calculating TAPS tariffs.

Representative Gara asked about the issue of net profit share leases. Mr. Dickinson pointed out costs disallowed, including net profit shares. Representative Gara asked how that compared to current law. Mr. Dickinson replied it is current law.

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PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, made comments on the bill as proposed by the committee. He referenced the summary comparison handout. He summarized the fiscal issue. The ACES proposal included a gross tax floor as well as a 25 percent base rate and the .2 slope on progressivity. He maintained that the floor needed to be included to protect the state at the low end, or the progressivity needed to be increased.

Commissioner Galvin emphasized that the TIE credits, as proposed, remain problematic. He recommended that TIE credits be frozen until there is production. The explorers need to be able to take advantage of the credits, as well as the producers.

Commissioner Galvin addressed exploration credits and well data. The intent is to recognize that when the state contributes a substantial amount of the upfront costs, the data acquired should be available to the state and be made public in a reasonable period of time.

Commissioner Galvin discussed a fair approach to the state's purchase of transferable credits. The easiest way to provide full value to the explorers is for the state to provide cash payments. The approach suggested in the proposed bill would require additional legislation to authorize the ARM Board to make the purchases. Given the intent to provide full value, the explorer should be able to get the state to pay 100 percent.

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Representative Gara asked about the data from lease lands and private lands. He understood that the state wants seismic data to help it lease out neighboring lands. He requested more information about private land credit money. Commissioner Galvin responded that the state is getting the credit money and will receive the data, which would be useful to provide insight into actual seismic information. He summarized that the issue is if the state pays for a portion of the costs, then the data should be made available to the state.

Representative Gara asked for further clarification of the benefit of the data. Commissioner Galvin stated that the information would "fill in the picture" like missing pieces of a puzzle.

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Commissioner Galvin referenced page 3 of the handout regarding the "bad acts" and the corrosion issues. He proposed that within ACES, the intent addresses the costs associated with unscheduled maintenance, not just criminal negligence.

Co-Chair Chenault provided an example of best maintenance practices. He understood that any cost incurred during an unscheduled event would be disallowed. Commissioner Galvin replied that was not correct. Any act of God, not within the reasonable course of operation, would be deductible. Co-Chair Chenault countered and maintenance that an unscheduled maintenance operating cost would be denied.

Commissioner Galvin agreed, however, he thought it was a more objective standard and had significant overlap. Co-Chair Chenault acknowledged that the intent was to address both sides of the coin and the effect on the day-to-day operations. He noted that he would approach the administration with compromise language.

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Representative Hawker asked if the regulations to implement this statute were complete. Commissioner Galvin suggested another director answer that question. Representative Hawker spoke to "willful misconduct". Writing of a regulation contains tremendous broad power. He wanted to see the regulations written and implemented before any changes were made in statute. Commissioner Galvin responded that regulations must be written to represent the intent of the legislature. The issue is whether "willful misconduct" was intended to represent improper maintenance or not meeting an industry standard of care as it applies to

maintaining a pipeline. If it is the intent of the legislature to write language that broad, it would be more defensible.

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Commissioner Galvin addressed page 3 regarding the allowable lease expenditures. He related that ACES was written to require the definition of what costs are to be included or excluded from the lease expenditure definition. Within the current language of the statute and in the proposed bill, lease expenditures include all ordinary, necessary expenditures unless defined out. He encouraged that the language be returned to that of the original ACES bill.

Commissioner Galvin addressed the section that deals with disclosure of taxpayer information. He commented that the current language is "extremely" dangerous. He worried about backing out the data and the risk of exposure. In order to reveal taxpayer information, a safe harbor is necessary, as provided for in the original ACES language. He did not want to see that rule violated.

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Representative Gara asked which language the reference was toward. Commissioner Galvin referenced page 3. Representative Gara understood that the state wanted more information. Commissioner Galvin replied that it was a matter of revealing enough information for taxpayer information such as gross income, costs deducted, credits received, and applied tax rate. He listed information which is "black boxed" in the proposed bill. In order for the tax system to represent to the public what is actually happening, there must be enough data to indicate how the costs are falling out. The original language of ACES provides for the disclosure needed.

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Commissioner Galvin directed comments to topics on page 4 of the handout, statute of limitations and audits. He recognized that a more complex and demanding tax system requires more time for auditing. He guaranteed that audits would require more than three years. The question is whether or not a deadline will be established and the state forced into a formal claim before the statute of limitations expires. He pointed out that the federal standard is seven years and he is requesting six.

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Commissioner Galvin spoke to the effective date. The governor supports a retroactive effective date.

Transitional provisions would allow an orderly movement into the system and to ensure that taxpayers are held harmless from any penalties or interest that would normally accrue.

Representative Gara requested an estimate of the fiscal impact of the deletion of the retroactive provision. Commissioner Galvin stated he would provide the information at a later date.

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Commissioner Galvin discussed reasonable transportation cost deduction. The department should have the authority to set the rate. He reported that he supports the in-state gas intent language to ensure clarity that the purpose is to provide low cost energy opportunities within the state, not to provide subsidies.

In response to a question by Representative Gara, Commissioner Galvin explained that any production tax decrease is enjoyed by the consumer. A regulatory process addresses that. The inference is not that the gas development requires a subsidy, but to provide lower cost fuel for in-state use.

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In response to a question by Co-Chair Meyer, Commissioner Galvin explained the intent of the language is to ensure that an entity that does not have to pay a production tax cannot acquire the credits. If an entity is exempt from paying the production tax they should also be exempt from receiving credits. Commissioner Galvin further added that the intention is to provide equity; if a company is paying the production tax, they should get the credit.

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In response to a question by Representative Kelly, Commissioner Galvin noted that small producers are not tax exempt. They do get a credit.

Representative Gara questioned if Anchorage utility rates will be raised. He noted that rural Alaska still has concerns regarding energy cost reduction. He thought that ML&P was entitled to credits which are passed on to current rate payers, and the current bill removes those credits because they produce less than \$12 million worth of petroleum product a year.

Commissioner Galvin understood that the entity is exempt because they are a subdivision of the state. The issue in regard to the small producer credit is not relevant since it applies to entities that are subject to the tax. They owe

the tax, but are also credited, which results in zero. An entity that is legally not required to pay the tax should not be eligible for the credit. Commissioner Galvin could not discuss information on specific taxpayers.

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ADJOURNMENT

The meeting was adjourned at 5:45 PM.