

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

October 26, 2007

10:11 a.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Chair  
Representative Nancy Dahlstrom  
Representative Mark Neuman  
Representative Jay Ramras  
Representative Ralph Samuels  
Representative Mike Doogan  
Representative Scott Kawasaki

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Andrea Doll  
Representative Bryce Edgmon  
Representative Anna Fairclough  
Representative Les Gara  
Representative David Guttenberg  
Representative Lindsey Holmes  
Representative Mike Kelly  
Representative Bob Roses  
Representative Peggy Wilson

**COMMITTEE CALENDAR**

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."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB2001

SHORT TITLE: OIL & GAS TAX AMENDMENTS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

10/18/07	(H)	READ THE FIRST TIME - REFERRALS
10/18/07	(H)	O&G, RES, FIN
10/19/07	(H)	O&G AT 1:30 PM HOUSE FINANCE 519
10/19/07	(H)	Heard & Held
10/19/07	(H)	MINUTE(O&G)
10/20/07	(H)	O&G AT 12:00 AM HOUSE FINANCE 519
10/20/07	(H)	Heard & Held
10/20/07	(H)	MINUTE(O&G)
10/21/07	(H)	O&G AT 1:00 PM HOUSE FINANCE 519
10/21/07	(H)	Heard & Held
10/21/07	(H)	MINUTE(O&G)
10/22/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/22/07	(H)	Heard & Held
10/22/07	(H)	MINUTE(O&G)
10/23/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
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10/24/07	(H)	Heard & Held
10/24/07	(H)	MINUTE(O&G)
10/25/07	(H)	O&G AT 10:00 AM HOUSE FINANCE 519
10/25/07	(H)	Heard & Held
10/25/07	(H)	MINUTE(O&G)
10/26/07	(H)	O&G AT 10:00 AM HOUSE FINANCE 519

**WITNESS REGISTER**

MARCIA DAVIS, Deputy Commissioner  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** During the hearing on HB 2001, assisted in the slide presentation presented telephonically by Robert Mintz, and responded to questions.

ROBERT E. MINTZ, Attorney at Law  
Kirkpatrick & Lockhart Preston Gates Ellis LLP (K & L Gates)  
Anchorage, Alaska

**POSITION STATEMENT:** During hearings on HB 2001 presented a topical analysis of the Alaska's Clear and Equitable Share (ACES) bill.

JERRY BURNETT, Director  
Administrative Services Division  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** During the DOR presentation of Alaska's Clear and Equitable Share (ACES), responded to questions.

#### **ACTION NARRATIVE**

**CHAIR KURT OLSON** called the House Special Committee on Oil and Gas meeting to order at [10:11:16 AM](#). Representatives Olson, Neuman, Samuels, Ramras, Doogan, Kawasaki, and Dahlstrom were present at the call to order. Representatives Doll, Edgmon, Fairclough, Gara, Guttenberg, Holmes, Kelly, Roses, and Wilson were also present.

#### HB2001-OIL & GAS TAX AMENDMENTS

[10:12:15 AM](#)

CHAIR OLSON announced that the only order of business would be 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."

[10:12:17 AM](#)

MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), introduced Mr. Robert Mintz, who will present a topical analysis of the Alaska's Clear and Equitable Share (ACES) bill.

[10:12:56 AM](#)

ROBERT E. MINTZ, Attorney at Law, Kirkpatrick & Lockhart Preston Gates Ellis LLP (K & L Gates), began with slide 2 "A Few Background Basics," to ascertain that "we're all on the same page." The slide bullets that Alaska's oil and gas production tax (PPT) resides in AS 43.55; is in addition to other taxes imposed, which include royalty, property, and income taxes; this tax has existed since statehood; in general it applies a percentage tax rate to the value of oil and gas produced; and unlike royalties, it applies to production from private and onshore federal leases as well as state leases. On slide 3, he presented that the PPT legislation, HB 3001 enacted in 2006, allowed for certain core elements: AS 43.55.011(e)-(i) requires a tax to be levied on the value of oil and gas produced in the state; AS 43.55.160 describes the calculation of the taxable value of oil and gas - also referred to as the net value, which is the base to which the tax rate applies; AS 43.55.165 & .170 addresses the topic of deductible upstream costs to be considered in calculating the taxable value of oil and gas - exploration, development and additional lease expenditures are included. Continuing on slide 4, AS 43.55.023 & .024 name the 2006, newly enacted tax credits; AS 43.55.020(a) addresses the tax payment provisions for monthly estimated tax payments and final payment on March 31 of the year following production - enacted because it became an annual vs. monthly tax; and AS 43.55.030(a) requires the one annual return, again because it became an annual tax. He opined that slide 5, bullets the most fundamental part of the PPT law with AS 43.55.011(e) stipulating the levy on the producer of 22.5 percent of the production tax value of the taxable oil and gas as calculated under AS 43.55.160, and note, he said, that the production tax value is a net value. There are exceptions to the general principle of 22.5 percent of the net value. Listed on slide 6, the exceptions are the state or federal share of production; landowner's royalty share - which is subject to a different tax provision; Cook Inlet production subject to ceilings based on the pre-existing Economic Limit Factor (ELF) base taxes. Responding to a question from the committee chair, he emphasized that Cook Inlet, other than a conforming change, was "basically ... left alone." The final exception, he continued, is the North Slope production subject to a minimum tax depending on price of Alaska North Slope (ANS) [products].

[10:21:11 AM](#)

REPRESENTATIVE DOOGAN asked if this means all North Slope production.

MR. MINTZ responded, "Yes," under current law.

[10:21:25 AM](#)

MR. MINTZ directed attention to slide 7 and explained the progressivity component. In addition to the 22.5 percent base rate, for each month when the net value of a producer's oil and gas exceeds \$40 per barrel, the tax rate is increased by one-quarter of a percentage point for each dollar per barrel over the \$40. Gas and oil is added together, in this equation, by treating 6 million Btu (British thermal unit) of gas as equivalent to one barrel of oil.

[10:22:12 AM](#)

MS. DAVIS emphasized that under both current law and ACES, the net value of \$40 a barrel represents the value at the point of production, after netting the operating and capital expenses, but before consideration of capital credits. This provides the point of comparison number to ascertain if there are any dollars that fall above \$40, or, in the ACES model, above \$30.

[10:22:58 AM](#)

MR. MINTZ directed attention to slide 8, to indicate how [HB 2001] would change the current law. New sub sections (g) and (h) are added to AS 43.55.011, to determine the tax rate. Bill sections 17 and 18 raise the tax rate to 25 percent plus the progressivity tax. The progressivity tax rate becomes one-fifth of a percentage point for each dollar per barrel over \$30 net value and it is calculated on an annual, not monthly, basis. Because the tax is calculated annually, rather than monthly, it's easier to calculate, and performs differently due to the trigger point being lowered to \$30 a barrel as well as the change to one-fifth of a percentage point.

[10:24:36 AM](#)

REPRESENTATIVE SAMUELS asked, regarding the progressivity tax, "you're averaging the month, you're not just going to collect at the end of the year every individual month."

MS. DAVIS responded that the average is averaged over the year, not by individual months.

REPRESENTATIVE SAMUELS stated his disagreement with this approach, and asked if it would be helpful to minimize the accounting burden on the administration by establishing an annual calculation/payment system. He stressed the importance of calculating the months individually vs. the yearly average. This captures monthly spikes in price fluctuations, which he opined was the point of establishing the progressivity section.

MS. DAVIS cited ease of administration in performing a one time calculation vs. a per month average throughout the year. This keeps the administrative burden down. The economic effects are different than what is proposed.

REPRESENTATIVE SAMUELS asked the deputy commissioner to provide the committee with a comparison figure of the two different methods of calculation. Specifically what will be lost in administrative costs; and what is given up in the time-value of money.

[10:27:04 AM](#)

REPRESENTATIVE HOLMES asked what was the administration's rationale for an annual, rather than a monthly, calculation.

MS. DAVIS responded that it was an effort to strike a balance point with the producers, as well as easing the administrative burden.

[10:27:56 AM](#)

REPRESENTATIVE DOOGAN requested a simplistic checklist of the takeaways and givebacks represented in the bill.

MS. DAVIS said that could be accomplished, utilizing certain assumptions.

[10:28:59 AM](#)

REPRESENTATIVE NEUMAN inquired what was analyzed to start progressivity at \$30, what were the considerations, and what deductions were scrutinized, to arrive at this figure.

MS. DAVIS reviewed the process and calculations considered in changing the existing system. The involved exercise included: testing calculations based off of a number at wellhead value; values without impact on the fields were tested through a range

of trigger prices; curves were calibrated utilizing net present value structure; calibrations were run on new development; and review of existing North Slope investment structures were compared to standings in the global environment.

REPRESENTATIVE NEUMAN inquired about the percentages that were used, and was 25 percent the primary number.

MS. DAVIS answered that a range of calculations were used ranging from the 22.5 percent to 30 percent. "We tried to hit the wall, in a lot of different areas," she said, "And then once we figured out where the numbers hit walls, we then had to step back and ask ourselves the political salability." The goal was to test the existing elements of the PPT, pushing them out step wise, and thus avoid shocking the system with an extreme move in one direction, and fine tuning in others.

REPRESENTATIVE NEUMAN surmised that the wall was reached at 25 percent.

MS. DAVIS clarified that it fell solidly in the middle of a safe zone. To the committee member's further query, she said it is not a percentage, but established from a number that hit the wall and then "coming back half-way."

[10:33:58 AM](#)

REPRESENTATIVE DOOGAN asked, "If there was a political calculation involved in this did you model it?"

MS. DAVIS said that has not come up.

[10:34:24 AM](#)

MR. MINTZ continued with slide 10 to provide section 16. The new AS 43.55.011(f) applies a tax floor to legacy fields. The minimum tax is 10 percent of gross value at the point of production of oil and gas from a unit or non unitized reservoir that (1) has produced a cumulative total of 1 billion barrels; and (2) is producing over 100,000 barrels a day based on an average during the most recent calendar year.

[10:35:33 AM](#)

REPRESENTATIVE SAMUELS observed that this would only apply to Prudhoe Bay and Kuparuk.

MS. DAVIS replied, "Yes." To a follow-up question she said Alpine falls well short of this production.

[10:36:02 AM](#)

MR. MINTZ restated that the minimum tax is 10 percent of the gross value at the point of production, to stress that this concept has long been in the PPT and remains unchanged. Slide 11, he said, focuses on Cook Inlet. The tax ceilings have not changed but conforming amendments include language relating to how lease expenditures are addressed.

[10:37:29 AM](#)

REPRESENTATIVE SAMUELS recalled that during last year's hearings a ceiling of 50 percent for progressivity was discussed and he asked if that ceiling has made the final version of the bill.

MR. MINTZ replied, "Yes." It is the ceiling on the total tax rate; 50 percent. It is the same as under current law; Section 17(g).

REPRESENTATIVE SAMUELS clarified that there is not a change pending in the current bill.

MR. MINTZ answered, "No."

REPRESENTATIVE SAMUELS pointed out that in current law the tax cap is at 50 percent.

MS. DAVIS interjected that in the existing PPT it is worded as a 25 percent tax cap, but the calculations equivocate it to the 50 percent allowed.

MR. MINTZ called attention to current law .011(g), and said it provides a cap on the progressivity component of 25 percent. Add that to the base rate of 22.5 and the sum totals 47.5 percent.

[10:39:38 AM](#)

MR. MINTZ continued with slide 12, stating that 43.55.160 (sections 52-55) have retained the basic principles: taxable value equals gross value at the point of production minus lease expenditures. The wording has been changed for clarity and conforming purposes to (1) monthly values are no longer needed as progressivity is now calculated annually.

[10:40:52 AM](#)

REPRESENTATIVE SAMUELS referred to the tax cap, and asked, "What will be the current price of oil when we hit that cap ... the 50 percent?"

MS. DAVIS offered to provide that information to the committee.

[10:41:51 AM](#)

REPRESENTATIVE DOOGAN referred to the wording change that states monthly values are no longer needed, and asked, "Do we have any idea what the value of that giveback is?"

MS. DAVIS answered that the calculation for 2009 was \$25 million.

[10:42:18 AM](#)

MR. MINTZ continued with slide 13, and said that the language changes in section .160 are to make the law clearer and more specific on when a producer may or may not use lease expenditures incurred in one location as deductions for oil and gas produced at another location. The original PPT concept allowed a producer to tally their statewide gross value of production, subtract the tally of their statewide lease expenditures, and simply subtract one from the other to arrive at the single taxable value. Eventually distinctions were made by the legislature, which gave rise to the Cook Inlet tax ceilings, the North Slope tax floor, and special credits for small producers outside of Cook Inlet and the North Slope.

[10:43:43 AM](#)

REPRESENTATIVE NEUMAN observed that the bill sections are being taken in groups and not necessarily in order.

MS. DAVIS explained that the sections are being presented based on the topic as opposed to moving directly through the bill sections.

[10:45:37 AM](#)

MR. MINTZ continued to describe how the segregation of tax treatments, and values, evolved for the different areas of the state. Over time, some of the values have been addressed via

departmental regulation, but it is recommended that the basic tax structure be addressed in statute. Therefore it is necessary to embed the various aspects into the different sections of the bill. The examples on slide 14 give "for instance" possibilities of how the tax floor deductions and the tax ceiling deductions, of sections 54 and 55, could be manipulated and cause "double-dipping. The rules set out in the bill help to prevent these scenarios. Further, the new text in .160, which addresses Cook Inlet as previously mentioned on slide 11, ensures consistent operation and prevents double-dipping.

MS. DAVIS relayed that this language has been introduced to provide clarity and uphold the original intent of the law. She emphasized that the law is not being changed, the ELF ceiling continues to be the ceiling.

[10:50:51 AM](#)

REPRESENTATIVE HOLMES translated that this means other fields can interchange credits back and forth from one field to another, Prudhoe and Kuparuk have a ring around them, and Cook Inlet is mostly excluded..

MS. DAVIS said, "Correct."

[10:51:33 AM](#)

REPRESENTATIVE SAMUELS inquired about the possible double-dipping in Cook Inlet, and whether regulatory policies have prevented this.

MS. DAVIS assured that it is not occurring.

[10:52:12 AM](#)

MR. MINTZ recapped what has been reviewed: the percentage changes in the basic tax levy; and the minor changes in the tax base and how to arrive at the taxable value of oil and gas. The next area for review, he said, is the lease expenditures; the types of costs that a producer is allowed to deduct to arrive at the taxable value. He directed attention to slide 15, and said these expenditures are contained in AS 43.55.165, bill sections 56-59, and 64. New text was written, (a) and (b), to add clarity and to limit lease expenditures to only what the Department of Revenue (DOR) allows by regulation. Currently the

department may, but is not required to, interpret and define deductible lease expenditures by regulation.

[Chair Olson turned the gavel over to Representative Samuels.]

[10:54:26 AM](#)

REPRESENTATIVE NEUMAN referred to sections 56 and 57 and read the language dealing with deductions. He stated his interest in having a discussion on what constitutes "reasonable" overhead expenses; "what's there now, and what's going to be, with ACES."

MS. DAVIS said that the language relating to overhead now appears on page 41, section 56, subsection (a)(2).

[10:55:49 AM](#)

MR. MINTZ turned to slide 16 to explain the next change in the treatment of lease expenditures; subsections (c) and (d), of AS 43.55.165 are repealed. Under current law these sections allow a "separate alternative" track for determining what constitutes an allowable lease expenditures. The department proposes the repeal of this language because the utilization of a "single" track for these determinations, is more feasible for the administration to manage.

[10:58:03 AM](#)

REPRESENTATIVE SAMUELS provided a private business scenario for complying with changing regulations based on regulatory regime changes. He asked the deputy commissioner to comment on the concepts of statute vs. regulation.

MS. DAVIS said:

The idea of putting enough detail into a statute that's fixed for a very, very long, and fairly inflexible period of time is unusual, because it really isn't as workable long term as far as industry [is concerned]. ... Unless it's something that is ... [a] high, intense public concern, and scrutiny needs to be at that level, that the legislators can't delegate it out; you need to keep that type of control. Under ACES what we're proposing, is it has to be spelled out now. Instead of PPT which said, 'it's got to be direct, it's got to be reasonably related, and here's some general rules, ... go forth

and deduct.' And then it was up to the department to figure out ... does this deduction fit that generic rule. ... The judgment call to put the detail in the regulation, we think is a sound one, and a good one. ... Our goal is, as we implement these regulations, it's going to be bringing industry in, it's going to be trying to make sure our [regulations] fit their realities.

[11:05:31 AM](#)

REPRESENTATIVE SAMUELS agreed with the DOR proposals for leaving these provisions under regulatory authority. However, he opined further on the effects of fluctuating regulatory changes that create difficulty in an industry.

[11:06:53 AM](#)

REPRESENTATIVE NEUMAN stated, "Regulations ... allows ... for more adaptation as industry changes; statutes you're locked in."

MS. DAVIS agreed.

[11:07:57 AM](#)

MR. MINTZ related his observation that there has been progress in production tax regulations by the incorporation of many resolutions that will minimize future disputes. He stated that slide 17 continues the lease expenditure provision changes. AS 43.55.165(e) is a list of excluded costs that will never qualify as a deduction. Section 58 of the bill expands this existing list. Paragraph (6) is modified to include costs arising from violation of law or noncompliance with lease or permit obligations. Paragraph (15) now includes all dismantlement, removal, and restoration (DR&R) costs. Continuing with the exclusions on page 18, paragraph (19) includes repair or replacement of facilities or equipment associated with an unscheduled drop in production or an oil spill or release. If there is a problem with the pipeline or other facility, the state will not share in the repair costs.

[11:12:02 AM](#)

REPRESENTATIVE SAMUELS inquired how soon after the effective date of the legislation would the language on this regulation be available.

MS. DAVIS responded that the drafts are still being worked on and industry will be consulted as the language is established. The range and magnitude of disruptions in production will be a major consideration. Once passed, she anticipates regulation to be enacted "as soon as possible."

REPRESENTATIVE SAMUELS asked if regulation could be enacted with the effective date of the bill.

MS. DAVIS offered that emergency regulations can be issued to provide guidance in the near term, if necessary.

[11:15:07 AM](#)

REPRESENTATIVE DOOGAN asked how paragraph (19) addresses the issue of the pipeline suffering a shooting incident.

MS. DAVIS responded that the provisional language was imported to address acts of God and third party acts, as exclusions; unless reasonable measures were not taken to avoid such incidents.

[11:16:27 AM](#)

REPRESENTATIVE DAHLSTROM continued to discuss the liability issues pursuant to providing security for the pipeline.

[Representative Samuels returned the gavel to Chair Olson]

MS. DAVIS suggested that perhaps a first time, unforeseen incident occurs, the company would not be penalized but put on notice.

REPRESENTATIVE DAHLSTROM reminded the committee that many first time incidents would totally shut the pipeline down. She recommended scrutiny of the definition for this aspect of the bill.

MS. DAVIS underscored that this language is about the cost to repair or replace, and does not address the economic impact of production loss.

[11:19:43 AM](#)

REPRESENTATIVE NEUMAN presented the issue of being able to establish whether approved maintenance was scheduled or

unscheduled. He elaborated on how "things happen," and the reason may not be clear.

MS. DAVIS agreed that this is the major point of concern for administration. She described the process and considerations that the department undertook to address this topic. The result/effect of the producer's acts became the bottom line for the department to scrutinize. It is important to note, she said, that this provision does not replace or take away the other exception that remains in the law, which stipulates gross negligence. "This," she said, "is what I call ... a strict, liability, event based exclusion."

REPRESENTATIVE NEUMAN maintained, "This is going to come down to a regulator, in an office somewhere, who just makes his decision."

MS. DAVIS stated agreement and stressed that the regulations need to be "ground based, and the way operations actually happen on the slope."

[11:24:46 AM](#)

MR. MINTZ pointed out that the scenarios described would have to do with activity downstream from the point of production, and the language for this legislation only addresses upstream costs. He returned to slide 18, paragraph (20) to explain the final change in cost exclusions, which pertain to crude oil topping plants or refineries. One of the inputs to the production costs is diesel fuel used in the oil and gas operations. Assuming it is a direct cost of production, the cost of the diesel fuel would be an allowed deduction. Paragraph (20) clarifies that, although the cost of fuel may be deducted, the deduction may not be expanded to cover the cost of building, acquiring, or operating a refinery or topping plant that generates the diesel product.

MR. MINTZ recapped how the amount of tax is levied on a producer: beginning with the gross value of the oil and gas, subtract the lease expenditures, and multiply the remainder by the tax rate. However, he said, the final element in the process is the application of tax credits. Slide 19 addresses the application of these tax credits. The current law, enacted under HB 3001, provides for several new tax credit provisions, aimed at public policy to create economic incentives/improvements benefiting both the producers and the state. He described the amendments as improvements,

clarifications, and conforming changes. The first set of tax credits appear in AS 43.55.023, and found in bill sections 26-31 and 65. Subsection (a) addresses qualified capital investment expenditure credits, which are capital investments for oil and gas exploration/development, which earn a 20 percent credit against the production tax. Several changes were made to this subsection beginning with a provision that "requires spreading out of the credit." No more than 50 percent of the credit may be taken in the first year. The second sets of changes are associated with exploration expenditures that qualify for capital credit. Long before the PPT bill was enacted, he reminded the committee, the legislature enacted some exploration incentive credits; appearing in section 025 of the production tax statutes.

[11:29:25 AM](#)

REPRESENTATIVE NEUMAN pointed out that this "doesn't affect the big operators, but it affects the little guys who ... Alaska is trying to attract."

MS. DAVIS said that, from the state's perspective, this does not represent a monetary issue. The goal, she explained, was to modulate impacts to the state's revenue and minimize spikes created by capital credits; "we dampen that effect and spread it over two years." By creating the way in which information is reported to the state, future forecasts will allow the administration to prepare this legislature for those "spikes."

REPRESENTATIVE NEUMAN said that this does not represent a significant revenue issue.

MS. DAVIS agreed.

[11:31:56 AM](#)

REPRESENTATIVE DOOGAN pursued further discussion on how this credit would work, creating a liability displacement to the state, not eliminating it. He said that it seems "foolhardy ... to be proposing a change of this nature without ... knowing what the real world effects are going to be."

MS. DAVIS suggested that this has been considered by the DOR, and offered how this has been looked at in creating this model.

[11:35:57 AM](#)

REPRESENTATIVE SAMUELS asked how the diesel fuel credits are considered by the auditors in the event that ConocoPhillips Alaska, Inc., chooses to build the refinery on the North Slope.

MS. DAVIS explained how the fair market value of the product was assessed for the model. Further, she clarified the 50 percent credit approach, in response to a further question from the committee.

The committee took an at-ease from [11:37:52 AM](#) to [12:02:47 PM](#).

[12:03:07 PM](#)

MR. MINTZ finished explaining the second point of the conformation language on slide 19. The final change made to the capital credit position, slide 20, prevents undercutting the purpose of the tax floor by disallowing capital credits from being applied, or exported, outside of the legacy field from which they were incurred. The language reads: credits for capital expenditures in a unit subject to the tax floor may be applied only against tax on oil and gas production from that or another unit subject to the tax floor. Beginning on slide 21, a set of changes is addressed, which deals with the type of tax credits associated with "loss carried-forward;" AS 43.55.023(b), bill section 27. This section conforms the percentage allowed, from 20 percent to the percentage tax rate of 25 percent. He explained how a carried forward credit might be incurred by an exploration company; however, there is no carry forward allowed in a legacy field.

[12:07:15 PM](#)

MS. DAVIS pointed out that in making this change from 20 to 25 percent, the new entrants and incumbent exploration companies maintain a parity; without this, new entrants were placed at a tax credit disadvantage. In response to a question from the committee, she explained how this disparity could arise out of the current structure, and how this change creates equality between the taxpayers.

[12:10:19 PM](#)

MR. MINTZ presented slide 22, AS 43.55.023(d), bill section 28, which clarifies the use of transferable tax credit certificates. The new language specifies that two certificates will be issued, each for half of the credit; and one certificate cannot be used until the following year. Additionally, the language of

subsection .023(1) makes it clear that a tax-exempt entity may not obtain a transferable tax credit certificate.

[12:13:16 PM](#)

REPRESENTATIVE DOOGAN clarified that the credits are being provided for exploration purposes, and pointed out that exploration may not lead to production. He suggested that this may cause a disparity if the tax credits are not offered to tax exempt entities, which may undertake exploration/production activities.

MS. DAVIS answered that this is addressed in bill section 40, slide 29, which also excludes the ability of a tax exempt entity to purchase a tax credit certificate under the exploration incentive program. The intent of this language is to direct tax credits to companies that would pay production tax. Using a municipality and utility as an example, she pointed out that these land owners would not be eligible to pay a production tax, should oil be discovered on their land.

REPRESENTATIVE DOOGAN stated his understanding that this is aimed at companies that are in the business of exploring and producing oil.

MS. DAVIS said, "Correct."

[12:15:43 PM](#)

MR. MINTZ directed attention to slide 24, bill section 65, which repeals AS 43.55.023(i); the transitional investment expenditure credits for investments that were made during the five years before April 1, 2006. The department believes this is no longer good public policy. The language for this amendment is still being drafted to avoid unintentional effects that were identified after submission.

[12:18:02 PM](#)

MR. MINTZ introduced slide 25, dealing with the exploration incentive credit provisions; AS 43.55.025, bill sections 36-44. As previously mentioned, the exploration well credit program existed prior to enactment of the PPT, and was rewritten to conform to the PPT. In ACES, additional minor adjustments are proposed. He explained the changes in each of the sections beginning with section 36. This section stipulates four categories of exploration expenditures that qualify for credits.

It is recommended that a uniform sunset date, of 2016, be applied to all four of these categories. As currently written this date applies only to wells drilled 25 miles from an existing unit, or in Cook Inlet 10 miles away, not otherwise meeting qualifications for the strict criteria for exploring a previously untested prospect. In the bill, sections 37 and 43, change language to allow for delineation wells within two drilling seasons. This is accomplished in the bill by redefining the term pre-existing well.

[12:20:56 PM](#)

CHAIR OLSON inquired whether this will have an impact on specific platform wells in Cook Inlet.

MR. MINTZ explained that it comes down to a question of geology and location; in Cook Inlet a presumptive three mile limit has been removed.

[12:22:11 PM](#)

REPRESENTATIVE HOLMES asked if unintentional consequences have been considered in proposing this action, and whether it is expected to encourage developers.

MR. MINTZ responded by describing the categories of development addressed in section 37. Concern arose for the overuse of the suspension category, and DNR proposed this language to minimize that concern. To receive the credit the well must be completed or abandoned, but a suspended well could still qualify for a credit, under specified terms.

MS. DAVIS offered to have DNR generate a response to the committee.

[12:25:05 PM](#)

MR. MINTZ continued with slide 26, addressing the proposal to exclude costs arising from gross negligence or violation of health, safety, or environmental statutes/regulations. Section 38, considered by the department to be a core improvement, requires a clear, geologically based definition, to indicate that a new exploration target is being explored; the target must be pre-approved through the Department of Natural Resources (DNR).

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REPRESENTATIVE RAMRAS pointed out that DNR is currently understaffed, with 139 vacant positions, and asked if this might create a "bureaucratic lag in the process."

MR. MINTZ responded that a determination deadline of 60 days is included in the language.

MS. DAVIS clarified that section 38 (c) imbeds a 60 day timeframe in which DNR must respond.

MR. MINTZ said that no automatic legal consequence would be imposed, however, the departments take these deadlines very seriously. Neither, he said, should this create an administrative burden to be carried out.

REPRESENTATIVE RAMRAS reviewed counsel from Commissioner Irwin's statement with regard to lack of staff; this is an endemic problem within state departments.

MS. DAVIS noted her agreement that with the imposition of this type of hurdle, a realistic stance must be taken. She offered to have DNR respond to the committee on how this directive will be accomplished within the department. To her knowledge, this function will be performed by the scientific geology group, which is fully staffed.

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REPRESENTATIVE HOLMES referred to section 37 and asked if additional administrative concerns are being added by including a gross negligence standard; does this invite arguments for litigation.

MS. DAVIS assured that this language is not unlike the generalized statute that exists. The premise of the underlying legislation has not been changed.

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REPRESENTATIVE NEUMAN observed that if DNR does not meet the 60 day deadline, the consequences are minimal. However, if industry is required to provide documents, daily fines may be incurred.

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MR. MINTZ continued to slide 27, bill section 39, that sets out specific data requirements for exploration credit eligibility. Additionally, existing law provides for 10 years of confidentiality for well data, and represents an inconsistency with existing law.

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REPRESENTATIVE HOLMES referred back to slide 26, regarding gross negligence and observed that gross negligence issues appear in different aspects of the bill. Criminal negligence also occurs, and she asked if this would be considered automatic admission prima facie for gross negligence.

MS. DAVIS suggested that the attorney general could provide a response on this type of tort question.

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MR. MINTZ returned to the tax credit requirements on slide 27, and continued to explain the confidentiality period. Section 39 requires well data confidentiality to be limited to 24 months. Also, a 50 percent rule for tax credits will be imposed in this section. Proceeding to slide 28, continuing with bill section 39, and the basic information about the tax credits for exploration will be made public. Section 40 is a companion provision to .023 credits, and specifies that a tax-exempt entity may not transfer a tax credit certificate. A new five percent tax credit is made available in Section 44, for old seismic data if DNR determines that acquiring the data for public distribution is in the state's interest. This is a means for the state to acquire valuable data for DNR that otherwise would not be available.

MS. DAVIS pointed out that the 5 percent credit in section 44 purchases historical information for the state.

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REPRESENTATIVE DOOGAN questioned if a company with old seismic data could receive 5 percent of their current tax liability by providing the information to DNR.

MR. MINTZ answered that 5 percent of the original expenditure incurred to obtain the data would be considered. In further response to committee discussion, he stepped through the means by which the state would purchase seismic data from an entity.

[A brief discussion on the viability of obtaining seismic data ensued.]

[12:45:02 PM](#)

MR. MINTZ continued with the final subject of tax credits, as indicated on slide 29; how an explorer can turn credits into cash if no tax liability exists to which to apply it against. This bill repeals AS 43.55.023(f), which authorized the department to provide cash refunds for particular tax credit circumstances up to a limit of \$25 million per year, per explorer. The bill replaces that with a new program, AS 43.55.028, establishing an oil and gas tax credit fund to purchase credit certificates from explorers or small producers that have no tax liability to apply credits against. The fund is an appropriation of a percentage of PPT revenues. With the exception of the \$25 million cap, the remainder of the criteria for qualifying provisions remains intact. He reviewed the existing policies.

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REPRESENTATIVE HOLMES asked if this is a dedicated fund.

MS. DAVIS responded, no.

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JERRY BURNETT, Director, Administrative Services Division, Department of Revenue (DOR), responded that this fund is subject to appropriation each year by the legislature. He explained the process for making it a dedicated fund.

REPRESENTATIVE HOLMES said, "So this is another one of these funds that we like to create and ... put money over here but the legislature still has the authority to pull it out and put it somewhere else."

MR. BURNETT replied, "That is exactly correct." Refundable credits are unique. That is, the state is paying a tax payer for a tax refund, when in actuality no tax liability exists. The current PPT law stipulates that these credits are a general fund appropriation. During the past year, the department requested a supplemental appropriation to pay the tax credit liability. He reviewed the recent authorization figures that have come before the legislature for funding tax credits: FY 07

totalled \$59 million; FY 08 will be \$25 million, and a supplemental request will be made to pay the actual \$100 million plus that will be due. Forecasting the tax credits is difficult, he explained, and the department believes that it would be prudent to set aside the total PPT liability to ensure that money will be available at the end of the year.

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REPRESENTATIVE DOOGAN speculated that if the department has the ability to compute the percentage of the total tax liability for creating the fund, why not apply that to the appropriation.

MR. BURNETT clarified that DOR computes an estimate for the fund and the money remaining, after payment, will carry forward or not, based on legislative action. He explained how the estimated revenues work in the bill's fiscal note, and when reported in the general fund. He maintained that the proposed change will create a more transparent process.

REPRESENTATIVE DOOGAN stated that he could see no reason for this to not come under the appropriation request system currently in place.

MS. DAVIS agreed that status quo would be an alternative mechanism. However, the department attempted to take an industry perspective on this issue. It is difficult to package this in a "way that gives confidence to industry that we are taking seriously this funding requirement."

REPRESENTATIVE DOOGAN underscored that arguments continually come before the legislature regarding funds that are not dedicated. He opined that "all you're really trying to avoid here is the appropriations process." Unless a better argument can be brought, he said, he cannot support this proposal.

MR. BURNETT pointed out that this proposal still requires an appropriation decision from, and to, the fund each year by the legislature. The intent is to place parameters around how much money, looking forward, would be available for that purpose. In a time of falling revenues there would potentially be carry forward money from a previous year, that could be used for paying credits vs. using current year general funds.

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REPRESENTATIVE SAMUELS provided a scenario of a company without a tax liability, that incurs a credit but the legislature doesn't appropriate funds to purchase it; what happens legally to the credit.

MS. DAVIS responded that the credit will remain viable and transferable. Thus, it could be commuted to another company that owes a tax to the state, and that company would subtract it from its tax liability.

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REPRESENTATIVE SAMUELS ascertained that the fund couldn't be used for anything else.

MR. BURNETT said that the legislature is able to appropriate money from this fund for any legal purpose.

REPRESENTATIVE SAMUELS continued to pursue the question of the fund availability for other than the legislature's intent.

MR. BURNETT assured that the executive branch and DOR do not spend money in ways for which it isn't appropriated.

REPRESENTATIVE SAMUELS asked if there would be administrative costs to operate the fund.

MR. BURNETT responded that there would be no incremental costs. Furthermore, the fund would earn interest at the same rate as other state funds.

REPRESENTATIVE SAMUELS referred to slide 30, and questioned how and who would establish the specified "criteria" for this fund. He recalled advice from former Commissioner Bill Corbus who cautioned that, when dealing with numbers this large, an individual should not be making the decision.

MS. DAVIS responded that the criteria embodied in the law now, are verifications that expenditures occurred, are accurate, and complete; there is no discretionary call. Also, she pointed out, under ACES it is split into two years, and the cap is removed.

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MR. MINTZ interjected that the criteria for issuing the certificate is different than the criteria for cashing the

certificate. On page 31 of the bill, the objective criteria are set forth, and do not involve discretion.

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REPRESENTATIVE HOLMES inquired how the fund would be managed.

MR. BURNETT explained that a fund of this type would be managed in the Treasury Division of DOR, and accounted for by the Department of Administration (DOA). It would be invested with the general fund and other similar type of investments. Treasury would have the control of the actual investment.

REPRESENTATIVE HOLMES referred to the investment formula in the committee packet, and the provision in section (f) indicating the carry over from year to year. She asked, "How big is big enough."

MR. BURNETT stated that the department would come before the legislature to report and receive advice on the size of fund. He used FY 08 projections as an example of what could be expected if this fund were in place right now.

REPRESENTATIVE HOLMES suggested that this creates a presumption in law, and predicted that it could be growing "out of control for awhile until somebody noticed."

MR. BURNETT agreed that oversight would need to be exercised.

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MR. MINTZ continued with slide 31, to understand how the payment of tax occurs. The exact rules of calculating monthly installment payments have been conformed to the changes in the tax. That is, the different tax floor, and accounting for the Cook Inlet tax ceiling. The progressivity aspect is not included in the monthly installment payments, but will be considered in the total amount of tax due on March 31. Slide 32 clarifies that the department can be particular about the form of electronic payments made, for uniformity purposes.

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MS. DAVIS interjected that also included in bill section 51 is language to provide DOR the authority to issue advisory bulletins to industry.

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MR. MINTZ continued, stating that the tools for the department to improve the administration and transparency of the PPT begin on slide 33. Bill section 46 makes clear that every oil or gas producer must file an annual return, whether or not the taxpayer believes that a tax is due. Additionally, the existing list of information examples required in the return is expanded in this section, and the department retains the right to require more information if deemed necessary. Reporting requirements continue on slide 34, where bill sections 47 and 49 require additional penalties, of up to \$1,000 per day, for late or non filing of returns or reports. There are existing general penalty provisions that apply to the revenue statutes, including penalties for late filing; however, they are based on the amount of tax deficiency without a penalty for failing to file a report. Explorers or producers are required, under bill section 48, to file an annual statement on expenditures or adjustments, even if no oil or gas is produced during the year. Bill section 48 provides DOR clear authority to require monthly reporting. This will keep the department better informed of activity throughout the year. Additional authority is included in bill section 49. Although the department has general authority to require reporting, this would allow it the express authority to require reporting of forward-looking information for revenue forecasting purposes. The final reporting requirement, slide 36, bill section 51, clarifies that the department can require returns and reports to be filed in a specific electronic format.

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MR. MINTZ moved on to the confidential and public information on slide 37. Beginning with AS 38.05.035, bill section 2 recognizes the overlap of information required by DOR and DNR. This clarifies to what extent these agencies may share information while respecting the necessity for maintaining information confidentiality. Under the heading of additional transparency, slide 38 clarifies how PPT information may be published; in an aggregated form based on information from at least three producers or explorers, to minimize the identification of individual taxpayers. Additional administrative improvements in the law, slide 39, bill section 10 places oil and gas auditors into exempt service. He provided that this is necessary in the recruitment/retention of highly qualified auditors who can perform the sophisticated audits. The transition provision, bill section 67, allows current employees to opt to remain in classified service. The

administrative improvement in bill sections 14 and 50, extend the statute of limitations for PPT from the current three years to six years. This is in recognition of the expanded audit requirements. Slide 40, he said, deals with section 1 of the bill and could be considered to be arcane. He explained the current understanding of how the statute of limitations has been handled, and said that this provides a clear interpretation of how these statutes are to be applied. There are no outstanding disputes around this issue, but this provision is timely for clarification purposes.

MS. DAVIS said that AOGA commented on this provision and expressed concerns that interest rates may be impacted.

MR. MINTZ addressed the AOGA interpretation and when interest rates begin to run, regarding retroactive statute of limitations. That is not the intent of this provision, he assured the committee. He said:

We are just trying to make clear that when there's an event that occurs years after the original tax was due, and that event actually involves new money changing hands, that retroactively relates back to the amount of the tax, that the statute of limitations starts to run again with that event, and we're not foreclosed from recognizing the tax consequences.

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MR. MINTZ referred to slide 41, stating that, as previously mentioned, it provides language in bill section 51 to allow DOR the ability to issue advisory bulletins on the interpretation of the PPT statute and regulations for the benefit of the taxpayers and others, without running afoul of the administrative procedures act. The final slides address the issue of transition, applicability, and effective dates. Slide 42, sections 66 and 72 set out that the changes in the PPT are prospective and would begin on January 1, 2008. The changes to lease expenditure exclusions and the use of unit operating agreements for lease expenditures are established in bill sections 66 and 71 as retroactive to April 1, 2006. Also, this is where 165(c) and (d) are repealed, as previously discussed. Slide 43, bill sections 66 and 71 extend the statute of limitations to still-open periods and sets a retroactive date of April 1, 2006. Bill section 71 makes clear that the tax exempt entities may not transfer tax credits back to the beginning of the respective tax credit provisions. The final slide, 44, bill

section 73, aside from specified provisions mentioned, all other aspects of the bill are effective date immediately. Bill sections 68 and 70 address the time line for DOR and DNR to develop and implement regulations; providing a retroactive date for applicable statutory provisions being implemented.

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REPRESENTATIVE SAMUELS referred to the "switching of information" between the departments, and asked how criminal penalties would be applied.

MS. DAVIS stated that the intent would be to have the confidentiality penalties carry over to both departments. She deferred to Mr. Mintz for further clarification.

MR. MINTZ stated that he is not familiar with DNR's penalties regarding confidentiality protection, and offered to provide further information to the committee.

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REPRESENTATIVE DOOGAN referred to the reported vacant auditor positions, stated that conflicting information has been received, and asked to how many oil and gas auditor positions are not filled; what is the requirement history for these positions; and what alternatives to exemption classification could be considered.

MS. DAVIS agreed to provide this information to the committee.

[1:27:22 PM](#)

CHAIR OLSON closed public testimony.

[HB 2001 was held over.]

[1:28:14 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [1:28:18 PM](#).