

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 8, 2010

1:04 p.m.

MEMBERS PRESENT

Representative Craig Johnson, Co-Chair
Representative Mark Neuman, Co-Chair
Representative Bryce Edgmon
Representative Kurt Olson
Representative Peggy Wilson
Representative David Guttenberg
Representative Scott Kawasaki
Representative Chris Tuck

MEMBERS ABSENT

Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE BILL NO. 308

"An Act relating to the tax rate applicable to the production of oil and gas; relating to credits against the oil and gas production tax; and relating to the period in which oil and gas production taxes may be assessed."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 308

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): REPRESENTATIVE(S) JOHNSON

01/19/10	(H)	READ THE FIRST TIME - REFERRALS
01/19/10	(H)	RES, FIN
02/08/10	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

DONALD BULLOCK JR., Legislative Counsel
Legislative Legal and Research Services
Legislative Affairs Agency
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 308, answered questions.

DAN DICKINSON, CPA, Consultant
to the Legislative Budget and Audit Committee
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 308, provided a PowerPoint presentation and answered questions.

ACTION NARRATIVE

[1:04:52 PM](#)

CO-CHAIR MARK NEUMAN called the House Resources Standing Committee meeting to order at 1:04 p.m. Present at the call to order were Representatives P. Wilson, Tuck, Guttenberg, Olson, Johnson, and Neuman. Representatives Edgmon and Kawasaki arrived as the meeting was in progress.

HB 308-OIL AND GAS PRODUCTION TAX

[1:05:19 PM](#)

CO-CHAIR NEUMAN announced that the only order of business is HOUSE BILL NO. 308, "An Act relating to the tax rate applicable to the production of oil and gas; relating to credits against the oil and gas production tax; and relating to the period in which oil and gas production taxes may be assessed."

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REPRESENTATIVE JOHNSON, sponsor of HB 308, stated that a couple of the bill's provisions, such as the progressivity, are very similar to those that were included in the original version of Alaska's Clear and Equitable Share (ACES) that was introduced by Governor Palin. He said he believes the state may have overstepped its bounds with ACES, and therefore HB 308 would make six changes to the current ACES law.

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REPRESENTATIVE OLSON moved to adopt the proposed committee substitute (CS) for HB 308, Version 26-LS1328\E, Bullock, 2/5/10 ("Version E") as the work draft.

REPRESENTATIVE TUCK objected for purposes of discussion.

REPRESENTATIVE JOHNSON explained that the primary difference between the original version of HB 308 and Version E, which he is asking to be adopted, is the local hire provision. That provision was not ready at the time the original bill was introduced. While the local hire provision is a substantive change, the other differences between the two versions are technical changes where language was moved from section to section to make the bill read more smoothly.

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REPRESENTATIVE GUTTENBERG asked why Representative Johnson believes the local hire provision in HB 308 would stand up to constitutional muster anymore than anything else has in the past.

REPRESENTATIVE JOHNSON responded that he does not know about constitutional muster, but he does know that the film credit bill [Senate Bill 230] passed by the Twenty-Fifth Alaska State Legislature offered a 10 percent discount for local hire. Those provisions have not been challenged and have worked successfully for two years.

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REPRESENTATIVE GUTTENBERG argued that the film industry is a completely different animal than the oil industry and pointed out that the legal counsel's memo states there may be a constitutionality issue. This issue has been to court. The oil industry has a history of opposing the legislature's efforts to hire Alaskans, and has actively engaged in opposition to hiring Alaskans to such a degree that he has had to explain to top level executives why they are not good corporate citizens in Alaska. He surmised Version E will go to the House Judiciary Standing Committee.

REPRESENTATIVE JOHNSON responded that HB 308 would put local hire at the forefront of what the legislature expects. This is not like the cases that Alaska has lost for local hire or for charging more for out-of-state hunting and fishing licenses than for in-state, he maintained. Under HB 308, local hire is not mandatory, it is an incentive. If a company chooses not to take advantage of the provision, it will pay the tax rate it has today. If a company chooses the incentive, it can buy down its base tax rate by the percentage of local hire. It is no different than Tennessee offering a 10-year moratorium on taxes

to Saturn for putting a plant in that state and hiring local people. He thinks this is a way that is legal because half the people he talks to say it is legal and half say it is not, and Mr. Bullock's memo says the provision may be unconstitutional, not that it is unconstitutional. The only way to know for sure is to test it and he is prepared to go to court.

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REPRESENTATIVE GUTTENBERG maintained that incentives have never worked before with the oil industry.

REPRESENTATIVE JOHNSON disagreed. He said he thinks the oil industry is a creature of profit and that no industry or business has a conscience. Industry adds up the numbers and if they are in the black they do it, and if they add up red they do not, and the largest black number gets the investment. Through this incentive, HB 308 would help to make the industry's bottom line look good by replacing some of the non-resident workers on the North Slope with Alaskans.

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REPRESENTATIVE P. WILSON understood Version E would not mandate a company to do local hire; it is just available to the company if it wishes to have a bigger tax write-off. She asked what the results of the local hire incentive have been with the film industry.

REPRESENTATIVE JOHNSON replied that this week a local casting director was hired for a movie that will be filmed in Alaska and to receive the tax reduction this director is looking for local residents. He said he believes the film industry makes its decisions the same way as does the oil industry - the biggest black number gets the investment.

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REPRESENTATIVE JOHNSON, in response to Co-Chair Neuman, noted that the current discussion is on the differences between Version E of HB 308 and HB 308 as introduced, and the main difference is the local hire provision. The other five changes that would be made to current ACES law are the same in both versions of the bill. In further response, he said that all six changes will be explained once Version E is adopted and discussion begins on it.

REPRESENTATIVE TUCK maintained his objection to adopting Version E as the working document.

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REPRESENTATIVE JOHNSON, in regard to scheduling for HB 308, stated that today he will provide his presentation as the sponsor and presentations will also be made by committee consultant Dan Dickinson and bill drafter Don Bullock. The administration will be available at the next committee meeting to answer questions about the six proposed changes. Anyone else that members wish to have testify can be asked to do so.

CO-CHAIR NEUMAN requested that members let the co-chairs know whether there are any particular departments that should come speak to the committee regarding HB 308.

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REPRESENTATIVE TUCK, in regard to the factory in Tennessee, inquired whether that corporate tax credit was for the factory moving there and/or for an audit program to ensure the factory was hiring in-state workers.

REPRESENTATIVE JOHNSON answered he is uncertain how Tennessee set up its plan, but that it was a 10-year tax moratorium - not a tax credit - so the factory paid no taxes for 10 years. The basic premise of Version E is that the state would be offering incentives with the understanding that there will be local hire. There is probably no direct correlation with anything else other than the film industry that could be looked at regarding someone getting a discount for hiring Alaskans.

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REPRESENTATIVE JOHNSON added that Alaska charges more for out-of-state fishing licenses than resident licenses. The state also charges more for out-of-state commercial licenses than in-state, thus a bidder preference of 10-15 percent is provided as a direct discount for just living here. Version E does not even go to those levels; it would provide that a company can choose to take advantage of a discount. There would be no mandate that a company hiring an Alaska resident gets something another company is not entitled to - which is the basic premise, called equal treatment, for the lawsuits that the state has lost. Each individual company, not the state, would make the determination as to the hiring of an out-of-state person or a local resident.

CO-CHAIR NEUMAN said the crux is that a company can take advantage of tax credit progressivity by hiring Alaska residents.

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REPRESENTATIVE JOHNSON explained the mechanism by which the tax credit progressivity would work. Alaska currently has a flat base production tax rate of 25 percent. According to the Department of Labor & Workforce Development (DLWD), about 70 percent of the 5,000 people working on the North Slope are Alaskans. Version E would provide incremental buy-downs of the tax rate in return for hiring a workforce that is greater than 80 percent Alaska residents. A company with 85 percent local hire would have its base production tax rate reduced to just over 24 percent. A company with 100 percent local hire would have its base production tax rate reduced to 20 percent. Each half point increase in local hire would have a correlating reduction of the base production tax rate. Compared to the original ACES, the 5 percent tax reduction would reduce annual revenue to the state treasury by about \$500 million while generating about \$1.2 billion in economic benefit to the state.

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REPRESENTATIVE JOHNSON portrayed legislators' potential support or opposition to Version E as being related to two differing philosophies: one philosophy being it is better to have \$500 million in the state's treasury and one philosophy being it is better to have \$1.2 billion in the private sector. He said his philosophy is that \$500 million in the hands of private citizens is better than \$500 million in the state's treasury; philosophically, he believes it is better that his constituents have the money and make their own decisions. However, he recognizes that the various regions of the state will differ in philosophy, and some regions will believe it is better for the money to go to government because that would mean work through capital projects and other social programs.

CO-CHAIR NEUMAN agreed with Representative Johnson.

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REPRESENTATIVE TUCK disagreed that Version E is about private versus public as he thinks all committee members want to see Alaskans get jobs on the North Slope. Rather, it is about

whether the method proposed in Version E would be successful in the courts. He understood a recent court decision found that the price difference between out-of-state and resident fees for fishing licenses is unconstitutional under the basis of equality between the states. To him, Version E is about out-of-state jobs versus in-state jobs. He knows plenty of Alaskans that would love to have those jobs on the North Slope. It is the highest paying industry in the state and Alaskan families would prosper from those job opportunities.

REPRESENTATIVE TUCK related that when he first became involved with the Alaska Process Industry Careers Consortium, an organization that trains Alaskans for jobs on the North Slope, work was being done on an instrumentation program that would be implemented nationwide. However, when his organization tried to get buy-in, the oil industry refused while utilities were all for it, so it subsequently went to the back burner. Fortunately, the oil industry is now getting more involved because, he thinks, industry has realized it will soon need to replace workers on the North Slope due to top-heaviness in age.

REPRESENTATIVE TUCK said he does not know whether it really is cheaper to hire out-of-state workers than to train local people and put them to work. He wants to make sure that Version E will actually accomplish the intent and do so effectively and legally. He does not want to see the state get balled up on good intentions by making a mistake along the way, so he wants to work through this to find the best way to accomplish the intent.

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REPRESENTATIVE JOHNSON responded that Version E is not like fishing licenses because it does not charge anyone for anything; it would not charge a company an additional business license for not hiring Alaskans. He hopes there has been a sea change in the oil industry and that there will be cooperation in hiring more Alaskans and he wants to incentivize the industry to do so. He wants it to make sense to the accountants sitting in offices in Houston, Texas, to decide to hire Alaskans for those \$83,536-per-year jobs. He also hopes that if a company cannot find a resident for a job that it will require the non-resident it does hire to move to Alaska in order to be hired. He predicted the oil companies will become the state's biggest training facilities. The industry will do what is right for its bottom line and he is trying to align that bottom line with what works for Alaskans.

CO-CHAIR NEUMAN pointed out that the State of Alaska provides a 7.5 percent buyer preference when the Department of Corrections purchases cheese, milk, or produce from Alaska's farmers. Additionally, the state offers corporate tax credits for training programs.

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REPRESENTATIVE GUTTENBERG related that for approximately 20 years under the economic limit factor (ELF), the tax rate for the Kuparuk oil field was close to zero and the investment rate was very low. Had industry been investing at the rate the sponsor is projecting, the state would not be seeing the production decline that it is seeing now. He asked whether anyone will be available to answer questions about how reducing the tax rate as provided under Version E will change the industry's business plan of very little reinvestment even when it had almost no taxes.

REPRESENTATIVE JOHNSON replied that someone will be testifying on all aspects of the bill. Times have changed considerably; for example, it was heard on the House floor today that it will be very difficult for anyone to invest in the National Petroleum Reserve-Alaska (NPR-A). The only place where companies will be able to invest for awhile is Kuparuk and Prudhoe Bay, and this is what the state must look at to fill the Trans-Alaska Pipeline System (TAPS). The focus is going to be on those legacy fields and HB 308 deals with that by addressing well workover in addition to new exploration for tax credit.

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REPRESENTATIVE TUCK inquired as to the reasons for the oil industry's hiring of so many out-of-state workers.

REPRESENTATIVE JOHNSON suggested this question be asked when industry representatives are before the committee, but he guesses it is a little bit the money as well as the availability of help. He thinks Version E addresses this issue by making it worth industry's while to train Alaskans as opposed to the easy way of hiring someone from out of state. He reiterated his belief that the oil industry would become the state's number one trainer in order to take advantage of this tax break.

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REPRESENTATIVE JOHNSON, in response to another question from Representative Tuck, said the [base production] tax rate is currently 25 percent. If 100 percent resident hire is achieved, the tax rate would be reduced to 20 percent. This reduction represents about \$500 million less to the state's treasury and about \$1.2 billion more to the private sector, using a 1.9 multiplier factor.

CO-CHAIR NEUMAN pointed out that there are several charts in the committee packet in this regard and witnesses will be explaining it further as well.

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REPRESENTATIVE JOHNSON, in response to Representative P. Wilson, explained that there are 5 percentage points in tax reduction and that this percentage is split into 10 equal increments between 85 percent resident hire and 100 percent resident hire. He wanted the increments to be small enough to provide an incentive to go beyond an 80 percent resident hire and to strive for 100 percent local hire.

REPRESENTATIVE P. WILSON said she likes this as she thinks more Alaskans are not hired by the industry because they are uneducated in the areas desired by the oil industry. Version E would be a definite incentive that makes it worth the industry's while to educate Alaska workers.

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REPRESENTATIVE KAWASAKI disagreed, saying he thinks a lot of people in Alaska are qualified for these jobs but have not been hired. Even with a nominal to 0 percent tax rate on the legacy fields, the companies still refused to hire locals. He cited a report in the committee packet regarding mining, oil, or gas extraction jobs that states: 3,000 workers are residents and 1,000 are nonresident workers; wages for resident workers are \$440 million and for nonresidents the wages are \$150 million; and for earnings per quarter resident workers received \$37,000 and nonresidents received \$44,000. While he appreciates offering an incentive to industry to do more for local hire, the university has done a lot of training, as has the Department of Labor & Workforce Development and local pipeline construction companies. He offered his opinion that something is being missed by chasing an industry that has done well in the state and that has refused to hire local. He is tired of providing corporate welfare to this industry, as both the industry and the

state are making money off this non-renewable resource and that is a fair thing to do.

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REPRESENTATIVE JOHNSON agreed the state has done a lot and has trained a lot of people, and that it is not working. Therefore, he is trying something different by offering an incentive. If industry does not play, it does not get the tax advantage and the state still gets its money. The only thing being chased is jobs for Alaskans, and under Version E this would be done through the local hire provision as well as the other provisions related to investment credits.

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REPRESENTATIVE TUCK, referred to page 4, Version E, line 19, and asked whether the tax savings are based on how ACES is currently administered or on the changes proposed by the bill.

CO-CHAIR NEUMAN requested Representative Johnson to first identify the section that the local hire provision is in.

REPRESENTATIVE JOHNSON said the local hire provision is located on page 6 under [AS 43.55.022]. The section that is being referenced by Representative Tuck is in the original bill and has to do with progressivity, and Version E makes no change to that. The only difference between the original bill and Version E is Section 43.55.022, which relates to local hire.

CO-CHAIR NEUMAN interjected that this is Section 15 [page 6, Version E].

REPRESENTATIVE JOHNSON agreed. He said the section he was referring to is on page 6, lines 12-31, Version E, which deals with local hire, not progressivity.

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REPRESENTATIVE TUCK surmised that the provisions on page 6, roughly lines 12-31, Version E, are related to the new number from page 4, lines 19-23, Version E.

REPRESENTATIVE JOHNSON said that is incorrect and is an apples to oranges comparison because one is progressivity and one is local hire. One deals with the base rate and the other deals

with progressivity, which is a different section of law and a different tax.

REPRESENTATIVE TUCK understood that the local hire provisions are not tied to the tax progressivity.

REPRESENTATIVE JOHNSON replied correct, [the local hire provisions] are tied to the base rate of 25 percent.

REPRESENTATIVE TUCK maintained his objection to adopting Version E as the working document. He requested that members be able to ask questions of Mr. Donald Bullock, the drafter of Version E.

[1:52:33 PM](#)

DONALD BULLOCK JR., Legislative Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, Alaska State Legislature, stated that he wrote the [2/5/2010] memo referred to earlier. He explained that Version E takes a different approach to local hire than what has been seen before. It would not require that 5 percent of the workers be residents, which means that 5 percent of those jobs may not be filled by nonresidents. It is distinguished from the license issues because workers from out of state are not paying anything differently to come in and work. Rather, Version E would introduce an economic factor to the employers to take into consideration the cost through the tax of hiring different percentages of Alaska residents versus nonresidents. That is only one factor because employers must also look at whether the skills are available. The tax break would be offset if out-of-state labor was less expensive than in-state labor, and in that case it would be an economic decision to hire workers that cost less. Therefore, Version E introduces another factor by providing an incentive that lowers a company's taxes when it hires Alaskans.

MR. BULLOCK pointed out that Version E does not say a company must do this. It gives the company a benefit if it does, and that is why his memo does not say it is a waste of time to do this. It is a different approach that would be open to interpretation, and he is unaware of a case that has dealt with this approach. Version E would provide incentives to employers to hire Alaskans and see where their economics lie in their business.

MR. BULLOCK noted that this is also different than the situation where there were no taxes due for an oil field because without

an incentive it does not make any difference who a company hires. It would be an economic decision if the field is coming close to breaking even or if the company can start saving costs. It is not a residency or non-residency issue; the tax is already zero - there was not an incentive for the state to offer.

MR. BULLOCK said he cannot tell members that if the state is taken to court it is going to lose. However, he expects that it will be taken to court, and the issue will be whether this is enough of an incentive that is offered to employers that it in fact is onerous to nonresidents. He does not know the answer to this and that is why he did not offer anything affirmative in his memo. Had this been like other bills or other passed legislation that requires 20 percent of a company's workers be Alaskans, it would be pretty clear that no, this cannot be done.

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REPRESENTATIVE TUCK inquired whether there was a similar concern when the tax advantage for the film industry was being considered [Senate Bill 230].

MR. BULLOCK answered he cannot speak to that bill because he did not work on it; he can only speak to Version E of HB 308, which he drafted.

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REPRESENTATIVE KAWASAKI asked whether other industries might challenge that this benefit is only given to the oil industry.

MR. BULLOCK responded probably. This offer is an economic incentive; other industries could be eligible to the same thing. Calculation of the percentage is based on the number of hours that are worked for projects and expenses that are qualified expenditures under ACES 43.55.165, and the number of hours directly relates to the number of people that would be working. Because contractors, as well as the companies themselves, are making lease expenditures that may be allowed, contractors would be included within this rebate system. However, the benefit goes to the person that is subject to the production tax, the person who is paying the contractor.

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REPRESENTATIVE GUTTENBERG understood Mr. Bullock to be saying that this would apply not just to the leaseholder but to all the leaseholder's subcontractors down the line.

MR. BULLOCK replied any work that is done on a lease expenditure that is allowed as a deduction in determining what the production tax is.

[1:58:12 PM](#)

REPRESENTATIVE GUTTENBERG inquired whether a non-resident person could claim that this is a commerce clause issue - if it cannot be done one way, then it cannot be done another way that would accomplish the same thing.

MR. BULLOCK answered that he is not saying it will not be challenged. He reiterated that there is not a direct burden on a non-resident, the burden is only indirect. It is on the one that makes the decision - the employer - as opposed to a law that says a person will pay more to buy something, such as a license, because he or she is a non-resident. The state would not be requiring that a certain percentage must be Alaska residents, which would mean that that percentage is unavailable to nonresidents. All jobs are available to all people, whether residents or nonresidents. If nonresidents are hired, they may cost more; however, they could cost less because of differential labor costs. So, Version E takes an economic approach rather than requiring a certain number of positions or a certain percentage. That is where he is unsure, because it is not a direct burden, it goes through the employer and what it costs the employer to run the business overall.

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REPRESENTATIVE GUTTENBERG asked whether there is something comparable to this that has happened in the past.

MR. BULLOCK responded not that he is aware of. Most of what has happened in the past is that the state has charged nonresidents more to do something, such as go to college or fish. Or the state has said employers must have a certain percentage of residents. So, Version E is different than the majority of the cases that have come. He is just saying there is a possibility that it could be challenged; the plaintiff would have to show that it is a direct impact on nonresidents.

REPRESENTATIVE GUTTENBERG said he thinks the legislature would hear that it is a direct impact on nonresidents, but he respects Mr. Bullock's opinion.

CO-CHAIR NEUMAN said members are the legislature and it is the legislature that makes the laws.

[2:01:13 PM](#)

REPRESENTATIVE KAWASAKI noted that some industries already have a workforce of 80-90 percent residents. He asked whether this would impact how the state does business with other industries.

MR. BULLOCK replied he is unsure what is being asked, but that under the equal protection argument there is a sliding scale in economic issues. If the legislature says there is a good reason why it is discriminating in this case and that good reason does not have to do with a fundamental right - but working is a fundamental right - that there is more flexibility. The state must show that it is good public policy and in the best interest of the state to do that discrimination, and that the means of doing it is a reasonable way to get there. This is a bill for a particular industry and it could be done in different industries but it would depend on the mechanism that is used. In this particular case, there is a significant tax on Alaska's largest industry, so there is a clear vehicle for providing a rebate or a tax break. The state could have another break in AS 43.20, which has a benefit to corporations that pay income tax, but it does not do anything for taxpayers that are not subject to that because they are not incorporated.

[2:03:19 PM](#)

REPRESENTATIVE GUTTENBERG requested a definition of residency worker under AS 43.40.092 and severability, as there is no severability in Version E at this time.

MR. BULLOCK answered that severability is presumed in every act. While severability is sometimes put in specifically, the court will separate what may be separated. The definition of a resident worker is in the motor fuel statutes, and it takes on from the definition in Title 1, which is that someone is physically present with the intent to remain. That statute is about the burden of proof and one of the proofs is whether a person is eligible for a dividend from the Alaska Permanent Fund; a resident worker is not defined anywhere in the statutes

except in that one provision. Therefore, he took what the state had available when drafting Version E.

2:04:57 PM

REPRESENTATIVE GUTTENBERG posed a scenario in which HB 308, Version E, passes in its current form as a tax incentive, but the residency provision is cut by the courts. He asked whether the other provisions in the bill would still remain in place.

MR. BULLOCK responded that there is no direct link between the provision providing a rebate for Alaska hire and the provisions for relief from interest on retroactive regulations and change in the progressive tax rate. Therefore, it is possible the court would leave the remainder of the bill in place.

2:05:51 PM

REPRESENTATIVE TUCK maintained his objection to adopting Version E as the working document. He said he thinks the concept of ensuring that Alaskans are taken care of first is very good. Therefore, he would like to see this provision as its own bill to ensure that it gets all the way through the legislature. He has always tried to figure out ways to ensure that Alaskans get those North Slope jobs. One way is to make sure Alaskans are trained. The state's high schools and universities could be doing more, as could the Department of Labor & Workforce Development. For sure, however, is that the oil industry could be doing a lot more. To get more Alaskan hires, he would like to see the oil industry do the training rather than relying on the state to do the training. He pointed out that he has worked on the North Slope as an electrician and that people without a southern drawl or British accent usually feel out of place on the North Slope. He further stated that most of those North Slope workers do not spend their money in Alaska because they fly directly from the North Slope to where they live outside of the state. Version E would provide the opportunity to see whether this works and whether it has potential for being applied to other industries.

REPRESENTATIVE TUCK withdrew his objection. There being no further objection, Version E was before the committee.

2:08:31 PM

REPRESENTATIVE JOHNSON said that to him HB 308, as a whole, is a jobs bill. The best way to reduce social ills such as domestic

violence, drugs, and prisons is to give someone a home, respect, and a reason for getting up every day, and the way to do that is with a job. Therefore, he has named the bill the Alaska Job Security Act. He said he hopes the bill will be transferable to other industries and welcomes members to file other bills in this regard. He stated that in terms of progressivity, the language in HB 308 is the same as the original ACES bill introduced by Governor Palin to take the place of the petroleum production profits tax (PPT). He offered to go over the history of the ACES legislation with Representative Tuck since he was not in the legislature at that time.

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REPRESENTATIVE JOHNSON reviewed the six changes that would be made to existing law by HB 308, Version E. He said some of these changes are related to small errors and oversights in the ACES bill and some are substantive policy changes. The first change is that Version E would allow credits for workover rigs, the philosophy being that anything that puts a barrel of oil down the pipeline, whether from a new or existing well, should be allowed to have those credits. Additionally, he related, both a new well and a workover each represent 100 jobs, according to industry. The second change is that Version E would drop the interest rate so that 11 percent is the [ceiling]. The third change is that HB 308, Version E, would provide that until the ACES regulations are accepted and published, the state can go back and collect any taxes that are mispaid by a producer, but it cannot charge interest on those mispaid taxes if the taxpayer was operating in good faith.

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CO-CHAIR NEUMAN pointed out that under existing statute, the credits are forwarded to try and get further exploration, but that he thinks HB 308, Version E, targets new technology for the workover of existing wells. He surmised that this provision will also be an incentive for smaller companies to do workovers on smaller wells.

REPRESENTATIVE JOHNSON replied that a qualified workover may be as simple as a collapsed casing that is causing reduced production. In an effort to put more flow through the Trans-Alaska Pipeline System, the tax credit would apply to anything from exploring for new geology to basically everything below the wellhead, regardless of whether a well is already there. Currently, it is considered new exploration when the distance is

something like one to three miles from an existing well and the credit does not apply to wells that are drilled within a shorter distance than that. He thinks that was an oversight in the original ACES that has deprived the state of both royalties and throughput. Governor Parnell has indicated this is something that will be included in his bill as well [the governor's bill, HB 337/SB 271, was introduced on 2/10/10].

[2:15:20 PM](#)

REPRESENTATIVE JOHNSON, in response to Representative Guttenberg, said he will have Mr. Dan Dickinson point out where the six changes are located in Version E, but for the moment he is providing an overview.

REPRESENTATIVE JOHNSON continued his review of the changes. He noted that ACES changed the look-back period for an audit from three years to six years, and HB 308 would return this look-back period to three years so that the oil industry is treated the same as other industry. The fifth change is the local hire provision that has already been talked about. The sixth change would reduce the progressivity from 0.4 percent to 0.2 percent. He explained that 0.2 percent was the figure proposed in the administration's original ACES bill and that it was changed somewhere in the committee process. A 0.2 percentage would preclude the possibility of having 110 percent progressivity. He maintained that this change is also about jobs because it leaves more money for investment which would translate into more oil flowing through the pipeline. He related that in 2009 there were 2,776 unemployment claims for the oil industry, almost double the 1,067 claims made in 2007 and the 1,350 claims made in 2008.

[2:19:11 PM](#)

REPRESENTATIVE P. WILSON inquired whether the proposed changes in HB 308 could make it beneficial for industry to drill even when it is known there is no oil in a certain location. She further asked whether there will be a sectional analysis.

CO-CHAIR NEUMAN said the bill will be reviewed section by section so members can ask questions.

REPRESENTATIVE JOHNSON added that the plan is to spend some time reviewing the bill and that Legislative Legal and Research Services is in the process of preparing a sectional analysis. In regard to encouraging the drilling of a dry hole, he pointed

out that if \$1 million was spent to drill a well, the 20 percent tax credit would amount to \$200,000; so drilling dry holes for the tax credit just would not happen.

[2:21:29 PM](#)

REPRESENTATIVE KAWASAKI asked what the value is of the credit for well workovers.

REPRESENTATIVE JOHNSON responded that if a producer does not do a workover, it gets nothing, and it costs the state nothing. If a workover is done, the credit will depend upon the amount of capital expenditure and he thinks each individual well will be dealt with differently. He suggested this question be asked of the producers when they testify.

[2:22:35 PM](#)

REPRESENTATIVE KAWASAKI inquired whether industry is currently doing these workovers and whether it is a higher or lower number today.

REPRESENTATIVE JOHNSON understood that very little workover is occurring on the North Slope and that most of those rigs are setting on their sides. He suggested that this question also be asked of the producers when they testify because such rig counts are available.

[2:23:12 PM](#)

CO-CHAIR NEUMAN offered his understanding that the state is still writing some of the regulations for ACES, and HB 308 would work in a coordinated effort in this regard. He asked where the state is in writing these regulations and who is writing them.

REPRESENTATIVE JOHNSON replied he does not know. He related that he has talked to members of the industry and for the most part they are clueless as to what will be in the regulations even though ACES was passed two years ago. Some of the regulations are done and some are not.

[2:24:54 PM](#)

REPRESENTATIVE KAWASAKI pointed out that it took this body almost four months to decide on [Marmot] Day, so not having regulations in nearly two years does not seem out of the ordinary. He said he thinks it is premature to talk about

rolling back taxes on the oil industry when committee members have not heard from the administration or industry experts about how ACES is working to date. He said he hopes it is the sponsor's and co-chair's intent to hear from these folks before HB 308 is moved out of committee.

CO-CHAIR NEUMAN assured Representative Kawasaki that it is the intent of both co-chairs to take a look at where things are at.

REPRESENTATIVE JOHNSON stated that he will try to get any person that members wish to have come speak and that the administration is due to testify, as are industry experts. The committee is already ahead because of the four months that legislators spent reviewing and becoming educated about ACES. He intends to have serious discussions, not railroad the bill through. He said he thinks there is a problem and that it is costing the state jobs and opportunity. If the state does not develop its own resources and take charge, the state's future is dismal. Legislators can talk and talk, but nothing gets done until there is a bill before members. It will be up to members of the committee and the full body to determine which way to go with HB 308.

REPRESENTATIVE KAWASAKI reiterated he would like to hear what the administration has to say.

CO-CHAIR NEUMAN added that everyone is working through the regulations and all else the best they can.

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REPRESENTATIVE TUCK, in regard to the unemployment numbers cited by Representative Johnson, inquired how it is known whether the numbers are not Alaskans that are being replaced by people from the Lower 48. He further asked whether those unemployment numbers include out-of-state workers that have been laid off.

REPRESENTATIVE JOHNSON said he believes those were resident numbers that he cited. Both numbers are available because the Department of Labor & Workforce Development tracks both in-state and out-of-state numbers. He added that he believes the number would be closer to 5,000 if the out-of-state figures are included. He offered to get that number for committee members.

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REPRESENTATIVE TUCK related that according to the report entitled, Nonresidents Working in Alaska, 2008, issued by the Department of Labor & Workforce Development, the percent of total new hires for nonresidents in oil field services went up 42.7 percent. It would be nice to know whether Alaskans are being displaced, he reiterated.

REPRESENTATIVE JOHNSON answered that the Department of Labor & Workforce Development will be before the committee and able to address that. The department will also be responsible for auditing and making sure that the [42.7] percent starts going in the opposition. He said Version E is his attempt to fix the problem that he has perceived.

REPRESENTATIVE TUCK agreed, provided it does not go in the opposite direction so that the state is losing jobs overall. He inquired whether there is a fiscal note that reflects Version E.

REPRESENTATIVE JOHNSON said he will get that to members.

[2:32:44 PM](#)

REPRESENTATIVE P. WILSON stated she is pleased that members are looking at this and determining how HB 308 would affect ACES. She pointed out that even though it took the legislature a long time to look at ACES, a lot of amendments were done on the floor and many were done on the fly, making it hard to determine what all was affected.

REPRESENTATIVE JOHNSON responded that he likened it to a feeding frenzy and that there were amendments members did not understand. Numerous members wanted to prime co-sponsor HB 308, but he refused so he could maintain a certain amount of control and ability to slow it down to enable everyone to know what they are voting on. Given the months that were spent on ACES, most of HB 308 has already been reviewed by members. It is not a revisit of a whole new concept; it is a tweaking of what the governor originally brought to legislators.

CO-CHAIR NEUMAN urged members unfamiliar with ACES to learn about it from the administration.

[2:35:39 PM](#)

REPRESENTATIVE GUTTENBERG said it is currently unknown whether ACES is working because many of the regulations are not yet in place. Members learned much from both the Murkowski and Palin

administrations and were taught that international conditions have a lot more to do with what happens in Alaska than what is done by the legislature. The part of ACES that did pass and which has now lapsed is the standard deduction. Without doing anything, the industry will be getting a tax break of \$230-\$250 million from now on, and he would like to see what effect that will have on development and exploration. Much of ACES is still in play and it cannot be determined what it did or did not do. Additionally, the stock market has a lot of effect on everything. At this point, people can only speculate rather than talk about real history.

2:39:25 PM

DAN DICKINSON, CPA, Consultant to the Legislative Budget and Audit Committee, began his PowerPoint presentation by pointing out where each of the six proposed changes can be found within Version E [slide 3]. He explained that Version E is voluminous because of the changes in technical definitions about interest, and every time it is referred to in the rest of the statute book, the reference must be changed. The sections highlighted in yellow are the meat of the bill and are the sections that he will discuss.

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MR. DICKINSON said Section 6 of Version E deals with the proposed change in interest rate that is paid on delinquent taxes [under AS 43.05.225]. Section 6 would change this rate to be the [lower of] the federal funds rate plus two percent or up to a ceiling of 11 percent [slide 5]. He explained that this interest rate applies to all of Alaska's 20 tax types, such as cigarette, bed, and other taxes, and that percentage-wise the oil and gas production tax is by far the largest [source of revenue] at well over 90 percent. Under current law, the interest rate is established as the higher of the federal funds rate [plus 5 percent] or 11 percent. He suggested that the revisions be made effective on the beginning or ending of a quarter, given that the interest is compounded quarterly.

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MR. DICKINSON related the historical context of the current interest rate, which was implemented in 1991 when a huge series of litigations in both royalty and tax were coming to a peak. In the 1970s and early 1980s, many people were irked that the state's interest rate, particularly for royalty claims, was a

simple rather than compound rate; thus, in a 20-year-old claim the difference between a simple and a compounded rate was huge. These people argued that from a company's standpoint, it made sense to underpay taxes and then pay simple interest when the bill became due because - in essence - the company was getting a loan from the state for an incredibly low rate. Therefore, in 1991 the focus was on making the rate compound for both royalty and tax. Over the decade of the 1980s, the federal funds rate declined from about 14 percent to about 6 percent; thus, by 1991 the 11 percent floor had become a ceiling [slide 6]. Interest rates continued to fall over the next 20 years and under current law this 11 percent has become the required interest rate. Today the federal funds rate is 0.5 percent, but the interest rate that is being charged for taxes is 11 percent, which is 22 times the federal funds rate. He said this context is important because when the current interest rate was put in place, it represented a number below which the federal funds rate plus 5 percent was expected to be.

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MR. DICKINSON compared the actual interest rate charged by the state from 1980-2009 to the rate that would have been charged had Version E been in place during that same time period [slide 8]. He pointed out that the interest rate under Version E would have been considerably lower than 11 percent; thus, under Version E, the prevailing rate applied to all taxes would have been the federal funds rate plus 2 percent.

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MR. DICKINSON, in response to Representative Guttenberg, reiterated that the interest rate for all tax types is the same; thus the interest rate on oil taxes is the same as for the other types of taxes. He explained that the thick blue line [slide 7] represents the federal funds rate, and the thick red line above that blue line is the flat 11 percent floor and the thin purple line above that blue line is the federal funds rate plus 5 percent. Since passage of the [1991] bill, there have been only one or two quarters in which the federal funds rate plus 5 percent actually exceeded that 11 percent; thus, over most of [1991-2009], the interest rate has been 11 percent.

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MR. DICKINSON compared Alaska's current interest rate to the federal interest rates under the Internal Revenue Service and

the tax code [slide 9]. For individuals, the interest rate is the federal funds rate plus 3 percent for both overpayment and underpayment of taxes. For corporations the interest rate for overpayment of taxes is the federal funds rate plus 0.5 percent and for a large underpayment it is the federal funds rate plus 5 percent. Thus, Alaska's current rules line up with the federal situation of corporations with large overpayments. Version E would change Alaska's interest rate to being more in line with the federal general corporate rate [federal funds rate plus 2 percent for tax overpayment and federal funds rate plus 3 percent for tax underpayment]. He pointed out that the federal rate does not have a ceiling or a floor; it is only the federal funds rate plus a percent.

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MR. DICKINSON moved to the second proposed change located in Section 7 of Version E [slide 11]. Section 7 would mandate that interest is not due on an increase in tax liability that is the direct result of the adoption of regulation with retroactive application until 30 days after the effective date of the regulation. Governor Parnell has proposed to address this same issue in a bill that he will soon be introducing [the governor's bill, HB 337/SB 271, was introduced on 2/10/10]. In a January 14, 2010, press release the governor states that he would "allow for the waiver of interest charges on late payments due to the retroactive application of new regulations."

MR. DICKINSON explained why this second change is necessary [slide 12]. Production tax is due on the last day of the month following the month of production [AS 43.55.020(a)]. Generally, within that 30 days a company can get a fair estimate of the tax due. However, lots of things can happen that will change the amount of tax due: audits, the taxpayer receiving new information, retroactive revision of tariffs, and retroactive changes in regulations. Under current ACES law, when such changes happen, the change goes back to the first month that the company owed the tax. For example, if a tax is owed on the last day of August 2007 for production in July 2007, and an ACES regulation is later put into place that says something the taxpayer thought was an expense is not, the taxpayer will owe interest on that back to August 2007. The law says that if there is a tax dispute, the attorney general or the Department of Revenue can settle a compromise with the taxpayer in regard to a figure and a penalty [AS 43.55.070]. However, the statute does not mention interest and thus the attorney general's interpretation is that interest cannot be compromised.

Therefore, even if a taxpayer's position is deemed as having been reasonable at the time the tax was paid, the taxpayer must still pay the interest if more tax is owed as a result of subsequent regulations.

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MR. DICKINSON outlined the five major areas in which ACES gave the Department of Revenue new rules for taxpayers [slides 13-14]. The new reporting requirements [AS 43.55.030 and .040] came out in regulation in May 2008, effective as of June 2008. New regulations directing how taxpayers must deal with combining two half years of production tax came out in September 2009, effective October 2009. Because production tax is a yearly tax, and the effective dates of most of the ACES reforms was July 1, 2007, ways of combining two half years had to be implemented. Furthermore, ACES directed that allowable costs shall be defined by the department under regulation [AS 43.55.165(a)] and those new rules came out in January 2010, effective February 2010. He pointed out that the costs of employee training are not deductible under these new regulations. In regard to new rules for reasonable transportation for things like the Trans-Alaska Pipeline System and tankers, ACES directs that the cost a taxpayer is allowed to deduct will be the lower of what is actually paid or what the department thinks is actually reasonable [AS 43.55.150]. However, two years later, no regulation has been promulgated and taxpayers still do not know what the department thinks is reasonable. Under HB 308, Version E, interest could not be charged on the difference in the tax when the regulation comes out retroactively.

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MR. DICKINSON turned to the third proposed change located in Section 11 of Version E [slides 15-24]. Section 11 would change progressivity [AS 43.55.011(g)] from 0.4 percent to 0.2 percent. He pointed out that the progressivity can be huge. Of the \$6.9 billion brought in from the production tax in fiscal year 2008, \$4.2 billion came from the 25 percent base tax rate and \$3.2 billion came from progressivity [slide 17]. This \$3.2 billion in progressivity is the same amount that was received from royalties that same fiscal year. The amount received for income taxes was \$0.6 billion and the amount for state and local property taxes was \$0.4 billion.

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MR. DICKINSON reviewed how the proposed change in progressivity would work [slide 18]. Progressivity would start at 0.2 percent until an additional 25 percent in progressivity is added. Then it would go to 0.1 percent per additional dollar until 50 percent in progressivity is added, at which point the progressivity is capped. Under current law, the initial progressivity goes up at 0.4 percent for every extra dollar until the 25 percent is reached [slide 19]. Then it goes at 1.0 percent [until the 50 percent cap is reached]. He noted that the progressivity proposed by Version E is identical to the original version of ACES introduced by Governor Palin, except that Governor Palin's proposal would have capped progressivity at 25 percent.

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MR. DICKINSON, in response to Representative Guttenberg, said he has not done an analysis of what this would have meant over the past two years. However, slide 21 depicts a graph from the Department of Revenue's January 14, 2010, analysis in which the department talks about three important aspects of the tax rate: the nominal rate; the marginal rate, which is the amount paid in tax for every additional dollar of revenue that a company receives; and the effective rate, which is a restatement of the tax as a gross figure. He referred members to [slides 22-24] for a further sense of what would have happened in the intervening years.

[2:58:27 PM](#)

MR. DICKINSON addressed the fourth proposed change regarding local hire [Section 15 of Version E]. He noted that most of the employers in the oil and gas industry on the North Slope are companies that provide oil field services, and the employment figures shown on [slide 29] are only for companies that provide direct services. Not included on that slide are Alaskan companies that provide services for catering, security, engineering, transportation, communication, and construction. He pointed out that these are the companies that will have to improve their local hire rates, and they will have to pass that information on to the taxpayers to get the credit. So, what will happen is that the taxpayers will insist in their contracts with these companies that the amount of local labor be proven. Therefore, the proposed provision will translate down from the taxpayers to the operators of the units to the contractors to the subcontractors. This is not an imposition; it is an

economic incentive that is removed several times from the folks who actually have to make the behavioral changes.

CO-CHAIR NEUMAN urged members with questions to speak to staff at the Department of Revenue and to Representative Johnson.

[3:00:36 PM](#)

MR. DICKINSON pointed out that slide 33 deals with the fifth proposed change regarding the 30 percent credit for well work [Section 17 of Version E].

REPRESENTATIVE JOHNSON reiterated that work on HB 308 will continue and that Mr. Dickinson will be available by phone for further questions when the bill is again considered by the committee. In response to Representative Kawasaki, he stated that it will be up to the administration to determine which people to bring before the committee to answer questions and present the administration's position.

[HB 308 was held over.]

[3:02:52 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:03 p.m.