

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

October 29, 2007

1:31 p.m.

MEMBERS PRESENT

Representative Carl Gatto, Co-Chair
Representative Craig Johnson, Co-Chair
Representative Anna Fairclough
Representative Bob Roses
Representative Paul Seaton
Representative Peggy Wilson
Representative Bryce Edgmon
Representative David Guttenberg

MEMBERS ABSENT

Representative Scott Kawasaki

OTHER LEGISLATORS PRESENT

Representative John Coghill
Representative Nancy Dahlstrom
Representative Max Gruenberg
Representative Kyle Johansen
Representative Mike Kelly
Representative Bob Lynn
Representative Woodie Salmon

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
10/23/07	(H)	Heard & Held
10/23/07	(H)	MINUTE(O&G)
10/24/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
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
10/26/07	(H)	Heard & Held
10/26/07	(H)	MINUTE(O&G)
10/27/07	(H)	O&G AT 2:00 PM HOUSE FINANCE 519
10/27/07	(H)	Heard & Held
10/27/07	(H)	MINUTE(O&G)
10/28/07	(H)	O&G AT 2:00 PM HOUSE FINANCE 519

WITNESS REGISTER

DON BULLOCK, Attorney
Legislative Legal Counsel
Legislative Legal and Research Services
Legislative Affairs Agency
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided a sectional analysis of CSHB 2001(O&G).

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

POSITION STATEMENT: During hearing of HB 2001, offered additional information.

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

POSITION STATEMENT: Answered questions and outlined the differences between HB 2001 as introduced and CSHB 2001(O&G).

STEVE PORTER, Consultant
for the Legislative Budget and Audit Committee
Alaska State Legislature
Tehachapi, California

POSITION STATEMENT: During hearing of HB 2001, answered questions and provided information.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at [1:31:05 PM](#). Representatives Gatto, Johnson, Fairclough, Wilson, Seaton, Roses, Guttenberg, and Edgmon were present at the call to order. Also present were Representatives Coghill, Dahlstrom, Gruenberg, Johansen, Kelly, Lynn, and Salmon.

HB2001-OIL & GAS TAX AMENDMENTS

[1:31:42 PM](#)

CO-CHAIR GATTO 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."

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CO-CHAIR JOHNSON moved to adopt CSHB 2001(O&G), Version L, as the working document. There being no objection, it was so ordered.

[1:33:30 PM](#)

CO-CHAIR GATTO announced that Mr. Bullock would explain the changes incorporated in CSHB 2001(O&G).

DON BULLOCK, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, Alaska State Legislature, began by clarifying that he is not present to advocate any particular position on the legislation. As drafted, the legislation is enforceable if it were enacted in its current form. Mr. Bullock opined that it's helpful to step back and review how the petroleum production profits tax (PPT) works. The tax is on the production of oil and gas, which is an activity that is subject to tax under AS 43.55. Within that statute there is the tax rate, which is proposed to be increased from 22.5 percent to 25 percent in Alaska's Clear and Equitable Share (ACES) [HB 2001]. Furthermore, there's a progressive aspect to the PPT, which is based on the taxable value, the gross value minus the allowable lease expenditures. A new approach to progressivity is included in CSHB 2001(O&G), which is based on the gross value at the point of production. He then explained that one must also review what is taxable. What is taxable under PPT remains under ACES [HB 2001], the gross value at the point of production minus the allowable lease expenditures, except for the way in which the new progressivity tax would work. After the determination of the gross value minus lease expenditures, the tax value for PPT purposes is determined and then the tax rate applies to that, which continues to be 22.5 percent.

[1:35:56 PM](#)

CO-CHAIR GATTO inquired as to where that barrel of oil is at the point of production.

MR. BULLOCK specified that in the case of the North Slope, the point of production is on the North Slope, Pump Station 1 or thereabouts. He explained that value is derived by looking at the sale price of the oil at the ultimate point of sale and then the tanker costs back to Valdez are subtracted as is the pipeline tariff. Therefore, the gross value at the point of production values the oil at the sale price minus the cost to get it there. The aforementioned was the basis of the tax prior to the enactment of the PPT and is the basis for the new progressivity tax proposed in HB 2001.

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MR. BULLOCK continued by explaining that one must determine the taxable amount and then apply the tax rate, which is the gross tax liability. Against that amount of revenue, there can be credits; different investment expenditures will be recognized as a credit and they have to be authorized lease expenditures. This legislation doesn't make many changes to the credit provisions. The taxpayer then files a return to the Department of Revenue (DOR), which then begins its audit process to verify the information. This legislation includes additional tools to help DOR determine the proper amount of tax. At the same time, some of that information may be helpful to the department regarding whether any changes in the tax should be recommended.

[1:38:03 PM](#)

JERRY BURNETT, Legislative Liaison; Director, Administrative Services Division, Department of Revenue (DOR), highlighted that all of these barrels are reduced by the royalty percentage that the state takes or the federal landholder takes. Therefore, it's the gross value of the taxable oil, not all of the oil at the point of production.

MR. BULLOCK commented that royalty is interesting to compare to the tax because it is generally taken free of the cost of production. Royalty is a contractual obligation as opposed to a tax obligation. He pointed out that the state has some experience with net profit share leases in which the state received royalty as a percentage of what was left after the costs were deducted. There have only been a few such leases, he noted.

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MR. BULLOCK then turned to the particulars of [CSHB 2001(O&G)], which offers a new progressive tax based on the gross value at the point of production. The current progressivity, which is based on a dollar amount and the production tax value of oil and gas, is repealed in Section 38. The new progressivity is in Section 18 on page 13 where it adds a new subsection to AS 43.55.011. Under [CSHB 2001(O&G)], progressivity is based on the gross value at the point of production of the taxable oil and gas. The tax, he explained, has a nominal tax rate of .225, which is then multiplied by the total gross value at the point of production of the taxable oil and gas. Then the value of the taxable production is divided by the volume of production, which is effectively the gross value at the point of production per British thermal unit (BTU) equivalent barrel.

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MR. BULLOCK, in response to Co-Chair Gatto, specified that the tax is calculated on a monthly basis. Therefore, if the gross value at the point of production for the month averages more than \$50 per BTU equivalent barrel, then this tax is triggered and calculated for that month. Ultimately, for the year it's added together and becomes part of the tax liability for the year.

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REPRESENTATIVE SEATON asked if the tax is a monthly tax or an annual tax.

MR. BURNETT explained that the tax is [calculated] on an annual basis, while the progressivity addition to the tax is calculated on a monthly basis under CSHB 2001(O&G). The tax is payable in monthly installments, but there is an annual true-up on the amount of total tax for each producer.

MR. BULLOCK said that it's important to note that the trigger is \$50 and the calculation is against the full value at the point of production of all the taxable oil and gas. Therefore, the \$50 is only a factor in the following two instances: "First of all, whether for that month, you do the calculation at all. If it's less than \$50, you don't do it for that month. And also as a basis for determining what that multiplier is that multiplies the .225 times the gross value at the point of production for the tax for oil and gas." Mr. Bullock then pointed out that Sections 14, 16, 17, 19, and 20 are conforming amendments making

reference to the new subsection (o) and to delete references to the former progressivity tax in AS 43.55.011(g).

1:44:05 PM

REPRESENTATIVE ROSES surmised that Mr. Bullock said that on the progressivity factor, the .225 is multiplied times the gross value. However, he also recalled that Mr. Bullock said that the .225 is multiplied times the value of the oil.

MR. BULLOCK replied no, and clarified that it's [.225] multiplied by the total gross value at the point of production of all the oil and gas.

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REPRESENTATIVE ROSES referred to page 13 [subsection (o) in CSHB 2001(O&G)], and opined that it speaks to the difference between the quotient and the \$50. Therefore, it appears to be subtracting \$50. He requested an explanation of the language.

MR. BULLOCK said to forget the \$51 for a minute and suggested looking at all the oil and gas that is taxable and was produced in a month, which has a value. He said that one could start with the value per barrel and multiply it by production and that's the number you would get. Mr. Bullock explained:

Back to your \$51, if the BTU equivalent was \$51, then it'd be the quantity times the \$51. So whatever the total gross value at the point of production, the total of all the oil and gas that's taxable that was produced that month, you take that value and you multiply it by .225. ... so you get a number that's225 times gross value at the point of production, ... it's a small fraction The next thing you do is you ... figure out something similar to your \$51. You figure out how that ... total gross value at the point of production relates to a per barrel basis. And so, you divide that big number, that value of everything that's taxable that was produced, and you divide it by the quantity that was produced so you get an amount, so many dollars per BTU equivalent barrel. So, ... say that it comes out to \$70, and you subtract the \$70 from the \$50, there's language in here that says you don't subtract the dollars to dollars because you'd then be multiplying dollars by dollars So, you take the \$20 and ... you multiply, effectively,

that \$20 times the .225 so you come up with a new fraction that's then applied to the total gross value of the taxable oil and gas. And then that's the amount of the progressive tax. So, as the tax increases, that .225 is going to be a higher and higher number as the value of the taxable oil and gas rises above \$50. And there's limits in here, too, ... that says ... whatever it is it's not going to exceed 25 percent. ... in the assurance provision in here, we say that it won't be below zero. Already, you wouldn't calculate the tax under this section, if the value is \$50 or less because there's no tax. It also says you don't calculate it if it's lower, there's no credit that's generated by low gross value at the point of production for that month. So, you have a rate that applied to all the value and then it's multiplied by another number that's based on the difference between the actual gross value at the point of production for that month at \$50.

[1:48:10 PM](#)

MR. BULLOCK, in further response to Representative Roses, explained that .225 is multiplied times the gross value at the point of production times 20, in the case of 70. He specified:

So, it's .225 times x times y, and y is the difference between the per barrel gross value at the point of production and \$50.

MR. BULLOCK stated that it's a progressive tax based on the gross value at the point of production. The tax increased as the gross value at the point of production. Therefore, the rate under ACES is different than under the current law, and it's also applied to a larger number under ACES because the current progressivity is just applicable to the production tax value, which is gross value minus the lease expenditures.

[1:50:18 PM](#)

REPRESENTATIVE GUTTENBERG asked if the progressivity calculation is standard or are there other ways in which to do the calculation that arrive at a similar place.

MR. BULLOCK confirmed that this is just one option in which the tax increases by the difference between the value of the oil and gas produced compared to \$50.

REPRESENTATIVE GUTTENBERG asked if, in the end, [other methods] arrive at the same place.

MR. BULLOCK answered that it depends. In further response to Representative Guttenberg, Mr. Bullock noted that in the past there have been different tax rates that were applicable to different ranges. Under the former law, there were different tax breaks; 12.5 percent of the gross value at the point of production for the first five years and then it increased to 15 [percent]. There are a number of options and it comes down to the policy decision as to what the legislature wants to encourage through credits or tax reductions and what is determined to be the fairest measure of what the tax should be.

[1:52:27 PM](#)

MR. BURNETT pointed out that the method [in CSHB 2001(O&G)] is a different method than what was in the original bill [HB 2001]. The method proposed provides a smooth function and the same progressivity for all taxpayers regardless of the taxpayers' costs and circumstances whereas the net progressivity provides a different tax rate for each taxpayer, depending upon their costs. He mentioned that a tax table in which there are different rates at different prices could be used.

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REPRESENTATIVE GUTTENBERG recalled that early on in the House Special Committee on Oil and Gas hearings there was a calculation [that resulted] in more than one tangent on a progressivity chart. Without changing the number could a tangent line be achieved by changing the calculation, he asked.

MR. BULLOCK pointed out that the other tax aspect in this bill [CSHB 2001(O&G)] is a tax cap on new gas production outside of the Cook Inlet sedimentary basin and no part of which is north of 68 degrees North latitude. The aforementioned applies only to production from leases or properties that first produced gas after the end of this year.

CO-CHAIR GATTO interjected that 68 degrees is the North Slope.

MR. BULLOCK specified that it's the mountain range in the area. That division line is the same as what's in the PPT.

[1:54:10 PM](#)

REPRESENTATIVE GUTTENBERG recalled that CSHB 2001(O&G) includes a provision that discusses everything south of 64 degrees, referring to Nenana Basin. "What I'm wondering," he asked, "is if it's a different number, do you leave a ring around the state of a gap where there's nothing dealt with?"

MR. BULLOCK reiterated that the reference to 68 degrees is consistent with the tax law while the 64 degrees addresses a different subject area that isn't related to the tax. In further response to Representative Guttenberg, Mr. Bullock related his belief that the provision in CSHB 2001(O&G) that addressed the Nenana Basin also used the 68 degrees.

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MR. BULLOCK then turned to the expenditures for which there were some adjustments in AS 43.55.165. There are some changes in Section 32, AS 43.55.165(a), and Section 33, AS 43.55.165(e). He explained that AS 43.55.165(a) provides guidance for DOR to identify lease expenditures that may be allowed. He then pointed out that AS 43.55.165(c) and (d) were repealed. The repealed sections had to do with what was happening in the unit and the agreement regarding cost sharing between the operator and the working interest owners as well as what was being paid by the working interest owners. Under the new AS 43.55.165(a), DOR has the discretion to review whatever it wants and consider it in determining which lease expenditures are authorized. Mr. Bullock opined that the aforementioned provides more flexibility to "come up with the best information."

MR. BULLOCK noted that these changes on expenditures in Sections 32 and 33 go back to the beginning of the PPT. Section 33 includes something similar to SB 80 and HB 128, which addresses costs related to equipment that may not have been properly maintained and resulted in cost effects. He then highlighted that Section 33(e) disallows lease expenditures that relate to breaking the law or violating a lease provision and expenditures for dismantlement, removal, surrender, and abandonment. Section 33(e)(19) is a new provision that relates to the corrosion issue. He opined that the aforementioned provision is helpful from an audit standpoint because it reviews an event as the basis for reviewing the expenditures. Once that event is identified, the auditors can review the circumstances of the need for the repair. If the requirements specified aren't met, the exercise of due care in operating and maintaining the facility, then the costs for that repair would be disallowed

under [AS 43.55.165(e)(19)]. However, as was the case with HB 128, one of the difficulties was to identify the standard of care that's expected from an operator in the field. This bill [CSHB 2001(O&G)] uses the standard of exercising "due care" in operating and maintaining the facility.

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MR. BULLOCK recalled that there have also been some discussions regarding negligence. However, negligence [can't be defined] until the expected behavior is defined. Gross negligence continues to be disallowed as under current law. As far as simple negligence, [AS 43.55.165(e)(19)] specifies that if a company failed to exercise due care that resulted in harm to the state, in the form of low production or extraordinary costs, those costs won't be allowed. He characterized it as a policy decision in this area. Again, anytime a deduction is given for an expenditure or credit, there's the decision as to whether the state will share the cost or otherwise reduce the tax liability. The issue, then, is what standard of care an entity developing oil in this state is expected to meet. This provision establishes the standard of due care. As an aside, the recent settlement with BP is written in the terms of negligent; it may rise to the level of gross negligence or it may not. Under the current PPT gross negligence isn't allowed while simple negligence would be an allowable lease expenditure without a provision such as proposed in [CSHB 2001(O&G)].

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REPRESENTATIVE ROSES recalled that the plead was for criminal negligence, and therefore he requested that Mr. Bullock parlay that into this discussion.

MR. BULLOCK said that there's often similar penalties, even in the tax area. There are civil penalties for negligence as well as criminal penalties for negligence and fraud. He said that he didn't know the particular elements of the negligence in the criminal case. However, the statute the settlement was based on also generally refers to negligence and thus, he opined, the question is still open as to whether it rose to gross negligence.

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REPRESENTATIVE ROSES opined that it appears that in this particular situation the standards are being defined after the

act has occurred. He inquired as to how someone is held accountable under negligence, gross negligence, or criminal negligence when the terminology hasn't been defined prior.

MR. BULLOCK said what should be defined is what is expected. Common law will define what expected behavior is. If the expected behavior is what a "reasonable, prudent person" would do, then there hasn't been negligence. However, if that standard isn't reached and harm results, then there's a legal conclusion that the action constituted negligence and thus there would be liability to follow.

[2:02:36 PM](#)

REPRESENTATIVE ROSES expressed concern with the defensibility of determining whether an action is simple or gross negligence if the conditions of retroactivity are determined to be prior to the action.

MR. BULLOCK said that part of what Representative Roses is questioning is whether it's constitutional to apply the provision retroactively. He offered his opinion, that it is constitutional to apply this change retroactively. The standard is generally that the first legislative session following the first filing of a return is the time when changes can be made that are retroactive; after that time, there would be an issue as to whether that would be allowed.

[2:03:41 PM](#)

REPRESENTATIVE SEATON compared [paragraph] 19 to the addition of the language on page 26, line 14. If there's a plea of criminal negligence in the [BP case], then there seems to be a violation of law. If that's the case, isn't that covered in the additional language in [paragraph] 6, he asked.

MR. BULLOCK pointed out that [paragraph] 6 refers to the existing law: "costs arising from fraud, wilful misconduct, [OR] gross negligence" and then refers to "**violation of law, or failure to comply with an obligation under a lease, permit, or license issued by the state or federal government**", which is new language. One interpretation of this paragraph is that it would apply to the costs that arose from the violation of the law, which would be penalties, other fines, or other dollar amounts that relate to the violation itself, as opposed to repairing the equipment that went bad, which is addressed in [paragraph] 19. Mr. Bullock clarified that the aforementioned is just the

literal reading of this "and I'm not sure, this ... was offered by the administration and I don't know whether they had an interpretation that would reach the repairs that were required from an accident that also resulted in a violation of law." The settlement with BP specifically says that BP can't deduct the penalty costs it's paying under the settlement and that BP can't say other donations constituting community service are just regular community service because they're related to the settlement of the criminal charge.

[2:06:02 PM](#)

REPRESENTATIVE SEATON suggested obtaining a written statement from the administration as to how broad violation of law is because [paragraph] 19 is very problematic. For instance, what would be considered a scheduled shutdown versus an unscheduled shutdown. If the language could be made broad enough, then all of the unintended consequences can be avoided with regard to unscheduled interruptions as mentioned in [paragraph] 19.

[2:06:58 PM](#)

MR. BURNETT, in response to Co-Chair Gatto, related his understanding that the department would be adopting regulations that would specifically define what is meant by "unscheduled" with a timeframe.

CO-CHAIR GATTO, noting that the legislation is before the committee, questioned whether it's preferable to strike the term "unscheduled". He expressed concern that once the term is used in legislation, it may supersede any regulations.

MR. BURNETT commented that regulations have to conform to statute. He said that he would discuss the suggestion with the Department of Law (DOL) and let the committee know. He mentioned that he would also do so for Representative Seaton's questions.

[2:08:13 PM](#)

REPRESENTATIVE GUTTENBERG inquired as to who makes the determination of failure to comply under a lease.

MR. BULLOCK responded that the first person who makes that decision is the taxpayer, then the auditor looks at it and applies the department's standards, probably in conjunction with

DOL's standards. The determination of what expenses are allowed occurs during the audit process.

[2:09:15 PM](#)

REPRESENTATIVE GUTTENBERG inquired as to the timeframe from the time that the tax is filed and the auditor completing an audit.

MR. BULLOCK specified that under current law it's three years after the return is filed. Under CSHB 2001(O&G), that's extended to six years.

REPRESENTATIVE GUTTENBERG inquired as to the average time to complete an audit.

MR. BURNETT informed the committee that none of the tax returns under the current law have been fully audited. Historically, audits for production tax have taken two to three years.

[2:10:04 PM](#)

CO-CHAIR GATTO inquired as to how a discrepancy is resolved under current law.

MR. BURNETT explained that normally in the course of an audit, the auditor will find exceptions and work with the taxpayer to resolve those. If the exceptions can't be resolved, an assessment will be filed by the department. At that point, it's the taxpayer's responsibility to prove that the assessment isn't appropriate.

[2:10:54 PM](#)

CO-CHAIR GATTO posed a scenario in which there are too few auditors and a four-year-old assessment is discovered.

MR. BURNETT clarified that if nothing was found in the first three years, the taxpayer would be free and clear. Therefore, extending it to six years would provide additional time to the state. He noted that under current law, auditors often work with the taxpayer and extend the time of the audit. Without an extension there's a jeopardy assessment, which is when the auditor doesn't know what the assessment amount will be so the auditor estimates the maximum amount it might be and works backwards.

CO-CHAIR GATTO asked if extending it to six years is endorsed by the administration and the taxpayer.

MR. BURNETT said that he couldn't speak to whether taxpayers like that extension or not.

[2:12:07 PM](#)

CO-CHAIR JOHNSON inquired as to who determines whether due care was used.

MR. BURNETT responded that an auditor would look at the department's regulations, which would be so promulgated under this bill, and which would define what to look at for due care.

[2:13:01 PM](#)

CO-CHAIR JOHNSON surmised that this is then somewhat discretionary.

MR. BURNETT responded that he did not think it would be discretionary. It would have to be in accordance with the regulations as to what constitutes due care and industry practices. At this point, however, there is not a regulation that he can show to the committee.

MR. BULLOCK said one type of thing an auditor would look at is what would have been the reasonable expectation for maintaining a particular field, such as how often to run an inspection or cleaning pig. However, comparisons for what constitutes standard maintenance cannot be with just any field, they must be with similar fields with similar oil because characteristics of the oil can affect corrosion. Thus, a cost would be disallowed only if the company did not follow what is considered the norm for that particular type of field. He said it goes back to how much someone is expected to do to prevent a problem.

[2:14:18 PM](#)

CO-CHAIR JOHNSON commented that this goes back to previous discussions by the committee and the difficulty it had in trying to find the specifics as to what constitutes "good oil field practices". He urged that DOR be very specific in writing the regulations because they will be more important than the decisions made by the legislature. He said that very specific guidelines and regulations are something he will be looking at very closely.

2:16:10 PM

REPRESENTATIVE ROSES followed up on extending the auditing process from three years to six years. He reviewed Mr. Burnett's previous statements that, currently, it is not uncommon for an auditor and the taxpayer to negotiate an extension and that the jeopardy standard is imposed if DOR is unable to negotiate an extension. He asked how often a jeopardy situation has occurred.

MR. BURNETT said he would get back to the committee with that information.

REPRESENTATIVE ROSES stated that he did not want to extend the amount of time if the jeopardy issue has not come up very often.

2:17:30 PM

MR. BULLOCK explained that there are things outside the control of the auditors that affect when they can get the information for making the assessment. One example is that the PPT has opened up the issue of expenditures in the field and those are subject to audits by the Internal Revenue Service (IRS). In some cases, he said, the IRS will get an extension of its statute of limitations, resulting in a change to the Alaska tax liability. Pipeline tariff is a factor in determining gross value at the point of production. A retroactive adjustment to the tariff affects the value of oil and gas produced on the slope and, in turn, affects Alaska's tax liability. Taxpayers are required to notify the state when these types of changes are made, he said. An argument in favor of extending the period to six months, he continued, is that you wouldn't have to keep opening up the statute of limitations. Therefore, it may be a reasonable period to get everything settled so that at the end of six years it is possible to say what the liability is.

2:18:45 PM

REPRESENTATIVE ROSES asked whether Mr. Bullock is saying that the three years are not the issue; rather, the issue is that nothing can be done until these other determinations are made.

MR. BULLOCK said right. There may also be determinations made outside of the scope of what the auditor is looking at or can do.

MR. BURNETT, in response to Representative Roses reiterating his previous questions, said that he would get information to the committee about how often the jeopardy issue has occurred. He stated that since PPT was enacted only 14 months ago, DOR has not yet gotten through an audit.

[2:19:26 PM](#)

CO-CHAIR GATTO related that when the Federal Energy Regulatory Commission (FERC) investigated the pipeline tariff it took six years for the agency to determine that an excessive tariff had been charged. He asked whether, in a case like this, the excess charges would be forgiven because of the three-year limitation.

MR. BULLOCK responded that it could happen, but there is the expectation that people would be reasonable and fair.

MR. BURNETT agreed with Mr. Bullock.

[2:20:34 PM](#)

MR. BULLOCK pointed out that there is a statute of limitations that is applicable to state claims or civil actions in court, and this is a six-year period of limitation. There are some things that the state benefits from, he said, because the state is not just the DOR or the legislature, it is the public. So, in responding to a civil action or court case, the state has a longer period of time to answer a complaint so that it doesn't suffer default judgment. There is some flexibility to allow the government to protect the interests of Alaskans. This is the factor that the committee must look at when deciding what is an appropriate amount of time to determine the actual tax that is due.

[2:21:12 PM](#)

CO-CHAIR GATTO asked whether the clock starts when the challenge is filed or when the challenge is resolved.

MR. BURNETT answered that the statute of limitations for the tax would generally start when the tax is due and filed, so it would be three years from the annual March 31 deadline.

[2:21:39 PM](#)

REPRESENTATIVE WILSON understood that there is a manual for oil industry standards that the industry itself goes by and,

therefore, there is something for measuring what is considered a normal and acceptable standard.

MR. BULLOCK responded that this is the ["Manual of Oil and Gas Terms: Annotated Manual of Legal, Engineering, and Tax Words and Phrases" by Williams, Meyers, Martin, and Kramer] and that he thought the term that was in there was "good oil field practice". He explained that one reason it doesn't come up, and why it can't be said to be relevant, is because governments generally don't get involved with lease expenditures. He gave the example of royalties:

In other states it might be the farmer that owns oil under the ground, a traditional property interest you own from the surface to the center of the earth. The state owns the oil and gas reserves, but since our royalty has always been free of expenditures, we don't know what lease expenditures are, we never get involved in it. And...the Internal Revenue Service in figuring income tax - the state does not audit those expenses, the Internal Revenue Service does - and they determine the tax liability for a multi-state or multi-national corporation and then Alaska gets an apportioned amount based on the volume of production in the state, what the tariffs are, property investment, and other information. So, the state has no history of looking at these expenses, and other states don't because it is a can of worms. But, that's a policy decision that...has already been made. But, it...creates a problem when you get into lease expenditures as what reasonable expenditures are.

[2:23:43 PM](#)

MR. BURNETT added that:

Alaska's petroleum production tax - we call it a net tax - it is actually a tax on the gross margin on production, gross profit level. Unlike income tax, we don't have the same expenditure rules you would have for a corporate income tax. Not all of the costs that a company would normally deduct on a corporate income tax, even if we had a non-apportioned state income tax, would be the same ones that are deductible as lease expenditures. So there can be a number of costs in the state that an oil company has while they are producing oil that are not deductible lease

expenditures. And it is our mission here to define what those are and to make it clear.

2:24:34 PM

MR. BULLOCK further explained that other sources of information as to what constitutes "good oil field practices" usually come up in the context of environmental law and that these sources were discussed in terms of HB 128. On the tax side, however, there just is nothing out there.

2:25:26 PM

REPRESENTATIVE SEATON inquired whether the state is again in the situation of adopting a standard of exercise of due care or foresight for which there is not a judicial qualification or definition.

MR. BULLOCK said he did not know because it is the administration's language.

MR. BURNETT said he will have a DOR attorney get back to the committee in this regard. In response to Co-Chair Gatto, he said the committee would receive this information today or tomorrow.

2:26:53 PM

CO-CHAIR JOHNSON stressed that it is imperative for the committee to receive requested information quickly. He said he will be providing a written list of requests, not only from the House Resources Standing Committee, but also for information requested, but not received, by the House Special Committee on Oil and Gas.

MR. BURNETT, in response to Co-Chairs Johnson and Gatto, said that Ms. Davis or Commissioner Galvin might be able to answer the [standard of due care] question later in the hearing but, if not, he will get someone else to do so.

2:28:34 PM

REPRESENTATIVE EDGMON returned to the issue of auditors, and asked what is the possibility that the work load of an auditor might be significantly more in the future than what is currently anticipated.

MR. BURNETT answered that there is no intention for needing a lot more auditors than there are today. He recalled that there are currently 6 or 7 vacancies within the 17 positions for audit staff. The legislation includes language that would allow auditors to be paid more. The department is intending to contract with a firm to obtain the help necessary for completing the first and second years' audits and the fiscal note includes a funding request for this purpose. In further response to Representative Edgmon, Mr. Burnett said that the department has been working on this for over a year now and has quite a bit of knowledge about where the department is heading.

[2:30:43 PM](#)

CO-CHAIR GATTO asked whether the contracts will be made with auditing firms that specialize in oil and gas auditing.

MR. BURNETT said the intent is to find a firm specializing in oil and gas company auditing.

[2:31:21 PM](#)

MR. BULLOCK noted that the other disallowed lease expenditure is listed in Section 33, [paragraph 20], of the bill: "**costs incurred to construct, acquire, or operate a refinery or crude oil topping plant**". He explained that a topping plant is somewhat like a still; it is used to remove hydrocarbons to procure diesel oil. He understood that the process is done at some of the fuel stations. In response to a question from Co-Chair Gatto, he offered his understanding that it is the first four pump stations that have a supply of natural gas.

CO-CHAIR GATTO surmised that the amount of gas available in the product going down the line has been exhausted, so there would have to be a shift to different power sources.

MR. BULLOCK answered he did not know and that there are probably issues related to pipe size and demand to be considered.

MR. BURNETT explained that a crude oil topping plant is an expensive plant that produces a product that is commercially available from other sources. The administration does not consider a topping plant to be a lease expenditure because building a small refinery for a fuel supply is not something that is required by the lease. "There are other issues surrounding that," he added, "and so this is a topic that has

had some discussion in other committees as to whether it's in the best interest of the state to do it this way or not."

[2:33:02 PM](#)

CO-CHAIR GATTO asked if buying the product from Fairbanks would be considered a lease expenditure.

MR. BURNETT answered that purchasing the product from a commercial vendor would be considered an operating expense. He continued:

The difference is if you build the refinery on site, and you consider it a lease expenditure, it would be a capital expense, which would be a deduction, and it would qualify for capital credits. So, the state would be participating in a much larger portion of the cost upfront.

[2:33:36 PM](#)

REPRESENTATIVE SEATON asked if a plant built "on the lease itself" would escape production tax and royalties.

MR. BULLOCK replied that he did not believe it would. He explained that there are separate provisions that describe when oil and gas are considered as produced. He added, "I expect that it would be considered produced."

MR. BURNETT said he believed that is true.

[2:34:16 PM](#)

CO-CHAIR GATTO said:

But he makes a point that it's already produced when it shows up as crude. If we then take the crude and produce another thing, would that be double taxation then?

MR. BULLOCK responded that refined products are not subject to the production tax. He said, "So, if it's oil and crude oil, and it's natural gas that's produced, it's subject to the tax."

MR. BURNETT suggested a better way to look at it is that the producer is selling a certain amount of its production to itself for use on site.

[2:34:52 PM](#)

REPRESENTATIVE SEATON offered his understanding that any produced product sold off the lease hold to someone else is established at a value and taxed, while any product used on the lease hold itself "does not have that." He requested that the committee be provided with a better definition from someone who is more certain of the answer.

MR. BURNETT replied, "Certainly."

[2:35:27 PM](#)

MR. BULLOCK continued his review of CSHB 2001(O&G). He noted that there is only one change related to tax credits, and it has to do with transitional investment expenditures (TIE). There is a change that is retroactive to the start of the PPT. When PPT was enacted, it allowed taxpayers to look back to certain expenditures they made in the previous five years, between March 31, 2001, and April 1, 2006. He said that CSHB 2001(O&G) changes the five years to three years.

CO-CHAIR GATTO mentioned a claw back provision.

MR. BURNETT said the original governor's bill [HB 2001] eliminated the TIE credit provision entirely, but that CSHB 2001(O&G) reinstated the TIE provision at three years instead of five years. He said there is a sunset of January 1, 2008. Under the original governor's bill, some companies will have taken advantage of the TIE credits; but there are companies that made expenditures and had no production to use against those expenditures, thus these companies would be unable to take advantage of some of those TIE credits.

MR. BULLOCK noted that that credit provision is in Section 24 of the bill and it is an amendment to AS 43.55.023(i).

[2:37:45 PM](#)

MR. BULLOCK said that after the credits, the taxpayer knows what must be paid and files a return. Then it is time for review to determine how the returns and payments line up with the law. The bill has changes that will help expand the information that [DOR] has available. Furthermore, it gives [DOR] more time. The expansion from the three-year statute of limitation period for making assessments is in AS 43.55.075, and is shown in

Section 29 of the bill. Section 13, he noted, amends the current statute of limitations that recognizes an exception for the six-year period in the new section.

[2:38:41 PM](#)

MR. BULLOCK stated that the bill will allow [DOR] new auditors that would be in exempt service. Section 9, he said, makes oil and gas tax auditors and oil and gas royalty auditors in the Department of Natural Resources (DNR) exempt employees. Section 40 provides transition language that allows auditors that are currently employed by the department to opt to become exempt or remain in the classified service.

[2:39:10 PM](#)

MR. BULLOCK said the bill contains additional information requirements from the explorers and producers. Those show in: Section 26, amending AS 43.55.030(a); Section 27, amending AS 43.55.030(e); and Section 28, which adds AS 43.55.040. One of the changes in the information requirements, he noted, is that an annual report would be required from explorers, even if they didn't owe a tax. He said he thinks the intent is to allow the department to know what is going on and "help them with a revenue forecast." Furthermore, there are provisions in the bill that will allow DOR and DNR to share information that might otherwise be confidential. Those departments will have access to an encyclopedia of facts regarding oil and gas production in the state that relates to how the tax will be enforced, what the expenses are, what the future holds in terms of exploration and the likelihood of success. Sections 1-8, 10, and 12 relate to the information sharing. He clarified that the bill would not change the confidentiality of the information; it just allows it to be shared. In response to a question by Co-Chair Gatto, he said the structure of the confidentiality agreements of the two departments varies slightly, mostly in how the information is described. There are also outside limitations on DOR's information; anything that the department gets from the IRS is subject to different confidentiality requirements.

[2:41:21 PM](#)

MR. BURNETT said DOR has the ability to look at taxpayers' federal tax returns under certain circumstances and must follow the rules of the IRS in that respect. The department, for a number of other reasons, has other areas where it has confidential data and strict guidelines for handling that data

internally. In response to a question from Co-Chair Gatto, he stated that, under statute, there is a criminal penalty for revealing confidential information.

MR. BULLOCK said the issue is taken pretty seriously, because the state wants taxpayers to report the information voluntarily the first time and to have confidence that the information will be protected.

[2:42:22 PM](#)

CO-CHAIR JOHNSON said he is concerned about confidentiality. He questioned if it is necessary for everyone in the department to have the capability or if the language could be narrowed down to limit that capability to the auditors only. At some point, he observed, some of the state's departments are actually competitors of the producers, depending upon the situation.

MR. BURNETT proffered that at this point, the department certainly would not give confidential information to secretaries or others. That information would be given to tax technicians, tax auditors, the director, appeals officers, and executive management of the department.

[2:43:42 PM](#)

CO-CHAIR JOHNSON responded that what Mr. Burnett describes is good business practice. He suggested that language is needed in the proposed bill that would set restrictions regarding confidentiality.

MR. BULLOCK stated that as a practical matter, what Co-Chair Johnson suggests would be difficult to do. For example, he said Section 28 of the bill allows the department to require returns to be filed electronically. People in the mail room handle returns as they arrive. He said, "Whether they actually open the envelopes or not, they're going to see the information." The restriction, he said, applies to every person in the department, and if any one of them discloses the information, that is a violation of the confidentiality statute. He said this is a management issue; it's the job of management to ensure that only those who need the information actually see it.

[2:45:00 PM](#)

MR. BURNETT confirmed Mr. Bullock's remarks. He explained that tax payments come into the treasury, and there are people who

work cash management who have to be able to take care of the credit payment information. He said there are a number of places within the department where certain types of information must be handled, and these can change over time; therefore, it would be difficult to define in statute which employees would be allowed to see confidential material. In response to a question from Co-Chair Johnson, Mr. Burnett said every employee in DOR signs a confidentiality agreement when he/she is hired. He stated his belief that everyone in the tax division, treasury, and the financial section takes [the issue of confidentiality] "extremely seriously," as do those working in the Child Support Services Division and the Permanent Fund Dividend Division.

MR. BULLOCK noted that he worked for DOR 30 years ago at which time he signed a confidentiality form and, therefore, he still cannot reveal anything.

[2:47:14 PM](#)

CO-CHAIR JOHNSON asked if the same could be said for DNR.

MR. BURNETT said he could not speak for DNR, but that the Department of Administration requires all state employees to sign a form that requires that they keep all confidential information confidential.

[2:47:41 PM](#)

REPRESENTATIVE WILSON said confidentiality is demanded in the fishing industry related to when the processors pay their taxes, and she has never heard of anyone there saying that that information has ever been leaked.

[2:48:36 PM](#)

CO-CHAIR JOHNSON reiterated that he wants to ensure the integrity of confidentiality.

MR. BURNETT repeated that the department takes the issue seriously. In response to a question from Co-Chair Gatto, he said he is unaware of any violations occurring during his three years of working at DOR. He said a small amount of taxpayer information was inadvertently leaked to a legislative committee from DNR several years ago, but he offered his understanding that the information was "captured pretty quickly" and did not involve the oil industry. In response to a question from Co-Chair Gatto, he said there have been no violations regarding

confidentiality in the three years since he has worked for the department. He recollected that a small amount of tax payer information had been inadvertently leaked to a legislative committee from DNR several years ago, but that it was captured quickly and did not involve the oil industry.

[2:49:38 PM](#)

MR. BULLOCK said there is a current exception to the disclosure of taxpayer information if it is possible to cleanse the information for statistical purposes. For example, to show how much revenue is received from a particular tax. That can be disclosed, and that type of information is disclosed in the revenue forecast, he said. One of the changes in the bill is to allow the publication of additional information. Section 35 adds a new section, AS 43.55.890, which would authorize DOR to disclose some tax information, provided that the information is an aggregation of three or more producers.

[2:50:34 PM](#)

MR. BULLOCK recommended viewing CSHB 2001(O&G) as having three segments: the tax segment, with its change of progressivity and tax cap; the expenditure segment, which includes the disallowances of certain costs, violations of law, dismantlement, repairs resulting from negligent maintenance, the topping plant, and the tax credit change from five years to three years; and finally, that segment of the bill that relates to determining the actual amount of the cash that the state should receive, what the tax should have been, and auditors and information available to the department to make assessments. In response to Co-Chair Gatto, he said he does not believe there are any changes to penalties in the bill. He noted that there are existing penalties in Chapter 5 of Title 43 that apply to failing to pay without good cause and a penalty for negligence or intentional disregard of the law, the latter of which is 5 percent of the tax amount.

[2:52:01 PM](#)

MR. BURNETT, in response to a question from Co-Chair Gatto, said the interest currently has an 11 percent floor.

CO-CHAIR GATTO said 5 percent seems light.

MR. BULLOCK clarified that the federal failure to file penalty is 5 percent a month up to 25 percent and half a percent a month

for failure to pay. He said penalties are separate from interest. Interest, he said, is just the compensation to the state for the loss of use of the money, whereas penalty is an imposition for not doing something that should have been done and not having a good reason. He stated that if there is an honest dispute about the interpretation of law, then that is an issue where there might have been a reason for what the person did. He said there are also criminal penalties for negligence and fraud. He stated, "Fraud is when they know what it ought to be and they intentionally try to deceive the department otherwise."

MR. BURNETT noted that tax evasion is a Class C felony.

[2:53:56 PM](#)

MR. BULLOCK, in response to a question from Representative Seaton regarding installment payments, said the federal penalty is a penalty equal to the interest and from the date the installment payment was supposed to be made until the date when the tax is due on April 15. He said when it is unpaid at that date, then a statutory rate of interest applies. He added, "And if you don't pay it on that date, then the failure to pay penalty applies." He said the way the PPT is written is that if there is an underpayment of the installment during the year, the taxpayer would have to pay interest until that filing and due date, and then at that point it becomes an unpaid tax, as opposed to an unpaid installment, and then the interest is due on that amount. He said he did not know off-hand whether interest accrues on the interest on the underpayment of the installment.

[2:55:03 PM](#)

REPRESENTATIVE SEATON said:

But as I recall, the interest was not the statutory 11 percent interest until the actual true-up tax date, and that it was a lower federal rate and depended upon ... how much it was underpaid as to that rate.

MR. BULLOCK read:

The unpaid amount of an installment payment required under the installment payment statute that's not paid when due bears interest at the rate provided for an underpayment under the IRS Section 66.21, compounded

daily from the date the installment is ... due until March 31.

... Interest accrued, under that paragraph, that remains unpaid after March 31, is treated as an addition to the tax, and bears interest for the unpaid tax.

MR. BULLOCK said that answers what he did not know: The interest that is a penalty for underpaying the installment is fixed when the return is due, and that continues to bear interest the same as the unpaid tax, if there is any at that point.

[2:57:28 PM](#)

MR. BULLOCK, in response to a follow-up question from Representative Seaton, explained that this interest is on the underpayment of an installment; therefore, if the payer was brought current, then interest would just run for the period in which that installment was underpaid.

[2:57:46 PM](#)

REPRESENTATIVE SEATON noted that under the old Economic Limit Factor (ELF), a monthly tax was paid, and that this was changed by the PPT to a tax based on a taxpayer's annual yearly profit, thus becoming an annual tax. He inquired whether a conversion was made back to a monthly tax for progressivity when oil and gas was changed from a net tax to a gross tax under subsection (o) [in CSHB 2001(O&G)].

MR. BULLOCK said whether or not somebody is subject to the progressivity tax is determined on a monthly basis. If the gross value at the point of production is above \$50 in a month, then that triggers the tax for that month. The next month, if it's \$49, there's no tax under that provision, because it does not apply for that month. He continued, "And then, over the year, you look at all the months for which the progressivity tax was required to be paid, what that total amount was, and that's the amount that would have to be trued-up." He said there is a provision "in here" that amends .020 and addresses how monthly installment payments are determined.

[2:59:48 PM](#)

REPRESENTATIVE SEATON asked, "Is that monthly installments for the net tax or is that..."

MR. BULLOCK interjected, "It's for both. They continue to make installment payments." He specified:

The second of two amounts used to calculate the installment payment for a month is the amount calculated for the month under AS 43.55.010, which is the new provision.

MR. BULLOCK said there will always be timing elements. He explained, "Because it takes time from the time it comes out of the ground ... until it gets delivered to a refiner and they determine sales price. And so, the times aren't always exact; there's some adjustments, and those adjustments should show up in the true-up in a year." He reiterated that he had worked for DOR and in the case of monthly taxes, every time there was a return filed for that month it starts a whole new statute of limitation. Therefore, he continued, changing to an annual basis lumps everything together and provides a neat way of truing up before April 1, and then the statute of limitations can apply to that whole year.

[3:01:08 PM](#)

REPRESENTATIVE ROSES inquired why it is necessary to make the auditors exempt, as opposed to having a contract or reclassification of the position. Does [DOR] not already have the capability of making a position exempt without the help of the legislature, he asked.

MR. BURNETT said [DOR] does not have the authority under existing law to make positions exempt in the executive branch without additional legislative authority. He said there is a section that allows the governor to create exempt positions for a specific study or project for a temporary purpose, but this is ongoing work of the department.

[3:03:09 PM](#)

REPRESENTATIVE ROSES asked about reclassifying the current positions, as opposed to making them exempt.

MR. BURNETT responded that all of the department's auditor positions were reclassified about three years ago. He continued:

However, ... when you're doing a classification under the state classification and pay plan, you have job class families, and each job class family is a group of related jobs that have a similar type of work, and there are different levels The pay plan compares those jobs on, I believe, eight factors that relate to the type of work - the complexity, the qualifications, et cetera. The difference between the oil and gas revenue auditors and the corporate income tax auditors is not a difference specifically in qualifications or in the difficulty of work. It is that people with a specific industry knowledge have a market - there's a niche market for people in the oil and gas industry. And the market for those people is a higher paid job market than it is for people in other parts of those professions, while they may have the same technical qualifications. ... If you look at the statute ... Title 39, I don't remember exactly the site ... several years ago the legislature made ... petroleum geologists and petroleum engineers exempt from the classification pay plan for exactly the same reason - because they could not offer a competitive salary for people who were specifically in that industry. It's not so much the job they're doing, but the relationship with the industry and the pay in the industry.

[3:05:32 PM](#)

REPRESENTATIVE ROSES said his summary of Mr. Burnett's statement is that reclassification does not work because the entire group of employees that do auditing would have to be reclassified, as opposed to those that just do oil and gas auditing.

MR. BURNETT answered yes. He said that last year the Murkowski Administration adopted a market-based pay plan. That plan identified job class families where the market pay was less than where state employees were. Compared to other jobs in state employment, he said, those jobs were not necessarily underpaid. However, there are certain jobs, like nursing, where there is a nationwide labor shortage. Therefore, nurses and related jobs and tax auditors and related jobs were given a two-range pay increase, which is approximately equal to an increase of 15 percent in pay. Even with that increase, the state has continued to have difficulty in attracting people who have specific industry experience who would be familiar with the cost

of an actual oil production facility or an oil company. So, this is the reason for the request, he said.

3:07:17 PM

REPRESENTATIVE WILSON asked why the department doesn't just continue to contract "these positions."

MR. BURNETT explained:

We have not let any contracts at this point for this. This is ongoing work, which is done by members of a collective bargaining unit in state government. And every collective bargaining agreement that I'm aware of in state government has a provision that does not allow the state to contract out work that's normally done by the members of that collective bargaining unit, unless the state can clearly show through a feasibility study that it's less expensive for the state to do that. It is not less expensive for us to do this. It's necessary because we need to find an auditing company that has the skills - the specific industry knowledge and experience - to help us do this.

3:08:33 PM

REPRESENTATIVE WILSON asked if Mr. Burnett was saying that the department cannot contract out because the union agreement won't allow it.

MR. BURNETT replied that it is his understanding that it would require a feasibility study and/or some type of negotiation with the union before the department could change the agreement to contracting out. He continued:

And that would not allow us ... to be able to hire employees. ... We believe we need employees with specific industry experience [and] qualifications, and we believe that the market price for those is much higher than what we can pay under the classification and pay plan for the state.

3:09:24 PM

REPRESENTATIVE WILSON recalled a similar situation related to the nursing field and it took two years to complete a market comparison study.

MR. BURNETT said he was involved in that work and confirmed that it took at least two years.

[3:09:59 PM](#)

CO-CHAIR GATTO remarked, "So, doing that is sort of like an investment in future earnings."

MR. BURNETT concurred.

[3:10:08 PM](#)

CO-CHAIR JOHNSON asked whether there has been any analysis on contracting out:

I mean, right now it's not cheaper or less expensive to contract out with employees that we have now. Has there been any kind of analysis once we get our market comparison to the more skilled type auditors that we're going to have to pay for? Has that analysis been done?

MR. BURNETT answered:

That type of analysis would be something that would be ongoing as we contracted with people and hired people. So, what the ultimate mix would be is -- it's very difficult. If you look at the fiscal note that was presented with this bill, it indicates that our intent is to hire an auditing company full-time for the next three years, at least, and also bring in expertise so that we have people in the department.

[3:11:08 PM](#)

REPRESENTATIVE GUTTENBERG remarked that the House Resources Standing Committee is the fourth committee that has been faced with this question. He asked whether the administration has sat down with one of the bargaining groups and asked, "How can we resolve this?"

MR. BURNETT said he could not speak to that issue because the commissioner of the Department of Administration is responsible

for collective bargaining, not DOR. A solution is trying to be found that least compromises the state's classification and pay plan, has the least impact on the work force, and yet "allows us to ... accomplish this." He continued:

If you look at the statutes, you'll find that jobs like pharmacists, doctors, psychiatrists, ... petroleum economists, ... petroleum geologists, [and] commercial analysts are in the exempt service, and the reason is because there are market pay niches where you can't compare them to other work. ... So, that's what we're looking at here is a very specific niche market.

[3:13:48 PM](#)

REPRESENTATIVE SEATON said he would like Mr. Bullock to share any sectional analysis or notes with the committee.

CO-CHAIR GATTO mentioned material from [DOR Deputy Commissioner] Marcia Davis.

MR. BURNETT said a more descriptive document is being worked on currently. He said Ms. Davis and [DOR Commissioner] Pat Galvin are presently in a meeting with the governor but that they will probably attend the committee meeting in the afternoon.

[3:14:49 PM](#)

CO-CHAIR GATTO confirmed that Steve Porter was present in the room.

The committee took an at-ease from [3:15:14 PM](#) to [3:36:20 PM](#).

[3:36:44 PM](#)

CO-CHAIR GATTO asked whether there were further questions for Mr. Bullock.

CO-CHAIR JOHNSON offered the committee's appreciation for Mr. Bullock's hard work.

MR. BULLOCK responded that it is an honor to be doing this work because it is important to the future of the state and the people living here.

[3:38:47 PM](#)

CO-CHAIR GATTO inquired whether the limited information regarding results of the PPT and the lack of auditing is because of not enough DOR auditors.

MR. BURNETT explained that when PPT passed last year it authorized seven additional auditor positions for DOR, for a total of ten positions that includes tax technicians as well as auditors. While DOR has been hiring people over the past year, the existing production tax auditors were, and still are, auditing production tax returns under the old statute. Additionally, the existing auditors were also writing the regulations for PPT. He pointed out that there is a time lag because an audit cannot be done until after the taxpayers' returns are received which is in April.

[3:41:11 PM](#)

CO-CHAIR GATTO asked if April is when the data is just starting to be received or is completely received.

MR. BURNETT said April is when the tax returns are completely received. While the state knows how much money it has from the monthly filings, the audit process cannot begin until after the annual return is filed and the data is complete. That is one of the improvements that the state is looking for in the statute.

MR. BURNETT, in response to Co-Chair Gatto, stated that DOR has no intent to add new auditor positions beyond filling the department's five existing vacancies and hiring the contract auditors included in the fiscal note.

[3:43:10 PM](#)

REPRESENTATIVE WILSON inquired whether it is normal to be two years behind in the state's auditing process.

MARCIA DAVIS, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), confirmed that two years is normal. She explained that at the end of March DOR receives returns for the prior calendar year. However, many taxpayers are in joint ventures on the North Slope for which federal tax returns are not due until October, and this invariably results in the individual operators then having to file amended returns with DOR. It is therefore better for DOR to wait until November to begin the auditing process. Because the department is nearly a

year behind at the outset, she continued, being two years behind is actually quite good.

[3:44:59 PM](#)

REPRESENTATIVE FAIRCLOUGH asked how DOR processes its advertisements for auditor positions.

MR. BURNETT responded that all final recruitments for state employees in the classified service are posted on Workplace Alaska through the Department of Administration. Additionally, during the past year DOR also spent over \$100,000 for print advertising throughout the U.S. in trade magazines and general circulation newspapers.

[3:45:59 PM](#)

REPRESENTATIVE FAIRCLOUGH inquired whether centralizing the hiring process [through Workplace Alaska] causes so much delay in the processing of applications that applicants have taken other jobs before the state is even able to respond.

MR. BURNETT noted that DOR's hiring manager is able to see applications as they come into Workplace Alaska and can contact applicants as soon as the application period is over. However, he said, very few qualified auditors have applied and almost none have had the specific oil and gas experience and knowledge that DOR is seeking.

MS. DAVIS, in response to a further question from Representative Fairclough, acknowledged that the state hiring process is certainly less nimble than in private enterprise against which the state is competing for auditors. In those cases where applicants had accepted another position prior to being contacted by the state, she said it was unknown whether that was the result of timing or the clear disparity in pay.

[3:49:26 PM](#)

REPRESENTATIVE FAIRCLOUGH related that some of the departments have said that modifications to the hiring practices by the previous administration resulted in slowing the timeline for hiring. She asked whether DOR advertised for its vacant positions.

MR. BURNETT stated that DOR had advertised over the previous year for all of the positions. He explained that due to

insufficient applicants for the higher level positions, DOR decided to downgrade positions and try hiring people at the entry level. The department stopped advertising on Workplace Alaska during the process of reclassifying the positions which took a long time.

[3:50:43 PM](#)

CO-CHAIR GATTO commented that attracting teachers to the state is also becoming more difficult each year. He inquired whether the state is allowed to use more active, aggressive hiring methods than just waiting for people to apply.

MR. BURNETT said that having the positions be exempt would allow DOR to contact people and offer them a position. This could be done in a day as long as the commissioner and the governor's Chief of Staff agreed with the salary.

CO-CHAIR GATTO commented further that DOR needs to tell the committee what it will take to attract qualified auditors for the positions.

[3:53:27 PM](#)

CO-CHAIR JOHNSON requested organizational charts for the auditing divisions of both DOR and DNR that show staff positions and whether or not they are vacant.

MR. BURNETT agreed to provide a chart. He said the last time he looked there were 19 vacant positions in the tax division, including the oil and gas auditors.

[3:54:30 PM](#)

CO-CHAIR GATTO asked whether there is a cost-cutting environment directing that not all of the vacant positions be filled.

MR. BURNETT answered that there are guidelines on how many vacancies a department should budget for and the range is approximately four to seven percent depending on the size of the organization. He said that 20 out of 120 positions is significantly more than 7 percent and DOR is certainly not intentionally budgeting for that.

[3:55:19 PM](#)

STEVE PORTER, Consultant for Legislative Budget and Audit Committee, Alaska State Legislature, stated that as former deputy commissioner for DOR he is familiar with the state's difficulty in filling auditor positions. It is a problem that began six years ago and is not associated with the start of the PPT. He said that while he was with DOR, various strategies for attracting auditors were discussed, including one long-term strategy of hiring auditors fresh out of school and hiring many more than needed with the idea being to "train up your own." During the training period which can take up to six years, the state would lose its trainees to federal government and private industry because - on the salary scale - the state is at the bottom of the pile. Those auditors remaining with DOR would be staying out of loyalty to the state, not because of being well paid. Thus, he said, the vast majority of people before you today are working out of commitment to public service.

CO-CHAIR GATTO remarked that Alaska needs to pay its auditors enough so that Alaska is their first loyalty because they could work as loyal public servants for any state.

[3:59:19 PM](#)

REPRESENTATIVE FAIRCLOUGH pointed out that no audits have yet been done under PPT because of the two year time lag. She expressed her concern that the bill before the committee is based on auditing experience under the old ELF system and is therefore only a "best guess" at what information is needed by the state.

MS. DAVIS responded that DOR addressed this weakness by sending its current staff of auditors for training with an outside contractor whose specialty is auditing the joint interest accounts of companies operating around the world. The auditors who received this training were consulted during the drafting of the administration's bill, she said.

[4:01:27 PM](#)

REPRESENTATIVE GUTTENBERG said he is aware that DOR is about to lose some senior people who have been there for 20 years. He inquired whether DOR has a plan for filling these positions and addressing this loss of institutional knowledge.

MS. DAVIS said DOR's plan is to stop hiring entry level people and use the exempt auditor positions [established under HB 2001] to bring in "high-level" people with extensive oil and gas

experience. The exempt status will allow a higher pay scale for attracting experienced people from industry as well as government. Further, she explained, DOR will fill current vacant positions with the most experienced people that can be found and the senior auditors who are about to retire will work side-by-side with these junior auditors to ensure that they receive training.

[4:03:36 PM](#)

CO-CHAIR GATTO requested Ms. Davis to compare the differences [in the various versions] of HB 2001.

MS. DAVIS stated that her typed comparison is between the original HB 2001 [ACES], and [CSSB 2001(RES)], and the House Special Committee on Oil and Gas (HO&G) proposed committee substitute (CS) for HB 2001, Version 25-GH0014\K, Bullock, 10/27/07 ("Version K"), but that her handwritten notes on the comparison relate to the bill actually passed by the committee - CSHB 2001(O&G), Version 25-GH0014\L.

The committee took an at-ease from [4:05:41 PM](#) to [4:12:58 PM](#) to distribute copies of Ms. Davis's written comparison to committee members.

[4:13:18 PM](#)

MS. DAVIS reviewed how to interpret her written comparison and then addressed the differences between the bills. Section 1 of ACES [HB 2001] was removed in [CSHB 2001(O&G)], she said, but the administration would like the provision to be reinstated. She explained that Section 1 requested a statement of legislative intent regarding the interpretation of AS 43.05.260 by a DOR regulation. These relate to how the statute of limitation is applied when circumstances change after the statute of limitations runs out. Currently, the department has three years from the date a return is filed to claim that the return is incorrect. After three years, the state is precluded from re-opening the return. Ms. Davis continued explaining that under this statute and regulation, DOR has taken the position that it can go back and re-open a return after the statute of limitations has expired when a Federal Energy Regulatory Commission (FERC) ruling modifies the tariff rate for that time period or when expenses are disallowed on a federal tax return, resulting in an increase of taxes that would have been owed the state.

[4:18:13 PM](#)

CO-CHAIR GATTO asked whether the FERC ruling zeroes out the clock so that the state can go back three years after the FERC ruling.

MS. DAVIS answered that she was not sure and would get back to the committee, but that it does re-open the department's opportunity to look at a return.

[4:18:40 PM](#)

MS. DAVIS stated that DOR is not aware of any outstanding lawsuit on whether the statute should or should not be opened. But, she said, the Alaska Oil and Gas Association (AOGA) expressed its concern before HO&G that this statute was somehow a way to lock down an interpretation of how interest would be calculated. She said that it was not contemplated by DOR that this statute would affect other laws related to interest. Therefore, the Senate Judiciary Standing Committee is reviewing the language to make sure it does not override existing law relating to interest.

[4:19:29 PM](#)

MS. DAVIS skipped the differences in provisions relating to the progressivity factor and tax rate elements of AS 43.55.011(e)-(p), saying that they are scheduled for discussion by the committee on 10/30/07. Ms. Davis also skipped the provisions relating to AS 43.55.020 that describe how the tax gets paid, saying that any changes made to the tax rate in AS 43.55.011 will affect the provisions of AS.55.020.

[4:21:28 PM](#)

MS. DAVIS moved to a provision relating to economic terms in AS 43.55.023(b). She explained that under existing law the tax rate is 22.5 percent and that a company producing oil and gas can take deductions and capital credits, thus receiving a 22.5 percent relief against that tax. For a company with no production and therefore no tax liability, PPT allows the expenditures to be carried forward and used as deductions in the future, but only at 20 percent a year. She said this disparity probably arose when the tax rate was 20 percent and the carried forward loss was 20 percent, and that when the tax rate was changed it was forgotten to also change the operating loss carry forward. She said that the administration had asked HO&G to

correct this disparity by matching the operating loss carry forward to whatever tax rate the committee established. However, she stated, the committee overlooked this.

[4:23:25 PM](#)

CO-CHAIR GATTO inquired whether the 20 percent per year loss carry forward disappeared after five years.

MS. DAVIS answered yes, as it pertains to each particular "bucket of costs". For example, if the tax stayed at 22.5 percent, the administration would seek to have the loss carry forward changed from 20 percent to 22.5 percent. In further response to Co-Chair Gatto, Ms. Davis explained that the maximum per year for loss carry forward is 20 percent for each bucket of costs and that this amount is not reduced or increased for each successive year during that five year period.

[4:24:23 PM](#)

REPRESENTATIVE GUTTENBERG asked whether there is a point of having the same number between the tax rate and the tax credit.

MS. DAVIS responded, yes, the point is to give them the same economic benefit associated with having those capital expenditures and being able to use them as a deduction. This way, someone who is already producing will not have an economic advantage over someone who has not yet entered into production.

[4:24:57 PM](#)

REPRESENTATIVE SEATON inquired whether Ms. Davis is talking about net operating loss carry forward or TIE credits.

MS. DAVIS said she is referring to the net operating loss carry forward in AS 43.55.023(b), but that this provision is not included in the bill that is before the committee [CSHB 2001(O&G)].

[4:25:48 PM](#)

MS. DAVIS reviewed the difference between the administration's original bill [HB 2001] and [CSHB 2001(O&G)] regarding treatment of the TIE credits. She said the original bill removed TIE credits in their entirety because they had already been used for 2006 and 2007 and the effective date of the bill would be

January 1, 2008. Therefore, she continued, benefit was received for one and two-thirds years.

[4:27:16 PM](#)

CO-CHAIR GATTO commented that the previous House Resources Standing Committee (HRES) had addressed TIE credits and eliminated them altogether.

MS. DAVIS replied correct.

CO-CHAIR GATTO said the HRES's justification for eliminating TIE credits was because companies had already made the benefit of that investment, so being able to go back and access the benefit a second time constituted "double dipping". He said HO&G returned the TIE credits to the bill [CSHB 2001(O&G)] in a slightly different form.

[4:28:08 PM](#)

MS. DAVIS responded that under CSHB 2001(O&G) the TIE credits go back three years instead of five years. In working with the Senate Resources Standing Committee, she continued, the administration discovered a problem with completely eliminating TIE credits: incumbents can use their TIE credits for 2006 and 2007, but new entrants that have incurred costs but do not yet have production cannot. So, to put new entrants on equal footing with incumbents, the senate's version of the bill [CSSB 2001(RES)] allows the carrying forward of unused credits for 2006 and 2007. She said the administration estimates that this will preserve 60-70 million dollars' worth of credits from the smaller producers. Under CSHB 2001(O&G), which preserves unused 2006 and 2007 credits for incumbents as well as new entrants, the administration estimates it will be an additional \$900 million to \$1 billion.

[4:30:10 PM](#)

CO-CHAIR GATTO asked Mr. Porter if he agreed with the administration's estimate on the amount of money involved.

MR. PORTER said yes. The way the formula works is that a company's 20 percent credit is a fixed number - whatever the company spent during that five years it gets to take a credit on that at 10 percent per year. He explained that removing the years 2001 and 2002 results in roughly \$1.2 billion or so being taken off of the total value, but that the total value is only

what is subtracted against. Therefore, 2008 doesn't change because the formula doesn't change, it just reduces the amount; and the years 2009-2013 don't change either. The only thing that happens in those last two years is the loss of that proportion of the 20 percent. The money is taken off the back end, he continued, thereby leaving most of the credit the company would have applied for anyway. He agreed with Ms. Davis's estimate and said it's about \$200 million per year. In further response to Co-Chair Gatto, Mr. Porter explained that [unlike a deduction] credits reduce a company's tax bill dollar-for-dollar.

[4:31:52 PM](#)

REPRESENTATIVE SEATON inquired whether the credit for each company will be recalculated and adjusted down to the last three years.

MR. PORTER answered that the credit is a "single batch number" so that the year doesn't matter because it is a total number that is being reduced.

[4:32:47 PM](#)

MS. DAVIS, in response to questions from Representative Fairclough, stated that [HB 2001, as introduced,] did not have a provision for allowing new explorers to take their unused TIE credits, a harsh impact that the administration had overlooked. Therefore, she said, the administration sought an amendment to correct this harsh effect on new entrants. She explained the importance of a level playing field in order to attract new entrants to the state. Giving new entrants the full benefit of incentives created by the state's tax policy is not giving them an advance leg up, rather it is treating them the same as incumbents. New investment by incumbent producers is equally, if not more, important to the state's revenue picture, she opined.

[4:34:42 PM](#)

REPRESENTATIVE FAIRCLOUGH asked whether it was an issue of fairness, then, from the administration's perspective.

MS. DAVIS answered yes, because the administration is asking to make the law effective January 1, 2008. The benefit has been received, banked, and booked by incumbents for the 2006 and 2007 time period, she said, and it would be unfair to not provide the

same benefit to new entrants that were unable to use the credit because they had not yet gotten their production going.

4:35:24 PM

REPRESENTATIVE FAIRCLOUGH agreed that it is an issue of fairness for new entrants because they had laid plans. But, what about fairness for the incumbents that had laid exploration plans as well, she asked.

MS. DAVIS stated that in the five years prior to PPT, there was no expectation by companies that they would receive deductions for capital costs and investments made during that time period. The incumbents' decisions, she said, were based on the economics as they knew them at the time and all companies were treated the same in that time period. Now, one and two-thirds years after passing PPT, their TIE credit provision is being reconsidered and the question is how to change things while making sure that incumbents and new entrants are treated the same. This is done by allowing incumbents to keep the TIE credits that they used in 2006 and 2007 and giving new entrants the same opportunity for those years, because they both spent money in 2006 and 2007 relying on the TIE credit being in place at that time. Thus, what makes it fair is to make the law change effective January 1, 2008.

REPRESENTATIVE FAIRCLOUGH commented that she understood the administration's perspective and the distinction being made. She said that despite the cloud over the past legislature's head, she wanted to honor the body's recognition that both new and incumbent investors had moved forward.

4:39:25 PM

CO-CHAIR JOHNSON opined that the major producers have made investment decisions over the past 18 months that were based upon receiving TIE credits. Where is the fairness regarding the money they invested on the basis of receiving credits that are now being taken away, he asked.

MS. DAVIS responded that there are clearly key drivers in decision making, such as the ability to immediately apply capital credits in the year incurred. This additional credit that can exceed 10 percent of the total amount, may or may not have served as an added bonus or been a key change in the decision process for the years 2008 onward. She said the administration is looking forward, not backward; thus, the

question is fair in terms of benchmarking what incremental difference the TIE credit made for future investment decision.

4:41:25 PM

CO-CHAIR JOHNSON expressed his concern that companies made decisions based on the 10 percent credit being enough for moving ahead and assuming an investment risk. He said he would rather have jobs than \$900 million more in the state's treasury.

MS. DAVIS said the economic analysis due out on 10/30/07 will play a prominent role in evaluating what constitutes an appropriate tax structure and risk for both the state and industry. With the TIE credits being \$900 million-\$1 billion spread out over five years, the question is whether \$200 million a year makes a difference. This figure can serve as a benchmark while reviewing the numbers and what the companies were looking at for the next five years.

CO-CHAIR JOHNSON remarked that he is looking forward to the economic analysis because no one, including the companies, has been able to deliver any type of information as to what the companies were looking at for the next five years.

MS. DAVIS said she was looking forward to the information as well.

4:43:43 PM

REPRESENTATIVE GUTTENBERG submitted that the investment decisions made three to four years ago were made at oil prices of \$60-\$70 per barrel, but now the price is about to sail past \$100. The time the company goes into production is the time it gets its return. Giving the company a credit carrying forward might be nothing compared to what it is going to get on the dollar for the barrel; so, there is a balance there.

CO-CHAIR GATTO surmised that many investment decisions are based upon projections of at least five years, thus the decisions were made long before there were any TIE credits.

MS. DAVIS agreed that decisions made prior to 2006 did not contemplate TIE credits. What companies would have contemplated, she said, is a stress price. Prices in 2000-2004 were \$20-\$40 a barrel, so a stress price would have been somewhere in the \$20 range. Evaluation of whether a project is a "go" or "no go" is based on a very conservative estimate of

the future oil price. This stress price is used because a company has no control over what happens from there forward relative to price.

[4:45:48 PM](#)

MS. DAVIS next explained that Sections 36-44 of the original bill [HB 2001] contained provisions for improving the exploration incentive credits (EIC) in AS 43.55.025. She said DNR assisted with making these improvements which expanded the scope of wells eligible for the EIC and shored up DNR's right to receive data, well logs, and seismic information in the course of providing those credits. These provisions were left out of [CSHB 2001(O&G)], she said.

[4:47:01 PM](#)

REPRESENTATIVE SEATON inquired whether these provisions were left out for a future committee to address or rejected by HO&G.

MR. PORTER said he thought they were left out with the intent for a future committee to address. He said there were positives, such as date changes, that benefit the industry, but that there were also some added burdens on industry such as the types of data they are required to provide. The previous committee did not spend much time dealing with this issue, he continued, but the details could be addressed by this committee if it so wished.

REPRESENTATIVE GUTTENBERG urged that the committee address the issue because the lack of information hinders the state's ability to manage its "oil patch".

[4:48:34 PM](#)

MS. DAVIS outlined Section 45 included in the original house bill [but excluded in CSHB 2001(O&G)]. She explained that the provision expanded the tax credit fund in AS 43.55.028 to include the buy back of exploration incentive credits in addition to the buy back of capital credits under PPT. The department must request an appropriation in advance for purchasing the capital credits; however, DOR is working blind because the capital credits have not come in by the time that the request must be made. Under current PPT law, the credits must be refunded within a 60-day turn around. Therefore, DOR must come back with supplemental appropriations. For example, she said, the appropriation for next year is \$25 million, an

amount that is clearly inadequate. The original bill set up a fund that would be there for the coming year, Ms. Davis continued. The fund is 15 percent if the price of oil is less than \$60 and 10 percent if it is above \$60. Since it is a non-dedicated fund, it is available for the legislature to appropriate to other purposes, but its express purpose is for providing the refunds presented to DOR. She suggested that whenever any funds are left over, the legislature could choose to either appropriate less for the following year or let the number increase and create a cushion for those times when extraordinary costs are being offset against net tax or the price of oil plunges.

[4:51:04 PM](#)

MS. DAVIS noted that CSHB 2001(O&G) includes the original bill's requirement for producers to file annual reports and non-producers to file both annual and monthly reports. However, the penalty provision for failure to file a report was not included in CSHB 2001(O&G), she pointed out. Additionally, both versions provide DOR with the right to request forecast information, but again the penalty provision for companies that fail to provide forecast information is left out of CSHB 2001(O&G). The result is that DOR can request information from the industry but cannot enforce that request. She explained that under existing law the penalties that DOR can impose are percentages of the existing tax liability. However, since there is no tax liability associated with information reports there is no penalty and, thus, no means of enforcing DOR's requests for information. Therefore, she said, DOR is requesting that the committee consider reinserting these penalty provisions.

[4:52:27 PM](#)

REPRESENTATIVE SEATON related concern by industry that the penalty provisions would allow DOR to go back under the six year timeline and assess fines of \$1000 per day for that entire time period. He asked whether DOR would assess the penalty based on the date the report is requested or the date the report was to have been filed.

MS. DAVIS responded that she had not heard of this particular concern. In further response to Representative Seaton, she said she would get back to the committee in this regard.

[4:53:54 PM](#)

MS. DAVIS stated that the provision in Section 56 of the original house bill was excluded from CSHB 2001(O&G). She explained that this provision would re-write AS 43.55.165(a) to require DOR to issue regulations that specifically define what are considered leasehold expenditures, rather than having the statute define what are not leasehold expenditures. The current statute is self-implementing and therefore precludes DOR from issuing regulations. This has resulted in producers being given too much discretion in interpreting what constitutes direct and reasonable leasehold expenditures related to the development of oil and gas upstream.

MR. PORTER added that the provision would reverse the current structural relationship between the industry and the state.

CO-CHAIR GATTO surmised that it is much easier to say what is in because it is impossible to come up with all of the outs.

MR. PORTER responded that saying what is in is not without problems because it is possible to accidentally exclude numerous things that are probably normal lease expenditures. So, both occur and the state needs to be aware of the risk of both sides of the equation, he advised.

[4:57:07 PM](#)

REPRESENTATIVE SEATON asked whether this provision was omitted intentionally by HO&G or was a deferral for another committee to deal with.

MR. PORTER said he did not know.

MS. DAVIS, in response to Co-Chair Gatto, explained that non-substantive conforming language had to be inserted into [CSHB 2001(O&G)] when it excluded the Section 56 provision.

[4:58:07 PM](#)

REPRESENTATIVE GUTTENBERG requested an elaboration of the cost allocation for expenditures upstream in AS 43.55.165(h) [a provision excluded from CSHB 2001(O&G)].

MS. DAVIS said this was a rewrite by DOR of AS 43.55.165(h) in regard to the department adopting regulations that describe the means for allocating costs between oil and gas and between leases and properties in order to determine which leasehold expenditures apply to which leases. While drafting regulations

to implement the PPT statute regarding this issue, it was discovered that the statute is not as clear as DOR would like. Because the department has written the regulations, she said, this is only a clarifying amendment because it doesn't change or specify any allocation rules.

[4:59:35 PM](#)

REPRESENTATIVE SEATON said he thought the whole goal of having oil and gas together in PPT was so that there wasn't a cost allocation between oil and gas. Is this now instituting an allocation between oil and gas, he asked.

MS. DAVIS answered that this is exactly right regarding concerns that were expressed during the last time. This does not change the language in PPT to that extent because the original language still remains. Where there is a reasonable method of allocating cost between oil and gas in between leases, she explained, there can be instances when facilities are shared between units and it is necessary to figure out which costs go to which participating area (PA).

[5:00:48 PM](#)

REPRESENTATIVE SEATON inquired whether the clarification is related to the upstream utilization of energy that is non-taxable when the energy is used within the unit, but is taxable when it is sold outside of the unit.

MS. DAVIS responded that there might be numerous reasons why, from a tax point of view, there is a need to allocate a leasehold expenditure between oil or a gas in between fields or PAs, and that Representative Seaton's example could be one of them because there is non-taxable and taxable product flowing at the same time.

[5:01:33 PM](#)

MS. DAVIS finished her comparison of the bills by noting that the differences in regard to definitions, repeal, retroactivity, and applicability are due only to the need for conforming language as a result of removing sections from [CSHB 2001(O&G)].

[5:02:26 PM](#)

CO-CHAIR JOHNSON reiterated that maintaining confidentiality is of utmost importance to him. He asked for assurance that there would be no breaches of confidential information by the state.

MS. DAVIS responded that both DOR and DNR take their obligation for preserving taxpayer confidentiality very, very seriously. Sharing of information between the departments would be undertaken using aggressive systems for maintaining confidentiality that would be put into place from the very beginning. She said she envisioned that a protocol committee would be established by the two commissioners to set up standards, lockdown procedures, and a list of the individuals having access to the information.

[5:04:51 PM](#)

CO-CHAIR GATTO surmised that confidential documents would be related to property rights and that the release of these property rights would be a criminal offense.

MS. DAVIS stated that DOR's standards for confidentiality impose criminal sanctions for any release and that those criminal sanctions would also apply to DNR personnel who have access to confidential DOR information.

[5:05:31 PM](#)

CO-CHAIR GATTO asked whether it would be a Class C felony.

MR. PORTER said he did not know.

MS. DAVIS said she is unsure whether it is a Class C misdemeanor or felony and that she would get back to the committee.

CO-CHAIR GATTO opined that this is an important issue because information sharing between the two departments will increase the volume of documents being viewed by individual state employees and that the committee was as concerned about this as the industry.

[5:06:20 PM](#)

REPRESENTATIVE GUTTENBERG pointed out that legislators also have confidentiality agreements and cannot talk about any proprietary information given to them. He asked what the penalty is, other than job loss, for an industry employee who releases confidential information.

MR. PORTER answered that there is no requirement for the industry to keep its own data confidential and that each company would determine its own penalty. If information is accidentally released, he said, it becomes public data.

[5:07:17 PM](#)

REPRESENTATIVE GUTTENBERG said he is referring to the concept of the whistle blower - where industry gives the state confidential information, but someone from inside the company then releases information that shows there is something wrong with the information that was given. While the information may be confidential for the state, the industry person releasing the information will only suffer ramifications from inside the company.

MS. DAVIS said that this is correct. However, companies usually have contractual arrangements with each other and with operators about what information can and cannot be publicly divulged.

[5:08:30 PM](#)

REPRESENTATIVE GUTTENBERG asked why some people were required to sign confidentiality agreements in order to see the Wood Mackenzie reports, while others were not.

MS. DAVIS explained that Wood Mackenzie sells its product to an entity, such as the state or a company. Generally, the terms of that contract allow the sharing of the information internally with the entity's employees, directors, and officers. Any sharing of information beyond this circle, such as with a contractor hired to help analyze the report, must be approved by Wood Mackenzie. She said that DOR and the Legislative Budget and Audit Committee purchased the report together and that Wood Mackenzie reserved the right to approve the list of contractors with whom the report would be shared.

[5:09:58 PM](#)

CO-CHAIR GATTO inquired whether DOR ever has confidential documents that must be supplied to the producers for which the department insists must remain confidential.

MS. DAVIS responded that DOR can discuss confidential taxpayer information only with that taxpayer.

CO-CHAIR GATTO surmised that whatever DOR tells the taxpayer is, in turn, confidential.

MS. DAVIS said correct.

[5:10:38 PM](#)

CO-CHAIR GATTO asked if DOR included legislators in the group that it would be sharing the Wood Mackenzie information with.

MS. DAVIS said she was unsure because the contract was with the Legislative Budget and Audit Committee. The report was shared between DNR, DOR, and the committee, and it was DOR's intent that the information also be shared with legislators. The protocol was that any legislator viewing the report would need to affirm that he/she understood the terms imposed on the report by Wood Mackenzie.

REPRESENTATIVE SEATON confirmed that legislators were required to sign a confidentiality agreement, but that [the ability to review the Wood Mackenzie report] did not extend to [legislative] staff.

[5:12:05 PM](#)

REPRESENTATIVE SEATON referred to the new language in paragraph (6) on page 26 of CSHB 2001(O&G). He recalled that there was some question as to whether the costs [specified in paragraph (6)] could be interpreted as fines and court fees. He opined that it seems very unreasonable that "we would say that a lease expenditure does not include costs arising from fraud or wilful misconduct and then limit it to court fees and fines." He related his understanding that a clarification of what "a violation of law" means and whether it includes a criminal negligent plea by BP on the North Slope. He then said that he wants to find out whether paragraph (19) [on page 28 of CSHB 2001(O&G)] is necessary for the intent of the legislature or whether the new language in paragraph (6) is sufficient. He characterized paragraph (19) as problematic for the industry to work with in the future.

[5:15:40 PM](#)

CO-CHAIR GATTO commented that he is always cautious with regard to unintended consequences of language.

[5:16:47 PM](#)

CO-CHAIR GATTO reviewed the schedule for tomorrow, during which public testimony will be taken at 6:30 p.m.

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at [5:18:07 PM](#).