

SENATE FINANCE COMMITTEE

November 12, 2007

4:10 P.M.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice Chair
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas
Senator Fred Dyson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Lyda Green; Senator Gary Stevens; Senator Hollis French;
Senator Johnny Ellis; Senator Gene Therriault; Senator Thomas
Wagoner; Senator Bill Wielechowski; Steve Porter, Legislative
Consultant, Legislative Budget and Audit Committee; Dan
Dickinson, Consultant, Legislative Consultant, Legislative Budget
and Audit Committee; Barry Pulliam, Senior Economist, Econ One,
Research, Contractor, Legislative Budget and Audit Committee;
David Teal, Director, Legislative Finance Division

PRESENT VIA TELECONFERENCE

None

SUMMARY

CS HB 2001(FIN) am

An Act relating to the production tax on oil and gas and to conservation surcharges on oil; providing a limit on the amount of tax that may be levied on the production of certain gas that is produced outside of the Cook Inlet sedimentary basin; relating to the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; expanding the period in which the Department of Revenue may assess the amount of oil and gas production tax and conservation surcharges; prohibiting a producer or explorer from receiving tax credits if certain judgments are not satisfied and

requiring, as a condition of receiving the tax credits, the deposit of the amount of certain unpaid judgments and certain interest on those judgments in the court during an appeal and relating to that interest; relating to state oil and gas audit masters; making conforming amendments; and providing for an effective date.

CS HB 2001 (FIN) was HEARD & HELD in Committee for further consideration.

CS FOR HOUSE BILL NO. 2001(FIN) am

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Co-Chair Steadman called the Senate Finance Committee meeting to order at [4:10:55 PM](#).

[4:11:47 PM](#)

STEVE PORTER, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, reminded the Committee about a past presentation which talked about the value equation; value, minus the costs, times the tax, minus the credits, yields the total value. He began his presentation by focusing on total revenue - West Coast - received from selling the oil, as depicted on graph 1. He related that the next step is that transportation costs are deducted from every barrel of oil, both the royalty barrels and the non-royalty barrels, shown in slide 2.

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Mr. Porter highlighted gross production value - the value after the royalty is taken care of, as depicted on slide 3. Next, producer costs are taken out before the production tax value is determined - slide 4. The production tax value is the value upon which the tax is calculated.

Mr. Porter turned to slide 5 to show the base production tax, which on the current PPT is 22.5 percent. The new proposed tax is 25 percent. The slide shows the producer cash flow, not producer profit, because "profit" suggests a return on the money. The state tax is based on a single snapshot in a year - whatever cash flow happens in that year is taxed.

Co-Chair Stedman noted that Senator Stevens, Senator Ellis, Senator French, and Senator Therriault had joined the meeting.

Mr. Porter explained that in a low price world the margin for the tax base begins to occur. Revenue share is a percentage of the effective rate of the tax.

Mr. Porter discussed excluded costs from the producer cash flow. Those costs are actual costs and cannot be included in the producer cash flow. As excluded costs are increased, the producer cash flow is lessened. They cannot be considered as part of producer profit.

Mr. Porter turned to slide 7 to show the next piece, corporate income tax.

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Mr. Porter discussed the progressivity tax shown on slide 8, which is based on the trigger price. It is based on the amount of cash flow per barrel. The slope of the line is based on the tax factor, whether it was .4 or .2 percent.

Co-Chair Stedman noted that Senator Wagoner and Senator Wielechowski had joined the meeting.

Mr. Porter addressed the federal government take shown on slide 9, which is 35 percent off the top after all the other calculations are made. The producer does get to deduct state taxes against the federal tax. Two elements are not shown on this slide: property tax and credits.

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Mr. Porter reported that slide 10 shows that, at the current price of roughly \$9 per barrel, the base tax ends up being about 22.5 to 25 percent, the progressivity tax, if it caps out at 25 percent, would be roughly the same, corporate income tax and federal tax are added, and the current effective tax rate is plus or minus \$90 per barrel.

At-Ease: [4:21:25 PM](#)

Reconvened: [4:22:56 PM](#)

DAN DICKINSON, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, referred to a handout entitled "Summary Comparison between Various Approaches to Production Tax" (copy on file.) The analysis compares current law with HB 2001 (Alaska's Clear and Equitable Share - ACES), and CSHB 2001(FIN)am, which passed out of the House recently. The color coding shows red as current law, yellow depicts the Governor's proposal (ACES), and white reflects something not found in either of the other two proposals.

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Mr. Dickinson explained that on the first page, the base rate for the House version of the bill is 25 percent. The progressivity has elements from current law and the Governor's proposal, as well as elements of its own. The trigger point - or how much margin is allowed on each barrel before progressivity kicks in - is at \$30. The slope - or the amount added to the tax for each dollar per barrel over the starting place - is at .4 percent. It is calculated on a monthly basis and it is applied to the net with a cap of 25 percent of net.

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Mr. Dickinson suggested examining the language in the bill at this point. He referred to page 12 of the House version of HB 2001 where subsection (g) deals with progressivity. He summarized that the monthly production tax value is calculated in the manner described in AS 43.55.160(a), except that the gross value at the point of production for the month is substituted for the gross value at the point of production for the calendar year. The base tax is calculated by taking the gross value and subtracting the costs in order to come up with the net value.

Mr. Dickenson reported that the floor remains as in current law - a single floor calculated on the North Slope. Credits can still be applied against the floor. The rate ranges from 0 to 4 percent. The one difference has to do if there are gas sales from the North Slope for use in state.

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Mr. Dickinson explained the investment credits, which are found in AS 43.55.023. The provision in current law that says they can be taken in the year of investment, applies to the House version of the bill. The percentage of loss carry forward credits has been changed to 25 percent. A new entrant would get 20 percent. The ability to use transitional investment (TIE) credits ends December 31, 2007. If investments were made between March 31, 2001, and March 31, 2006, then there is money in the TIE credits. He explained how TIE credits could still be allowed to go forward.

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Mr. Dickinson related that exploration credits are found in AS 43.55.025 and predate PPT. The exploration credits varied depending on certain conditions. With PPT, the same set of rules applied. This legislation raises exploration credits to 30 percent, but keeps development and production capital investments at 20 percent.

Mr. Dickinson noted that bad acts are disallowed when applying for credits. Under the new legislation, DNR will take a more active role. In addition, exploration outside of the Cook Inlet has to be three miles from any pre-existing well.

Mr. Dickinson reported that the confidentiality of well data has changed to two years, or if the Commissioner of DNR thinks the data would adversely affect a lease sale, or if a private landowner does not want the information to become public.

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Mr. Dickinson explained that the current bill expands what is allowed for pre-existing wells. Transitional investment credits prior to 2003 can be offered by DNR for up to 5 percent of the costs incurred.

Mr. Dickinson listed the exception to tax credits. If there is an unpaid judgment, the state will withhold credits.

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Mr. Dickinson addressed the state purchase of the credits, which can be made by appropriation and has a limit of \$25 million per taxpayer. The ARM Board is authorized to purchase credits and the state would, in turn, purchase the credits from the ARM Board.

Mr. Dickinson dealt with the allowable lease expenditures - costs that are deductible. AS 43.55.165 has been changed to say that before a cost can be deducted, the State has to authorize it through regulations. The idea behind the structuring of costs was the notion that most of the oil produced are in units with working interest owners. The change involves the implicit use of producer audits of operators.

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Mr. Dickinson explained that there is a list of bad acts which would disallow the deduction of costs for repair or replacement. The current law regarding dispute resolution remains. Public outreach costs are listed and removed.

Mr. Dickinson reported that the final item under deductible costs for operating a lease would be determined on a formulaic basis. He explained the formula, which will apply to legacy fields. Base costs in 2006 would be multiplied by 3 percent annually. He related how recalculations would be determined if overpayments were made. The first year, the base would be multiplied by 137 percent due to a shortened timeframe.

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Mr. Dickinson continued to speak to forecast issues. Before a penalty is assessed, the state must ask for documentation. The request for documentation can not occur retrospectively.

Mr. Dickinson addressed the disclosure of tax information, comparing the three various approaches. The House version states that information of individual taxpayers cannot be revealed. It does require that tax information for three taxpayers be combined.

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Mr. Dickinson explained that in the House version, the sharing of data between departments remains unchanged. The statute of limitation was changed to six years. The Department of Revenue would create six exempt positions for master auditors and the remaining positions would remain classified.

Mr. Dickinson noted that the effective date of the bill would be January 1, 2008.

Mr. Dickinson mentioned that downstream costs were changed in the House version to be the lower of the actual or the reasonable costs for tankers and for the pipeline.

Co-Chair Stedman noted that Senator Green was present.

Mr. Dickinson addressed the gas ceilings in Cook Inlet. The average rate is calculated and any gas produced for instate use receives the same rate.

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Mr. Dickinson spoke about additional penalties for over and under reporting of payments. The IRS rules apply for under payment of taxes. An additional penalty has been added for under reporting of payments. If costs are overestimated by 10 percent, the company would owe a 10 percent penalty. Gross negligence would incur a 20 percent penalty.

Mr. Dickinson reviewed the intent language. He noted that savings from the ceilings on gas should be passed on to the consumers.

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Mr. Dickinson discussed the final four administrative issues. Monthly estimated payments under current law do not allow for a ceiling. The House version of the bill allows for ceilings to be applied monthly. Up to \$50 million generated by progressivity may be appropriated to go to LIHEAP funding. There is new language that deals with whistleblowers. There is a provision which allows DNR to rewrite their Net Profit Share Lease Regulations to be retroactive. The required 2011 Report was deleted.

Mr. Dickinson addressed a mechanical issue in one of the amendments that dealt with fixed operating costs, which also required a report in 2011.

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Senator Elton asked about the unpaid judgment as an exception to tax credits. He assumed that it would apply to the Exxon Valdez, but not to Point Thomson. Mr. Dickinson did not know.

Senator Dyson stressed the importance of protecting high level auditors from punishment for disagreeing with their boss. He questioned if the whistle blowing provisions would apply. Mr. Dickinson explained that state employees are excluded from the provisions. Senator Dyson questioned if they should be provided protection. Mr. Dickinson noted that auditors can only be removed for cause. Master auditors could be removed merely because they were thought to be troublesome to the administration's vision.

Mr. Porter added that the application is correct in that the risk is there. Generally, auditors are in the professional ranks and it normally would not be a problem.

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BARRY PULLIAM, SENIOR ECONOMIST, ECON ONE, RESEARCH, CONTRACTOR, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, referred to a handout entitled, "Estimated Average Effective Tax Rate, Government Shares and Revenue Impacts at Various West Coast ANS Price Levels" (copy on file.) He noted that the charts contain new DOR volume projections and new cost projections. The House version of the bill was also added.

Mr. Pulliam highlighted the first chart, "Effective Tax Rate on Gross Taxable Value at Various West Coast ANS Price Levels." The chart compares PPT, PPT Expected, SB 2001, Senate Judiciary CS, and the House bill. He noted that the difference between PPT and the PPT expected is the cost issue. The PPT expected incorporates the cost as expected last year, while PPT incorporates currently expected costs. All five tax rates use the Fall 2007 DOR Forecasts.

Mr. Pulliam pointed out that the House bill and the Senate Judiciary version closely mirror each other because they have some of the same elements. They have the same 25 percent tax rate and the same progressivity feature. They each top out at a 50 percent overall tax rate. They fall below, at low prices, the SB 2001 line because they don't have the same gross floor that SB 2001 has. They raise more quickly, over \$55 per barrel,

because of the higher progressivity. He pointed out that the House bill is not retroactive, which results in a lower tax rate. Another difference is that the House bill incorporates deemed operating costs for Prudhoe Bay and Kuparuk. EconOne has estimated these numbers in aggregate, which could cause them to change.

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Mr. Pulliam explained that the next chart is "Estimated Total Government Share at Various West Coast ANS Price Levels". The House bill and the Senate Judiciary bill are very similar because each is progressive with the government share rising at higher price levels. All the tax scenarios have a progressivity feature to them.

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Mr. Pulliam spoke to the "Estimated Marginal Government Share at Various West Coast ANS Price Levels". He explained the revenue to the state and federal government as prices rise by a dollar per barrel. At \$80 per barrel, the share of the increased revenue at \$81 would be 80 percent to government take and 20 percent to the industry. The figures increase until 85 percent; at that time they decline. Until that point, rising progressivity causes the tax rate to climb. Prices begin to decrease due to cap provisions; all are at 50 percent with the exception of the current PPT, which caps out at 47.5 percent.

Mr. Pulliam noted that the Senate Judiciary and House versions of the bill, with .4 progressivity, will reach the higher take point sooner than the current PPT or SB 2001. At \$100 ANS the cap would occur. When progressivity is not as steep, it would not be reached until \$120 or more.

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Mr. Pulliam spoke to the fourth slide, "Estimated Average Effective Tax Rate, Government Shares and Revenue Impacts at Various West Coast ANS Price Levels". The bottom box shows the estimated revenue impact of each of the different proposals relative to the current PPT. The Senate Judiciary CS and the House bill have similar figures. He explained that at \$80 a barrel, the Senate Judiciary CS and the House bill both would have significant revenue impacts over and above SB 2001.

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Co-Chair Steadman asked for an explanation of how Capex and Opex are handled when the price deviates from the \$60 mark. Mr. Pulliam explained that the operating and capital costs are fixed at a \$60 reference level and then allowed to deviate from that point. If prices rise above \$60 they both increase; if prices fall below \$60 they both decrease. They operate with a one-year lag. The relationship for Capex is larger than for Opex. Capex modeling is consistent with DOR assumptions and the modeling that results in their fiscal notes. The specific figures for capital are that if prices go up by 1 percent, capital spending would go up .3 percent the following year. The reverse is also true. The relationship for operating costs is, for every percent increase in price over \$60, operating costs go up by .2 percent the following year. The reverse is also true.

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Senator Thomas noted that the chart indicates that PPT Expected would outperform all versions other than a price range from about \$95 - \$122. Mr. Pulliam agreed. He explained that the analysis of the PPT Expected forecast focused on a narrower price band. Forecasters did not foresee the high rise of prices. The assumption reflects a fixed cost world.

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In response to a question by Senator Thomas, Mr. Pulliam stated that it would be unlikely in the near time period that prices would fall below \$40 per barrel.

AT EASE: [5:24:02 PM](#)

RECONVENE: [5:26:35 PM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, provided a handout entitled, "Tax Rates in Various Versions of SB 2001" (copy on file.) He reviewed the major provisions of a tax system based on net cash flow. PPT has a base rate of 22.5 percent. ACES, Senate Judiciary, and House versions of the bill raise the base rate to 25 percent. The Senate Finance version returns to a base rate of 22.5 percent. Currently under PPT, the trigger is at \$40. All of the other proposals have a trigger at \$30. The rates vary; under PPT the progressivity is .25 percent, ACES is .20 percent, Senate Judiciary and the House versions are at .40 percent, and the Senate Finance version is at .60 percent and has multiple triggers and multiple rates. Comparing maximum

rates shows PPT at 47.5 percent, ACES, Senate Judiciary, and House at 50 percent, and Senate Finance is capped at 75 percent, but never actually goes beyond 50 percent.

Mr. Teal compared the tax systems three ways: increase in revenue, total revenue, and government share. He emphasized that the models are snapshots and many components such as monthly take vs. annual take and credit delays don't show up. These models depict relative positions.

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Mr. Teal looked first at increases in revenue under ACES relative to PPT. The base rate is 25 percent. He described the gross floor and the impact of the trigger, which flattens out and produces \$400 to \$500 million more a year than PPT. He compared the progressivity factor in PPT and ACES.

Mr. Teal described what would happen when adding the Senate Judiciary line. The base rate is 25 percent, but at the trigger point, a much higher progressivity kicks in, which generates more revenue more quickly. PPT is a longer, slower climb. Eventually, ACES, and Senate Judiciary produce the same revenue at high oil prices.

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Mr. Teal noted that the House and Senate Judiciary versions are the same. He described the addition of the Senate Finance version to the graph. It produces the same amount of revenue as PPT does with a 22.5 percent base rate until the trigger point is reached, at which point progressivity is high - as much as .6 percent. Then it begins to taper off producing between \$1 billion and \$1.7 billion more than PPT. Where others reach their maximum at 50 percent, PPT continues to climb at .1 percent progressivity and holds flat at very high oil prices.

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Mr. Teal turned to the second way of comparing tax scenarios, total state revenue. Revenue continues to climb under all scenarios. PPT is low; ACES is a shift upward. Senate Judiciary and House versions are higher revenue at lower oil prices, but then the high progressivity in the Senate Finance begins to catch up, and at the \$90 range, the same revenue is produced. At higher prices, the progressivity continues to climb and produces more revenue than the others.

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Mr. Teal addressed the third way of comparing tax scenarios, government share of revenue. PPT has the lowest government take, ACES is higher because of a higher base and lower progressivity, the House and Senate Judiciary versions shift up and then flatten out, and Senate Finance almost follows PPT. The difference is due to reasonable transportation costs.

Senator Dyson questioned the net surcharge and trigger for the Senate Finance version. Mr. Teal explained that progressivity begins at \$30 and the rate is .6 percent. At \$50, it drops to .5 percent, at \$70 it drops to .35 percent, and beyond \$90 it is .1 percent. He explained the advantage of having multiple trigger points.

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Senator Elton referred to the charts on page 8 and 9 and requested clarification regarding crossover points. Mr. Teal responded that they differ because the scale of each graph is different.

Senator Elton expressed confusion that the numbers on page 8 did not concur with the numbers on page 9. Mr. Teal referred to page 10 and pointed out that the numbers fall on top of each other. The differences are quite small. This chart was drafted right before the meeting started so some errors may be present.

[5:43:14 PM](#)

Senator Thomas asked if there were other differences such as TAPS language or other specific items that may have an impact. Mr. Teal replied that, unlike EconOne, he left out estimates of costs to the operating cap in order to present a snapshot. There are production, volume, credits, and delay factors that do affect these models.

Co-Chair Stedman explained the importance of having Legislative Finance involved in the process. EconOne will have presentations on progressivity in the near future.

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Senator Dyson asked if the changes in the CS were largely regarding base rates, trigger points, and progressivity. Co-Chair Stedman said there would also be other changes.

CS HB 2001 (FIN) am was HELD in Committee for further consideration.

ADJOURNMENT

There being no further business before the committee, the Senate Finance Committee meeting was adjourned at [5:48:40 PM](#).