ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE
October 29, 2007
9:38 a.m.

MEMBERS PRESENT

Senator Hollis French, Chair
Senator Charlie Huggins, Vice Chair
Senator Bill Wielechowski
Senator Gene Therriault

MEMBERS ABSENT

Senator Lesil McGuire

COMMITTEE CALENDAR

SENATE 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: SB2001
SHORT TITLE: OIL & GAS TAX AMENDMENTS
SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

10/18/07	(S)	READ THE FIRST TIME - REFERRALS
10/18/07	(S)	RES, JUD, FIN
10/19/07	(S)	RES AT 9:00 AM BUTROVICH 205
10/19/07	(S)	Heard & Held
10/19/07	(S)	MINUTE(RES)
10/20/07	(S)	RES AT 8:00 AM BUTROVICH 205
10/20/07	(S)	Heard & Held

10/20/07	(S)	MINUTE(RES)
10/21/07	(S)	RES AT 1:00 PM HOUSE FINANCE 519
10/21/07	(S)	Heard & Held
10/21/07	(S)	MINUTE(RES)
10/22/07	(S)	RES AT 11:30 AM BUTROVICH 205
10/22/07	(S)	Heard & Held
10/22/07	(S)	MINUTE(RES)
10/23/07	(S)	RES AT 9:00 AM BUTROVICH 205
10/23/07	(S)	Heard & Held
10/23/07	(S)	MINUTE(RES)
10/24/07	(S)	RES AT 10:00 AM BUTROVICH 205
10/24/07	(S)	Heard & Held
10/24/07	(S)	MINUTE(RES)
10/25/07	(S)	RES AT 10:00 AM BUTROVICH 205
10/25/07	(S)	Heard & Held
10/25/07	(S)	MINUTE(RES)
10/26/07	(S)	RES AT 1:30 PM BUTROVICH 205
10/26/07	(S)	Heard & Held
10/26/07	(S)	MINUTE(RES)
10/27/07	(S)	RES AT 9:00 AM BUTROVICH 205
10/27/07	(S)	Moved CSSB2001(RES) Out of Committee
10/27/07	(S)	MINUTE(RES)
10/28/07	(S)	RES AT 0:00 AM BUTROVICH 205
10/28/07	(S)	-- MEETING CANCELED --
10/29/07	(S)	JUD AT 9:00 AM BUTROVICH 205

WITNESS REGISTER

MARCIA DAVIS, Deputy Commissioner
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Answered questions regarding SB 2001.

JONATHAN IVERSEN, Director
Tax Division
Department of Revenue (DOR)
POSITION STATEMENT: Answered questions regarding SB 2001.

ROBERT MINTZ, Consulting Attorney for the Administration
Kirkpatrick & Lockhart Preston Gates Ellis LLP (K&L Gates)
Anchorage, Alaska
POSITION STATEMENT: Answered questions regarding SB 2001.

KEVIN BROOKS, Deputy Commissioner
Department of Administration (DOA)
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding auditor requests in SB 2001.

NIKKI NEAL, Director
Division of Personnel and Labor Relations
Department of Administration
Juneau, Alaska
POSITION STATEMENT: Defined classified and exempt employment.

JAN DEYOUNG, Attorney
Department of Law
Anchorage, Alaska
POSITION STATEMENT: Answered questions about exempt employees.

JIM DUNCAN, Business Manager,
Alaska State Employees Association--Local 52 (ASEA)
Juneau, Alaska
POSITION STATEMENT: Supported hiring classified employees for oil and gas revenue auditor positions in SB 2001.

BRUCE LUDWIG, Business Manager
Alaska Public Employees Association/AFT
Juneau, Alaska
POSITION STATEMENT: Supported using classified employees.

MARILYN CROCKET, Executive Director
Alaska Oil and Gas Association (AOGA)
Anchorage Alaska
POSITION STATEMENT: Introduced Tom Williams.

TOM WILLIAMS, Senior Royalty and Tax Council
BP Exploration-Alaska, Inc.
Chair of the AOGA tax committee
Anchorage Alaska
POSITION STATEMENT: Spoke in opposition to SB 2001.

MICHAEL HURLEY, Director
Government Relations
ConocoPhillips
Anchorage, Alaska
POSITION STATEMENT: Spoke in opposition to SB 2001.

ACTION NARRATIVE

CHAIR HOLLIS FRENCH called the Senate Judiciary Standing Committee meeting to order at 9:38:48 AM. Present at the call to

order were Senators Huggins, Therriault, and French. Senator Wielechowski arrived later.

SB2001-OIL & GAS TAX AMENDMENTS

9:39:08 AM
CHAIR FRENCH announced the consideration of SB 2001. Before the committee was CSSB 2001(RES), labeled 25-GS0014\M. The plan is to get an overview and walk through a series of legal questions. On Wednesday there will be a discussion of net versus gross taxation. Today the committee will begin to discuss penalties; the legality of penalties; information sharing; Qui Tam (whistle blower); statute of limitations; retroactivity of certain aspects of the bill, including corrosion; duration of lawsuits and settlements of a net-based system whereby the public has expressed concern; and any other legal questions.

CHAIR FRENCH recognized Senate President Green and Senator Hoffman.

9:41:45 AM
MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), said she did a topical analysis of ACES [Alaska's Clear and Equitable Share] in the resources committee. There is now version "E", which has portions of the bill deferred for later consideration.

CHAIR FRENCH said a topical presentation of the bill as initially presented would be best.

9:43:30 AM
SENATOR THERRIAULT said he reviewed the bill and legal memo. "It appeared that there were a lot of sections that were deleted, sort of conforming because a previous section had dropped out. But I wasn't sure that I was able to track all of those, and so the global discussion would be good for me too."

MS. DAVIS said she can note what language has remained in Senate version "E".

CHAIR FRENCH said time is short and his intention is to move the bill this week. Public testimony will be more limited and will probably occur at the end of each day. It will be truncated, however, so the bill can be moved. He said he's a firm believer that there are two sides of each question.

9:45:32 AM

MS. DAVIS said Robert Mintz is on the line, and he helped prepare the topical overview.

9:46:11 AM
ROBERT MINTZ, Attorney, Kirkpatrick & Lockhart Preston Gates Ellis LLP (K&L Gates), said he has been working with DOR and the Department of Law (DOL) drafting production tax legislation. The oil and gas production tax has been in Alaska law since before statehood. That revenue is in addition to royalties on state lands, property tax, and corporate income tax. A production tax typically applies a tax rate to some measure of the value of oil and gas that is produced. He said to keep in mind it is exercising the state's taxing power and, unlike royalties, it applies to production from private, federal, and state lands.

9:48:42 AM
MR. MINTZ referred to slide 3, "Core Provisions of HB 3001 (enacted in 2006)". Section 011 levies the tax on oil and gas based on a percentage of value. Section 160 helps calculate the taxable value of oil and gas—the production tax value. "Think of it as the net value," he said. An important part of that calculation is the deduction of the upstream costs, defined in Sections 165 and 170. Another change from that law was to establish new tax credits. Unlike previous production tax laws, it provides for an annual tax with an annual return, and it also provides for monthly estimated installment payments.

9:50:40 AM
MR. MINTZ said he will now speak of the core provisions of the Governor's bill and how those would change current law. Slide 8 refers to Section 15, which is not in the committee substitute (CS). It levies a tax on the producer that is equal to the production tax value of oil and gas multiplied by the tax rate. Subsection (g) gives the tax rate two components: a base rate of 25 percent plus a progressivity tax rate, but the term 'progressivity' is not in the bill. That rate is an additional 1/5 of a percentage point for every dollar per barrel over a $30 net value. The current law provides for a slightly steeper slope of 1/4 of a percentage for each dollar per barrel. Progressivity currently kicks in at $40 per barrel, but the governor's will kick in at $30. Currently, progressivity is calculated monthly and it's annual under the governor's proposal.

9:52:57 AM
CHAIR FRENCH clarified that version \M is before the committee and the provisions being discussed were in the original bill

submitted by the governor. He asked how the drafters came to the trigger value of $30 versus $40.

JONATHAN IVERSEN, Director, Tax Division, Department of Revenue (DOR), said starting the progressivity at a lower amount was made to capture "situations in which there are—where you're driving down production tax values. You've got a higher cost that would drive down the net per barrel, so in a high-cost environment, when you're at a $30 per barrel amount, that would start the progressivity trigger at an earlier time, so it captures more of that."

SENATOR THERRIAULT said, "So you've got a lower trigger … but starting earlier than PPT [profits-based production tax of 2006—current law]."

MS. DAVIS said costs are much higher than anticipated when PPT was passed. "Previously it was thought because the costs were lower … the value you look at to decide whether it's above or below the trigger is the value at point of production and it's the net value at the point of production. So you deduct transportation costs, you get to the point of production and then it's net, so you deduct the OPEX and CAPEX," which "drives the number down, and then you look at that number. And the way it was written in the … PPT; that number was $40, and what we found is because the costs had gone up significantly, it was going to take a West Coast price of approximately $62 before the trigger—the progressivity price—would kick in. That was approximately $10 higher than people had anticipated when they originally passed PPT." The trigger price was moved to $30, so it would work as originally intended, "because you're subtracting a larger number at the point of production."

9:55:39 AM
SENATOR THERRIAULT asked what all was in play, and "what were you trying to strike a balance with on the fiscal terms." He has heard that part of decision of setting the tax and trigger was based on the lower 10 percent gross floor.

MS. DAVIS said that was a good description. The administration made a base tax rate of 25 percent to capture a larger share of the revenue, and the progressivity trigger was changed to kick in sooner. Based on the resulting net present value (npv) to ongoing operations and new field developments in that climate, the administration made an assessment of the npv of future projects to see if it would impact future decisions. "We wanted to compare what that resulting government take percentage would

be and compare that to what we thought were our peer group comparison—Norway, UK, Gulf of Mexico, and Alberta, and make sure we hadn't … increased the state's government take to a point where it made us uncompetitive with other countries, in terms of competing for investment dollars."

MS. DAVIS said the tax, progressivity, and 10 percent floor—which were directed at legacy fields—made a need for a slightly lower slope of recovery. So there is a 0.2 percent increase for each dollar instead of 0.25 percent. "We flattened the curve slightly in balance to keep the government take number in the ball park; to keep the npv of future development projects we're assessing in the range of positive, so it was a multifactor calibration." Each factor played some role. "Any time you reach in and take, say, a 10 percent floor out … then … the balance there was, if the state was going to secure itself with a minimum stream, it does impact … from an investment decision, they have to evaluate the downside of being in a world where you've got a minimum tax rate that's essentially set like a gross, and it might be uneconomic at low prices, and … companies are willing to take that risk if there's a more significant upside. So that's when … we didn't push high if we had the floor. But if the will of this body is to not have a floor, then the option is now open to then—in countries around the world, when they … return capital quickly, even at a low price, in a low-risk environment, the countries generally feel more comfortable taking a higher share of the upside. So once you teeter it here, you actually have the option to teeter it up on the upper end." She noted that the committee has a blank slate because before it is the current PPT.

9:59:29 AM
CHAIR FRENCH asked if the progressivity of the current version takes into account the high cost of developing heavy oil.

MS. DAVIS said the current progressivity trigger is still a net number; therefore, the evaluation takes into account the costs of a given barrel produced. Prudhoe oil has high margins of profit compared with heavy Kuparuk oil, so the progressivity would be triggered at different points.

CHAIR FRENCH asked if the high costs of developing heavy oil is built into the base that rises before progressivity kicks in.

MS. DAVIS said yes.

Senator Thomas joined meeting.

SENATOR THERRIAULT said there is an idea that the state should just get its take by adjusting progressivity instead of the trade off between the progressivity percentage rate and the tax rate. He asked how that would change the investment climate, "because whatever the tax rate is, that's also the deduction rate that the companies get." That isn't set by the progressivity rate. "So you can reach out and grab more with a higher tax rate, but that means you're going to also offer more in the incentives through the deductions. If you reach out and grab more through progressivity, you don't have an offset on the investment side."

MS. DAVIS said that is an interesting aspect between the base rate and progressivity rate. As the tax rate is raised, ironically, it enhances the more expensive new field development because it makes the credits have greater value because they offset a higher tax.

CHAIR FRENCH said it is counterintuitive and is one of the aspects of the net tax that the public doesn't get.

10:03:00 AM
MS. DAVIS explained that if the tax rate is 20 percent of profits and $100 is spent and allowed to be deducted against taxes, then when that $100 is deducted against taxes, there is a 20 percent or $20 savings. So, that capital was really $80. The state has invested the $20. If the tax rate were 30 percent, the calculation would be a $70/$30 split between the investor and the state. "The irony is that in terms of their spend, which may be the same thing, they get a greater uplift—a greater subsidy of their costs, the higher the tax rate is."

CHAIR FRENCH asked if it is true with or without a credit, or is it the credit that really makes that viable.

MS. DAVIS said it is true with the base deductions, because under PPT that capital spend gets two boosts: it can be deducted in the net tax and it can be a capital credit. So, it's really more the base deduction. The credit comes after "you've applied your percentage and now it's just straight off the bottom line. So it's really the deduction."

10:04:56 AM
MR. IVERSEN said the deduction rate tracks the tax rate. The credit rates don't necessarily track the same way. It's fixed.

SENATOR THERRIAULT said a company is going to be attracted to the investment by getting the deduction based on the capital dollar that was spent last year, "so you get it back quickly, and that's real important to the companies because it's a dollar almost immediately back to them, versus something well out into the future."

MS. DAVIS said that is absolutely correct. As DOR looked at the economic variables, there's no question that it was the ability for a company to receive that immediate return or offset against their capital costs that was the most leveraging in the determination of npv for a project. That's where she learned that the higher the tax rate, the higher npv the newer developments had. It is also is impacted by the capital credits.

SENATOR THERRIAULT said that leads him to believe that if someone was interested in getting another dollar of government take, but also concerned about reinvestment, "you then want to be careful of your choice of whether you get that government take additional dollar through progressivity or through the base tax rate." Doing it through the base tax rate provides more incentive for the companies to make the investment.

MS. DAVIS said that is correct for new developments. "The countervailing side of it is when we looked at the tax structure from a state perspective, and we were trying to assess what the revenue impacts were; what we found is: increasing the tax rate is very slow or not significantly an increase in state-revenue take. In fact what was more leveraging was the progressivity. In an environment that's triggering a progressivity, that enhances the state revenue more significantly than a tax rate change."

10:07:25 AM
SENATOR HUGGINS said he used some of the same rationale in his resources committee. "Because of the balance that you described, we removed the floor with the understanding that the balance, now, when you talk about tax rate versus progressivity, and I never was able to come to a full conclusion when I listened to people presenting about whether tax rate was a big impacter versus other variables. And then right towards the end of the committee process, someone says, we'll no longer be the highest taxing authority in North America because of Alberta. And then I heard a few hours ago that that was not the case--that Alberta had, in fact, backed away from some of the things that Pedro van Meurs had described to us." He asked where Alberta ended up.

MS. DAVIS said there is an outline of an update of where Alberta stands. Alberta's strategy is a mixed bag—some things are more aggressive and some are not, but overall Alberta increased its government take. She doesn't know where it falls relative to others.

SENATOR HUGGINS said progressivity can be more surgical and flexible.

MS. DAVIS said she thinks that's accurate. There are ways to select different trigger prices for different rates. It doesn't have to be a single trigger price and a single slope.

SENATOR HUGGINS said he saw a news program that mentioned catastrophic events like oil prices at $140 a barrel. Looking at that scenario, the progressivity has some advantages of being able to self adjust.

MS. DAVIS said a slope can be created to look at prices that high. The question is whether the trigger is a gross or net number. Gross, as defined by the House Oil & Gas Committee, is the sales price without transportation costs. It doesn't matter what kind of oil it is, it will all pay the same progressivity. The trigger price may become outdated. "If we multiply the error by adding in yet another progressivity for a much higher take, we really get an out-of-whack system, so we would have to come back in and retune the progressivity to match the market." The nice thing about a net progressivity is it is self adjusting.

10:12:53 AM
CHAIR FRENCH said the tax should be in place for a decade.

SENATOR THERRIAULT said in Alberta the federal government disallowed the deduction of the royalty, so part of their severance tax applies to total production, which would skew the data.

MS. DAVIS agreed.

10:14:29 AM
MR. MINTZ said there are two exceptions in current law to the tax. One is a tax floor for North Slope production. The governor's bill would replace a floor that applies only to legacy fields, which are units that have produced a cumulative total of a billion barrels and are producing at a rate of at least 100,000 barrels a day. The minimum tax would be 10 percent of gross value at the point of production. The second exception

to the core tax is for Cook Inlet. The new bill won't change that. It has wording changes to make it clearer.

CHAIR FRENCH asked where lease expenditures are defined in Version \M.

10:16:14 AM
MR. MINTZ said in Sections 19, 20, and 21 of the CS that is before the committee. Section 160 of current law is changed by the governor's proposal, but the CS doesn't change it. He spoke of the PPT and a tax ceiling in Cook Inlet.

The committee took an at-ease from 10:19:12 AM to 10:21:56 AM.

MR. MINTZ summarized the changes that SB 2001 made in Section 160 that are not in the current CS. The changes were made to make explicit some rules about how lease expenditures are deducted to implement the different tax treatment of different parts of the state.

MS. DAVIS asked Mr. Mintz to define point of production.

MR. MINTZ said the term "wellhead value" is often used for point of production. The term implies the value of oil and gas just before it comes out of well, but it is more complicated in practice because of the processing after it comes out. Oil, gas, and water need to be separated. Oil is considered produced when fluids are separated and it is in marketable condition. It also requires accurate metering. Typically the gross value at the point of production is determined by subtracting the cost of transportation from the sales price at the destination.

CHAIR FRENCH noted that the point of production is the last place at which costs can be deducted against the tax. "If it's upstream to the point of production, it's a deductible cost; if it's downstream, it is not."

MR. MINTZ said the transportation costs after the point of production are, and always have been, deductible, but in a different way. The PPT maintained the current interpretation for determining the value at the point of production, and then it added a new provision for deducting the upstream costs.

CHAIR FRENCH said there is a physical place in each field that can be identified.

MR. MINTZ said that is generally true.

CHAIR FRENCH said he was confused previously. He worked at Kuparuk, and it has a custody transfer meter at the last flange as the oil leaves that facility, and then the oil goes in a transportation pipeline to pump station one. When the leak developed at Prudhoe, "I assumed that was downstream of the point of production because it was downstream of the production facilities." But at Prudhoe Bay the custody transfers are handled differently; they handle it right at pump station one. He asked about Alpine and Endicott.

10:26:56 AM
MR. MINTZ said he understands that the AOGCC requires metering before oil and gas leave the unit. That would mean there would be a point of production before it is taken off the unit. Within each unit there are different satellites. After separation in the main facility it goes to the last meter. Slide 15 speaks to a provision that is in the governor's bill and the CS.

10:28:54 AM
SENATOR WIELECHOWSKI joined the hearing.

MR. MINTZ said Section 165 of the law is where the term "lease expenditure" is described.

CHAIR FRENCH asked for the sections in the CS.

MS. DAVIS said Sections 19, 20, and 21.

MR. MINTZ said these provisions are the same as in the governor's bill. Most of it was written for more clarity, but one substantive change in Section 19 of the CS is that the department may, but is not required to, provide further definition by regulation. The bill changes it to provide that in order to be a deductible lease expenditure, a cost must be allowed by regulation. It is to make it clearer and more predictable in determining what costs are deductible.

CHAIR FRENCH asked if the regulations are written.

MR. MINTZ said not on that point, but there is a voluminous set of regulations that went into effect last March. Since then the department has been working on developing phase two.

10:32:06 AM
MR. IVERSEN said the regulations on lease expenditures were carved out from PPT. He said the department has been on two

tracks, and one is to get the first set of returns in without having honed in on these particular expenditure leases. “We have been grappling with those over time.”

MS. DAVIS said the department was getting ready for the regulations to go out for comment at the time the special session was called. They didn't want to be inefficient with people’s time. The goal is to have the regulations out by January.

SENATOR HUGGINS said, “It’s my understanding [that] we are in concurrence that affirmatively stating the deductions is what we’re pursuing and that we concur with that. Is that correct?”

MS. DAVIS said, absolutely, “We want to state what is in and not simply what is out.”

CHAIR FRENCH said the PPT had a list of 16-17 things that were disallowed, and it left open the universe of other possibilities. That is reversed by saying what a deduction is, and it must be affirmatively listed or it will never qualify. In the bill in front of the committee it will happen in regulations, not statute.

MS. DAVIS said yes, with the guidelines that the legislature places in this bill.

10:35:00 AM
SENATOR THERRIAULT asked if the infield costs were deductible from the gross before the tax is applied.

MS. DAVIS said that is correct.

SENATOR THERRIAULT said there was discussion about whether there are any fields in production that now have an allowance for a deduction on the royalty side. “Do we have a similar deduction of infield expenses on the royalty side, when the royalty valuation is calculated?”

MR. MINTZ said 100 percent of the qualifying lease expenditures are deductible. “There’s no allocation … between royalty and non-royalty [indecipherable].” Section 20 language is simply moved around for clarity with no substantive changes.

MS. DAVIS said Section 20(c) deals with overhead, which is now in Section 19(2).

MR. IVERSEN said that was changed because currently the PPT sets forth overhead as a direct cost which typically isn't.

10:37:30 AM
MR. MINTZ said Section 21 of the CS maintains and expands the list of exclusions. Paragraph 6 of subsection (e) currently includes costs arising from fraud, willful misconduct, and gross negligence, and the administration added costs arising from violation of law or failure to comply with a lease, permit, or license obligation. This change came from a suggestion from a member of the public. The second change in the list of exclusions is in paragraph 15, and it deals with dismantlement, removal, and restoration costs. Current law excludes that type of cost for past production, but it allows it if it is attributable to future production. "These costs really should not be deductible under … and shouldn't be considered … cost of production." The change in that paragraph would exclude all dismantlement, removal, and restoration costs.

CHAIR FRENCH asked if the theory is that when building a facility the economics of dismantling and restoring should be part of the plan.

MS. DAVIS said yes. Under the leases the lessee is required to build in future abandonment costs. In fact, they generally make an allowance in their federal tax and depreciate that cost over time, recovering it as a normal incident of the cost of business.

CHAIR FRENCH surmised that the day a lease is awarded through the competitive bid process, part of the lease payment takes into account the removal costs.

MS. DAVIS said yes. "When you acquire the lease you incur the legal obligation that should you do any development … you will have that incumbent responsibility—financial responsibility—for doing the abandonment, and for that reason, when we looked at how the state's dollars should be targeted by way of the deductions and the credits, we didn't feel it appropriate to essentially spend those dollars toward something that a party was already legally required to do and had built in to their decision." As lease-hold expenditures the costs are both deductions and capital credits.

10:40:58 AM
MR. MINTZ said the third change to the list of exclusions deals with issues from SB 80 of 2007. The bill takes a little bit

different approach to the same issue. [He was told that issue will be discussed tomorrow.] The final exclusion is for costs for a crude oil refinery or topping plant.

CHAIR FRENCH asked why that is excluded, and he noted that he worked at a crude oil topping plant.

MS. DAVIS said it is not considered an upstream cost. It is a midstream refining process. It is oil that is taken from the lease and is run through a processing plant to yield a marketable product, "and we do not consider that in the same vein as what we consider upstream costs—the costs to take production and deliver it to market."

SENATOR HUGGINS stated that the resources committee asked the administration to continue to look at that, because presently the diesel would have to be pipelined to Anchorage from Kenai, railed to Fairbanks, and trucked north. He said that is a left-handed way to get diesel to the North Slope, so based on risk of pollution and road degradation, the committee asked the administration to make it attractive for the producers to do this function on the North Slope.

MS. DAVIS said it is a balance of environmental, cost, and job issues and the overall revenue to the state. When low sulphur diesel is needed, it is manufactured in Nikiski and transported north. Kuparuk has lower sulphur diesel than Prudhoe, but air emissions requirements will require lower sulphur. "So they need to do modifications to the Prudhoe topping plant that would be upwards of $300 million."

CHAIR FRENCH asked if the diesel produced on the North Slope is used to run trucks and other equipment.

MS. DAVIS said it is used for a wide variety of purposes. It is incumbent upon them to make modifications, and she believes the producers are looking at modifying the Kuparuk plant and not the plant at Prudhoe. There also may be a third plant constructed further east if development makes it viable. It's a very expensive retrofit. "Whether the state should undertake to subsidize those in some fashion or decide that they want to subsidize them to the tune of 20 percent plus whatever the tax rate is … it needs to balance that, which has its benefits and detriments to the options, which is the haul road repair costs, which were estimated by the Department of Transportation to be $1.5 million for an increase of up to 150 truck trips, as well as the fact that in Fairbanks right now, there is a group that

had purchased a refinery and as a consequence of their contract with the state, the state sold them royalty oil, and as a consequence of selling the royalty oil, they were required to retrofit the plant in Fairbanks to be low sulphur. What happened in lieu of that is they, instead, funded the low-sulphur modifications to the plant in Nikiski."

SENATOR HUGGINS noted that is would be 150 trucks per day—a huge amount.

MS. DAVIS said that was a cost estimate.

SENATOR HUGGINS said one can imagine accidents and spills.

MS. DAVIS said the estimate from ConocoPhillips, if it is not allowed to modify its plant at Kuparuk, was an incremental increase of 10 trucks per day.

10:49:17 AM
MR. MINTZ said the governor's bill and the CS repeal AS43.55.165 (c) and (d), and "those provisions allowed the department to substitute cost billings under unit operating agreements in place of the general standards for determining lease expenditures." Instead of applying the general definition of lease expenditures, it would be the actual costs that an operator is allowed to bill under a unit operating agreement. The department confronted some serious implementation issues, which convinced it that it is preferable not to have the second track, but go with a single track, which would be regulations specifying allowable lease expenditures. So that is why the bill repeals it.

10:51:54 AM
MR. MINTZ said Slide 19 deals with tax credits. The PPT enacted a group of new tax credits, and some are in AS 43.55.023. The CS omits all of the changes made by SB2001 except one, which deals with Transitional Investment Expenditures (TIE). The governor's bill, SB2001, made changes including a provision to spread out the use of capital credits so that no more than half could be used the first year. SB2001 has information-sharing requirements that explorers would have to agree to in order to get credits for exploration expenditures. Slide 20 states the following change: "credits for capital expenditures in a unit subject to the tax floor may be applied only against tax on oil and gas production from that or another unit subject to the tax floor." There are several agency rules that follow from the gross tax

floor on the legacy fields to avoid undercutting that floor, and this is one of those rules.

MR. MINTZ referred to Slide 21 that states the following: “no carry-forward for unused lease expenditures for units subject to the tax floor.” That is a change in the carry-forward annual loss credit. An explorer or producer that incurs a cost that would be deductible, but there is no production to deduct it against, those costs can be turned into a credit to be used in the future or sold. The Governor's bill conforms the percentage of that credit to the tax rate: 25 percent. If a producer can deduct costs against the 25 percent tax rate, it reduces the net cost. Current law only allows a 20 percent credit rate, which introduces a disparity between producers that have current production and those that don’t have any to apply their credits against.

10:54:57 AM
MS. DAVIS said regardless of what tax rate comes forward, “we just want to council you to match that rate to this provision.”

MR. MINTZ said there is another rule to implement the North Slope tax floor to prevent undercutting that floor. Under current law, the person that earns the tax credit can turn that into a transferable certificate. Under the governor's bill, an explorer that doesn’t have any production tax liability would be under the 50 percent rule as well.

SENATOR THERRIAULT said he understands that the administration wants to spread out the application of credit for the benefit of the state treasury. “But by delaying the company’s recouping that dollar, you impact the net present value of their investment decision, and I’m just wondering if it’s worth it.

MS. DAVIS said there is that negative effect of delaying the return of that value for the investor. But this aids in providing the legislature with clear revenue flow figures to aid in budgeting. In a year with a spike in spending, it can hit rigorously and the state will find an unexpected decrease in revenue. This would moderate the swing leading into a high year. It hasn’t been a problem in the recent past. Producers may spend extraordinarily large chunks on heavy oil development.

10:59:20 AM
MR. MINTZ noted Section 14 of the CS. The bill gives more express authority to require electronic tax filing in a usable form.

CHAIR FRENCH asked how taxes are paid now.

MR. MINTZ said large payments must be made electronically. This would eliminate any doubt. Referring to Slide 33, under current law the requirement to file a tax return is triggered by owing tax. But it is important for the department to know of tax credits as well as liabilities. The bill requires producers to file an annual return whether or not there is tax liability. That is in Section 14 of the CS.

11:02:52 AM
MS. DAVIS said an oil or gas producer must file a report even it there is no tax due. The report will contain the information in 14(1) through (9), including the details about where production is located, the gross amount of the oil, the costs, credit claims, and more. It is a tax return, but this was required only when paying the tax.

11:04:33 AM
CHAIR FRENCH said Alaska has a net profits tax system, so "how can we not be in a position of knowing what each company makes, given the lay of the land?"

MS. DAVIS said the state does know.

MR. IVERSEN said the returns for calendar year 2006 were filed in March of 2007. They aren't public documents.

CHAIR FRENCH asked if there is any reason the public shouldn't know the net profit of each company since that is the basis for the tax system.

MS. DAVIS said, "We should be able to aggregate the information, and roll up what a net profit would be across the North Slope, for instance."

CHAIR FRENCH said he can go to Wall Street and find the profits of a company globally, so why can't Alaska have statutory requirements to provide the information.

MS. DAVIS said, "We essentially do." She said to look at page 21, Section 23 of the CS regarding the public disclosure of tax information. The statute authorizes and clarifies that the state needs to aggregate at least three taxpayers and release the information listed, which provides the ability to calculate profit by gross value and the deductions.

CHAIR FRENCH asked why it had to be aggregated.

MS. DAVIS said the aggregation is required because current law prohibits the state from disclosing individual taxpayer information. Generic information can be provided. Three companies are aggregated because it is successfully done in fisheries taxes. It is done so as not to violate constitutional issues related to privacy.

11:08:00 AM
CHAIR FRENCH asked how the rights to privacy are overcome on the New York Stock Exchange. Shareholders get thick, detailed financial reports from these companies.

MS. DAVIS said a state law prevents revealing that information.

CHAIR FRENCH asked if the bill repeals that.

MS. DAVIS said she thinks it does "in the sense that … basically, not withstanding those provisions, we can reveal the information in Section 890. So we are carving out this body of information saying we're not going to have this type of information be constrained from public disclosure under that general statute."

11:09:02 AM
SENATOR THERRIAULT asked if that is normal for an oil producing state.

MS. DAVIS said there is a sense, globally, that you need to protect that requirement. Virtually all other countries had "some sense of needing to aggregate it." Exceptions are some of the newer countries that tend to be third world countries that need to meet standards established by the United Nations for transparency.

CHAIR FRENCH said he is struggling with the idea that the stock exchange requires revealing information in great detail, yet a company is protected in Alaska. If a company gets a profits-based tax, then the state should know its profits and it shouldn't be forced to guess through an aggregation process. "I should be able to go to each taxpayer and say, 'what did you make?'" This is not a Mom and Pop store; it is the central foundation of the state's fiscal regime, and there is a great deal of public interest in this. There is a big public push to have more transparency.

11:11:35 AM
SENATOR HUGGINS said the administration is working to respond to Senator Wielechowski's [request to learn how much profit ExxonMobil made in Alaska last year].

MS. DAVIS said there is a requirement for materiality before a company has to break out segments of its report, and because Alaska doesn't meet the threshold for BP's and Exxon's global portfolios, Alaska can't look at the records that are currently filed under the SEC and ferret out the Alaska portions. For ConocoPhillips, Alaska does meet the materiality criteria, and it can look at its Alaska portion on its public filing.

CHAIR FRENCH said, "I thought they did it out of the goodness of their hearts."

11:13:10 AM
MR. MINTZ referred to Slide 34, provisions that are aimed at insuring that the department has the information it needs to properly administer the tax. Section 15 of the CS establishes an additional penalty for failure to supply all the required reports. Under current law there are existing penalties for failure to file; however, the amount of the penalty is based on the amount of the tax deficiency. Some of the new reports don't have taxes.

CHAIR FRENCH asked if the reports referenced on page 12 are tax reports.

MS. DAVIS said yes, they are the annual and monthly reports required of producers and non-producers. Without this provision, there is no mechanism for DOR to enforce the requirement.

MR. MINTZ said Section 16 of the CS imposes an annual reporting requirement.

11:16:03 AM
MS. DAVIS said there was also a blank spot on the state's ability to collect information because an explorer or producer that was developing a project but had not yet had production was previously not required to file a return. This closes that gap.

CHAIR FRENCH suggested that a company doing seismic work will still need to file a report.

MS. DAVIS said yes because it would be incurring lease expenditures that will show up later. Having the annual report gives the department an understanding of what is yet to come regarding credits and deductions.

CHAIR FRENCH said that sounds like a good idea.

MS. DAVIS said Section 17 in the CS gives DOR the right to request forecast information. Under existing rules the DOR could request information as it related to a taxpayer's tax liability. That is a backward way to do it, and the revision makes it a forward-looking feature. It is narrowly focused and does not make taxpayers create a separate report, but includes information already shared with other interest owners. In advance of a year the owners will sit down and develop an operating plan and make a proposal to the working-interest owners. Once they know what the operations will be, they develop a cost scenario and essentially issue bills to their working-interest owners quarterly. There may be changes along the way, and those will get flagged at that accounting level, and the bills will change. "We want the state in the same footing … pretend like we're working-interest owners; give us a copy of all the correspondence." It will not be a burden to the taxpayer, and the state can adjust the revenue forecast accordingly.

11:20:26 AM
CHAIR FRENCH asked about Section 5 on page 14, which describes that process. But it seems to carve out specific reports on line 28, and it seems that the state isn't asking for the bills but just for the communications between the two.

MS. DAVIS said it uses communications in the broad sense because the state didn't want it limited to the written record. She expressed concern that once the accounting organization is aware the state is getting copies of everything, things might be done verbally.

CHAIR FRENCH said it looks like the required information is limited to just communications and not billings.

MS. DAVIS said it is intended it to be broad, and an [authority for expenditure] issued by an operator to a working-interest owner is a communication. Bills and solicitation of approvals are too. If it doesn't read that way, then it should be reworded.

CHAIR FRENCH said he will come back to this. He added that this is a second type of penalty—it's not a tax report penalty.

11:23:59 AM
MS. DAVIS said it attaches to the obligation to respond to the department's request for reports on the forecast information.

MR. IVERSEN said the penalty is associated with receiving the information; it's not related to the forecast being off.

MS. DAVIS turned to slide 36, Section 18 of the CS, which requires electronic filing of reports in a format prescribed by the department. The state is creating a database that will be populated with the annual and monthly returns that get filed. The correct format will reduce errors, time lag, and staffing needs. She hopes that it will upload automatically giving an immediate picture. Some information will be shared with DNR.

11:26:21 AM
CHAIR FRENCH asked what stage the database is in.

MS. DAVIS said there are bids on the cost.

MR. IVERSEN said a scoping contract has been done. It is like a needs assessment, but bids haven't been solicited.

CHAIR FRENCH asked how long it will take to create.

MR. IVERSEN said it will be a multi-year process to get it fully integrated and functional.

CHAIR FRENCH asked how returns are filed now.

MR. IVERSEN said it's a mix of paper and electronic returns. The taxpayers can also use a template from the state's website. Some of the provisions in the bill are geared to getting information in a useful format.

11:29:01 AM
MS. DAVIS said subsection (g) of Section 18 was added. The state wants to be able to issue advisory bulletins to give guidance through the initial phases. Mr. Mintz researched and found that this section gives the department the authority to be able to issue advisory bulletins for any tax.

MR. MINTZ clarified that it is limited to the production tax.

SENATOR THERRIAULT questioned the use of the bulletins.

MS. DAVIS said advisory bulletins have been used to head off audit problems with regard to how the department is interpreting and applying a regulation. It can flag things early.

SENATOR THERRIAULT asked if a taxpayer can still disagree.

MS. DAVIS said yes.

CHAIR FRENCH asked how many taxpayers are on the North Slope.

MR. IVERSEN estimated there to be about 30.

CHAIR FRENCH asked who else is making money besides the big three producers.

MR. IVERSEN said he will look up who is actually making money. It is probably significantly less than that.

CHAIR FRENCH said it probably boils down to 10-15 corporate entities.

MR. IVERSEN said that might be closer to it. There are also others generating credit.

11:33:49 AM
MS. DAVIS said Slide 37 references ACES Section 2, and this language was included in the Senate CS. It authorizes DNR to share oil and gas information with DOR. It is a provision that has a companion piece for sharing information the other way. There are confidentiality requirements for both agencies, and the ability to speak to each other about relevant information is very limited. The two have had to jump through a lot of hoops to be able to work together, including making models generic, for example. Consultants were quite surprised that the state put the two agencies in "such silos." That is not found in other places, so the goal is to enable the sharing while keeping the protection of information.

SENATOR WIELECHOWSKI said page 3 shows two reasons that the director can request the information, and one is for forecasting revenue and the other is for administering AS 43.55. He wants to make it broad enough. How do you define forecasting revenue and what is 43.55?

MS. DAVIS said 43.55 is specifically the production tax provision. It would not include the oil and gas income tax provision. This was the area where the information came into play. Section 13 of ACES or Section 12 of the CS is the parallel provision. It doesn't have a limitation on DNR's use of it.

11:38:24 AM
CHAIR FRENCH said to suppose commissioners couldn't decide if the information is released fast enough. A governor could straighten that out.

SENATOR WIELECHOWSKI said it may be best to have the sections conform more. He expressed concern over hamstringing DOR.

MS. DAVIS said the intent is that DOR would be able to use the information it needs, so she wouldn't object to that.

11:39:56 AM
MR. MINTZ said to keep in mind the scope of the proclamation. Venturing outside the production tax could be a problem. But it is written very broadly to make sure the department can get the relevant information for administering production taxes.

MS. DAVIS said Section 23 in the CS is about public disclosure of information and how to aggregate it. She referred to a list on Slide 39 of administrative improvements. There is an auditor provision and a transition provision to keep current auditors to stay in classified service. There are two places that relate to the statute of limitations, and it was not picked up in the CS. The governor’s bill proposed a change from three to six years, and the CS doesn’t.

11:42:32 AM
MS. DAVIS said Slide 40 deals with a provision that was in the governor’s bill and not in the CS. Its intention was for the legislature to confirm an existing regulation of DOR. When taxable value changes, the DOR has always taken the position that the statute of limitations does not run on a claim for the state to recover the differential, even though it may have run on that tax period. There is not a current lawsuit on that issue. The AOGA said this had a hidden agenda related to interest on the tax due—“that when we recognize that our statute of limitations operates to allow us to go back and pick up a period that had otherwise been closed such that there was now a tax liability for a previously closed period, their concern is: does this provision alter the balance of the ability to fight about what interest rate should apply and when it should attach

to that liability. It was never our intention to affect that dialogue or that legal debate."

11:44:59 AM
CHAIR FRENCH said the \M CS doesn't have that provision.

MS. DAVIS said that is correct.

SENATOR WIELECHOWSKI asked about a current tariff dispute, and "how many years back would that cover if we were to prevail?"

MR. MINTZ said Congress recently passed a law placing some limitations on that. He said he didn't think it would affect any pending dispute on TAPS tariff.

SENATOR WIELECHOWSKI said it seems that if there was a lawsuit and the state was supposed to be getting X tariffs but didn't, the state would be due interest. That is standard civil law, "so I think we need to be careful when crafting that provision."

MR. MINTZ said that one of the reasons for the debate is that typically when FERC orders a retroactive refund, it does come with interest. However, if the interest rate is different ….

11:47:05 AM
SENATOR WIELECHOWSKI said if it was money the state should have gotten under the state system, it should be the state interest.

CHAIR FRENCH asked the difference between interest under a FERC ruling versus the state.

MR. IVERSEN said the state would assess interest at 11 percent. The IRS charges about 8 percent, but he doesn't know about FERC.

11:47:59 AM
MS. DAVIS said Slide 42 relates to transition, applicability and effective dates. They are essentially the same in both versions.

MR. MINTZ added that applicability and retroactivity are companion provisions. The expansion of the list of exclusions and the repeal of 155 (a) and (d) on unit agreements are made retroactive to 2006, when PPT started. Other changes are either prospective or immediate.

CHAIR FRENCH said the committee will discuss how far back retroactivity will go, but tax changes will take effect next year and corrosion issues go back to April 1, 2006.

11:50:15 AM
MS. DAVIS said there is a provision that the resolution of statute of limitations applies to tax periods that are still open, so if something was in its second year and had not passed the three-year statute of limitations, six years would extend it out another four years. Nothing would be reopened that was closed.

MR. MINTZ added that Section 29 was done in the PPT legislation, and it makes sure the department is implementing regulations as soon as the new statuary provisions apply, even though it will take some time to develop the regulations.

CHAIR FRENCH said he is having trouble understanding how some provisions will be retroactive to 2008 if the bill passes in the next month.

MR. MINTZ said the regulations might not be adopted by then.

11:52:39 AM
MS. DAVIS said the CS didn't carry through Section 023 (l) regarding tax-exempt entities not receiving credits. However, it was amended to the House version yesterday, she said. It needs to be discussed.

11:53:24 AM
CHAIR FRENCH outlined this afternoon's schedule and recessed the meeting from 11:54:16 AM until 1:23:52 PM.

The committee reconvened with Senators Wielechowski, Huggins and French.

1:24:21 PM
KEVIN BROOKS, Deputy Commissioner, Department of Administration (DOA), Juneau, Alaska, explained that Sections 9 and 28, in version M CSSB 2001(RES), moves classified oil and gas auditors to the exempt service with the intention of being able to pay them what the market is requiring these days. He said he has been seeing difficulties in recruiting revenue auditors, and the DOR did a pay analysis. There are 60 individuals in the auditor job class family, but the primary focus was the oil and gas auditors, but the system requires dealing with the family as a whole. They raised the pay 15 percent across the board for all 60 employees based on the market. This bill refers to about 23 auditors from DNR and DOR, and it exempts them.

CHAIR FRENCH asked what it means to be exempt.

MR. BROOKS replied that they aren't represented by a union. Every employee is considered classified unless the position is listed as exempt. Alaska is a right-to-work state; employees are represented by unions.

MR. BROOKS said the increased pay didn’t have its “desired effects.” DOR and DNR are still having problems attracting employees because private industry pays significantly more.

CHAIR FRENCH surmised that the public is asking why you can't pay these employees more.

SENATOR THERRIAULT joined the committee.

MR. BROOKS replied that statutorily, classifications are constructed on a "like-pay for like-work" concept. It's not so simply to pay employees what the market will bear. The pay adjustment was the first attempt to work within the constraints of the rules. Instead of changing the complex statutes, the other strategy is to make the employees legislatively exempt. Medical professionals, oil and gas geologists, and the Limited Entry Commission are fully exempt. So he is suggesting taking these specific jobs and making them fully exempt.

CHAIR FRENCH asked if classified and exempt are the only two choices. What is a partially exempt employee?

NIKKI NEAL, Director, Division of Personnel and Labor Relations, Department of Administration, Juneau, Alaska, said partially exempt employees are subject to the classification and pay plan, so they cannot be paid an override rate. They are not subject to recruitment provisions and are often at-will employees.

1:32:49 PM
MR. BROOKS said we all serve at the pleasure [of the governor].

CHAIR FRENCH said you could be discharged for any or no reason.

1:33:09 PM
JAN DEYOUNG, Attorney, Department of Law, Anchorage, Alaska, said there are some restrictions on termination for bad reasons.

1:33:35 PM

CHAIR FRENCH said but a person can be discharged for no reason but is still subject to the pay classification rules. He asked who the partially-exempt employees are.

MR. BROOKS said they are identified in statute and include assistant attorney generals, division directors, deputy and assistant commissioners, and executive assistants for the commissioners.

CHAIR FRENCH asked if the exempt employees are at-will and not tied to the like-pay strictures.

MR. BROOKS replied yes. He said he is partially exempt and serves at the pleasure and political whims. There are a number of fully-exempt employees including pharmacists and medical professionals. There is less turnover with fully-exempt professionals as opposed to political appointees.

MR. BROOKS, referring to the topic at hand, said there are 23 positions classified as oil and gas revenue auditors, and the bill specifies: and their immediate supervisor. Currently there are six vacancies.

CHAIR FRENCH asked if 23 are enough to maintain a strong cadre of sharp pencils.

1:35:51 PM
MR. BROOKS replied that DNR and DOR should answer that. Some positions were added after the PPT was passed. Some people have asked if the positions can be contracted, but the bargaining contracts require a feasibility study. It has to be more cost effective, and the idea is to pay these people more. Making the positions fully exempt allows them to be contracted temporarily.

SENATOR WIELECHOWSKI said Section 28 would allow people who are currently in the bargaining unit to opt in or out of the exempt service.

MR. BROOKS said yes.

SENATOR WIELECHOWSKI asked if the current exempt employees will get paid more.

MR. BROOKS said yes, if they are doing the same kind of work.

SENATOR WIELECHOWSKI noted that there will be people working side by side getting different salaries.

MR. BROOKS replied yes, but with different protections and rights.

1:39:03 PM
CHAIR FRENCH asked if the work is highly technical, why isn't that sufficient reason to create a higher classification. That set of skills must require a higher price out in the market.

MR. BROOKS replied that it is a bit of a quandary. The like-pay for like-work requirements would have to get into a niche among auditor work.

CHAIR FRENCH asked if he is concerned that creating a higher classification for these oil and gas revenue auditors would encourage other auditors to demand the same.

MR. BROOKS said there is an element of that. Currently there are auditors 1 through 4, and they start at a range 18. An oil and gas auditor 4 who has been around about 5 or 6 years is making about $85,000 a year after adding the 15 percent. A partially-exempt division director is a range 27, and the auditors would go beyond that.

CHAIR FRENCH asked how much the state will need to pay auditors.

1:42:26 PM
MR. BROOKS replied that he is not sure, but fully-exempt oil and gas engineers and geologists working in DNR and in the Oil and Gas Conservation Commission make $125,000 to $150,000.

CHAIR FRENCH asked how many fall under that category.

MR. BROOKS replied about 25, and they are in another section.

1:44:22 PM
SENATOR WIELECHOWSKI asked if grievances can be filed by the bargaining unit or by individuals.

MR. BROOKS said it can be an individual or a group.

SENATOR WIELECHOWSKI said he thought that the union pursues a grievance on behalf of the individual.

MS. DEYOUNG replied that is correct.

SENATOR WIELECHOWSKI said if the union agreed to some kind of solution, would that preclude an individual from disagreeing.

MS. DEYOUNG said there is a process for the union employee, but the state is in litigation frequently with employees who have exhausted that process and have other claims.

SENATOR WIELECHOWSKI asked about the union agreeing.

MS. DEYOUNG said, "We like to argue that that should be the final decision … but that's not actually clear in the case law."

SENATOR WIELECHOWSKI said that is usually discrimination issues.

MS. DEYOUNG said that is one area because one has a statutory right to make those claims that the union can't foreclose.

1:46:44 PM
SENATOR THERRIAULT asked if professional geologists make $125,000 to $150,000.

MR. BROOKS said it is petroleum engineers.

CHAIR FRENCH said the auditors will be pursuing potentially multi-million dollar claims against extremely powerful companies. He asked what assurance they will have against political pushing and retribution.

MS. DEYOUNG said they would be exempt from those protections. The grievance procedure applies to classified employees.

1:48:56 PM
CHAIR FRENCH said, "You could imagine that you might have a governor who takes a position that we shouldn't be pursuing claims too rigorously … It is an item of concern for me in these audits with millions of dollars at stake that there be some insulation between the person pursuing those claims and the political forces in the world."

SENATOR THERRIAULT asked if there could be a whistle-blower provision to protect them.

MS. DEYOUNG said statutory protections are there, and the whistle-blower would be one of them.

CHAIR FRENCH said he thought a whistle blower was someone inside the organization. These are state employees looking at oil companies.

SENATOR THERRIAULT explained that someone could be pressured not to follow the dictate of the statute.

1:50:19 PM
MS. DEYOUNG replied there are lots of protections against unlawful discrimination, and that would be one. But there doesn't need to be good cause to fire an at-will employee.

SENATOR THERRIAULT suggested getting a good understanding of the protections.

MR. BROOKS added that there are thousands of exempt and partially exempt employees. Previous legislatures have provided this tool to others to specify positions.

Senators Thomas and Hoffman are in attendance.

1:52:41 PM
SENATOR WIELECHOWSKI said he was a hearing officer for workers compensation. He was glad to have the protection of being a classified employee. All hearing officers who were exempt had been fired when a new administration took office. He was concerned that these positions can be terminated for any reason at all.

1:55:26 PM
SENATOR HUGGINS said these are key positions for professionals in a very competitive environment, "so I'm supportive of the administration being able to do this because it's … a cornerstone to what we're asked to do in this case for a net tax."

1:55:57 PM
JIM DUNCAN, Business Manager, Alaska State Employees Association--Local 52 (ASEA), said ASEA is the exclusive representative of many of these positions being discussed here today. If they are not supervisors, the auditors are in his union. It is critical to have auditors who can perform the necessary duties to protect the revenues of Alaska. The disagreement is that those positions can be in the classified service. The merit system of state employees is set up in the constitution. Exempt personnel should be in policy-level positions. A revenue auditor is not setting policy. The exempt

auditor would be exempt from the state personnel act, the state pay plan, and a competitive hiring process. They can be discharged at any time. Title 39 has a list of exempt positions, and most of those work for boards and commissions; they are not in the departments themselves.

2:00:42 PM
MR. DUNCAN said the auditors won't have a right of appeal a dismissal to the state personnel board. They will be subject only to general labor laws of Alaska and personnel policies of the agency. Those policies can change with administrations. There is a legitimate concern about the pressures these auditors will come under. There will be clients out there very interested in what oil and gas revenue auditors are doing. Clients can approach the administration and request a change. He said he doesn't believe the current administration would respond to that type of pressure, but there will be other administrations. The state risks continuity of service in exempt positions.

MR. DUNCAN said the auditors could be subject to outside pressures, and the public would be opposed to that. He said he heard Mr. Brooks say they need to do this to fill the positions even after the two-range increase. He finds it difficult to understand why they can't find the auditors. There are 7 auditor-4 positions at a range 24, and 6 are filled. There are 2 auditor-3 positions, and they are filled. There are 6 auditor-2 positions, and 2 are filled, but it is noted that the other positions are being held vacant. They are not having trouble recruiting based on the organizational chart. The administration hasn't expressed this problem to the union. He was just bargaining, and this issue about recruitment of auditors was never brought up. He said ASEA was just presented with administrative order 237 from August 24, where a cabinet-level work group was created, and the chair asked for input. He gave her several suggestions on positions that were hard to recruit for. That task force should deal with this if it is an issue.

2:07:12 PM
MR. DUNCAN said several things could be done. There is no reason not to have auditors-5 at a range of 26, and that would be 15 percent higher pay. Salary ranges in ASEA's contract go up to range 27—"we could even put 28 and 29 if we want to negotiate that." If it gets to close to supervisor salaries, then perhaps their pay needs to go up too. He is willing to provide language for the bill to resolve the issue. He recommended temporary establishment of unique salary schedules and offering moving allowances, hiring bonuses, and forgiving student loans. There

is a way to improve the compensation package if the state is flexible.

2:09:57 PM
MR. DUNCAN noted page 2 or 3 on the 10/17/07 fiscal note, and he said he would work with management on the issue of "contracting out to hire some experts to help train the auditors." The auditors should be trained and have the best knowledge possible, and he offered help with writing a provision for this.

2:12:19 PM
CHAIR FRENCH said the administration wants to pay up to $150,000. He asked if that can occur with classified service.

MR. DUNCAN said it can't happen with the current salary schedule, which goes through range 27, but he proposes constructing some language to create unique salary schedules and remain in classified service.

MR. DUNCAN said right now the schedule maxes out at range 27, but more ranges can be added. When last at the bargaining table, "we could very well have just added a range 28 and range 29 if we had some specific issues that needed to be addressed."

2:14:07 PM
SENATOR WIELECHOWSKI thanked Mr. Duncan for pointing out page 2 of the fiscal not. "These are auditors doing the same type of work that the other current auditors are doing." It is $4,000 per week. It would seem that the state doesn't need to pay anything near that. The state could pay half of that in classified service, he surmised.

MR. DUNCAN said he thinks that is reasonable. He repeated that six out of seven positions are filled, and by unique salary schedules, the state can find the people to do the job.

SENATOR THERRIAULT asked if it's a problem to allow higher ranges in a narrow band of employment.

MR. DUNCAN answered that it wouldn't open the door. There is always pressure to raise salaries. And nurses were all moved up recently. The state won't have to move everybody up. This would address unique circumstances.

SENATOR THERRIAULT asked if the nursed were moved up within the already established range.

MR. DUNCAN guessed that they were moved from a range 15 to 17.

SENATOR WIELECHOWSKI presented the question of if the employees are exempted and with high salaries, will the state start paying the directors and commissioners more too.

MR. DUNCAN replied that is another problem. Commissioners and directors got a sizable raise three or four years ago.

SENATOR WIELECHOWSKI asked if an auditor-5 was created, could it be isolated to oil and gas auditing.

MR. DUNCAN replied that he wasn't sure. There could be an internal alignment problem, but that could be addressed by putting an auditor-5 in all categories. It would not have to be filled if the work is not as specialized.

2:20:51 PM
SENATOR WIELECHOWSKI asked if it would be possible to break out the oil and gas auditors in a separate job classification, which is done with hearing officers.

MR. DUNCAN replied it's possible.

CHAIR FRENCH asked if worker's compensation hearing officers get paid differently than a standard hearing officer.

MR. DUNCAN said there are two different classifications.

2:21:54 PM
SENATOR THERRIAULT said hearing officers were put into a pool.

MR. DUNCAN said ASEA is working with management on that issue.

2:22:51 PM
BRUCE LUDWIG, Business Manager, Alaska Public Employees Association/AFT, said he represents supervisory employees including two of the auditors being discussed. He stressed that the constitution requires a civil service system, which is very important. It is what keeps government clean in a lot of respects. The exempt statute has "whole pages of exceptions, and it almost makes you wonder what's left in the other." It is likely that most of the thousands of exempt employees get salary overrides. The Murkowski administration raised commissioner pay by 39 percent. But there is deferred maintenance on the classified service. "Our pay is virtually 39 percent less than what the cost of living has done in the last twenty years." The

result is not finding people to fill jobs. Some division directors have a 33 percent vacancy, and he has been told by some directors that "if we can't do something to spur recruitment, they're not even going to have people that are going to be able to permit AGIA when we get applications in five years." Something has to be done with the salaries. Making auditors exempt defeats the purpose of the classified service. This came up when the legislature took pharmacists out of classified service.

MR. LUDWIG said, "The division of personnel is saying they aren't special enough that they could be their own classification that we could set salaries on. If it's this big of a problem that's dragging you all into it, seems to me that's special enough that it would require a special classification." He said his bargaining unit is still open and he would be willing to add salary ranges. He said auditors tend to be conservative people and might not want to take a job that is at-will.

2:27:25 PM
MR. LUDWIG said his union used to represent doctors and the state epidemiologist. A doctor called him and said federal services are making $40,000 per year more than him. He had been told by personnel that the only way the doctor could make more money was by going into the exempt service, but he liked the protection he had. There are no more doctors in the bargaining unit. Many departments contract out work for $200,000 a year, and "we don't pay our own people anywhere close to that."

2:29:10 PM
Senator Ellis joined the hearing.

SENATOR WIELECHOWSKI asked if the administration has raised this as an issue.

MR. LUDWIG said, "No, in fact at our table we raised recruitment and retention. We brought it up from the very first day." The only thing they got back from the administration was a slogan contest and an idea from the commissioner of relaxing hiring requirements.

2:30:30 PM
SENATOR THERRIAULT asked if 6 of the 7 positions are full.

MR. BROOKS clarified that out of 23, 6 are vacant. He offered to get accurate vacancies. Oil and gas revenue auditors are a

separate job classification with 4 series. He doesn’t know which are vacant.

CHAIR FRENCH asked for that. He asked for a response to the idea of keeping the positions in a classified service.

MR. BROOKS said there were a lot of general statements that are discussed with the union on a regular basis. “Perhaps you could put a fifth level, but there’s a lot of different factors.” As you progress up the salary schedule, once you pass range 25, the spread between ranges is only 3.5 percent. Everything is compressed as the ranges get higher. “I’m sure that higher range wouldn’t bother the unions at all; I’m sure if we added whatever number of steps or ranges that we wanted to, and those become part of a more complex bargaining exchange.”

2:33:31 PM
CHAIR FRENCH said he would like to pay auditors sufficiently and protect them within the union at the same time.

MR. BROOKS said they did a market-based pay analysis, and about 1,000 classified employees have benefited from the adjustments. Nurses were part of one of the study groups and hundreds of nurses got raises. The attempt to do that with auditors had some success, but this group needs a surgical adjustment.

2:35:24 PM
SENATOR WIELECHOWSKI asked about the executive order.

MR. BROOKS said that was Administrative Order 237, and they are looking at recruitment and retention issues more broadly. The goal is to make recommendations to the governor in November. The belief is that there are other things to do outside of pay, like flexible staffing and flexible work weeks. Input was solicited from the unions. This won't be solved overnight.

SENATOR WIELECHOWSKI asked if recruiting is difficult elsewhere within the classified service.

MR. BROOKS replied yes - some more than others.

SENATOR WIELECHOWSKI said he is hearing it's systemic.

MR. BROOKS replied it's many, but not all. The administration is trying to establish criteria of failed recruitment rates and then do a market-based analysis.

2:38:58 PM
SENATOR WIELECHOWSKI asked if the administration plans to come to the legislature and exempt more individuals.

MR. BROOKS replied there is no intent to whittle away at the unionized work force; the administration is trying to address a specific need here. “It’s not something you see very often.”

2:39:32 PM
SENATOR THERRIAULT asked about recruiting the oil and gas auditors and if they need to be trained. A CPA has learned all kinds of accounting, but this is very specialized. “Are you trying to get to a point where you actually have the potential of attracting somebody from a company who’s done that training up for you?”

MR. BROOKS said to ask the DOR.

SENATOR THERRIAULT said he is curious if the state is looking for someone who is already trained and ready to work.

MR. BROOKS said the requirements are established for the family, and then the DOR looks for the specific experience in the field. A less experienced person could be hired at a lower level.

2:41:51 PM
SENATOR WIELECHOWSKI noted the fiscal note had just over a million dollars for 3 auditors, and the math doesn’t compute.

MR. BROOKS said it is a weighted number because contractors have to pay their own social security tax or benefits. The DOR put the fiscal note together.

SENATOR WIELECHOWSKI asked if it's an average of $340,000 per auditor.

MR. BROOKS said to ask the DOR.

2:43:13 PM
SENATOR WIELECHOWSKI asked the average salary of ranges 24-28.

MR. BROOKS replied that a range 24-F is $7,000 month.

CHAIR FRENCH asked Mr. Brooks for the number of auditor vacancies by class and the allowable pay scale. He asked for him to have a conversation with Jim Duncan of ASEA.

The committee recessed from 2:44:37 PM to 2:59:03 PM.

SENATOR GARY STEVENS joined the committee.

CHAIR FRENCH asked for an overview of the penalty sections.

JONATHAN IVERSEN, Director, Tax Division, Department of Revenue (DOR), said penalties relate to the transmittal of information to DOR and are not based on delinquent tax payments. It is up to $1,000 per day for failure to provide monthly, annual, or forecasting information. This is the way to force companies to file the reports whether tax is due or not. Current statutes deal only with unpaid tax.

CHAIR FRENCH noted a helpful memo on that topic.

MR. IVERSEN said there are several penalty provisions. AS 43.555.430, Section 46 of ACES, and Section 14 of the CS discuss the annual reporting requirement.

CHAIR FRENCH asked the penalty for not filing it timely.

MR. IVERSEN said it is up to $1000/day in ACES and is in addition to other civil and criminal penalties.

CHAIR FRENCH asked if this makes certain that anyone doing oil and gas business on the North Slope files a return.

MR. IVERSEN said it is statewide.

SENATOR THERRIAULT asked for clarification.

3:04:20 PM
MR. IVERSEN replied it could be an additive penalty if there is failure to file with an underpayment. The first one is related to the annual filings.

CHAIR FRENCH asked if an oil company decides to not file a return, could it skirt the law by paying a $365,000 penalty for missing 365 days of reporting.

3:05:43 PM
MR. IVERSEN replied he will answer that by discussing other penalty provisions. The basic penalty provision is in AS 43.05.220, and it sets up a civil penalty of 5 percent for each 30-day period, or fraction of that period, during which a taxpayer fails to file or underpays. That penalty may not exceed

25 percent in the aggregate underpayment. If a company fails to file, the DOR will do an assessment and jeopardy audit, and it will base the tax on that.

CHAIR FRENCH asked if the new requirement in ACES is on top of existing laws to bring taxpayers into compliance.

MR. IVERSEN replied yes. There is a "get-out-of-penalty" free card if the burden of proof is met where the taxpayer can show—which is not easy—that the failure to file or to make payment is due to a reasonable cause and not willful neglect. He said that wording is based on internal revenue code standards and it's a tough burden to meet. From Section (b) there is another penalty due to intentional disregard of the law or to negligence with an additional 5 percent assessed of the unpaid amount. There is an option for reasonable cause. In the same section, (c) covers fraud penalties, which are 50 percent or $500. There are other penalty provisions addressing interest. AS43.05.290 describes criminal penalties based on willful attempts to evade taxation. There are felony and misdemeanor charges, perjury penalties, and abetting penalties. What ACES adds are just penalties for failing to file reports even if there is no tax consequence.

3:11:36 PM
SENATOR WIELECHOWSKI asked how often the penalties are used.

MR. IVERSEN said interest is a different matter, but "we don't see a failure-to-file type penalty currently." There are a limited number of taxpayers. There is a penalty provision that relates to the estimated installment payments from the PPT.

3:14:36 PM
CHAIR FRENCH asked about failure to provide independent information in ACES.

MR. IVERSEN said Section 17 is the penalty for not reporting.

CHAIR FRENCH asked if it was for specific information requested by the DOR.

MR. IVERSEN said it is information that is deemed necessary for forecasting revenue.

CHAIR FRENCH said it needs to be worked out, but he wanted to be clear that there are two types of penalties, one for returns and one for forecasting. The forecasting information penalty is the same as the report penalty--$1,000 per day.

MR. IVERSEN said yes. That one penalty provision hits both monthly and annual reports. The other hits the forecasting information. The annual one is due on March 31. The final monthly is due at the end of January for December production.

CHAIR FRENCH surmised there are 12 monthly reports and 1 annual. "So someone who is getting into trouble at least knows that the maximum amount of trouble they're going to get into is 13 per year." But is seems different under the forecasting information, which could be requested everyday. It is brand new, so how will it work and how will penalties be assessed?

MR. IVERSEN said there are a lot of vagaries, but DOR would request budget-related materials that are being communicated between parties in the units. If there is only one working-interest owner in a unit, DOR would request whatever budgetary projections they have. At that point, DOR would likely ask for specific information about how often those are done, with updates on a monthly basis. If a unit is only doing quarterly budget updates, then DOR might get only that.

CHAIR FRENCH asked how to know what to ask for, and if any of that information is collected now.

MR. IVERSEN said it will likely not come from the auditors, but from the economic research staff. Michael Williams heads up that section. There is a certain amount of value in these forecasts, but it is not the be all and end all. It won't be used to harass the taxpayers for everything they have.

3:22:45 PM
CHAIR FRENCH assumed a scenario of the state making a reasonable request that is not complied with, and he asked if that is one violation or an ongoing violation.

MR. IVERSEN said if DOR requested a report that it knows exists, it would be $1,000 per day until it was received.

CHAIR FRENCH noted that 10 reports would add up to $300,000 in one month. He asked if there will be appeal rights.

MR. IVERSEN said it will be the same as exists now. It would first go to an informal conference within the DOR, and it could end in the Superior Court.

3:25:43 PM

CHAIR FRENCH mentioned a memo from Mr. Bullock on penalties. He believes these penalties are defensible.

MR. IVERSEN spoke of the statute of limitations—the time period from when the return was filed until DOR could assess it. ACES made it 6 years; the CS keeps it at 3 years.

CHAIR FRENCH asked if that pertains to the two penalty provisions.

3:27:46 PM
MR. IVERSEN said the statute of limitations begins when the return is filed. That period can easily be more than three years anyway if both parties agree. If the state runs out of time with the statute of limitations and the taxpayer still hasn't provided the information, DOR would be forced to do a jeopardy assessment, making its best guess at the tax. DOR wants to use the joint-interest billings as part of its audit process, and the audits of joint-interest billings between taxpayers. Those can take years to accomplish. After filing, there are "a few years there where we've got joint-interest audits ongoing and then conflicts and hopefully an eventual resolution." That would be through arbitration, negotiation, or litigation between the parties, and "we would like to have the benefit of those audit resolutions in making our own assessment." That is part of the impetus for the extended statute of limitations. Also, DOR is now dealing with the extra figures of upstream costs.

SENATOR THERRIAULT asked for the section.

MR. IVERSEN said the first reference in ACES is in Section 14. It is also in AS 43.55.075, Section 50.

3:34:17 PM
SENATOR WIELECHOWSKI asked the revenue consequences to the state if the statute of limitation is not extended.

MR. IVERSEN answered that the state could run out of time with the compressed time frame and the additional data it needs to deal with. There may not be more tax revenue. But there are extra costs associated with that. Jeopardy assessments are a tough way to do business and the state prefers not to. He would rather have the time to do it right the first time and not fight it out during appeals, with all the associated costs.

3:36:11 PM

SENATOR WIELECHOWSKI surmised that there might be a little saving in money or time and aggravation. The other side is complaining about the 6 years of back interest at 11 percent.

MR. IVERSEN said if they underpaid their tax, that's correct. Using waivers under current law, they now have to pay that interest. "If we do a refund of the amount that has been assessed within … 90 days of the date the return was filed and the state does not owe interest … for an overpayment. It is an issue." The counter argument is that more information is needed, and under PPT and ACES, the state is required to look at the billing practices. The pressure will burden information management and being able to use the information in making the assessments. Auditing is always behind; one must wait until the returns are filed. That triggers an amended return, which would start the clock again. He said DOR has been rather speedy, however. But PPT returns audits have not begun.

3:39:45 PM
SENATOR WIELECHOWSKI asked if the state loses anything when negotiating the time limits with taxpayers.

MR. IVERSEN replied no, it is not a compromise at all. "We don't decrease the amount of tax due; we don't abate any penalties; we don't reduce any interest … because we'll just go ahead and make the assessment." The provision is more of a means to reduce conflict.

SENATOR WIELECHOWSKI asked if the state doesn't have the time to do an assessment and three years comes up, "can you just make an assessment with not very much foundation?"

MR. IVERSEN replied he didn't know of any specific prohibition, but he would want to avoid that. "It would be horrible on taxpayer relations." A jeopardy assessment would come into play when the state is not getting the information and there is no willingness by the taxpayer to waive the time limit.

3:42:06 PM
SENATOR HUGGINS said a witness spoke about 38 cents and 92 cents on the dollar with regard to this provision. It needs examination.

SENATOR WIELECHOWSKI said it is based on compound interest.

MR. IVERSEN added that other states have gross production taxes with a statute of limitations of 4 or 5 years, and Alaska is the only state using a net production tax.

CHAIR FRENCH noted that 6 years appears to be the outer boundary of what other states use, but no state has adopted the complex net production tax.

SENATOR WIELECHOWSKI asked why the state really needs 6 years. "Is it the joint billings?"

MR. IVERSEN took him to AS 43.55.165 where there is a requirement for determining what costs are lease expenditures, and the state is required to look at direct costs and typical industry practices and standards. Joint-interest billing audits are a tool in seeing what items have been excluded by other interested partners.

CHAIR FRENCH said the items excluded are what the partners won't be reimbursed for.

3:47:52 PM
SENATOR HUGGINS said the DOR is not bound by that, so there is flexibility.

3:48:31 PM
CHAIR FRENCH asked about the itemization of returns and how detailed and specific it is.

MR. IVERSEN replied that it varies. DOR has not been able to determine costs attributable to a particular well from the filed returns. It can determine operating and capital expenses and the value of production from a unit. For example, "For a taxpayer in the Prudhoe Bay unit it would be that particular taxpayer's share of that unit, and sometimes it is broken down, in addition to that, by field." He said it depends on the area. It is more specific in Cook Inlet, for instance, because the calculation is made based on each lease or property. There is a level of detail provided and it is delineated according to the components that would go into the tax calculation. The DOR gets varying degrees of backup data. Some taxpayers submitted very detailed spreadsheets down to the nuts and bolts level of capital and operating expenses.

CHAIR FRENCH asked if DOR has the level of specificity that is needed to do accurate audits.

MR. IVERSEN said that is the start; “that is the base document that we audit.” So by taking that information, then with every audit, “we ask a lot of questions.”

CHAIR FRENCH surmised: “You volley back with 20, 30, 40, 50 questions and try to separate that out.”

MR. IVERSEN said that is correct in some instances.

CHAIR FRENCH asked why not require that information in the first place.

MR. IVERSEN said DOR is working toward that to some degree. It has to be audited anyway. ACES asks for “the additional authority … with the annual reporting requirements, there are at least a couple more delineations. And, really, we have this authority anyway, but we wanted to clarify it and crystallize it in the ACES bill so that when we get to the point of standardizing that information that we want to feed into the database in the form that we want—electronically--that we’re not going to have any pushback to get there.” It’s a step toward standardization, and it has been a learning process.

CHAIR FRENCH said he is asking if the state will be able to get enough information through this legislation because it will be hard to make changes in the future if the state needs more power to do that.

MR. IVERSEN said there is a catchall provision, which has caused some angst with the taxpayers. Section 48 of the bill and Section 16 of the CS refer to the monthly reports: other records and information the department considers necessary for the administration of this chapter. He noted that under the general powers of the commissioner of revenue, it gives the department broad powers to gather information for computing tax. We have the authority, arguably, under current law. What we’re seeking to do with ACES, again, is to crystallize that--particularly with (f) relating to the monthly reporting requirements.” Under current law there isn’t the same type of monthly reporting requirements.

3:57:36 PM
CHAIR FRENCH said "qui tam" is a provision for whistle blowers. Qui tam is a legal provision in the United States code under the false claims act. It dates back to the Civil War when there were a lot of false billings. It compensates people who report the wrongdoers. Recently, ConocoPhillips was fined for an oil spill

from a tanker, and the crew member who reported it to the Coast Guard got $250,000. Without that tip-off the spill might not have been discovered. There is no qui tam provision in ACES. It was argued that it would only pertain to oil taxes because that is the issue at hand. He asked the administration's position.

MR. IVERSEN said he doesn't have the authority to state that right now. There are concerns of just relating it to the production tax. He said Illinois had such a provision, and it was repealed as it applied to taxes. There are at least two states, Oregon and Florida, that have whistle-blower provisions relating to tax.

The committee took an at-ease from 4:01:47 PM until 4:15:07 PM.

MARILYN CROCKET, Executive Director, Alaska Oil and Gas Association (AOGA), said AOGA is a trade organization with 17 members representing the majority of oil and gas exploration, production, refining, marketing, and transportation activities in Alaska. She introduced Tom William who is a tax attorney for BP. He was once the Director of the Tax Division in the DOR and later the commissioner. He was the architect of several oil and gas tax methodologies that are in place today. He wrote the regulations that implemented the state's former separate accounting tax and the tax method that replaced it. He supervised the first property tax valuation of the Alaska pipeline, and he administered the state's temporary reserves tax in 1976. He was on the Board of Trustees for the permanent fund. He became the father of ELF [economic limiting factor tax method]. He was vice president of Cook Inlet Regional Corporation before joining BP. The tax committee developed a unanimous testimony for SB 2001.

4:18:55 PM
TOM WILLIAMS, Senior Royalty And Tax Council, BP Exploration-Alaska, Inc., Chair of the AOGA tax committee, said AOGA concurs that the state should have capable auditors. "Session audit staff is essential for legislators, government officials, and the public to have full confidence that Alaska's tax laws are being firmly, fairly, and consistently enforced." That will help provide stability and transparency, which will help AOGA members pay the correct amount of tax as it become due. He doesn't mean to disparage any auditor currently working for the state. The legislature can make the tax fair and straightforward for auditors, or it can make it a nightmare for them as well as for the taxpayers. The difference lies in whether producers and explorers may rely on an operator's joint-interest billings to

them. If allowed by DOR, such billings would still be adjusted to remove expenditures in them that are specifically disallowed or to adjust those that are subject to allocation. AOGA is worried that repealing AS 43.55.165 (c) and (d) could deprive DOR of this important tool.

4:21:17 PM
CHAIR FRENCH said he has a copy of the white paper on that.

MR. WILLIAMS said it was encouraging to hear that Mr. Iversen would like to use the joint-interest billings where it is appropriate. He said the authority to use them will be repealed. The original version of the bill, Page 42, adds language to 43.55.165 (b), which says: "in determining whether cost or lease expenditures, the department shall consider, among other factors, typical industry practices and standards in the state that determine the costs that an operator is allowed to bill a producer that is not an operator." AOGA's concern is if beginning with industry standards and practices, "it is a little like saying 'here is books and records with 10,000 or … 100,000 receipts that we've been invoiced for and we're going to let you … we're just going to hand the internal revenue code to see where you start.'" That is different from starting the audit with the filed tax return. "Here it's saying use the principles." It can use this authority to adopt regulations to proscribe exactly what those practices and standards are. He doesn't dispute that, but once a standard is set, it's not always the same as starting with the results that have been created under them. The work for the auditor and the taxpayers will be much harder if DOR doesn't start with the billings.

4:24:46 PM
MR. WILLIAMS said he thinks Mr. Iversen was agreeing with that point. It can be a very useful starting point, especially for the people who don't operate the field. "That's all they get is the billings from the operator, and they write their checks."

MR. WILLIAMS said it starts on page 16 of version m.

SENATOR THERRIAULT asked what part of that language is being proposed for deletion.

MR. WILLIAMS said that is in his white paper. The first page of the white paper has language in bold that reads: "the department may authorize or require ... that the costs that are incurred by the operator during a year and are billable or billed to the producer may be used as the lease expenditures." He said this is

the specific authority to use billings from the operator to the partners. It is not mandatory and is subject to conditions of regulations. The department can put conditions upon the use of the joint-operator billings if it finds that it is appropriate to do that. These will be in phase 2. His whole point is if this is discretionary, DOR may do it, but if the conditions are met and comply with the regulations then the billings can be used. Under (c), if there was a field right next door, the department could authorize to take the principles from the field where there are arms-length billings and extend them to that next field. It wouldn't have to, he noted.

4:27:58 PM
MR. WILLIAMS said that if the discretion is repealed—not the directive—"doesn't that usually mean that the department can't do it?" He said there is nothing proposed for deletion that is tricky, other than the fact that it does say that the department may authorize or require these materials to be used as a starting point. That is a good starting point, but if it gets repealed it implies that now DOR can't use those, they must go back to the first principles. This is the short cut for taxpayers and auditors, because they will know where to start. They don't have to figure out what costs weren't billed. The costs that aren't going to be billed may be costs that an operator has that aren't sufficiently direct costs. "We don't get into fights about whether it's ordinary or necessary. What we have instead is a starting point—what the partners were willing to pay, who aren't in the business of letting the operator spend their money unless it's for the right purpose. And that's the point."

CHAIR FRENCH said is seems like Mr. Williams is arguing to give the DOR more power.

MR. WILLIAMS said, "We want the Department of Revenue to be able to start with the thing that makes the most sense. We want to have a tax that, when we report and pay it, and we may have all these penalties that you just heard about if we underpay it; we'd like to be able to get it right the first time." It will be audited, and nothing will be slipped by. There is a value to getting it done right. A lot of it is automated for the operators and partners. If the software is right the first time, it will repeat with the same groups of billings. It will make things easier for taxpayers and simplify it for the auditors.

4:31:22 PM

MR. WILLIAMS said he thinks the repeal could have unintended consequences. The authority is that the DOR "may" do this, so there is no harm by keeping it on the books. It is not forcing the department to do anything, but it gives it the discretion.

SENATOR WIELECHOWSKI said he would like DOR's comments. AS 43.55.165 seems to lay out a way for the DOR to determine what is a lease expenditure. On page 16 of the CS, there is a section that reads: "in determining whether costs are lease expenditures, the department shall consider, among other factors, a number of things listed." He asked if there is a conflict there and that is why the DOR took it out.

4:33:06 PM
MR. WILLIAMS said he doesn't know where the concern was.

SENATOR WIELECHOWSKI asked if there is a dispute between the language requiring DOR to make a finding of fact and page 16 in the CS. "I'm wondering if that is why they changed it."

MR. WILLIAMS said the language of the CS is currently almost exactly the same as in 165 (a) now. This is not new language in the tax law; it is being relocated from (a) to (b). But (c) and (d) are in there as well, and that is the discretionary authority to start with what's been billed to the partners.

SENATOR WIELECHOWSKI said it requires the DOR to make a finding that operating agreements are substantially consistent with DOR determinations of standards. "It is very complex, but I'm wondering if that's the difference because what they're changing requires them to make an actual finding, and I'm not sure the new law actually requires them to make that similar finding."

4:35:32 PM
MR. WILLIAMS said the new law does. The word is 'determination' at the bottom of Page 16. The DOR will make a determination. There is nothing here that the DOR isn't going to do in enforcing the tax, and the whole purpose is not to get into a debate with the DOR, but to caution about repealing it for no reason.

CHAIR FRENCH said the law doesn't say it is mandatory, nor does the overview. It allows, not mandates, DOR to substitute billings. Perhaps they have been imprecise in their testimony, but the language suggests it is still allowable. "Am I missing something?"

4:37:08 PM
MR. WILLIAMS said the commissioner said it was mandatory at hearings. "I don't know why he thinks that, but if that's the reason, then so be it." But it seems that nothing in (c) and (d) seems to be mandatory, but the justification has been that they aren't necessary. He is not telling the committee what it does, but the committee will know after reading it carefully. But if there is a high element of discretion about using the joint interest billings, and it is taken away, the most logical consequence and implication is that it can't be done any more. If there is a problem with the language, fix it rather than repeal it.

4:38:33 PM
CHAIR FRENCH asked if changing the word "shall" to "may" on Page 16, line 31, would satisfy this concern.

MR. WILLIAMS said, "That language is not the source of our concern." "Our concern is that when you have language elsewhere that's going to be repealed that says you may use the joint interest billings, that doing that repeal may be construed to take away that authority."

SENATOR HUGGINS suggested conferring on this. It is interesting.

4:39:48 PM
MR. WILLIAMS said AOGA has no position on whether [auditors] should be classified. On the issue of penalties, AOGA has problems with the two penalties referred to by Mr. Iverson. He noted the $1,000 per day for late tax returns in addition to $1,000 per day for each report, statement, or other document that DOR considers necessary to forecast state revenue. It runs from the date that DOR requires the information. The penalties are unnecessary because there are already significant penalties on the books, and they threaten to become excessive out all reasonable proportion to the nature of the infraction in most situations. There already is a 5 percent penalty for failure to file based on the amount of the unpaid tax. If a company ends up paying a tax but doesn't file a return, there may still be a penalty for not paying on time. It is capped at 25 percent after 4 months and a day.

MR. WILLIAMS said there is a second one for underpaying. The third penalty is 5 percent for an underpayment due to negligence without intent to defraud. Sometimes taxpayers believe a regulation is wrong, and their position is legally correct. The penalty is paid unless the taxpayer wins. By regulation, DOR has

linked this failure-to-pay penalty to the 25 percent penalty, making it a 30 percent payment. There is a 50 percent penalty for underpayment due to fraud. In addition, AS 43.05.130 already provides that a person who violates a provision of the tax code or a regulation adopted under those provisions is subject to a civil penalty of not more than $1,000 for each violation.

4:43:38 PM
MR. WILLIAMS said in terms of DOR's ability to use other means of getting the information it needs, 43.05.010 makes the commissioner hold investigations necessary for the administration of state tax and revenue laws. "That gets you right into the issue of forecasting—that's existing authority." The commissioner can issue subpoenas and require the production of necessary documents and correspondence. Section 40 of the general provisions of the tax code also amplifies on the powers of the DOR to issue subpoenas and provides for judicial enforcement of them. If DOR wants information it can get it. With respect to forecasting information, DOR could just as easily write a regulation on the types of information it wants. There is sufficient statutory basis for such a regulation. It has the further advantage of being open to updating when circumstances change. For these reasons, the proposed penalties are not necessary. A penalty of $1,000 per day for each "document" can quickly reach disproportional levels.

4:46:05 PM
MR. WILLIAMS said to suppose an individual document is given to the DOR on a timely basis, but copies of it are two weeks late. It is the information that DOR needs--not all the documents. This should be dealt with in regulations. He recalled a situation involving the former $25 a day late filing penalty, and DOR issued an audit for $28 million, even though the amount of tax was less than $4 million. There is nothing in the bill to indicate the standards for setting the penalty. This is the administration's bill, so DOR could have explained some standards. He said to ask the DOR on how the penalty should be scaled down from $1,000 per day and for what reasons. Even if the legislature chooses not to proscribe standards for reducing the penalty, at least DOR's opinion can guide taxpayers if the penalty becomes law.

4:48:24 PM
MR. WILLIAMS asked if he can submit testimony on the statute of limitations. Qui tam is the kind of lawsuit that arose in medieval England, and it became common in the United States as a suit by a private person brought against someone for alleged

fraud against the federal government, usually by overcharging the government for goods and services. Under it, the lawsuit is filed under seal and the defendant is forbidden from disclosing anything about the case to anyone. The U.S. attorney has a choice of appearing in the case and taking over the prosecution of the claims. Otherwise, the plaintiff--or relator—can prosecute the case alone. A successful relator gets a percentage of the government's recovery plus attorney's fees. The whole concept is inapplicable to the concept of the oil tax. Because of the confidentiality of the tax information, no one will have the information except for company employees and the state employees who enforce the tax. No one working for the company preparing the tax return is a plausible candidate, because those people are under oath, and the penalties for perjury would be applicable if a false return were knowingly filed. State employees already audit the tax returns, so it is their job to find erroneous claims.

4:51:18 PM
CHAIR FRENCH asked about people working for the company who are not in charge of preparing the returns, but may stumble upon a false claim or another attempt to deceive the state.

MR. WILLIAMS said that is a remote possibility given the size of even the small companies. He noted the thousand or tens of thousands of bills Prudhoe Bay pays each month to contractors. So it is automated as much as possible. The opportunities for individuals to intervene are slim, because it is a computer. A software error should be fairly easy to find, "but the opportunities for a person to actually say, 'well, is this in or out?'--those are pretty unusual."

4:53:26 PM
CHAIR FRENCH said that reasoning doesn't go to the point that no one working for the company is a plausible qui tam candidate. There may be individuals who become aware of tax misdeeds, and absent a financial incentive, they won't expose their company and risk their jobs.

MR. WILLIAMS said there are two people working in volume accounting at BP, and they make sure that all the partners know how many barrels of oil are being produced and that their share is exactly what they nominated to receive. Other people are responsible for talking with software people regarding changes. Otherwise, they are mostly working with the state in response to audit requests. The head of the division is a federal tax person working with the IRS. He said his job is to provide legal advice

when regulations change. “I suppose it is me who could be a whistle blower, and I can tell you from personal experience that if there were anything that I thought was false or incorrect that was in the return, I would blow the whistle internally to try to stop us from doing it before it ever got so far as I’d have to come to the state in a qui tam proceeding.”

4:57:11 PM
SENATOR WIELECHOWSKI said no one is implicating you, but there are bad apples in organizations, and criminal negligence was just pled. There are breakdowns in systems. This revenue is 85 percent of Alaska’s budget. If information is being hid, there is a lot of trepidation by the Alaska people in going to a net profit system, and qui tam is an extra layer of protection.

4:58:22 PM
MICHAEL HURLEY, Director, Government Relations, ConocoPhillips, spoke of moving the statute of limitations from three to six years. “Our perspective was: we were hiring more auditors, so if you have more auditors you shouldn’t need extra time.” Six years is a long time, especially with 11 percent interest. The auditor’s job is to find underpayments, and they always do. “We fight about it, and sometimes we just pay it off, and sometimes we argue about it some more.” Going to six years makes it difficult.

MR. HURLEY said reporting and penalties go together. In the CS, Section 14, there is a discussion about what is going to be in an annual return. Additional detail is required. That’s fine, but subsection (f) on page 13 covers monthly reporting. That is analogous to federal quarterly filings. The annual filing is awful with forms of all kinds and detail once a year. Quarterly filings are just one little form, and that was the way the PPT was set up. He understands the department’s desire to get more than just a check, but there are seven things required on a monthly basis plus anything else DOR wants. “I have no clue what that means; I don’t know if it means my entire set of books and records, or what?” He said he doesn’t feel comfortable with the DOR getting whatever it wants every month.

5:03:13 PM
MR. HURLEY said the other reporting relates to forecasts. In asking for information about the future, the tax division director said it includes whatever the operators and working-interest owners talk about. He said he understands that, but when there is no working-interest owner, it could be lots of information. For example, ConocoPhillips regularly participates

in lease sales, and under this language, DNR and DOR can share information. So DNR can tell DOR to ask ConocoPhillips what it plans to spend on a lease sale. That would be legal. The DOR can require the company to tell what it plans to spend. Sharing that information isn't always a good thing.

5:06:12 PM
CHAIR FRENCH said it is unreasonable to ask what you will spend for a lease next month. He said he reads it differently but understands his concerns.

SB 2001 was held in committee.
The committee adjourned at 5:06:38 PM.