

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 17, 2010

1:05 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

MEMBERS ABSENT

All members present

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 & 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
02/08/10	(H)	Heard & Held
02/08/10	(H)	MINUTE(RES)
02/10/10	(H)	RES AT 1:00 PM BARNES 124
02/10/10	(H)	Heard & Held
02/10/10	(H)	MINUTE(RES)
02/15/10	(H)	RES AT 1:00 PM BARNES 124
02/15/10	(H)	Heard & Held

02/15/10 (H) MINUTE(RES)
02/17/10 (H) RES AT 1:00 PM BARNES 124
02/17/10 (H) -- MEETING CANCELED --
03/10/10 (H) RES AT 1:00 PM BARNES 124
03/10/10 (H) Heard & Held
03/10/10 (H) MINUTE(RES)
03/17/10 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

DAN E. DICKINSON, CPA

Consultant to the Legislative Budget and Audit Committee
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 308, explained the changes made by Version P, the proposed committee substitute.

ACTION NARRATIVE

[1:05:21 PM](#)

CO-CHAIR CRAIG NEUMAN called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Guttenberg, Edgmon, Olson, Wilson, Johnson, and Neuman were present at the call to order. Representatives Seaton, Kawasaki, and Tuck arrived as the meeting was in progress.

HB 308-OIL AND GAS PRODUCTION TAX

[Contains discussion of HB 337]

[1:05:43 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." [Before the committee was HB 308, Version 26-LS1328\E, Bullock, 2/5/10.]

REPRESENTATIVE OLSON moved to adopt the new proposed committee substitute (CS) for HB 308, Version 26-LS1328\P, Bullock, 3/17/10, as a work draft.

REPRESENTATIVE SEATON objected for discussion purposes.

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CO-CHAIR JOHNSON requested Mr. Dan Dickinson to explain the changes made by Version P.

DAN E. DICKINSON, CPA, Consultant to the Legislative Budget and Audit Committee, noted he is a self-employed certified public accountant doing some work for the Legislative Budget and Audit Committee, and HB 308 is part of that work. He began with a summary of the eight changes and provisions proposed under Version P [slide 3]. The first change is to the progressivity provision. Version P would leave the rate the same but change the base [the previous proposed committee substitute, Version E, would have changed the rate]. In response to Co-Chair Neuman, he described base and rate by providing an example using sales tax: the goods being sold are the base and a 3 percent sales tax is the rate. However, progressivity is more complicated because different rates apply to different amounts. He used an income tax example to explain progressivity: one tax rate applies to income between \$0 and \$15,000, another tax rate applies to the income between \$15,000 and \$20,000, and another tax rate applies to income between \$20,000 and \$25,000.

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MR. DICKINSON said the second change is to the interest rate provision. Version P would set the interest rate charged by the state for delinquent tax to be the federal funds rate plus 3 percent with no ceiling [Version E proposed the federal funds rate plus 2 percent with a ceiling]. The third change is to the provision that no interest is due on [additional tax owed as a result of implementing] retroactive regulations; Version P adopts the governor's version of this provision [HB 337, SB 271] with a few minor changes.

MR. DICKINSON said the fourth change is a new provision made by Version P that would allow credits to be applied immediately rather than over two years as required by current statute under the Alaska's Clear and Equitable Share (ACES) legislation. The fifth change is to the 30 percent credit provision for well work in which one definition from Version E is reworded slightly. The sixth provision is restoration of the three-year statute of limitations which remains the same as Version E. The seventh change is a new provision that would remove the requirement for matching spend when a company wants to sell its credits to the state. He said this provision is also proposed in the governor's bill. The eighth change is that the tax rate tied to resident hire, as proposed in Version E, has been removed.

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CO-CHAIR NEUMAN noted that Co-Chair Johnson's goal as the sponsor of HB 308 is to work with the administration in regard to similar legislation proposed by the governor [HB 337]. He said Version P incorporates the positive aspects of both the bills to create jobs.

MR. DICKINSON pointed out that four of the major issues addressed in Version P are also addressed in the governor's bill, although treatment of the issues in the two bills may not be identical. Those four issues are: interest would not be due on retroactive regulations prior to their implementation, credits would be spread over one year, there would be a distinct credit for well work, and no matching spend would be required in order for the state to purchase credits.

REPRESENTATIVE SEATON removed his objection. There being no further objection, Version P was before the committee.

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CO-CHAIR JOHNSON, in response to Representative P. Wilson, stated that the removal in Version P of a tax rate tied to resident hire does not diminish his desire to encourage resident hire. He had anticipated five minutes of discussion on that issue, but instead it took two days. The real issue of HB 308 is to build a structure that allows people to invest and spur development and he does not want to cause a sidetrack from that because the bill would still create jobs, just maybe not for Alaskans as he had hoped.

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MR. DICKINSON commenced his presentation, addressing the topic of progressivity [slide 5]. He said that under the federal personal income tax rules each bracket represents an amount of income that is taxed at a different rate, but the state's current production tax law does not have this feature. Rather, the same tax rate is applied to the net value of every single barrel of oil. The current base rate is 25 percent and is always there; progressivity then adds an additional 0 to 50 percent up to a maximum production tax of 75 percent, and this then applies to every bit of value generated on every barrel.

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MR. DICKINSON explained that Version P would create two production tax brackets [slide 6]. The first bracket would be the base tax rate of 25 percent on the value of each barrel up to \$30 per barrel. Once above \$30 per barrel, the second bracket would be the 25 percent base rate plus progressivity. He noted that \$30 per barrel has always been used to trigger the progressivity calculation.

MR. DICKINSON compared progressivity under current law and as proposed by HB 308, versions P and E [slide 7; note: Version "S" on the slide is a typographical error, it should read Version "P"]. Under current law, the tax rate is established by taking the value per barrel, subtracting \$30, and then adding 0.4 percent for every dollar that is left. For example, for \$10 of additional production tax value above \$30, an additional 4 percent in progressivity is added to the 25 percent base, for a total tax of 29 percent that is applied to every barrel. Version P would maintain the current 0.4 percent progressivity rate, but the base would be the same as the number used to calculate the rate. Thus, the base would be production tax value less \$30 per barrel, and the progressivity would be applied only to the net value above \$30. Version E would have taken the production tax value per barrel, subtracted \$30, and then added 0.2 percent for every dollar left [which would then be added to the 25 percent base].

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MR. DICKINSON, in response to Representative Kawasaki, said the progressivity provision is under sections 5 and 6 of Version P.

CO-CHAIR JOHNSON added that this is the same way the federal income tax is based. A certain tax rate is applied to the first amount of income and anything above that income amount is taxed at a different rate; the total amount of income is not taxed at the higher rate.

MR. DICKINSON, in response to Co-Chair Neuman, said the net value is determined by subtracting all of the downstream costs of transportation and all of the upstream costs of producing the oil and gas. The idea behind the current tax is that all the costs are subtracted and what is left is the net value.

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MR. DICKINSON compared the state's current progressivity tax system [AS 43.55.011(g)] to the federal income tax system to show the difference in tax that would be paid. Assuming a 25 percent tax rate, under both systems the total amount of tax paid on a net value income of \$27, \$28, \$29, or \$30 per barrel would be the same [slides 8-11]. At a net value income of \$31, \$32, \$33, \$34, or \$35 per barrel, more tax would be paid only on the amount above the \$30 under the federal income tax system; but under the state's progressivity system, more tax would be on all of the \$31, \$32, \$33, \$34, or \$35 of income [slides 12-16].

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MR. DICKINSON, in response to Co-Chair Neuman, explained that most states with income tax, as well as the federal corporate and personal income taxes, use a progressivity measure. For example, sales taxes typically have a different rate for food and clothing than for luxuries. Most states have one or two different rates, but Alaska's corporate income tax has nine different brackets between \$0 and \$100,000 and everything above \$100,000 is at one rate. In further response, he explained that his examples on slides 8-16 are focused on only one piece of Alaska's production tax. Royalties, property taxes, the base rate of the production tax, and the floor of the production tax are all regressive. The income tax is mildly progressive. Overall, Alaska's system remains a regressive system. However, in situations of very high prices, such as \$130 per barrel, the progressivity piece so dominates the state take that the system is actually progressive.

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MR. DICKINSON, in response to Representative Kawasaki, said the income shown on slides 8-16 is increasing; it is depicted in yellow and increases from the bottom to the top of the graphic. This income increases less fast than the whole. Under the state's progressivity system (right graph), as the per barrel net value increases, the income increases very slowly relative to the increase in the tax; whereas, under the federal income tax progressivity system (left graph), the tax increases less slowly so the income increases more.

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MR. DICKINSON, in response to Representative Tuck, said the relationship between income and tax is 75 percent income and 25 percent tax [slides 8-11] until the bracket trigger [of more

than \$30 net value per barrel] is reached. In further response, he agreed that on slide 16 the ratio between income and tax is nearly 50:50 [for the depicted net value of \$35 per barrel]. He clarified, however, that the graphics are not representative of either the actual federal income tax rate or State of Alaska progressivity under AS 43.55.011(g). The graphics are simply to illustrate the point of how progressivity moves.

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MR. DICKINSON resumed his presentation, noting that the chart on slide 17 is from the Department of Revenue and depicts the nominal and marginal tax rates under current law. The graph shows that when the progressivity trigger is hit, there is a very rapid change in the marginal rate because each percentage that is added is applied to a very large base.

MR. DICKINSON said slide 18 depicts what would happen under Version P, which would change the state's current system to a bracketed system. Under Version P, the nominal rate is a little bit lower and rises less quickly, and there is not a sudden leap in the marginal rate when progressivity is triggered [slide 19]. Instead, as the tax rate increases, the marginal rate also increases.

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MR. DICKINSON, in response to Representative P. Wilson, explained that the red line on slide 18 is the nominal rate under current [ACES] law. For example, at a net value of \$100 per barrel, the tax rate would be roughly 42 percent. When the value goes from \$100 to \$101, more of that dollar is consumed by tax so the marginal tax rate on that additional dollar is more like 70 percent because of how progressivity works.

CO-CHAIR NEUMAN understood the marginal rate to increase proportionately at a much higher number than the nominal rate.

MR. DICKINSON agreed, saying one reason it is higher is because as soon as the progressivity threshold is reached under the current law there is an immediate bump-up in the marginal rate. This bump-up is because every dollar then immediately has this new rate applied to it.

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MR. DICKINSON, in response to more questions from Representative P. Wilson, said that to calculate the tax rate, every dollar of additional value that is taxed creates also a higher rate. Under current law, the rate and the base both increase after \$30 net value is reached. When there is no progressivity, the nominal rate is 25 percent and it always applies. Once progressivity is hit, the progressivity formula determines what is added to the 25 percent base rate, so the tax rate goes up; thus, nominal means the actual rate. Marginal means how much of each additional dollar earned goes to the tax collector.

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MR. DICKINSON, in response to several questions from Co-Chair Neuman, said the progressivity rate is 0.4 percent for every additional dollar. The red line [ACES nominal rate] on slide 18 is where the 0.4 percent is seen for each additional dollar; as each dollar is increased along the X axis, the tax rate increases by 0.4 percent. The green line [ACES marginal rate] increases much more quickly [than the ACES nominal tax rate] because what it is being applied against is also getting larger.

REPRESENTATIVE SEATON interjected that the [ACES marginal rate] could also be thought of as the windfall profit tax. It is a windfall profit tax because progressivity is triggered when the net value is above the area where the base tax applies. He said windfall profit is the term that was used during deliberations on ACES, and it seems to him that conversations during these deliberations are being ignored.

MR. DICKINSON responded that under the Department of Revenue assumption for slide 18, there is a \$26 cost per barrel that is not visible in the diagram. Therefore, everything depicted on the diagram is profit. Whether it is windfall or not can be debated, but there is no tax unless there is a profit. When deciding whether to make an investment that will generate an extra dollar, the decision maker considers who will receive that extra dollar. Thus, someone thinking about an investment thinks about the marginal rate, not the average rate, and that is why the [ACES marginal rate] is important to look at.

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REPRESENTATIVE SEATON noted the graph depicts marketplace prices above the \$30 per barrel profit at which progressivity kicks in. He cautioned that the graph not be confused with the decision point on whether to drill a well which is based on production

and anticipated hurdle rates and anticipated revenues. At some point in time a decision maker will look at anticipated profit and that is when discussion about what happens above the \$30 profit trigger will occur.

CO-CHAIR NEUMAN said a company looks at how fast its netback will be because it must have fluid capital for reinvestment, and that is what HB 308 is about.

MR. DICKINSON replied tax is one of the things taken into consideration when a company performs calculations to decide whether to invest. The [ACES marginal tax] is what will be used in that calculation. He said he does not think many investors will ignore the tax when making the calculation, and while tax will not be the only thing that is considered it is clearly something that is part of the calculation.

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REPRESENTATIVE GUTTENBERG inquired whether there is a graph showing total government take when operating along this line.

MR. DICKINSON answered he had such a graph in his previous presentations, but for today's presentation he only has slides about production tax.

CO-CHAIR NEUMAN urged members to look at charts in the committee packet provided by Representative Seaton comparing estimated production taxes.

REPRESENTATIVE GUTTENBERG asked whether the total government take rises as much as the graph shows [slide 18] or is capped; i.e., does the state take come out of the federal take or does it all rise together.

MR. DICKINSON responded both effects are there. For income tax there is simply some switch between state take and federal take. However, property tax is fixed, so as the value per barrel of oil increases the percentage going to property tax decreases. Thus, graphs showing total government take have curves that slope up as the marginal rate increases, but the variation is generally between 65 and 55 percent.

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REPRESENTATIVE TUCK surmised the green line representing the ACES marginal tax [slide 18] is not how much in a dollar is invested, but rather how much an additional dollar is made.

MR. DICKINSON replied correct.

MR. DICKINSON, in response to Representative P. Wilson, said the red line depicted on slide 18 is the nominal rate under current [ACES] law. The purple line represents the new nominal rate that would go into effect if Version P became law.

MR. DICKINSON, in response to Representative Tuck, explained that Version P would create a bracketed system like that for personal [federal] income tax. He confirmed that the graph on slide 18 can be used as a comparison between current law and Version P.

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MR. DICKINSON returned to his presentation, noting that slide 20 depicts the mechanics of why there is a very large increase as the net value moves from \$30 to \$31. At \$30, the base tax rate is 25 percent under both [Version P's proposed bracket methodology and current ACES methodology]. At \$31, the progressivity tax is triggered - under Version P's bracket methodology the 25.4 percent tax would apply only to the additional \$1, the other \$30 would remain at 25 percent; under current ACES methodology the 25.4 percent applies to the additional \$1 as well as to the other \$30, which generates 12 cents more in tax. This 12 cents jumps the effective tax rate [on that \$1] by 12 percent, from 25 percent to 37 percent.

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CO-CHAIR NEUMAN, in regard to this tremendous increase for just one more dollar, inquired whether this same rate follows through for net values of \$32 or \$34.

MR. DICKINSON pointed out that the initial bump in the green line [ACES marginal tax] on slide 19 is the jump from 25 to 37 percent. After that initial bump, the marginal rate increases, although it does not continue at that slope. The marginal rate also increases more rapidly than the nominal rate, but most of the change occurs because of the jump in the base.

MR. DICKINSON, in response to Representative Tuck regarding slide 20, confirmed that "personal federal income tax

progressivity" is the same as what is proposed by Version P, and ["AS 43.55.011(g) Progressivity"] is the same as current law under ACES.

MR. DICKINSON, in response to Representative Guttenberg, clarified that because the jump from 25 percent to 25.4 percent is on \$31, the effective rate on that \$1 is 37 percent. He further confirmed that for each subsequent dollar there is a jump.

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REPRESENTATIVE SEATON surmised the state is taxing on the nominal rate, not the marginal rate, and that Mr. Dickinson is extracting the marginal rate to explain the effect of the tax on that portion of dollars above the \$30 profit per barrel.

MR. DICKINSON answered correct, the state uses the nominal rate, but that does not make the marginal rate any less real. A company calculates its taxes with the nominal rate, but the marginal rate tells what is really happening.

MR. DICKINSON, in response to Co-Chair Neuman, reiterated that the nominal rate is what a company needs for calculating its tax, but the marginal rate tells a company what is really going on with any additional investment or cash inflow when it tries to figure out what will happen if it adds an additional dollar.

REPRESENTATIVE SEATON said that happens with an additional increase in price, not an additional investment, so it is not an investment. That calculation can be made, but it does not tie into a company's investment, it may tie into investment strategy. Looking at the marginal on what a dollar earns is totally based on the differential between the Alaska North Slope (ANS) West Coast (WC) price and a company's expenses in that month's time. Therefore, it is a price variable, not an exploration or production variable, so it is important to not get these things confused.

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CO-CHAIR JOHNSON said he does not think there is any confusion at all because he thinks the marginal tax rate does influence investment, so they correlate. Testimony was recently heard that the ability to get a return on investment is what triggers a company's investment decisions. This is precisely what the companies were talking about regarding return on investment.

REPRESENTATIVE GUTTENBERG surmised that even if a company does nothing, profits will be made because the price of oil is going up regardless of what a company does; therefore, a company may not do anything until it can take better credits off its money.

MR. DICKINSON responded that, clearly, taxes are thought about, along with a forward-looking price forecast. He cited Ronald Reagan who, during a time of very high incremental and marginal tax rates, said it was better to make four movies rather than five because taxes made the fifth movie not worth doing. Thus, decisions are made based on the marginal tax rates.

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CO-CHAIR NEUMAN interjected that taxes can get to the point where netback on the profits is not there, and in essence that is what progressivity is. A company making money in Alaska is not a bad thing because then the company will continue to invest more in Alaska. When taxes get too high, it will affect how much money a company wants to continue to invest in Alaska.

MR. DICKINSON reiterated that clearly taxes are part of the decision and clearly they are not the only part of the decision.

[1:55:32 PM](#)

MR. DICKINSON commenced his presentation, describing what happens in production tax as the destination value increases [slides 21-23]. He said the figures in these slides are based on the assumption that the destination value is \$26 higher than the production tax value per barrel of oil. The slides compare current tax law with the tax proposed by Version P. As the destination value increases, the amount of tax paid under Version P would be less than that paid under current law because the Version P tax rate would remain at the 25 percent base rate when destination values are [between \$26 and \$56] (the red triangle at the bottom left of the graph).

MR. DICKINSON, in response to Representative Seaton, said that at a destination value of \$156 per barrel, the production tax would be roughly \$10 less per barrel under Version P than under current law.

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MR. DICKINSON compared current law, Version P, and the previous committee substitute [Version E], which posed to halve the current progressivity rate [slide 22]. At destination values above \$90 per barrel, Version P would generate more progressivity than would Version E.

MR. DICKINSON, in response to Representative Tuck regarding slides 21-23, explained that destination values of \$0-\$26 per barrel are the amounts where a company is recovering its costs. Destination values of \$26-\$56 (the red triangle) are within the thirty-dollar bracket and above \$56 is when progressivity applies. Therefore, progressivity would apply to everything in the blue line [current law]; but in the purple line [Version P], progressivity would apply only to the amount above the thirty-dollar bracket [above the destination value of \$56]. In further response, he clarified that for Version P the 25 percent rate is all that would apply to destination values of \$56 or less.

MR. DICKINSON, in response to Co-Chair Neuman, explained that "PTV" is the production tax value, which is what is taxable after subtracting all costs. The Department of Revenue used \$26 for these costs, so he imported that figure into these graphs.

MR. DICKINSON, in response to Representative P. Wilson, confirmed the turquoise line on slide 22 represents [Version E].

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MR. DICKINSON explained the black line on slide 23 represents the base tax rate of 25 percent, and depicts the amount of production tax that would be paid per barrel at each destination value if there was no progressivity. It can therefore be seen how much tax is generated from progressivity. At a destination value of \$136, Version P would remove about one-quarter to one-third of the progressivity. At destination values around \$90, Version P would halve the progressivity, but the amount of progressivity being halved is much smaller.

REPRESENTATIVE SEATON, in regard to the destination value of \$136, stated that under a 25 percent base rate the tax would be about \$30 and under current law the tax would be about \$60. Thus, at \$136, the total production tax of \$60 under current law would be about 50 percent [of the destination value], which means the companies would be retaining about 50 percent.

MR. DICKINSON agreed that is correct, roughly speaking.

[2:01:16 PM](#)

MR. DICKINSON reviewed slide 24 which depicts the progressivity that would be generated over a time period of one year in which the oil price increases by \$10 each month. At \$50 [in destination value] no progressivity would be generated under either current law or Version P because of the \$26 in production costs and the \$30 at which there is no progressivity. As the destination value rises, the increase in progressivity is more under current law than Version P. For example, at a destination value of \$140, Version P would bring in about \$420 million per month in progressivity, whereas the current law would bring in about \$600 million.

REPRESENTATIVE P. WILSON surmised that as price goes up, Version P would allow producers to keep more money [than current law].

MR. DICKINSON replied correct.

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MR. DICKINSON, in response to Co-Chair Neuman, stated there are five bites at the apple that a producer must worry about: federal tax, and State of Alaska property tax, production tax, income tax, and royalties, given 99 percent of the production in Alaska is on state land. The revenue generated per barrel is primarily from the state income tax and state production tax and not so much the property tax. In further response, he confirmed that slide 24 shows neither the total tax nor the 25 percent base production tax; it only shows the progressivity.

[2:04:00 PM](#)

REPRESENTATIVE SEATON noted that a third of the tax difference between Version P and current law would be taxed by federal income tax anyway. So, under Version P, a producer would pay a little over one-third of that difference to the federal government instead of the State of Alaska.

MR. DICKINSON answered that is correct because this would be fully deductible for federal taxes.

REPRESENTATIVE P. WILSON inquired what difference it makes to the company as to who it is paying the tax to.

MR. DICKINSON responded probably not much, but every dollar that is deductible only has a 35 percent effect on income tax.

Changing state taxes by \$1 would change federal income tax by 30 cents; so, net, a company would still be 65 cents ahead.

[2:05:08 PM](#)

REPRESENTATIVE P. WILSON, given that producers would be looking at overall taxes and not just Alaska taxes, asked what the difference would be if Alaska lowered its taxes and the federal government then took it anyway.

MR. DICKINSON pointed out that of the eight largest producing states, the combined federal and State of Alaska tax is much, much higher at current price levels than it is in any of the next seven. Further, the Gulf of Mexico has no state taxes so only federal taxes apply. Thus, when making a decision, one piece of a company's thinking is that in Alaska it would keep 35 percent of the money but in the Gulf of Mexico it would keep 65 percent.

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CO-CHAIR NEUMAN inquired whether Alaska's taxes are similar to those of Alberta, Canada, before Alberta's taxes were changed a year or two ago.

MR. DICKINSON replied that in 2007, Alberta instituted a much higher royalty under a document called "Our Fair Share". Royalty in Alberta is like tax in Alaska, and Alberta also has a property tax and an income tax. This increase resulted in much push-back by industry, and last week Alberta announced that starting in 2011 it will roll back the rates to lower than they were in 2007. The limit of no more than 5 percent in the first year of a well's existence will stay.

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CO-CHAIR NEUMAN related that Alberta had a tremendous loss in revenue, which forced the roll back to create more investment.

MR. DICKINSON agreed, saying the statements made by the Alberta government last week were focused on attracting industry investment because investment had fallen off or not increased in some areas to the degree that had been hoped. In further response, he said an important distinction between Alberta and Alaska is that Alberta is much more heavily invested in gas than is Alaska. The gas price has fallen by several hundred percent

from its high point and gas probably accounts for the majority of Alberta's royalties.

[2:10:44 PM](#)

REPRESENTATIVE GUTTENBERG understood that the [marginal rate] from progressivity is 37 percent on the dollar over \$30. He asked what happens to the investment dollar, such as what credits are received for that investment dollar.

MR. DICKINSON answered this is accounting for any dollar change. So, if a company did not invest and therefore generate an extra dollar of free cash flow, this would have the same effect and that is the whole reason it is structured the way it is. That is to say, the state is going to pick up a significant portion of a company's investments because every time an investment is made it is deductible, and in Alaska even capital expenses are deductible costs and lower the production tax value (PTV), which is the value that is taxed. By deliberately choosing the high point of the marginal rate, it can be shown that the state is picking up over 90 cents of every dollar invested and taking over 90 cents of every additional dollar being earned, although that problem does not happen very often.

[2:12:15 PM](#)

REPRESENTATIVE GUTTENBERG surmised that in some ways the higher the rate, the more a company gets back on its investment dollar.

MR. DICKINSON responded that the investment dollar has an immediate value from the state. When making an investment, a company is looking for long-term return. If less is spent initially, then the rate of return might look better, but ultimately a company is looking at the return that will be received in future years. So, just looking at the dollars, an investor would like to invest at a point at which the marginal rate is very high and then collect it all later when the marginal rate is lower.

[2:13:11 PM](#)

REPRESENTATIVE GUTTENBERG inquired how that affects the total lifting cost.

MR. DICKINSON replied there are two ways an investor can think about those taxes. When the marginal rates are very high, an investor is writing a much larger check. When the marginal rate

is really high, a drilling manager is not thinking that the government is paying for most of what he or she is doing because actual out-of-pocket costs remain relatively constant and what is changing is the amount of tax that a company pays on that.

REPRESENTATIVE GUTTENBERG argued the drilling manager is not doing that because an accountant is doing that. He said legislators have heard repeatedly that the most important thing is stability. The most stable location shown to legislators by industry was a place where the government take was something like 95 percent and had not changed in 30 years. There are lots of things in play and legislators are trying to balance all those things against what is in the state's best interest.

REPRESENTATIVE P. WILSON commented that in locations like the aforementioned there are no environmental rules so the companies have much lower costs than in the U.S.

[2:15:21 PM](#)

MR. DICKINSON returned to his presentation and addressed the proposed interest rate provision for delinquent taxes [slide 26]. Version P would do away with a floor [and ceiling] and would charge the federal funds rate plus 3 percent, which is the same general interest rate that a corporation would pay for underpayment of tax under the Internal Revenue Service system. In response to Co-Chair Neuman, he said slide 26 incorrectly states Version S instead of Version P.

CO-CHAIR JOHNSON explained this interest rate is being proposed because a taxpayer that is delinquent on taxes through no fault of its own should not be punished. However, an intentional mistake would be another set of circumstances. In response to Co-Chair Neuman, he confirmed that it is the commissioners in the administration who make the initial assessment as to whether an underpayment is intentional.

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MR. DICKINSON related that under current law the interest rate on delinquent taxes is 11 percent, although the rate did go slightly above that for a short period (red line on slide 27). The federal funds rate is currently at a historic low of 0.5 percent (dark blue line). Under Version P, the interest rate would be the federal funds rate that is announced each quarter plus 3 percent; thus, the current rate under Version P would be 3.5 percent (turquoise line).

REPRESENTATIVE TUCK, in regard to Co-Chair Johnson's previous statement, said he can see how someone would intentionally hang on to money knowing a good rate of return would be received on that money through investments or even deposits.

CO-CHAIR JOHNSON responded that is why the ceiling on the interest rate was removed. Should the interest rate go up in the future, he did not want the state to be stuck with a ceiling. Additionally, Version P would make the rate consistent with what the federal government charges for use of its money.

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MR. DICKINSON discussed the proposed provision for interest from retroactive regulations [slide 28]. Version E would not have considered tax payments owed as a result of retroactive regulations to be delinquent. Version P adopts the more complex scheme proposed under the governor's bill, which is that the Department of Revenue (DOR) is required to waive the interest between the time of production and implementation of the regulation if an underpayment arises. However there is one difference between the governor's bill and Version P: under the governor's bill, DOR is required to make a finding that the producer acted in good faith; Version P provides that no interest is due if DOR does not find that the producer failed to make a good faith estimate.

[2:21:03 PM](#)

REPRESENTATIVE SEATON asked whether that puts the onus on DOR to come up with a legal demonstration that the taxpayer acted in bad faith.

MR. DICKINSON replied he does not think it is a question of bad faith. Rather, if DOR finds something that appears not to be in good faith, then it can require interest. He said it is unclear to him where the burden of proof would be, but Version P takes away the affirmative requirement that DOR determine good faith beforehand in every case.

REPRESENTATIVE SEATON said he thinks it would be advisable to obtain a legal opinion as to whether that change makes a shift of burden to the department to prove something.

[2:22:25 PM](#)

REPRESENTATIVE SEATON noted that slide 26 states the proposed interest rate would apply to almost all taxes, but the discussion has been about only one tax. He inquired what the implications would be across all the other departments from this proposed change in general law and asked which taxes this change would apply to.

MR. DICKINSON answered he believes this change would not apply to the property tax, the insurance tax, and a third tax which he cannot remember at the moment.

REPRESENTATIVE SEATON said this does not tell members what the economic effect is to the state given that all of these other taxes would be covered by this bill.

MR. DICKINSON responded he has not done a fiscal note on this provision, but the vast majority of the taxes that would be affected, in terms of dollars, are the production tax and the income tax. All the other taxes together would constitute only 2-3 percent of the total tax burden compared to those two.

MR. DICKINSON, in response to Co-Chair Neuman, said he does not know of any models that are being built to look at the incidence of delinquency in the insurance, fisheries, or other taxes.

CO-CHAIR NEUMAN suggested Representative Seaton discuss with Mr. Dickinson the modeling being done related to production tax.

[2:25:34 PM](#)

REPRESENTATIVE SEATON asked whether Mr. Dickinson has looked at the dollar effect of any retroactive regulations that apply to Cook Inlet or other small producers that are not in Prudhoe Bay or Kuparuk where a standard deduction was implemented for upstream expenses [for the time period of 2007-2010].

MR. DICKINSON replied the upstream expenses that were frozen are one piece of the calculation. For Prudhoe Bay and Kuparuk there is downstream transportation. The law changed in 2007, the regulations were not implemented until 2010, so there were three years in which the gross value could vary. The capital piece was not frozen and the capital piece is of the same order of magnitude as what he has seen for Prudhoe Bay and Kuparuk. Roughly speaking for those three years, the piece of costs that will be regulated that way is larger than the piece of cost that was frozen.

[2:27:49 PM](#)

MR. DICKINSON, in response to Co-Chair Neuman, clarified that slide 26 focuses on the interest rate and slide 28 focuses on the issue of regulation changes. He confirmed that penalties would not be applied to any additional tax that is owed as a result of the changes.

MR. DICKINSON reviewed the proposed provision for credit recovery [slide 29]. The 2007 ACES legislation required that certain credits be recovered over a two-year period. Version P would restore the 2006 rule that allowed credit recovery over a one-year period. He related that the Department of Revenue has advocated for this change because the two-year period has created a lot of complexity with very little value.

MR. DICKINSON, in response to Co-Chair Neuman, confirmed this provision would assist the Department of Revenue.

[2:29:23 PM](#)

REPRESENTATIVE SEATON recalled that the reason for implementing the two-year credit recovery period was to protect the state from having to pay large capital credits during times of low oil prices when taxes would be lower because of the profits-based tax system. He asked whether the assumption now is that the era of high oil prices is here to stay so there is no longer a need to worry that they may go back down.

MR. DICKINSON answered that that argument might hold up under an assumption that a level of high and low investment corresponds exactly with the years of high and low revenue. While looking through Department of Revenue slides, the only argument that he saw advanced for advocating a two-year credit recovery period was that most places have two, three, or four years. The federal tax code considers five years to be much accelerated. In-so-far as these credits are considered analogous to depreciation, [one year] was the fastest depreciation found around the world and therefore the department was trying to spread it out. He said he thinks it assumes a precision in the correspondence that may not have been seen over the past two and a half years.

[2:31:17 PM](#)

REPRESENTATIVE GUTTENBERG said he is looking for the practical effect on this same subject: who has benefitted and who has been unable to use the credits.

MR. DICKINSON responded that given the prices seen over the two and a half years this statute has been in effect, he believes the three large taxpayers have probably used their credits fairly effectively and still have a lot of tax obligation remaining for the state. In further response, he said the other taxpayers can have the state purchase their credits. Having to hold off on some of that cash flow for six months might have an effect in the first year, but for a company in roughly a steady state of investment not much difference would be seen in the cash flows by having to split the credits over two years.

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MR. DICKINSON outlined the proposed provision for capital investment credits [slide 30]. Version P would only provide a change to a definition; therefore, it would provide a 30 percent credit for well work that includes operating and capital costs. He compared the differences between Version P and the governor's bill. The governor's bill would rewrite the existing exploration credits in AS 43.55.025 as well as insert a development well credit [slide 31]. Version P would take the existing system of lease expenditures and allow certain lease expenditures that are used for well work to also qualify for the 30 percent credit. In response to Co-Chair Neuman, he confirmed that development wells would include the reconditioning of old wells, the notion being to develop a well further even if it has been producing for awhile.

[2:34:18 PM](#)

REPRESENTATIVE SEATON observed that Version P would provide a 30 percent credit for both capital and operating expenses for well work. He inquired whether the governor's bill also proposes the 30 percent credit for operating expenses.

MR. DICKINSON replied he believes the governor's bill is for both because there is no specific requirement that it be a capital cost. In response to Co-Chair Neuman, he said that this well work would be an upstream cost, not a midstream cost. Version P requires it be a lease expenditure first, and then this is a subset of lease expenditures; there is nothing similar to that in the governor's bill. In further response to Representative Seaton, he stated that Version P includes

injector wells while the governor's bill specifically excludes service [injector] wells. He said intangible development costs (IDC) are all the costs that are necessary for drilling a well. First, however, this must be a lease expenditure and, if not, it would be excluded.

[2:37:38 PM](#)

REPRESENTATIVE GUTTENBERG inquired as to what the state gives now for well work.

MR. DICKINSON answered that any capital expense is already included and is at a 20 percent credit, and capital investments already include the creation of wells. Version P would boost that 20 percent credit to 30 percent. He explained that at the point of production the well fluid coming out of the ground is a combination of oil, gas, water, and sand, and it requires time and money to separate them. Version P would provide that the costs for getting the fluid out of the ground are eligible, but the costs dedicated to separation would not be eligible.

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REPRESENTATIVE GUTTENBERG observed that expenses for putting in a well, such as hooking up the Christmas tree and flow lines and constructing the shack would be capital expenditures. Then there are normal yearly maintenance expenses which are covered under operation expenses. Enhancements would be such things as fracking, more seismic work down in the well, and so forth. He asked whether the state gives credits for that now. He further asked where the definition of a service well can be found.

MR. DICKINSON, regarding the definition of a service well, responded that he goes to the definitions in Alaska regulations, which he believes are those used by the Alaska Oil and Gas Conservation Commission (AOGCC). In regard to the difference between maintenance and capital expenditures, he said fracking is considered an intangible drilling cost that would currently be eligible for a 20 percent capital cost credit. Version P would raise that 20 percent credit to 30 percent. In further response, he confirmed that the governor's bill would also raise this to 30 percent.

CO-CHAIR NEUMAN added that the idea behind this provision is to help re-develop older fields to raise production.

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REPRESENTATIVE SEATON referenced page 9, lines 29-31, of Version P and inquired what is "26 U.S.C. 263(c)". He further asked whether the language on these lines means that all operations of the well itself during the entire operation of the field will be given a 30 percent tax credit for operating expenses. Will pumping the oil through a collector line be the only thing that does not receive this credit, he queried.

MR. DICKINSON, regarding the second question, replied no. He explained that the huge above-ground facilities on the North Slope are separation facilities. The cost of the well is below the ground and where it hits the Christmas tree is where the cost deductions cease.

[2:43:13 PM](#)

REPRESENTATIVE SEATON offered his belief that under the definition on page 9, the injector wells, operation of the injector wells, pressurizing of the field, bringing the fluid to the surface, and anything connected to that portion of operating these fields would all receive a 30 percent credit.

MR. DICKINSON answered that the processing by which the gas is pressurized up before being re-injected is not eligible for the credit.

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REPRESENTATIVE SEATON understood an injection well is permitted under Version P. Given that operation during production includes costs of operating a well and moving well fluids up, he inquired how the costs of operating a well are excluded when an injection well is specifically allowed.

MR. DICKINSON responded that upon listening to Representative Seaton's definition, perhaps more language would be appropriate and could be done here in statute or in the regulations. He explained that an injection well is not bringing fluids to the surface; rather, it is pumping something back down into the well. For purposes of an injection well, the process of drilling the well would be included. But, during production, well related expenditure would be the cost of operating a well and moving the well fluids.

[2:45:14 PM](#)

REPRESENTATIVE SEATON requested that the sponsor state his intent on this language when the committee gets to discussion.

REPRESENTATIVE P. WILSON requested that before the next meeting on HB 308, Mr. Dickinson provide members with something that shows the cumulative effects of all of this and whether anything will be left for the state.

MR. DICKINSON replied there will be quite a bit left for the state and there will be a fiscal note from the administration that will tie together all the net effects.

REPRESENTATIVE P. WILSON said she would like to see the effect in picture form rather than in words.

CO-CHAIR NEUMAN requested Mr. Dickinson to work with Deputy Commissioner Davis of the Department of Revenue.

[2:47:40 PM](#)

MR. DICKINSON returned to his presentation and addressed the proposed provision that would change the current statute of limitations for production tax from six years to three years beginning with the 2011 tax year [slide 32]. He said this provision is the same in Version P as it was in Version E.

MR. DICKINSON discussed the provision that would remove the matching spend requirement [slides 33-34]. He explained that under current law, a producer that is producing fewer than 50,000 barrels per day can bring its transferable credits to the state for purchase, assuming the producer has already lowered its taxes to zero. He clarified that these would be credits that have come about as a consequence of investment, not as a consequence of being a small producer. Currently, three conditions must be met for the state to purchase these transferable credits: 1) it is not earlier than allowed on the certificate, a condition that will become moot if the earlier provision to change the certificates is enacted; 2) within 24 months of applying for a certificate, the taxpayer pays out a similar amount in capital investment or lease bids - this is the requirement that would be removed by Version P; and 3) there are no other outstanding tax liabilities.

MR. DICKINSON concluded by noting that the local hire provision that was included in Version E has been removed from Version P.

[2:49:44 PM](#)

CO-CHAIR NEUMAN requested further explanation regarding the first condition that must be met.

MR. DICKINSON responded there are currently two paths a company can take if it makes an investment or does something that earns a credit: the company can use the credit itself or it can get a transferable tax certificate from the Department of Revenue. A transferable tax certificate can be sold to another party, held for use in a future year, or sold to the state.

CO-CHAIR NEUMAN added that Version P would allow use of the transferable credits within the first year.

MR. DICKINSON related that when a taxpayer uses the credit itself, it estimates its taxes every month and applies one-twelfth of the credit. Everything is then trued up at the end of the year when the actual credit is known.

CO-CHAIR NEUMAN said this allows for more fluid capital for reinvestment.

MR. DICKINSON replied yes, the notion is to make reinvestment as quick and effective as possible.

CO-CHAIR NEUMAN noted there are incentives in Version P to try to attract that reinvestment.

MR. DICKINSON agreed. The idea behind this bill, as articulated by Co-Chair Johnson and the governor, is that making specific things subject to the credits, like well work, which is the nexus of the production, encourages reinvestment in these areas.

CO-CHAIR NEUMAN remarked that what must be found is that sweet spot for stimulating reinvestment back into Alaska and finding out whether a reduction in taxes results in the industry reinvesting that money back into Alaska. The goal is for that reinvestment to create more jobs in Alaska for Alaskans.

[2:52:39 PM](#)

CO-CHAIR JOHNSON stated that every drill rig provides 100 Alaskan jobs. More than a tax credit for well workovers, HB 308 is about the human element of jobs. At some point the state must look at the human consequences should that well not be re-worked to provide more oil down the pipeline. Version P should slow the fall in jobs that is now happening.

[2:55:46 PM](#)

REPRESENTATIVE SEATON recalled a producer's previous testimony about wanting to have more on the upside, which is what HB 308 is intended to do. At that time there was discussion about re-initiating a balance on the downside if more is added on the upside. To provide the public and committee members the time to review the amendment he is proposing in this regard, he moved Conceptual Amendment 1, written as follows [original punctuation provided], to be considered at the next meeting:

Page 2 after line 22

Insert new Section 5

AS 43.55.011(f) is repealed and reenacted to read:

(f) The provisions of this subsection apply to oil and gas produced from each lease or property within a unit or nonunitized reservoir from which 1,000,000,000 BTU equivalent barrels of oil or gas have been cumulatively produced by the close of the most recent calendar year and from which the average daily oil and gas production during the most recent calendar year exceeded 100,000 BTU equivalent barrels. Notwithstanding any contrary provision of law, a producer may not apply tax credits to reduce its total tax liability under (e) of this section for oil and gas produced from all leases or properties within the unit or nonunitized reservoir below 10 percent of the total gross value at the point of production of that oil and gas. If the amount calculated by multiplying the tax rate determined under (g) of this section times the total production tax value of the oil and gas taxable under (e) of this section produced from all of the producer's leases or properties within the unit or nonunitized reservoir is less than 10 percent of the total gross value at the point of production of that oil and gas, the tax levied by (e) of this section for that oil and gas is equal to 10 percent of the total gross value at the point of production of that oil and gas.

Renumber following sections accordingly

CO-CHAIR JOHNSON objected for future discussion purposes.

[2:58:11 PM](#)

MR. DICKINSON, in response to Co-Chair Neuman, drew attention to slide 36, which depicts Alaska's past, present, and projected oil production for the years 1965-2019.

CO-CHAIR NEUMAN pointed out that the projection is for a decrease in oil production; the projection is not even for holding a level amount of production. He noted that oil production affects 90 percent of the state's general fund revenue and it is only three companies that are paying these taxes, which is something to be concerned about.

[2:59:38 PM](#)

REPRESENTATIVE SEATON noted that Conceptual Amendment 1 addresses the previous version of the bill, Version E. He said it is his hope that the committee will be able to look at the issue and how the amendment would have affected things had it been in effect over the past three years.

[HB 308 was held over.]

[3:00:28 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:00 p.m.