

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 15, 2010

1:02 p.m.

MEMBERS PRESENT

Representative Craig Johnson, Co-Chair
Representative Mark Neuman, Co-Chair
Representative Bryce Edgmon
Representative Kurt Olson
Representative Paul Seaton
Representative Peggy Wilson
Representative David Guttenberg
Representative Scott Kawasaki
Representative Chris Tuck (via teleconference)

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 229

"An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas for delivery and sale from a lease or property in the state; providing for an effective date by amending the effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."

- HEARD & HELD

HOUSE BILL NO. 280

"An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for the storage of gas on state land; and providing for an effective date."

- MOVED CSHB 280(RES) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 229

SHORT TITLE: GAS EXPLORATION\DEVELOPMENT TAX CREDIT
SPONSOR(S): REPRESENTATIVE(S) CHENAULT

04/14/09 (H) READ THE FIRST TIME - REFERRALS
04/14/09 (H) RES, FIN
02/22/10 (H) RES AT 1:00 PM BARNES 124
02/22/10 (H) -- MEETING CANCELED --
03/12/10 (H) RES AT 1:00 PM BARNES 124
03/12/10 (H) <Bill Held Over to 3/15/10>
03/15/10 (H) RES AT 1:00 PM BARNES 124

BILL: HB 280

SHORT TITLE: NATURAL GAS: STORAGE/ TAX CREDITS
SPONSOR(S): REPRESENTATIVE(S) HAWKER, CHENAULT

01/15/10 (H) PREFILE RELEASED 1/15/10
01/19/10 (H) READ THE FIRST TIME - REFERRALS
01/19/10 (H) L&C, RES, FIN
02/08/10 (H) L&C AT 3:15 PM BARNES 124
02/08/10 (H) Heard & Held
02/08/10 (H) MINUTE(L&C)
02/15/10 (H) L&C AT 3:15 PM BARNES 124
02/15/10 (H) Moved CSHB 280(L&C) Out of Committee
02/15/10 (H) MINUTE(L&C)
02/17/10 (H) L&C RPT CS(L&C) NT 4DP 2NR 1AM
02/17/10 (H) DP: LYNN, NEUMAN, CHENAULT, OLSON
02/17/10 (H) NR: HOLMES, T.WILSON
02/17/10 (H) AM: BUCH
02/19/10 (H) RES AT 1:00 PM BARNES 124
02/19/10 (H) -- MEETING CANCELED --
02/26/10 (H) FIN AT 1:30 PM HOUSE FINANCE 519
02/26/10 (H) <Bill Hearing Canceled>
03/12/10 (H) RES AT 1:00 PM BARNES 124
03/12/10 (H) Heard & Held
03/12/10 (H) MINUTE(RES)
03/15/10 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

REPRESENTATIVE MIKE CHENAULT
Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Spoke as the prime sponsor of HB 229.

MARCIA DAVIS, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 229, answered questions and provided information.

ROBYNN WILSON, Income Audit Manager
Tax Division-Income Audit Group
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 229, answered questions.

KEVIN BANKS, Director
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 229, answered questions and provided information.

CARRI LOCKHART, Production Manager
Marathon Oil Corporation
Anchorage, Alaska

POSITION STATEMENT: Supported HB 229.

NICOLE BUSEY
Tax Attorney
Marathon Oil Company
(No address provided)

POSITION STATEMENT: During the hearing on HB 229, answered questions.

REPRESENTATIVE MIKE HAWKER
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Spoke as the joint prime sponsor of HB 280.

STACEY SCHUBERT, Intergovernmental Affairs Director
Mayor's Office
Municipality of Anchorage
Anchorage, Alaska

POSITION STATEMENT: Testified in support of the concepts proposed in HB 280, Version C, on behalf of Dan Sullivan, Mayor of Anchorage.{

STUART GOERING, Assistant Attorney General
Commercial/Fair Business Section
Civil Division (Anchorage)
Department of Law
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 280, answered questions.

ROBYNN WILSON, Income Audit Manager
Tax Division-Income Audit Group
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 280, answered questions.

LARRY OSTROVSKY, Petroleum Land Manager
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 280, answered questions.

LARRY PERSILY, Staff
Representative Mike Hawker
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 280, answered questions.

ACTION NARRATIVE

[1:02:54 PM](#)

CO-CHAIR CRAIG JOHNSON called the House Resources Standing Committee meeting to order at 1:02 p.m. Representatives Guttenberg, P. Wilson, Olson, Seaton, Neuman, and Johnson were present at the call to order. Representatives Edgmon, Kawasaki, and Tuck (via teleconference) arrived as the meeting was in progress.

HB 229-GAS EXPLORATION\DEVELOPMENT TAX CREDIT

[1:03:02 PM](#)

CO-CHAIR JOHNSON announced that the first order of business is HOUSE BILL NO. 229, "An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas for delivery and sale from a lease or property in the state; providing for an effective date by amending the effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."

CO-CHAIR NEUMAN moved to adopt the proposed committee substitute (CS) for HB 229, Version 26-LS0900\E, Bullock, 2/18/10, as a work draft.

CO-CHAIR JOHNSON objected for discussion purposes.

[1:03:58 PM](#)

REPRESENTATIVE MIKE CHENAULT, Alaska State Legislature, prime sponsor of HB 229, paraphrased from the following written sponsor statement [original punctuation provided]:

House Bill 229 amends and extends the exploration and development incentive tax credit that was originally enacted in the 23rd legislature in 2003 as [House Bill] 61. This tax credit continues to apply under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of natural gas primarily in the Cook Inlet area.

To more strongly encourage companies to invest additional capital in exploring for and developing new natural gas reserves, this legislation makes the following changes to current law:

1. Increasing the amount of the credit from 10% to 25% of the amount of qualified capital investment and qualified services spending.
2. Removes the 50% limitation on the amount of credits that can apply in a single year increasing the "time-value of money" for the credits.
3. Removes the "successful efforts" requirement that disallows the credit for wells that are drilled,

with all the same costs, but end up being non-productive.

4. Clarifies that the credits can be taken on a current tax return, on a timely filed tax return or on a timely filed tax return for the year immediately following the year the qualified capital investment is made.
5. Clarifies that the credits can be applied to a gas reserve regardless of whether or not there has been previous gas production in the area.
6. Clarifies that the credits do not apply to North Slope gas that is brought into Southcentral.
7. Extends the sunset date of the investment tax credit from January 1, 2013 to January 1, 2020.

This legislation makes no changes to definitions of qualified capital investment or qualified services.

Annual natural gas production and supply in the Cook Inlet area have been declining for a number of years. During the same time, demand has been increasing steadily. Therefore, a sharp increase in drilling to find new reserves is drastically needed. The original Investment Tax Credit enacted in 2003, while modestly successful in stimulating new drilling, needs to be made a much more effective incentive to developers to increase capital spending in a large manner. These changes will go a long way to achieving that goal.

[1:06:42 PM](#)

REPRESENTATIVE P. WILSON understood that HB 229 is needed to increase exploration, but asked why it is necessary to continue giving these tax breaks to the producers once they have found the new gas.

REPRESENTATIVE CHENAULT responded he does not believe there are any big pockets of gas left in Cook Inlet. Most of the remaining gas is in small pockets that are harder to find and require lateral drilling or jack-up rigs. This gas is expensive to find, and many more dry holes are drilled than producing holes. He said the bill is intended to encourage exploration in areas that have not yet been drilled and to look at newer drilling technology for more drilling in the formations currently producing gas.

[1:09:54 PM](#)

REPRESENTATIVE P. WILSON asked how much credit would be given under HB 229.

REPRESENTATIVE CHENAULT replied the bill would change the 10 percent tax credit to a 25 percent tax credit.

[1:11:31 PM](#)

REPRESENTATIVE SEATON recalled that in the past, testimony has indicated that the lack of exploration in the Cook Inlet is because the Regulatory Commission of Alaska (RCA) has kept the price of gas so low that it is unprofitable to explore further. He understood that recent gas finds were in conjunction with oil exploration.

REPRESENTATIVE CHENAULT replied that while he could address this, it would be better to have the Cook Inlet producers to speak the question.

[1:13:15 PM](#)

REPRESENTATIVE SEATON understood this proposed tax credit would be written off against corporate tax instead of production tax.

REPRESENTATIVE CHENAULT answered yes, capital investment, qualified services.

REPRESENTATIVE SEATON, in regard to page 2, lines 4-9, surmised that qualified services would include any expenditure, as well as the drilling cost, that is made on any gas reserve.

REPRESENTATIVE CHENAULT responded yes.

[1:15:16 PM](#)

REPRESENTATIVE SEATON noted that in the Cook Inlet basin the production tax on oil is zero and the gas tax is extremely low. He offered his belief that there are exploration tax credits in addition to the zero or low tax rates. He said it seems that absorbing a 25 percent tax credit for qualified services is making a subsidy investment in the companies instead of trying to stimulate a certain behavior, so he is trying to determine how all of these inter-relate.

REPRESENTATIVE CHENAULT replied the intention is to incentivize more drilling. The current tax credit system does help, but

drilling is not happening in Cook Inlet. He allowed that one reason why is the low price for the gas. He related that other people have stated it is hard to get capital investment dollars when competing worldwide for money because the basin is expensive to drill.

[1:17:56 PM](#)

REPRESENTATIVE GUTTENBERG noted that House Bill 61, the bill that HB 229 is amending, called for a report on the effect of exploration and development tax credit no later than 2008. He asked whether this report was completed.

REPRESENTATIVE CHENAULT answered he does not know and deferred to the administration.

REPRESENTATIVE GUTTENBERG said he is asking the question because he is wondering whether the report is the impetus for increasing the tax credit.

MARCIA DAVIS, Deputy Commissioner, Office of the Commissioner, Department of Revenue, said she believes the report has been done and will have it distributed to the members.

[1:20:42 PM](#)

REPRESENTATIVE GUTTENBERG inquired what qualifies as qualified services, qualified costs, and capital investments.

MS. DAVIS responded that HB 229 does not modify qualified services. According to statute, qualified services are expenditures for labor, seismic, and other services that are directly applicable to the qualified investment, and qualified investment is addressed by HB 229. However, she is puzzled because it has a subsection that excludes lease operating expenditures. Clearly, the expenses that should be covered are the labor services involved with leasing and operating a drill rig, building the infrastructure, such as roads, docks, port facilities, and bringing in and operating maintenance equipment and facilities, maintenance camps, and so forth. She deferred to Robynn Wilson as to whether the Department of Revenue has interpreted a definition of lease operating expenditure under existing law.

ROBYNN WILSON, Income Audit Manager, Tax Division-Income Audit Group, Department of Revenue, stated she does not believe the

definition of lease operating expenditure has yet been interpreted by the department.

1:22:28 PM

MS. DAVIS said her reason for asking Ms. Robynn Wilson this question is that lease operating expenses are generally those that are charged back to owners and are ordinary and typical. However, this credit provision is targeted at new development. She explained that development happens in phases: the seismic phase involves labor and possibly some qualified capital expenditure, both of which would be covered; if prospects are discovered, the next phase is the exploration phase which involves costs for exploratory wells, labor, waste disposal, and transport where there are not roads, all of which would be covered; the development phase is the major construction phase where the gathering centers, compressors, and so forth are built for operating the facility, but production of oil or gas has not yet been produced for sale. The qualified expenditures in this buildup are what would be targeted by HB 229. Once production begins, labor and capital investments for maintenance and so forth fall under what is typically called operating expenses, and she believes that that is what this exclusion is intended to cover.

1:24:51 PM

REPRESENTATIVE GUTTENBERG inquired whether the state has access to the seismic work once a well is abandoned, given that the seismic work is a qualified expense.

MS. DAVIS replied that since these are state oil and gas leases, she is confident the State of Alaska requires the sharing of the seismic information. She deferred to Mr. Kevin Banks for confirmation of her answer.

KEVIN BANKS, Director, Division of Oil & Gas, Department of Natural Resources, said Ms. Davis is correct. When seismic is shot over state land, whether it is under lease or not, the State of Alaska acquires the seismic data. The state does not receive the information for seismic that is shot over private or federal land.

MS. DAVIS added that an exploration incentive credit is built into the production tax. Production tax is owed on all land within state boundaries, so private, state, and federal land are included. A consequence of accepting that credit is that the

seismic information must be shared with the State of Alaska. However, that would not be the structure under HB 229.

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REPRESENTATIVE SEATON asked whether someone previously claiming a credit can also receive a credit for production and operating expenses under the provision on page 2, lines 6-9, Version E.

MS. DAVIS deferred an answer until she receives a copy of Version E.

1:30:02 PM

REPRESENTATIVE SEATON reiterated his earlier question regarding the interaction of the exploration tax credits in Cook Inlet and this qualified service tax credit against corporate income tax.

MS. DAVIS surmised Representative Seaton is asking how the gas exploration and development tax credit under AS 43.20.043 interfaces with the exploration incentive credit.

REPRESENTATIVE SEATON responded yes, as well as any other credits or deductions that would be allowed.

MS. DAVIS deferred an answer until she has talked with Ms. Robynn Wilson because there are two other bills currently in the legislature that propose additional Cook Inlet-targeted tax credits against the corporate income tax. On first blush, the credit under HB 229 would be dominant and applied before any other credits in this chapter. This credit removes the 50 percent cap, so presumably if the credits exceeded the corporate income tax there would be no interaction with any other corporate income tax credit. To the extent there is any remaining corporate income tax liability, the corporate income tax payer would then drop down the list to the next credit available and apply the amount of that credit against those income taxes. She presumed the expenditure could only be used once should it also qualify elsewhere, but she would like to verify that with Ms. Robynn Wilson.

1:33:31 PM

REPRESENTATIVE P. WILSON inquired whether it is a good probability that the producer would not have to pay any taxes.

MS. DAVIS replied she must answer hypothetically because each taxpayer's information is confidential. She said most taxpayers in Cook Inlet are smaller companies targeting exploration plays that do not have much ongoing production elsewhere in the state. These companies may not have a significant amount of corporate income tax, so the amount of expenditures incurred on the front end associated with seismic, exploration, and development would be expected to swamp their corporate income tax liability. However, these companies are relatively new players and not currently contributing to the state general fund through their corporate income tax. For large producers with ongoing production elsewhere in the state, the proposed Cook Inlet credits may not significantly dampen their overall income tax. Thus, it would depend on the entity and would range from wiping out the corporate income tax altogether to dampening it somewhat.

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REPRESENTATIVE P. WILSON asked whether HB 229 is enough of an incentive for companies that are not now exploring to start.

MS. DAVIS answered that several factors affect investment and the bill goes as far as it can to ensure that corporate income tax is not a disincentive and provides some financial incentive to incur costs and move forward. However, the bill cannot affect factors such as market prices.

[1:38:06 PM](#)

MS. ROBYNN WILSON, in response to Representative Edgmon, explained that the Department of Revenue calculates the taxable corporate income on a combined basis that includes the income for the whole corporate group. The first question is what amount of the group's activity happened in Alaska versus everywhere else; so, in effect, the state taxes a slice of the pie. Of that slice, it is a graduated rate with a top marginal rate of 9.4 percent.

[1:40:07 PM](#)

CARRI LOCKHART, Production Manager, Marathon Oil Corporation, spoke in support of HB 229 by paraphrasing from the following written testimony [original punctuation provided]:

By way of background, Marathon Oil Company's Alaska operations are focused on natural gas production

operations, limited to Cook Inlet. In 2009, our natural gas sales from Alaska averaged 87 mmcf/d [million cubic feet per day]. We sold to essentially every natural gas market available including the local utilities - Enstar and Chugach Electric, Tesoro, and the Department of Defense. We also provided natural gas to the ConocoPhillips/Marathon LNG plant. Marathon has been in business in AK for over 55 years and we remain committed to serving the natural gas needs of SouthCentral AK through our various contractual commitments.

As you are aware, in 2003 the Legislature passed, and the Governor signed several bills directed at providing incentives for new exploration and development activities. Marathon was particularly interested in House Bill 61, which was intended to incentivize the exploration and development of natural gas reserves in the Cook Inlet. The bill under consideration by this committee, HB 229, will merely strengthen the incentives provided for by the earlier bill.

One might ask about the need to provide incentives for natural gas development in the Cook Inlet. The answer to this question is found by considering the long-term decline in natural gas reserves and deliverability which the Cook Inlet has experienced. What must be addressed is whether there is currently sufficient exploration and development activity to address such decline in reserves and deliverability, and not simply to ask whether the Cook Inlet is running out of gas. At the current minimal level of Cook Inlet activity it is unlikely that Cook Inlet reserve additions will replace annual production on an ongoing long-term basis. As such, natural gas reserves and deliverability are at risk for continued decline in the Cook Inlet, resulting in the exposure to unmet utility needs in the future.

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The lack of Cook Inlet activity (especially exploration) is an artifact of the historic oversupply of natural gas which kept prices well below lower-48 indexed prices, creating a lack of incentive for additional drilling. Furthermore the regulatory

processes and deterioration in market availability have added to project uncertainty. The project economics and market uncertainties have made it difficult for projects to complete effectively for finite funding.

So how will HB 229 help?

As we are all painfully aware, Alaskan project economics are not considered solely on their absolute merit. They are also scrutinized on a relative scale in comparison to other worldwide opportunities in which companies such as Marathon may invest. The intent of HB 229 is to help level the playing field between Alaskan projects and other investment opportunities around the world.

HB 229 is intended to continue to provide an incentive to oil and gas exploration and development activities through an investment tax credit. You should have before you the committee substitute for HB 229 (version E). Since this is the first hearing for HB 229, let me walk through the main points of this new legislation: This legislation makes six significant changes to current law:

[1:43:57 PM](#)

CO-CHAIR JOHNSON removed his objection to adopting the proposed committee substitute as the work draft. There being no further objection, Version E was before the committee.

MS. LOCKHART continued her testimony:

1. Section 1 increases the amount of the credit from 10% to 25% of the amount of qualified capital investment and qualified services spending as well as clarifying that the credits can apply to costs incurred for a gas reserve for which the taxpayer previously elected to claim a credit.
2. Section 2 adjusts the dates for when qualified expenditures must be made to qualify for the old 10% and new 25% credits. It also changes the term "reserves" to "wells" to clarify that

- "wells" produce gas whereas "reserves" are what is being produced.
3. Section 3 removes the 50% limitation on the amount of credits that can apply in a single year, increasing the time value of money for the credits.
 4. Section 4 clarifies that the credits do not apply to North Slope gas that is brought into Southcentral.
 5. Section 5 removes the "successful efforts" requirement that developers must find and deliver new gas resources to market to qualify for the credit. It also clarifies that the credits can be applied to a gas reserve regardless of whether or not there has been previous gas production in the area.
 6. Section 6 clarifies that the credits can be taken on a current tax return, on a timely filed tax return or on a timely filed tax return for the year immediately following the year the qualified capital investment is made.
 7. Section 7 adjusts the date the credits expire from 2017 to 2024.
 8. Section 8 extends the sunset date of the investment tax credit from January 1, 2013 to January 1, 2020.
 9. Section 9 is gives this legislation an immediate effective date.

In summary, Marathon Oil Company believes HB 229 is one part of the equation to enhance Cook Inlet exploration and development activities, attempting to create more certainty in the overall natural gas deliverability in Cook Inlet. I would also add that timing is important. It takes multiple years to properly plan and execute drilling activity in Cook Inlet, which is necessary to meet future overall deliverability needs in SouthCentral AK.

MS. LOCKHART added that to qualify for this investment credit, the producer must make capital investments, which have value to the State of Alaska through the addition of jobs and other supporting services and activities.

[1:47:38 PM](#)

MS. LOCKHART, in response to Representative Seaton, explained that when companies make investments such as drilling a well, the cost of labor to drill that well is tied up in the whole package of economics which she believes would be invested. The everyday operations year after year, defined as operating expenses under the original House Bill 61, would be excluded under HB 229. It is the one time of drilling the wells and developing the product that are the investments that would qualify for these credits.

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REPRESENTATIVE SEATON surmised that under the expansion to existing fields provided by HB 229, the qualified services would exclude maintenance and operation costs, and the replacement of pipelines.

MS. LOCKHART responded that is her understanding. To qualify, an investment would have to be tied to drilling additional wells looking for new reserves. It would not be for replacing a line or piece of equipment in an existing area.

[1:50:43 PM](#)

REPRESENTATIVE SEATON referenced the provision on page 3, Section 3, that would eliminate the 50 percent taxpayer liability and inquired whether this has been a prior issue for Marathon Oil Corporation.

MS. LOCKHART deferred to Ms. Nicole Busey.

NICOLE BUSEY, Tax Attorney, Marathon Oil Corporation, replied no, it has not been an issue for Marathon. She said she believes the change would be in line with other changes that are being proposed to other taxes related to production tax. In response to Co-Chair Johnson, she said she is not familiar with the production investment tax credit, but she thinks there is not this present 50 percent limitation; or, if there is, that there is some current legislation proposed to remove that 50 percent limitation.

CO-CHAIR JOHNSON understood this elimination would be to maintain consistency with other bills working their way through the system.

MS. BUSEY answered yes.

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REPRESENTATIVE SEATON asked whether Ms. Busey is aware of any companies that have hit the 50 percent limit.

MS. BUSEY responded she does not know.

REPRESENTATIVE SEATON, in regard to Ms. Lockhart's statement about helping with long-term deliverability, requested a definition of long-term.

MS. LOCKHART replied she defines long-term as sustainable and being that when her children are grown they will have stability in where there electricity and natural gas are coming from for their homes. Based upon the production declines in Cook Inlet, she said she does not believe the activity in Cook Inlet will sustain the current deliverability needs for more than the next couple of years.

[1:54:29 PM](#)

REPRESENTATIVE GUTTENBERG inquired how an increase to 25 percent in the tax credit would play out for Marathon Oil Corporation.

MS. LOCKHART answered this is just one piece of the overall economic and risks that Marathon looks at when deciding to make capital investments. Projects in Alaska must be competitive at the corporate level against projects in other states or the world, so she cannot state that HB 229 would definitely result in more exploration rigs next year; however, it would increase the odds of getting exploration and development projects funded. More importantly, it may enable companies that have yet to entertain or commit to investment in Alaska to explore at a rate of return that is needed to start the project. She sees this as one enabler within a whole package that is reviewed as a company goes through its planning process.

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MR. BANKS, in response to Co-Chair Johnson, stated that new producers will be companies like Armstrong Alaska, a company that is currently developing the North Fork gas field on the lower end of the Kenai Peninsula. Armstrong Alaska is also building a gasline to Anchor Point and ENSTAR is extending its gasline from Ninilchik to Anchor Point, so that infrastructure will provide incentive to others that are interested in developing resources in that particular area. There is some

potential that Escopeta Oil & Gas will deliver on its promise to bring in a jack-up rig this year to begin drilling its Kitchen Lights Unit in Cook Inlet. He agreed with the bill sponsor that smaller gas fields will be the wave of the future. Of the current Cook Inlet players, Marathon is the most active developer and is in the process of exploration developments. He predicted that gas will be seen in Cook Inlet where it has not been seen before. A tax credit like this would reduce at least one of the high costs faced by these new producers.

1:59:49 PM

MR. BANKS, in response to another question from Co-Chair Johnson, said it is anticipated that new development of gas supplies in the Cook Inlet will be more costly than historical gas supplies. One of those costs represents the various kinds of income taxes that the producers have to pay, and HB 229 would help reduce that particular cost and contribute to more potential development. In further response, he said there are lease sales proposed for May [2010] in the Cook Inlet, but it is hard to say whether enactment of HB 229 would entice companies to bid on those leases. Much of the best acreage in the Cook Inlet is already under lease and some of the other acreage belongs to the federal government. His prediction is that a company would find a prospect slightly more attractive and would bid on it should HB 229 be passed, but he does not think that would be a very good indicator of whether this particular credit was working or not.

CO-CHAIR JOHNSON said he is looking for anything that can be done to entice companies to come to Alaska.

2:02:01 PM

REPRESENTATIVE GUTTENBERG reiterated his question about the report that was due out in 2008.

MR. BANKS answered he has not seen the report.

MS. LOCKHART, in regard to whether HB 229 would attract more development, said she thinks there is some incentive for new producers as well as existing players. Many of the current reservoirs are very old legacy reservoirs and Marathon is constantly stepping out to try to understand the boundaries of these reservoirs. She pointed out that this is a risked business; for example, even a project in development mode can end up being a dry hole because the sand packages being targeted

in many of the Cook Inlet reservoirs are discontinuous and a step-over can miss the sand completely. This investment tax credit will help enable projects that may be viewed as very borderline as companies continue reaching out to determine the extent of current reservoirs.

[2:03:50 PM](#)

REPRESENTATIVE P. WILSON understood that the average for oil exploratory wells is one successful well out of six. She asked what the average is for gas.

MS. LOCKHART responded there is not one magical number as it varies by area. In exploration, the number is more like one successful well in ten, and in development the odds are better.

MR. BANKS added that most of the obvious structures in the Cook Inlet region have been drilled, and now the hunt is on for the much more ephemeral seismic kinds of stratigraphic traps that are more difficult to locate. The provisions proposed by HB 229 would allow companies with legacy fields, like Marathon, to look for gas within their own units because gas potential within those existing fields can still be developed with more drilling.

[2:06:58 PM](#)

CO-CHAIR NEUMAN, in regard to risk assessment, inquired where Marathon places Cook Inlet compared to the rest of Alaska.

MS. LOCKHART replied Marathon is only active in Cook Inlet and has not looked beyond that area. In further response, she said compared to other projects across Marathon's portfolio, Alaska is a risky place. From a subsurface standard, Alaska is probably more risky than some, but maybe less than others. Other risks come into play in Alaska that are not necessarily faced in other areas, such as the regulatory risk and, in particular, the marketing risk. When looking at the entire package of risk, Cook Inlet and Alaska in its entirety are fairly risky places to do business.

[2:09:03 PM](#)

CO-CHAIR NEUMAN asked whether Marathon utilizes the oil and gas information put out in reports by the Division of Oil & Gas.

MS. LOCKHART answered the information used by the Department of Natural Resources is the same information that Marathon has

access to. Because producers own the information they have access to more information than does the department. She said she can confidently say that Marathon knows the Cook Inlet area better than anyone else since it has operated there for over 50 years. The reports can be complementary to companies because they are an educational tool that helps people outside the industry understand the potential that is out there. One thing the report does not do is assess the economics, and that is where everyone must work together to assess what will work and what will not. This is where this bill can come into play and help enable some of those targets that are outlined in that report. Whether the report is accurate is unknown until companies go out and spend money to test the concepts.

[2:11:07 PM](#)

REPRESENTATIVE SEATON, in regard to [the possibility that Marathon's liquefied natural gas (LNG) export license for Cook Inlet gas may not be renewed], inquired how much gas production would be left available for Cook Inlet and how would that amount of gas be absorbed.

MS. LOCKHART responded the LNG plant is a market outlet, so development could proceed in the event of a wild discovery because there would be a market for that gas. Additionally, the LNG plant is very important to the current overall deliverability in Cook Inlet because storage is not readily available to all players. Without storage, a shutdown of the LNG plant in 2011 would have implications on the wells due to the large difference between summer demand and winter demand. Without a home for the gas, the wells would have to be curtailed. Many of the wells in Cook Inlet are tied to water; when they are curtailed the water rushes in and the gas chokes out, making the gas unavailable for cold winter days. Therefore, she said she thinks there is some risk in the overall system if the LNG plant shuts down prior to having other infrastructure developed that can take its place.

[2:12:57 PM](#)

REPRESENTATIVE GUTTENBERG asked how HB 229 would affect gas development at Red Dog Mine, Holitna Basin, Nenana Basin, and Yukon Flats, given the bill would affect everything below the 68th parallel, which is the Brooks Range.

MR. BANKS replied that those players would receive the benefit of these credits to the extent that any of them are paying some

sort of income tax. He said he also believes that the carry-forward feature would provide five years for use of the credits. The most likely candidates are Nenana Basin and Yukon Flats because they are currently under active exploration, as is the Red Dog Mine area.

[2:15:08 PM](#)

REPRESENTATIVE SEATON posed a scenario in which Red Dog Mine is producing gas for itself and not for sale to others. He inquired whether this 25 percent credit could be used against the mine's corporate income tax for mining.

MR. BANKS deferred to Robynn Wilson, but said he thinks the mine would be able to do this.

MS. ROBYNN WILSON answered that her reading of HB 229 is that the credit would be applicable in this scenario.

[2:16:07 PM](#)

REPRESENTATIVE EDGMON surmised that the value of HB 229 is not so much the increases to 9.4 percent and 25 percent, but rather the provisions that broaden the definition of capital investment and the amount of liability that can be written off each year.

MS. BUSEY reiterated that the 50 percent limitation has not been an issue in the past for Marathon, so that is not where the value is. The values to Marathon, when evaluating its worldwide projects, are the increase from 10 to 25 percent on the qualified capital investment and the removal of the successful efforts requirement.

[2:18:00 PM](#)

MS. LOCKHART, in response to Representative Edgmon, said each provision has a small amount of value and it is the collective package that makes HB 229 attractive for enabling projects. She likes the provision that would allow both successful and dry holes to qualify because Marathon does not intentionally try to drill dry holes. Extending the sunset provision to 2020 makes sense because exploration activities are long-lead items. Exploration planning can take four to six years, which is already beyond the current sunset provision [of 2013].

[2:20:00 PM](#)

REPRESENTATIVE EDGMON commented that HB 229 would make the state a bigger partner in terms of sharing in the upfront risk of drilling, given that gas is not always found.

MS. LOCKHART said one could look at it that way. However, a company must make the investments to qualify; it is not like a company is getting something just for producing. It creates a win-win situation.

[2:21:14 PM](#)

REPRESENTATIVE P. WILSON asked what would be more of an incentive than HB 229, given that both Ms. Robynn Wilson and Ms. Lockhart have stated that the bill's provisions are just a small part of the overall picture.

MS. LOCKHART responded she does not want to downplay the importance of HB 229, but it is a package of other things that Marathon looks at. In an ideal world there would be unlimited market access, limited regulations, sufficient storage, and infrastructure to move gas at any time to any place, as well as investment credits. Various aspects of the bills that are now going through the legislature can help solve the problems in Cook Inlet and are all pieces that need to come together.

[2:23:05 PM](#)

CO-CHAIR JOHNSON stated that HB 229 sends a message to industry that the State of Alaska is willing to work with industry and is open for business.

CO-CHAIR NEUMAN said there are so many up-front costs in Cook Inlet that a small company cannot get started, and that is coupled with the risk.

MS. LOCKHART replied there are a lot of up-front costs for any location, but what hurts Alaska is the lack of competition in some of the providers, which raises a company's costs. Drilling a well in Alaska is significantly more costly than drilling in Oklahoma. In addition to the higher costs, the regulations are more stringent, although they are the right thing to do when drilling in environmentally sensitive areas.

CO-CHAIR JOHNSON pointed out that gas is down 14 cents today to \$4.28 [per thousand cubic feet]. The lower the gas price the more imperative it is for the state to spur development through

incentives to make Alaska competitive and to keep the heat and lights on within the state.

2:26:19 PM

REPRESENTATIVE SEATON noted that the credit on corporate income tax can only be used after making a profit and can only be carried forward for five years. However, the potential for a new player having development and profits within five years is minimal. He inquired whether HB 229 would have more impact on current gas producers that have corporate income tax liability than it would on those that do not.

MS. LOCKHART said her guess is that it depends on what is found and how fast it takes to get to production. The bill would help existing players and could help players currently in Alaska that want to expand into Cook Inlet, such as someone on the North Slope; so, it may not be a company that does not yet have a presence in Alaska.

CO-CHAIR JOHNSON added the jack-up rig that may be brought to Alaska, as mentioned by Kevin Banks, could potentially be of value to the other producers. A jack-up rig would drill for more than one company, so it could promote more exploration and this kind of credit would help further that along.

2:28:26 PM

MS. DAVIS addressed the issue of gas transportation by pointing out that Section 4, page 3, Version E, expressly disallows a credit for North Slope gas exploration and development, and expressly disallows the cost of gas transport from North Slope reserves to tidewater. This provision thus implies that for Cook Inlet gas, qualified capital expenditures do pick up transportation cost to the extent they are included in the allowed property description on page 4, subparagraph (C)(ii), which lists gathering lines, transmission lines, pumping stations, and compressor stations. So, conceivably, to the extent a taxpayer is an active explorer or operator of an oil and gas lease, there would be some additional boost to Cook Inlet deliverability through the transportation aspects. She said she is thinking specifically about new entrants like Armstrong Alaska, a company that is developing gas leases and which she believes engaged with the gas utility, ENSTAR, to share the cost of transmission lines for moving the gas from the leases to ENSTAR.

MS. DAVIS cautioned that when looking at language the courts assume that everything was put in for a specific purpose, and the wording in Section 4 is confusing. The first clause excludes investment associated with exploration and development of North Slope gas and the second clause excludes any of the cost to transport gas from the North Slope. Therefore, it is unclear why the third clause would be needed if costs associated with transporting gas from the North Slope have already been excluded regardless of where it goes, because this would suggest that only the delivery of North Slope gas to tidewater is being excluded. This then begs the question of whether it means that the cost of delivery of North Slope gas to Canada would be a covered cost. She said she is confident the intent is not to pick up a corporate income tax waiver for the large-scale Alaska Gasline Inducement Act (AGIA) gas line. While she does not want to lose sight of what HB 229 does for Cook Inlet gas transport, she does not want to see a problem created by this one clause.

[2:32:18 PM](#)

CO-CHAIR JOHNSON said he is not sure he reads Section 4 the same way as Ms. Davis.

CO-CHAIR NEUMAN said he finds that HB 229 would absolutely be of benefit in assisting with the drilling and development of gas wells. Help is needed in the development of infrastructure for gas transmission and he thinks it is good the bill includes this. Additionally, should gas go down even lower it will be difficult to encourage gas development without further incentives.

[2:33:48 PM](#)

REPRESENTATIVE P. WILSON asked how Section 4 could be changed to ensure an unintended consequence.

MS. DAVIS responded that the clause to exclude qualified capital investment and qualified services for North Slope gas is good because it locks down the upstream side of North Slope gas development. The second clause, "or that are made or incurred to transport gas from reserves located in the area of Alaska lying north of 68 degrees North latitude", means that any cost to transport gas from the North Slope will be disallowed. She said she thinks the third clause is already covered by the second clause. Unless there is a specific concern that could be explained to her, she would suggest that the second clause be changed by deleting from page 3, line 22-24, "or for the

delivery of Alaska North Slope natural gas to tidewater below 68 degrees North latitude", and inserting "regardless of the destination". That language would disallow all destinations from the North Slope and would make it very clear that the cost to transport gas from North Slope reserves to any destination is not covered.

CO-CHAIR JOHNSON said he thinks that was the intent, so the committee could entertain Ms. Davis's recommendation.

[2:37:08 PM](#)

REPRESENTATIVE TUCK inquired whether Marathon Oil Corporation currently has operations in Oklahoma.

MS. LOCKHART replied yes.

REPRESENTATIVE TUCK asked what percent of Marathon's operations are in Alaska versus the Lower 48, in regard to exploration.

MS. LOCKHART answered that over the past several years, Marathon has had very little true exploration in Alaska versus elsewhere. In further response, she said it is correct that Marathon has had a lot of true exploration in the Lower 48. That exploration has occurred in the shale plays, Gulf of Mexico, and Oklahoma.

[2:39:08 PM](#)

REPRESENTATIVE TUCK inquired whether Marathon would preference exploration in Alaska over the other areas should HB 229 pass as currently written.

MS. LOCKHART answered that HB 229 would provide for both exploration and development. On the development side, the bill would enable projects that are on borderline. On the exploration side, Marathon would have to take its current portfolio and make a comparison based on the new numbers. Since that decision making would be part of the normal annual planning process, she said she cannot state at this hearing that it would drive wild exploration for Marathon in Cook Inlet, but she thinks it would help projects compete.

[2:40:31 PM](#)

REPRESENTATIVE SEATON inquired whether expenses written off against the 25 percent credit in HB 229 could also be used to

write-off against the 40 percent exploration tax credit in Cook Inlet or any other tax credits.

MS. ROBYNN WILSON said AS 43.20.043(g) states that a taxpayer obtaining a credit under this section may not claim a tax credit or royalty modification provided for under any other title. She interpreted this to mean that the expenditures, the subject of which is this credit, cannot then be used for any other tax credit, such as Chapter 55 production tax or the royalty modification.

[2:42:19 PM](#)

REPRESENTATIVE SEATON requested future witnesses to state why a company would apply for the 25 percent corporate tax credit in Cook Inlet when it could receive a greater corporate tax credit available under other provisions. He further requested that the Department of Natural Resources provide the committee with a definition of qualified services and whether the department believes this provision would apply only to new well exploration and development or would also extend to ongoing work within an existing field.

MS. DAVIS, given the language would be contained in the state's corporate income tax code, offered to work with Mr. Banks in interpreting the qualified expenditures for the services side as well as the for the capital side. She said the original version only covered expenditures associated with a gas reservoir that had not yet produced gas. However, Version E makes a significant change by allowing a gas well to be drilled in an existing reservoir, tapping gas reserves. It will be a finer distinction for the Department of Revenue to ensure that the labor services and the expenses being charged against that new well are not actually associated with the adjacent wells and their ongoing operating expenses.

[2:46:29 PM](#)

MS. DAVIS, in response to Co-Chair Johnson, said she is unsure that anything the department would be able to say would necessarily require language differences as she thinks the language in Version E is really all about what an operating expense is and the department's ability to distinguish that. She said she and Mr. Banks will look at the language to see whether any additional guidance is needed from the legislature in assisting the Department of Revenue in interpreting what the scope of the operating expense exclusion is.

[2:47:29 PM](#)

REPRESENTATIVE GUTTENBERG understood that House Bill 61 applied to new oil or gas. He inquired whether a well drilled into an existing field that does not change the production level, or a well that is defined as stopping decline, would be eligible under HB 229.

MS. DAVIS responded she believes that under the current language of Version E the Department of Revenue would use the criteria that the well produce development of any gas reserve, regardless of whether there is commercial production in the area and regardless of whether the outcome is a successful or unsuccessful well. There is no requirement the well increase overall production or stem decline, it is simply a well that taps into gas reserve.

[2:49:00 PM](#)

CO-CHAIR NEUMAN, in regard to page 4, line 22, noted that the line for 68 degrees North latitude goes through the middle of Red Dog Mine as well as some other areas that are currently being explored. He requested Ms. Davis to work with him to ensure there is no interference with this development, since he believes the sponsor's intent is that HB 229 not cover an in-state pipeline to Southcentral Alaska or a pipeline to Canada.

MS. DAVIS replied there should be some kind of a descriptor that would provide a geographic zone around that area that up to now has no gas exploration so as to make it clear that would not be part of the excluded area.

CO-CHAIR JOHNSON opened public testimony, but no one wished to testify at this time. He kept public testimony open.

[2:51:27 PM](#)

REPRESENTATIVE SEATON noted that the property provision on page 4 has a lot of breadth in that it includes power plants, topping plants, compressor stations, and so forth. He said he would like to know how expansive this write-off of corporate income tax could be on these issues if it involves gas. For example, if some gas went through a port facility or power station, would all of that then qualify for the 25 percent tax credit.

MS. DAVIS agreed to be the lead regarding this question.

CO-CHAIR JOHNSON held over HB 229 and recessed the meeting to a call of the chair.

[5:40:20 PM](#)

CO-CHAIR JOHNSON called the House Resources Standing Committee meeting back to order at 5:40 p.m. Present at the call back to order were Representatives Edgmon, P. Wilson, Seaton, Olson, and Johnson. Representative Tuck joined the meeting via teleconference as it was in progress.

HB 280-NATURAL GAS: STORAGE/ TAX CREDITS

[5:40:41 PM](#)

CO-CHAIR JOHNSON announced that the next order of business is HOUSE BILL NO. 280, "An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for the storage of gas on state land; and providing for an effective date." [Before the committee was the proposed committee substitute (CS) for HB 280, Version 26-LS1185\C, Bullock, 3/9/10, adopted as a work draft on 3/12/10.]

[5:41:06 PM](#)

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, sponsor of HB 280, addressed two questions he was unable to answer at the 3/12/10 committee hearing. In regard to the bill's provision for recovery of tax credits when a storage facility stops cycling gas, Representative Guttenberg had asked what would happen if an operator failed to meet the requirement to cycle at least 100 million cubic feet of gas per year for reasons beyond the facility owner's control. Representative Hawker said he thinks the bill provides adequate protection in this regard because the threshold of cycling 100 million cubic feet per year for maintenance of commercial operation is relatively low. To provide a reference for just how small this amount is, he noted

that 400 million cubic feet can be used on one peak day in the winter. In regard to Representative Tuck's question about how gas storage would inter-relate with either the closing or continued operation of the liquefied natural gas (LNG) export facility in Nikiski, Representative Hawker explained that storage would be needed either way: if the facility closed, a large amount of storage would be needed to meet peak demands; if the facility continued, a lesser amount of storage would be needed.

[5:43:49 PM](#)

CO-CHAIR JOHNSON opened public testimony.

STACEY SCHUBERT, Intergovernmental Affairs Director, Mayor's Office, Municipality of Anchorage, spoke as follows on behalf of Dan Sullivan, Mayor of Anchorage:

The Municipality of Anchorage is concerned about the declining production of natural gas in the Cook Inlet, specifically as it relates to decreased deliverability through the gas system. Exploration in Cook Inlet is declining, which has prompted concern among the administration and others in the community. Railbelt utilities have been working with us on the Energy Watch Program, the green, yellow, and red system that implores customers to adjust their behavior in the event of an impending energy crisis. Last winter we nearly experienced a catastrophic event. This year we have been stable, but we cannot rely on the stability of the past to guide our future.

The timeline for action is growing shorter. As a result, I am testifying in support of the concepts proposed in the [committee substitute] version of HB 280 to encourage gas storage and exploration in the Cook Inlet and, therefore, stability for Railbelt energy consumers.

Specific features of the bill supported by the mayor are: the strong requirement that financial benefits flow through the utilities that contract for gas to the benefit of their customers; the provision for 40 percent credit for exploration expenses in Cook Inlet against production taxes that we hope will result in increased exploration; and the direction to the Department of Law to consider the impact to consumers

in the event the [Regulatory Commission of Alaska (RCA)] rejects the utilities' gas supply contract. We concur with the bill sponsors that this encourages the RCA to take a long-term view and provides a long-term benefit to consumers.

The mayor is committed to monitoring the bill as it continues to work its way through the legislative process.

CO-CHAIR JOHNSON closed public testimony after ascertaining that no one else wished to testify.

[5:47:28 PM](#)

REPRESENTATIVE SEATON inquired whether HB 280 would give the RCA the appropriate statutory authority to regulate gas storage in the Cook Inlet basin.

STUART GOERING, Assistant Attorney General, Commercial/Fair Business Section, Civil Division (Anchorage), Department of Law, first noted that he is the representative for the RCA. He said Version C does contain sufficient language to clarify RCA's jurisdiction over natural gas storage to the extent that would be necessary at this time. Version C addresses all of the concerns raised by the RCA in its recent decision. Version C clarifies the RCA's jurisdiction over third party natural gas storage and also clarifies its lack of jurisdiction over proprietary storage, which is existing storage that is owned and operated by natural gas producers for their own benefit and to assure that they can meet their contractual obligations under their gas supply agreements with the utilities.

[5:49:45 PM](#)

REPRESENTATIVE SEATON asked whether the provision giving direction to the RCA to consider failure to approve a contract is adequate.

REPRESENTATIVE HAWKER pointed out that this guidance is provided to Regulatory Affairs & Public Advocacy (RAPA) under Section 20 and to the Regulatory Commission of Alaska under Section 5.

MR. GOERING replied that this provision would require the RCA to consider certain things which, based upon an assessment of past RCA orders, have already been at the forefront of the commission's consideration. However, it would help the RCA's

consideration in that it would allow parties to specifically address those criteria when making presentations to the commission either in favor of or in opposition to a gas sales agreement. The provision would not really result in the RCA considering anything new, but it would draw to the parties' attention the need to address that in their presentations to the commission.

[5:52:18 PM](#)

REPRESENTATIVE SEATON requested Ms. Robynn Wilson to address the interactions that would result from the language in [Section 16, paragraph (1)] on page 14, lines 20-27.

ROBYNN WILSON, Income Audit Manager, Tax Division-Income Audit Group, Department of Revenue, answered that AS 43.20.043 is the gas development credit. She said her reading of this paragraph is that the taxpayer can take a credit under AS 43.55 but not under AS 43.20.043. She asked Mr. Larry Ostrovsky whether he has a different reading than hers.

LARRY OSTROVSKY, Petroleum Land Manager, Division of Oil & Gas, Department of Natural Resources, said he did not.

[5:54:47 PM](#)

REPRESENTATIVE HAWKER said he believes Ms. Robynn Wilson is 100 percent correct in her answer. He requested that his staff member, Mr. Larry Persily, be able to further address Representative Seaton's question.

LARRY PERSILY, Staff, Representative Mike Hawker, Alaska State Legislature, explained that Section 16 takes the 30 or 40 percent exploration credit, depending on distance from the existing hole in the ground, that is currently in statute and makes it 40 percent for Cook Inlet. Additionally, it expands the definition of allowable expenses for that credit to include all well-related lease expenditures.

[5:55:59 PM](#)

REPRESENTATIVE SEATON noted that provisions under paragraph (1), page 14, would allow a producer or explorer to also elect to apply a tax credit against AS 43.55.011(e). He inquired whether this provision would allow lease expenditure to count as credits in multiple sections of the law.

MR. PERSILY replied a taxpayer can only take a credit once, depending upon where there is a tax liability. In further response, he explained that AS 43.55.011(e) is the oil and gas production tax.

MS. ROBYNN WILSON recalled that under revisions of that statute in 2006 and 2007, the credit could be given even though the expenditure was deductible in calculating the production tax value.

[5:58:26 PM](#)

REPRESENTATIVE HAWKER interpreted Representative Seaton's question as asking whether double dipping would be allowed for the credit by applying the same credit against two different taxes. He said the answer is no and pointed out that line 22 in paragraph (1) contains the prefacing language, "unless a credit for that expenditure is taken under" someplace else, then a producer or explorer "may also elect to apply" it against the production tax.

REPRESENTATIVE SEATON stated he will be fine if the state's tax lawyers agree with Representative Hawker's answer.

MS. ROBYNN WILSON said a person cannot take two different credits for the same expenditure; they can, however, take a deduction for the expenditure in addition to a credit. The value of a deduction generally is a lot less than the value of a credit. So, although this section says a deduction and a credit may be taken, it also says that two different credits cannot be received for the same expenditure.

[6:00:23 PM](#)

REPRESENTATIVE HAWKER expressed his willingness for the word "also" to be deleted if it would make members more comfortable.

REPRESENTATIVE SEATON said this would help his comfort level. He moved to adopt Conceptual Amendment 1 as follows:

Page 14, line 24:
Delete "also"

There being no objection, Conceptual Amendment 1 was passed.

[6:02:10 PM](#)

REPRESENTATIVE P. WILSON understood that [paragraph (1)], lines 20-27, page 14, would provide that an expense may be deducted and also applied as a tax credit in the amount of 40 percent of that expenditure.

REPRESENTATIVE HAWKER replied yes. He said this provision parrots the language and methodology that was established in the petroleum production tax (PPT) and Alaska's Clear and Equitable Share (ACES) debates in the legislature previously. By adding new subsections, no new concepts and no new credits are created; it sets aside a separate section of statute for specifically the activities within the Cook Inlet.

REPRESENTATIVE P. WILSON posed a scenario in which a taxpayer has a cost of \$10,000 that can be deducted. She surmised that under HB 280, Version C, the taxpayer could also receive a tax credit of 40 percent for this \$10,000 expenditure.

MS. ROBYNN WILSON answered correct.

[6:04:04 PM](#)

REPRESENTATIVE SEATON asked whether AS 43.20.043 also allows a 10 percent deduction or credit on the corporate income tax.

MS. ROBYNN WILSON responded no, that would not be a duplicative credit. She cited AS 43.20.043(g), the gas exploration and development tax credit that is creditable against the corporate income tax, which reads as follows:

A taxpayer who obtains a credit under this section may not claim a tax credit or royalty modification provided for under any other title.

MS. ROBYNN WILSON said the department's reading of this statute is that the same expenses that would generate the credit under AS 43.20.043 cannot then be used for another credit under the production tax or any other chapter within the title.

[6:05:35 PM](#)

REPRESENTATIVE SEATON inquired whether a taxpayer could receive the 40 percent credit and royalty modification as well.

MS. ROBYNN WILSON said her reading of 43.20.043(g) is that there would not be a credit against royalties; however, she deferred

to the Department of Natural Resources because royalties are not her area.

MR. OSTROVSKY allowed he is not an expert in regard to this particular question, but noted that AS 43.20.043(g) says, "A taxpayer who obtains a credit under this section may not claim a tax credit or royalty modification provided for under any other title."

[6:06:44 PM](#)

REPRESENTATIVE SEATON asked whether the provision in HB 280, Version C, would allow a taxpayer to receive the 40 percent tax credit under 43.55.011(e) as well as a royalty modification.

MR. OSTROVSKY replied he will have to get back with that answer.

[6:07:48 PM](#)

REPRESENTATIVE HAWKER understood the question to be whether a taxpayer receiving the credits under Section 16 would be prevented from pursuing and receiving a royalty modification under the royalty modification statutes. He noted that it was the other reference that says if a deduction is taken under this section, then royalty modifications cannot be pursued. But, he pointed out, there is nothing in Section 16 that would preclude a taxpayer from pursuing royalty modification under the royalty modification statutes.

[6:08:42 PM](#)

REPRESENTATIVE SEATON inquired whether it is the sponsor's intent to allow the taking of a 40 percent tax credit against production tax as well as royalty modification.

REPRESENTATIVE HAWKER answered an application for royalty modification would still be available to a taxpayer that availed itself of deductions and credits under Section 16. However, royalty modification requirements have a very high bar. In making its decision the state would consider the deductions and credits available to that same taxpayer under Section 16.

[6:10:26 PM](#)

REPRESENTATIVE SEATON asked if this 40 percent tax credit would be one of the things available for consideration when the

Department of Natural Resources was making its decision on whether to grant the royalty modification.

MR. OSTROVSKY responded yes, he believes the department takes all the tax credits into account when considering royalty modification.

6:11:08 PM

REPRESENTATIVE SEATON said he would like to have a discussion on the record regarding how Section 11 would allow the tax credit generated from activity in Cook Inlet, which is ring fenced at a very low tax rate, to be applied without the deduction of considering that very low tax rate to the higher tax rate production taxes across the state.

REPRESENTATIVE HAWKER said he appreciates this discussion because it is potentially the most significant change in tax regime components as they relate to maximizing Cook Inlet's attractiveness for capital investment in the exploration arena. He explained that when the PPT/ACES structure was passed it was focused primarily on North Slope activities. It was realized late in the debate that if the PPT/ACES structure was applied on a statewide basis it would result in a very significant increase in taxes in the Cook Inlet, just as it did on the North Slope. If those tax increases were applied to the Cook Inlet, the taxes would be recognized as legitimate expenses and would therefore be paid by Southcentral consumers through the energy pricing process. Because a massive increase in consumer energy prices was an undesirable outcome, the Cook Inlet was ring-fenced to remain at the economic limit factor (ELF) tax rate. Other legislation has extended this same treatment to other in-state locations where gas is produced and consumed in-state.

6:14:59 PM

REPRESENTATIVE HAWKER explained that the PPT/ACES debates were truly focused on the North Slope. At the time, it was recognized that some producers worked in both the North Slope and the Cook Inlet, and a policy call was made that those producers would not be allowed to use a credit generated in the Cook Inlet on the North Slope or anywhere else in the state. While working on HB 280, he realized that the Cook Inlet is effectively being disadvantaged by this policy; a dollar invested in the Cook Inlet results in a lesser benefit to the investor than investing the same dollar elsewhere in the state, particularly on the North Slope. This provision in HB 280 says

that investment in Alaska is good and that the state does not want to disadvantage the Cook Inlet as an attractive investment climate. This change allows investors the ability to take those credits/deductions anywhere they may be operating in the state, even if those credits/deductions were incurred in the Cook Inlet with a lesser tax structure. The outcome of this change should be to maximize the attractiveness and competitiveness of the Cook Inlet within the borders of Alaska to develop the gas that everyone hopes is there. He said HB 280 takes a multi-tiered approach to meeting Southcentral Alaska's energy security by providing storage capacity as well as improving production in the Cook Inlet.

[6:17:54 PM](#)

REPRESENTATIVE SEATON stated that both the legislature and the public need to realize that areas are being ring-fenced with zero tax or tax rates that are so low they are effectively zero. This essentially gives 100 percent tax credit because whatever is done, it does not have to be offset against the tax because there is no tax being charged. When those expenses are allowed to offset the areas with a high tax, additional state participation is received with that reduction. Neither a low gross tax, nor an interaction of gross and net tax through ring-fencing, has yielded the exploration incentive that was desired. Now a 40 percent tax credit on investments on top of these extremely low tax rates is being proposed to provide that incentive. He said he is bringing this up because there are a number of other initiatives proposing to give big tax breaks to gas or oil if it takes place in a certain place. Every time this is done, the legislature gets in the situation where it is changing the entire theory of unified tax on profits that are made across the entire state. He said he thinks that if this is done, some companies will be significantly advantaged that have operations in both the low tax Cook Inlet and the high tax North Slope; whereas, those companies concentrating in a low tax area will not gain the benefit of being able to write these tax credits off against the high tax rates of elsewhere. When making these special rules for specific areas, the legislature may not be fully recognizing the impacts.

[6:22:00 PM](#)

REPRESENTATIVE HAWKER responded that when coming forward with HB 280, the challenge identified by Representative Seaton was recognized. It is not the sponsors' desire to have a tax structure that is prejudiced against any individual explorer or

investor in a region. In the aggregate, that is resolved here by making the credits refundable for small producers.

REPRESENTATIVE OLSON moved to report HB 280, Version 26-LS1185\C, Bullock, 3/9/10, as amended, from committee with individual recommendations and attached fiscal notes. There being no objection, CSHB 280(RES) was reported from the House Resources Standing Committee.

[6:23:56 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 6:24 p.m.