ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
March 26, 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

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

CS FOR SENATE JOINT RESOLUTION NO. 27(RES)
Urging the federal government to provide funding for domestic seafood marketing and promotional activities.

- MOVED CSSJR 27(RES) OUT OF COMMITTEE

SENATE BILL NO. 195
"An Act relating to the repeal of the establishment of the Goldstream Public Use Area."

- MOVED SB 195 OUT OF COMMITTEE

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."

- TABLED

PREVIOUS COMMITTEE ACTION

BILL: SJR 27
SHORT TITLE: FED. FUNDING: DOMESTIC SEAFOOD MARKETING

SPONSOR(s): SENATOR(s) EGAN

02/12/10	(S)	READ THE FIRST TIME - REFERRALS
02/12/10	(S)	RES
03/01/10	(S)	RES AT 3:30 PM BUTROVICH 205
03/01/10	(S)	Heard & Held
03/01/10	(S)	MINUTE(RES)
03/08/10	(S)	RES AT 3:30 PM BUTROVICH 205
03/08/10	(S)	Moved CSSJR 27(RES) Out of Committee
03/08/10	(S)	MINUTE(RES)
03/10/10	(S)	RES RPT CS 5DP SAME TITLE
03/10/10	(S)	DP: MCGUIRE, WIELECHOWSKI, HUGGINS, STEVENS, FRENCH
03/15/10	(S)	TRANSMITTED TO (H)
03/15/10	(S)	VERSION: CSSJR 27(RES)
03/17/10	(H)	READ THE FIRST TIME - REFERRALS
03/17/10	(H)	RES
03/26/10	(H)	RES AT 1:00 PM BARNES 124

BILL: SB 195
SHORT TITLE: MAKE GOLDSTREAM PUBLIC USE AREA PERMANENT
SPONSOR(s): SENATOR(s) THOMAS

01/19/10	(S)	PREFILE RELEASED 1/8/10
01/19/10	(S)	READ THE FIRST TIME - REFERRALS
01/19/10	(S)	RES
02/03/10	(S)	RES AT 3:30 PM BUTROVICH 205
02/03/10	(S)	Heard & Held
02/03/10	(S)	MINUTE(RES)
02/08/10	(S)	RES AT 3:30 PM BUTROVICH 205
02/08/10	(S)	Moved SB 195 Out of Committee
02/08/10	(S)	MINUTE(RES)
02/10/10	(S)	RES RPT 6DP 1NR
02/10/10	(S)	DP: MCGUIRE, WIELECHOWSKI, STEVENS, FRENCH, WAGONER, HUGGINS
02/10/10	(S)	NR: STEDMAN
02/12/10	(S)	TRANSMITTED TO (H)
02/12/10	(S)	VERSION: SB 195
02/15/10	(H)	READ THE FIRST TIME - REFERRALS
02/15/10	(H)	RES
03/26/10	(H)	RES AT 1:00 PM BARNES 124

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
03/17/10	(H)	Heard & Held
03/17/10	(H)	MINUTE(RES)
03/26/10	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

SENATOR DENNIS EGAN
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: As the sponsor, introduced SJR 27.

SENATOR JOE THOMAS
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: As the sponsor, introduced SB 195.

JENNIFER YUHAS, Public Communications Director
Legislative Liaison
Alaska Department of Fish & Game
Juneau, Alaska
POSITION STATEMENT: Spoke in favor of SB 195.

SHIRLEY LISS
Fairbanks, Alaska
POSITION STATEMENT: Supported SB 195.

MALCOLM MCEWEN
Fairbanks, Alaska
POSITION STATEMENT: Supported SB 195.

MARCIA DAVIS, Deputy Commissioner

Office of the Commissioner
Department of Revenue
Anchorage, Alaska
POSITION STATEMENT: During the hearing on HB 308, answered questions.

DAN E. DICKINSON, CPA
Consultant to the Legislative Budget and Audit Committee
Anchorage, Alaska
POSITION STATEMENT: During the hearing on HB 308, answered questions.

ACTION NARRATIVE

1:02:20 PM

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

SJR 27-FED. FUNDING: DOMESTIC SEAFOOD MARKETING

1:02:42 PM

CO-CHAIR JOHNSON announced that the first order of business is SENATE JOINT RESOLUTION NO. 27, Urging the federal government to provide funding for domestic seafood marketing and promotional activities. [Before the committee was CSSJR 27(RES).]

SENATOR DENNIS EGAN, Alaska State Legislature, sponsor of SJR 27, explained that this resolution urges Congress to spend more on marketing domestic seafood, including the state of Alaska. Alaskans know where their seafood comes from and that it provides the added benefit of supporting the state's fisheries economy. Alaska's fish are wild and fresh and do not have to travel very far to reach the plates of state residents. However, nationally, that story is different in that over 80 percent of the seafood is imported. Each year the federal government collects hundreds of millions of dollars in duties on the imported fish and fish products that aggressively compete with American seafood. Yet seafood producers receive only insignificant funds for domestic marketing and product development. He said SJR 27 calls for some of the taxes collected on imported fish to be put toward marketing American

seafood to Americans. In Alaska, marketing investments in the Alaska seafood industry have meant economic development and support for an industry that is vital to Alaska's economy and future. He requested the committee's support for SJR 27 and noted that it passed the Senate unanimously.

1:05:12 PM

CO-CHAIR NEUMAN inquired whether it would be possible to ask that Alaska's seafood be recognized in a highlighted fashion.

SENATOR EGAN responded that that is the whole thrust of SJR 27, so he would be willing to accept an amendment in this regard.

CO-CHAIR NEUMAN pointed out that the title references funding for domestic seafood marketing, so domestic farmed fish and would fall under that heading. He understood it is Senator Egan's intent to highlight Alaska's wild seafood and that more than half of the wild salmon consumed comes from Alaska.

SENATOR EGAN replied the statistics he has seen show that it is more than half. However, of the federal funds that go toward marketing seafood, Alaska receives a miniscule amount for marketing Alaskan seafood and that is the thrust of SJR 27. He further noted that it is at the request of the Alaska Seafood Marketing Institute (ASMI).

1:07:13 PM

CO-CHAIR JOHNSON opened public testimony, then closed it after ascertaining that no one wished to testify.

REPRESENTATIVE GUTTENBERG commented that he really likes the idea of using federal marine and fishery import tariffs to enhance Alaska's fisheries.

CO-CHAIR JOHNSON agreed.

REPRESENTATIVE TUCK also agreed. He understood that Japan's fish departments are large and its meat departments small, the opposite of America. He said Americans would live much better if they ate more fish, and more Alaskan fish, so SJR 27 is good.

CO-CHAIR NEUMAN moved to report CSSJR 27 out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSSJR 27 was reported from the House Resources Standing Committee.

SB 195-MAKE GOLDSTREAM PUBLIC USE AREA PERMANENT

1:09:08 PM

CO-CHAIR JOHNSON announced that the next order of business is SENATE BILL NO. 195, "An Act relating to the repeal of the establishment of the Goldstream Public Use Area."

SENATOR JOE THOMAS, Alaska State Legislature, sponsor of SB 195, explained that the bill's purpose is to remove the sunset provision from the Goldstream Public Use Area. He paraphrased from the following written sponsor statement:

> The Goldstream Public use Area (GPUA) was created in 1990 by Senator Bettye Fahrenkamp and Representative Mike Davis in order to preserve the recreational opportunities, traditional uses and atmosphere of the local neighborhoods. The GPUA is set to sunset on July 1st, 2010, unless SB 195 is passed this session.
>
> The GPUA encompasses a patchwork of nearly 2000 acres of state land bordered by Sheep Creek Road to the west, Goldstream Road to the north and the Steese Highway to the east. The GPUA is home to an ever-growing network of trails that connect users to the Chatanika River Valley, the White Mountains and the Fairbanks area, all from a central location close to Fairbanks' population base. The GPUA is passively managed by the state and the trails are maintained by volunteers at no cost to the taxpayers.
>
> All uses are allowed in the area and the GPUA is utilized year round by a variety of outdoor enthusiasts and families.
>
> The repeal of the GPUA's sunset clause is actively supported by the Alaska Outdoor Council, Alaska Dog Mushing Association, Alaska Miners Association, Nordic Ski Club of Fairbanks, Alaska Trapper's Association, Alaska Skijoring and Pulk Association, Fairbanks Snow Travelers, Northern Area State Parks Advisory Board, Fairbanks North Star Borough Trails Advisory Board, Alaska Trails, Interior trails Preservation Coalition, Interior Alaska Land Trust, Arctic Audubon Society, and the *Fairbanks Daily News-Miner*.

SENATOR THOMAS further noted that nearly 200 individuals have written letters of support. He said the companion bill, HB 250, is sponsored by Representatives Kelly and Guttenberg. He thanked his constituents, Richard and Mary Bishop, for their support and hard work for the Goldstream Public Use Area over the years. Mr. Bishop was the original impetus for the GPUA back in 1989 and is the person who alerted legislators of the area's impeding sunset. He asked for the committee's support.

1:12:23 PM

CO-CHAIR NEUMAN said he likes that this is a multi-use trail open to all user groups.

SENATOR THOMAS, in response to Representative Tuck, said the GPUA encompasses all of the various areas shown within the blue lines depicted on the map in the committee packet. In further response, he agreed that the various areas are not contiguous.

CO-CHAIR JOHNSON pointed out that the title states the bill is an Act relating to the repeal of the "establishment" of the Goldstream Public Use Area rather than repeal of the "sunset". He asked whether the sponsor is comfortable with that.

SENATOR THOMAS responded he did not write the title and agreed it should be looked at because the title should reflect what is being done, which is a repeal of the public use area's sunset.

1:14:35 PM

CO-CHAIR NEUMAN said that perhaps a title change is unnecessary if the repeal referenced in Section 1 of SB 195 is the sunset clause. He stated he does not want to make the mistake of doing away with the Goldstream Public Use Area.

SENATOR THOMAS agreed and said he will talk to Legislative Legal and Research Services.

CO-CHAIR JOHNSON stated for the record that the intention is to repeal the sunset date, not the establishment of the Goldstream Public Use Area.

SENATOR THOMAS, in response to Representative Guttenberg and Co-Chair Johnson, said he has Version R of the bill before him and he has previously verified that Section 2, chapter 48, is the sunset clause and that is what would be repealed by SB 195.

1:16:38 PM

CO-CHAIR JOHNSON opened public testimony.

JENNIFER YUHAS, Public Communications Director, Legislative Liaison, Alaska Department of Fish & Game, spoke in favor of SB 195 as follows:

> Goldstream Public Use Area is a model that works. It serves our user base, consumptive and non-consumptive, motorized and non-motorized, and this is a model we would like to see used more often. The users involved in the original creation of this area were inclusive. They focused on issues that matter to all of the users and, unlike other shared-use areas, we really do not see contentious arguments over superfluous issues here. What we see is a benefit to all of our users.

CO-CHAIR NEUMAN presumed the Alaska Department of Fish & Game's intent is to continue the multiple uses of the Goldstream Public Use Area. He inquired whether she has had heard about any changes in this regard.

MS. YUHAS replied she has not.

REPRESENTATIVE P. WILSON said she thinks it is nifty that the state passively manages the area because volunteers keep it up.

CO-CHAIR JOHNSON noted people are proud of that area and he is happy to see this.

1:19:03 PM

SHIRLEY LISS said she has been a Fairbanks resident since 1970 and has used the Goldstream Public Use Area ever since. She put in some of the trails and did a lot of the trail maintenance and is glad to hear that it looks like SB 195 is going to pass. If anything, she would like to see the area expanded.

MALCOLM MCEWEN stated he supports SB 195 and is encouraged by the members' testimony in support of the bill. He has used the trails since 1985 for cycling, skijoring, and photography, and he sees other people using the trails for dog mushing, snow machining, and blueberry picking. He would like to see this area stay a public use area.

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

1:20:59 PM

REPRESENTATIVE GUTTENBERG stated he has lived, skied, and mushed dogs in this area for 40 years and the area is a legacy of the multi-users and the ability to get along and work together. He said repeal of the sunset clause is a wonderful thing because the 100-mile-long loop that encircles Fairbanks is a big part of the community and people use it well and use it well together.

REPRESENTATIVE GUTTENBERG moved to report SB 195 out of committee with individual recommendations and the accompanying zero fiscal note. There being no objection, SB 195 was reported from the House Resources Standing Committee.

HB 308-OIL AND GAS PRODUCTION TAX

[Contains discussion of HB 337]

1:23:16 PM

CO-CHAIR JOHNSON announced that the next 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\P, Bullock, 3/17/10, adopted as a work draft on 3/17/10.]

REPRESENTATIVE SEATON withdrew Conceptual Amendment 1.

CO-CHAIR JOHNSON explained that Conceptual Amendment 1 was adopted on 3/17/10 and Representative Seaton will be bringing up another amendment later.

CO-CHAIR JOHNSON moved to adopt Amendment 2, labeled 26-LS1328\P.2, Bullock, 3/24/10, written as follows [original punctuation provided]:

> Page 9, line 8, following "expenditure":
> Insert "incurred after June 30, 2010"

REPRESENTATIVE KAWASAKI objected.

CO-CHAIR JOHNSON stated that Amendment 2 adds an effective date.

1:25:28 PM

CO-CHAIR JOHNSON, in response to Representative Tuck, confirmed that Conceptual Amendment 1 was withdrawn and Representative Seaton will be introducing another amendment that is not conceptual. He reiterated that Amendment 2 would provide an effective date.

REPRESENTATIVE KAWASAKI maintained his objection. He inquired about the implication of adding this effective date over the total bill's effective dates.

CO-CHAIR JOHNSON responded the purpose of this effective date is to end in the fiscal year so July 1 can be started with a clean set of taxes and not have overlapping taxation policies.

1:26:46 PM

REPRESENTATIVE KAWASAKI observed that the effective dates in Sections 18-22 regarding the applicability of these laws is confusing. He asked whether the regulation propagated by these would be done by that time and what the impact would be for the Department of Revenue (DOR) in analyzing how much the tax is.

MARCIA DAVIS, Deputy Commissioner, Office of the Commissioner, Department of Revenue, replied Amendment 2 would ensure that the tax credit for well-related expenditures applies to expenditures that are incurred after June 2010. In order for the Department of Revenue to identify what will and will not be considered well-related expenditures, the department will have to promulgate regulations if nothing else changes in the bill. However, she said she believes Co-Chair Johnson has another amendment pending which may clarify the type of costs that would fall within this credit, so the answer to the question depends upon what happens with the other amendment.

1:28:23 PM

REPRESENTATIVE KAWASAKI inquired whether the Department of Revenue would be able to come up with those definitions and the regulations before that date.

MS. DAVIS answered that the 70-80 days is the absolute minimum time necessary for moving out a regulation because the regulation must first be drafted, then 30 days must be allowed for public comment, followed by another 30 days for the

regulation to become effective. She presumed that if this passes the department might be able to do it.

1:29:27 PM

REPRESENTATIVE SEATON asked whether the taxpayer's tax year is July 1 or the calendar year.

MS. DAVIS responded it is the calendar year for the production tax.

REPRESENTATIVE SEATON speculated this may be problematic because the state has a profits-based tax and the profits are calculated on a yearly basis and estimated payments are made on a monthly basis. He inquired whether this will create a problem for DOR.

MS. DAVIS replied that any time a tax law has two phases in the midst of a single tax year it is more complicated for both the department and the taxpayer. While that does not mean it is insurmountable, it is a challenge to do.

1:31:11 PM

CO-CHAIR NEUMAN asked whether a profits-based tax is the same as a production tax given that both terms are being used.

MS. DAVIS answered the tax rate is applied to the dollar amount that is left over after the product is sold and the transportation and lease expenditure costs, which are all the costs to produce the oil or gas, are deducted from the price received. This dollar amount represents what is held by the company after it has recovered its costs, so by definition that is the net profit remaining and the tax rate goes against that net profit. However, the bill uses the term "production tax value at the point of production" rather than the term "profit".

1:32:51 PM

CO-CHAIR NEUMAN understood Ms. Davis to be saying that in the bill, expenditures for development are considered to be upstream development cost. He inquired whether it would also include midstream or delivery costs.

MS. DAVIS responded both are being talked about. The production tax liability is determined by applying the tax rate to the dollar amount that is left over after taking into account the downstream costs, which are the tanker and pipeline costs, and

the upstream costs, which are all the lease expenditure costs from out of the ground to the pipeline. A tax credit, which is a certain percentage of those costs, is applied against the taxpayer's tax bill. Thus, a certain cost may be counted to both arrive at the net taxable amount and to create a credit.

1:34:36 PM

CO-CHAIR NEUMAN noted that HB 308 would expand exploration credits. He asked whether this is a tax against the profits or a credit that can be used against additional taxes owed.

MS. DAVIS replied this particular provision is a credit that would be applied against the tax that is owed. In further response, she said it is a credit against the taxes that would otherwise be owed.

1:36:16 PM

REPRESENTATIVE KAWASAKI maintained his objection to Amendment 2, saying that the proposed effective date is much different than the calendar year dates of taxation, the retroactivity date of February 28, 2007, and the effective date of 90 days after the bill goes into law. This creates a confusing situation for the Department of Revenue, he surmised, especially when there are so many things at stake. He further commented that if the bill becomes law, some producers may wait to explore until after June 30, 2010.

CO-CHAIR JOHNSON, in response, inquired whether Representative Kawasaki thinks the date should be amended to May 30, 2010.

REPRESENTATIVE KAWASAKI answered his other objection is that the department would be unable to comply with this provision; additionally, he said he has a general objection to the bill.

1:38:25 PM

DAN E. DICKINSON, CPA, Consultant to the Legislative Budget and Audit Committee, in response to Co-Chair Johnson, said he does not have anything to add to the effective date argument. It would be preferable to have this become effective on the first of the month rather than the date the bill becomes effective because that could be the middle of the month, which would create argument over when something was actually paid for. The rules are clearest when they are over the division of a year. The Department of Revenue already has rules to deal with what

happens when it occurs on the first of the month. He said the reason for the bill's wide range of other effective dates is that interest is calculated on a quarterly basis so the provisions would affect interest on the first day of the quarter, and progressivity is calculated on a monthly basis so the provisions would affect progressivity on the first day of the month.

1:39:32 PM

REPRESENTATIVE SEATON stated he has no problem with the effective date provided that Amendment 2 will not prohibit discussion of how the bill would have affected state revenue in the years since Alaska's Clear and Equitable Share (ACES) went into effect.

CO-CHAIR JOHNSON responded he does not intend to limit debate on HB 308 in any way.

REPRESENTATIVE KAWASAKI maintained his objection.

CO-CHAIR JOHNSON, in response to Representative Guttenberg, confirmed that without Amendment 2 the bill would go into effect 90 days after being signed by the governor.

A roll call vote was taken. Representatives Seaton, Edgmon, Guttenberg, Tuck, P. Wilson, Olson, Neuman, and Johnson voted in favor of Amendment 2. Representative Kawasaki voted against it. Therefore, Amendment 2 was adopted by a vote of 8-1.

1:41:57 PM

CO-CHAIR JOHNSON moved to adopt Amendment 3, labeled 26-LS1328\P.3, Bullock, 3/25/10, written as follows [original punctuation provided]:

> Page 9, lines 24 - 31:
> Delete all material and insert:
> "(3) In this subsection, "well-related expenditure" means a lease expenditure that is
> (A) directly related to a well; a lease expenditure is directly related to a well if,
> (i) during exploration and development, the lease expenditure is a qualified capital expenditure and an intangible drilling and development cost authorized under 26 U.S.C. (Internal Revenue Code), as amended, and 26 C.F.R. 1.612-4, regardless of the

elections made under 26 U.S.C. 263(c); in this sub-subparagraph "exploration and development" includes well sidetracking, well deepening, well completion or recompletion, well workover regardless as to whether the well is or has been a producing well, stratigraphic test wells, and injection wells, except that "exploration and development" does not include disposal wells;

(ii) during production, the lease expenditure is an expenditure that is intended to increase, maintain, enhance, or mitigate the decline of well production and is directly related to the processes of operating a well and moving fluids to the assembly of valves, pipes, and fittings used to control the flow of oil and gas from the casinghead, but does not include the processes of gathering, separating, and processing well fluids downstream from that assembly;

(B) for seismic work conducted within the boundaries of a production or exploration unit; or

(C) an overhead expenditure authorized under AS 43.55.165(a)(2) and calculated on well-related lease expenditures allowed under (A) and (B) of this paragraph."

REPRESENTATIVE KAWASAKI objected.

1:42:14 PM

CO-CHAIR JOHNSON explained that Amendment 3 defines well-related expenditures and, for clarification and consistency, it adopts the same language that was included in a previous bill regarding gas storage. He invited Ms. Davis to speak to the amendment.

MS. DAVIS deferred to Mr. Dickinson.

MR. DICKINSON said Amendment 3 is based on the definition that was in HB 280, although there are some changes between that bill and HB 308. The idea is to draw a bright line rather than having a general definition that states "well-related expenditures", for which the Department of Revenue would then have to take public testimony and craft a definition. [Subparagraph (A)(i)] would use the bright line in federal tax law called intangible drilling and development costs. During exploration and during development, something that qualifies as an intangible drilling and development cost would be considered a well-related expense and would include: well sidetracking,

well deepening, well completion or recompletion, and well workover. When something is going to be part of a taxpayer's federal tax return, the taxpayer can take it as part of the credit and the state would be able to go back and check on this.

1:44:35 PM

MR. DICKINSON said subparagraph (A)(ii) would provide that during production a lease expenditure would be those things that are designed to enhance productivity. It draws the line that the credit would not apply once the well fluids hit the surface and move into processing facilities. While the Department of Revenue would write regulations, he said he thinks in general this credit could be effective immediately because producers would have a very good sense of what would be in and what would be out since they know what the federal tax rule is.

MR. DICKINSON stated subparagraph (B) clarifies that seismic work undertaken within a unit is included because, generally, seismic work within a unit is well-related. This provision complements the exploration credits for seismic work conducted outside the boundaries of a production or exploration unit that are provided under AS 43.55.025.

1:46:53 PM

MR. DICKINSON said subparagraph (C) simply fits this into the same category as the way other things are handled. For example, indirect costs are not allowed, but once the direct costs are known there is a markup on that. The size of that markup is determined by the Department of Revenue under AS 43.55.165(a)(2), which he said he believes is currently at 4.5 percent. Thus, instead of fighting about whether a particular support cost is part of this, a company would just take its direct costs and multiply them by 4.5 percent. Although Amendment 3 is longer than the existing language in Version P, it will give direction and make it clearer as to what the legislature had in mind.

CO-CHAIR JOHNSON clarified that this is the well workover section that Governor Parnell has in his legislation [HB 337], and he wants to ensure that the administration is comfortable with this definition.

1:48:10 PM

MS. DAVIS, in response to Representative Kawasaki, confirmed this provision for well-related expenditure would apply to new wells, existing wells, and well workovers because the intent is to capture the phases of the life of a well. [Subparagraph (A)(i)] would focus on the exploration and development phase of locating and drilling a well. Subparagraph (A)(ii) would focus on production of the well, but what would be covered under the various categories is different. The governor's bill would add a category for infill drilling because the current drill credit in the exploration section requires that the drilling be so many miles outside existing units, although infill drilling qualifies for 20 percent capital credit under AS 43.55.023. In terms of creating an enhanced credit for that type of infill work, this is similar to the governor's bill but a little broader.

1:49:41 PM

REPRESENTATIVE KAWASAKI asked what the reason would be for not wanting to give infill credits and having credits apply only for outside of the field.

MS. DAVIS responded that when ACES was considered and passed, it was thought that the 20 percent [capital] credit would be adequate for work within the unit and that the enhanced credit for exploration was necessary because of the risk. Kuparuk and Prudhoe Bay produce the lion's share of Alaska's production and revenue stream and those declining fields may require more extraordinary costs and efforts to continue their productivity. Since the passage of ACES, the question has become why the state would not want to also incentivize some of those in-field activities because that would have the same, if not a more immediate, effect on production.

1:51:19 PM

REPRESENTATIVE KAWASAKI understood that subparagraph (B) would provide for seismic work conducted within the boundaries of a unit, not outside.

CO-CHAIR JOHNSON said he believes Mr. Dickinson was explaining that seismic work outside the field is different than inside the field because seismic work inside a field is to enhance production and seismic work outside is to find.

MR. DICKINSON stated correct.

1:52:33 PM

REPRESENTATIVE GUTTENBERG inquired whether the enhancement under subparagraph (B) would be for a specific well, specific groups of wells, wells not drilled yet, or wells that might be drilled on other pads because of a redefined field.

MS. DAVIS understood that seismic work is often used in recompletions of an existing well bore to help redirect where to make another lateral completion from the bottom of the well bore. She further explained that there are fields within already-producing units where the resource is fractured and contained within lenses. She said she believes the Department of Natural Resources (DNR) often considers such production to be contiguous and part of the same unit and the seismic can be used to target these smaller pockets.

1:53:55 PM

REPRESENTATIVE GUTTENBERG asked whether there is a definition of seismic given that it can be two dimensional, three dimensional, or by explosives or vibrator.

MS. DAVIS replied she does not believe there is a definition in the state's tax code and she thinks that during the exploration phase the only type of costs that would be eligible for this credit are those that qualify under the Internal Revenue Service definition of intangible drilling cost. She said she does not think production is really going to apply in this piece because it is talking about existing production. The way this is written, development would more likely involve an existing field and continued development and access to new parts of the existing reservoir or new reservoirs. She said she therefore thinks the seismic is going to be tied to the exploration and development phase.

1:55:16 PM

REPRESENTATIVE GUTTENBERG inquired whether current state statute deals with well-related expenditures in any way.

MS. DAVIS answered this is a new term of art. For credits under AS 43.55.023, the term of art is qualified capital expenditure and both the statute and the department's regulations have defined that. For credit under AS 43.55.025, which is existing exploration, the statute defines categories of costs that are allowed to receive that credit and these categories include both

some capital and some operating types of expenses. However, this proposed credit would create a new category of expenses.

1:56:07 PM

REPRESENTATIVE GUTTENBERG, regarding subparagraph (A)(i), asked whether the intangible drilling cost under IRS code is specifically for exploration and development costs, or whether there are other definitions under the IRS code or other definitions outside of the IRS code that the committee might want to consider.

MS. DAVIS responded that Amendment 3 first starts with what would be allowed as a lease expenditure; it then goes to a subset of allowed lease expenditures that must qualify as intangible drilling and development costs. She said her understanding is that intangible drilling and development costs are a circumscribed set of cost items and that a large body of law has been worked up that makes it clear what those costs are.

MR. DICKINSON added he is unaware of any other definitions, although he is sure there are other definitions of what well-related costs are. Because this is a tax definition there are a lot of court cases that have clearly set the boundaries in a tax context. It therefore makes sense to go to this set of pre-existing definitions.

1:57:53 PM

REPRESENTATIVE GUTTENBERG inquired whether anything has been left out of Amendment 3 for which a deduction could be given.

MS. DAVIS replied that this particular subset of lease expenditures allowed during production is narrowly circumscribed in the amendment by virtue of having to be related to the processes of operating a well and moving fluids to the wellhead. By excluding the processes listed on page 1, lines 22-23, a line has been drawn at the wellhead assembly which says the costs incurred upstream of that will not be taken into account, but the costs downstream of that are included. So, yes, absolutely, there are things upstream that the committee could consider, but this is a fairly clear line in the sand.

1:59:19 PM

REPRESENTATIVE GUTTENBERG, given that a wellhead or Christmas tree might have a well house on top, asked how downstream is defined.

MS. DAVIS answered the language talks about the assembly of valves, pipes, and fittings used to control the flow of oil and gas from the casinghead, so it defines what is being called the assembly. She thus assumed that "that assembly" on line 23 of the amendment refers to the assembly described in the lines above it. She said she thinks it would be interpreted by Department of Revenue tax specialists as stopping at wherever the valves, pipes, and fittings that control the flow stop.

CO-CHAIR JOHNSON added that the intention is to stop once it gets above ground, so this is trying to define that as tightly and narrowly as possible.

2:00:44 PM

REPRESENTATIVE P. WILSON inquired whether every type of well there is has been named in subparagraph (A)(i).

MS. DAVIS responded there could conceivably be an injector well, which is not literally listed, but it should fit within this description.

MR. DICKINSON corrected Ms. Davis's statement by clarifying that injection well is included in subparagraph (A)(i). A difference between the governor's bill and this is that the governor's bill would exclude service wells, and service wells include injectors under Alaska Oil and Gas Conservation Commission (AOGCC) regulations. Amendment 3 is therefore a little broader than the governor's bill because it includes injection wells. One issue is how to minimize conflicts when drawing clean lines. For example, some wells are specifically drilled as injection wells, but a production well may be turned into an injection well when that area is no longer producing. This subparagraph makes it clear that injection wells would be allowed.

2:02:35 PM

REPRESENTATIVE SEATON asked what the distinction is between an injection well and a disposal well.

MS. DAVIS replied that water or a miscible fluid is injected into injector wells to enhance or drive production. A disposal well is a type of injection well used to get rid of something,

such as drill cuttings, mud, or water for which there is no useful purpose, and a disposal well does not enhance production.

REPRESENTATIVE SEATON surmised that the disposal of carbon dioxide, water, or natural gas would be considered an injection well under the terminology of Amendment 3, and not an injection well for mud, chips, or something else that does not pressurize the field in some way.

MS. DAVIS answered as long as there is some production enhancing aspect to the injection, the department would consider it to be an injector well that is allowed. The purpose of the injection would define whether the material is being disposed.

2:04:45 PM

REPRESENTATIVE SEATON presumed there is no way for either the Department of Revenue or the Department of Natural Resources to determine whether the disposal of carbon dioxide is to pressurize the field or to get rid of it.

MS. DAVIS responded that the location of the bottom hole relative to the reservoir makes it very clear whether an injector well is being used for pressurizing or disposal.

2:05:28 PM

REPRESENTATIVE SEATON understood that subparagraph (A)(ii) relates to the normal operation of the field and giving a tax credit for anything below the surface.

MS. DAVIS replied that there is a more nuanced approach to this because this is a part of the definition that was included in HB 280 in a nod to the governor's concern that a credit be given to get something. The design here is not to give a credit to someone who tinkers with the wellhead but does nothing to stem the normal decline of that well production. Rather, this is designed to target those activities that try to improve the production rate above what it would be if nothing was done.

MR. DICKINSON added that when he gives a presentation he always displays a graph depicting the amount of decline in Alaska's production. He said Ms. Davis's point is that if well production is maintained, the line in the graph would be flat rather than declining by 6-7 percent every year. So, that is the why the term "maintain" is used in Amendment 3.

2:08:18 PM

REPRESENTATIVE SEATON noted that every field on the North Slope is in decline, and asked whether there is any time that it could be said a producer is not attempting to maintain production above what it would otherwise be if nothing is done.

MR. DICKINSON answered the intent is to avoid just that kind of dispute by creating a rule that says any time new money is spent or invested to get oil out of the ground, the below-ground portion of that will be included. The costs for central gas facilities, gas compression plants, flow stations, and gathering centers are excluded from this. The line has been drawn to specifically aim for the well costs.

2:10:19 PM

CO-CHAIR JOHNSON inquired whether Mr. Dickinson or Ms. Davis knows of an oil company that has spent money to keep production at the same decline level.

MR. DICKINSON pointed out that there was no decline after 1999 because a lot of money was spent to simply not decline further. Generally, the reason a producer invests is to get oil out and if that investment does not get more production then that investment will not be made.

CO-CHAIR JOHNSON said his hope is to get more production.

2:11:05 PM

REPRESENTATIVE TUCK asked whether a well recompletion is different from a well workover.

MS. DAVIS understood that a recompletion is when the well has been drilled to the targeted zone but the producer believes the well's performance is suboptimal and therefore chooses to recomplete the well at a deeper or shallower depth. In further response, she said she thinks a well workover under Amendment 3 would include currently producing wells and wells that have been suspended. The presumption is that the well was drilled and producing at one time, and whether production has stopped or not, the provision is intended to cover well workover costs. In response to another question, she confirmed that tax credits for a well workover could be for re-opening a well that had been shut down or a recompletion by drilling down further.

[Co-Chair Johnson passed the gavel to Co-Chair Neuman.]

2:13:11 PM

REPRESENTATIVE TUCK requested a definition of stratigraphic test well.

MS. DAVIS described a stratigraphic well as one that is drilled solely for the purpose of ascertaining data. She said this is defined in various locations, one of which she thinks is AS 43.55.025. The challenge is that that kind of well can qualify as an intangible drilling and development cost if it is capable of transporting hydrocarbon fluids should they be encountered. Thus, it is possible to have a stratigraphic well that yields both data and production.

[Co-Chair Neuman returned the gavel to Co-Chair Johnson.]

2:14:42 PM

REPRESENTATIVE TUCK inquired whether a stratigraphic test well could end up becoming a disposal well.

MS. DAVIS replied it could, but it would be unlikely because most disposal wells are designed according to what will be disposed as far as the casing size, which usually has to be large for disposal. Also, the location to which a disposal well goes has to be carefully selected because it must be approved by various environmental agencies and demonstrated that the drilling is to a location that cannot access drinking water or be susceptible to leaking.

2:15:31 PM

REPRESENTATIVE TUCK asked whether a disposal well is the only exception to any type of exploration and development.

MS. DAVIS answered she cannot think of anything else that would be well related. As long as something fits within the definition of being a lease expenditure and meets the criteria of being an intangible drilling and development cost, that should pretty much exclude just disposal wells.

MR. DICKINSON agreed that that summarizes the kinds of wells. He added there are some wells for which a different credit would be used. For example, there is a 40 percent exploration credit for wildcat wells more than 25 miles from an existing unit or

other drilling location. If 30 years earlier a well had been drilled closer than that, then this would be the pertinent place where the credit would go.

CO-CHAIR JOHNSON stated Amendment 3 is a conforming amendment and is the same language for defining wells that was adopted a week ago [in HB 280]. He said he would like the committee to decide whether it wants consistent language in the bill.

2:17:39 PM

REPRESENTATIVE SEATON inquired whether the state receives the data for credits given under AS 43.55.025 for the North Slope.

MS. DAVIS responded yes.

REPRESENTATIVE SEATON asked whether the data would be received under this provision.

MR. DICKINSON replied not in this definition, but page 9 where Amendment 3 would go, lines 19-23, would require that the producer agree in writing to the terms and submit the data to receive the credit. So, yes, all the terms that apply to the exploration data would apply to anything that is done here.

REPRESENTATIVE SEATON noted that the state allows deductions for an amount of overhead and inquired whether there are any other places where credit is given for overhead.

MS. DAVIS answered no, this would be the only credit she is aware of that would have an allowance for overhead.

2:19:06 PM

REPRESENTATIVE KAWASAKI maintained his objection to Amendment 3.

REPRESENTATIVE P. WILSON asked whether there is a deduction for overhead anywhere else.

MS. DAVIS responded yes, and recalled her answer to Co-Chair Neuman about how transportation costs and lease expenditures are subtracted from the selling price of the product, and that one of the elements of lease expenditures is overhead. The taxpayer recovers 4.5 percent of all direct costs as its overhead, which is deducted before the department comes up with the net remaining amount, called the production tax value, against which the tax is applied.

MR. DICKINSON added that if HB 280 becomes law, a deduction will be there as well; however, Ms. Davis is correct that right now there is not.

REPRESENTATIVE P. WILSON surmised this would allow a taxpayer to deduct the overhead twice.

MS. DAVIS replied yes, the overhead as well as the underlying cost because all of those get deducted as lease expenditures to arrive at the net amount. The beauty of credits is that the taxpayer receives a double bang for its buck.

2:20:59 PM

REPRESENTATIVE EDGMON inquired whether the Department of Revenue supports Amendment 3.

MS. DAVIS answered the department supports the concept of having a credit similar to that included in the governor's bill for infill drilling expenditures. While HB 308 is not the administration's bill, it has similar elements.

REPRESENTATIVE EDGMON asked whether this language is more aggressive than the Department of Revenue and the governor would desire.

MS. DAVIS responded there are a few places where it goes further than the governor's bill. As far as having a credit for that type of activity, the governor is supportive. Speaking just to Amendment 3, she said she thinks the governor could live with this type of credit.

2:22:26 PM

REPRESENTATIVE KAWASAKI maintained his objection.

A roll call vote was taken. Representatives Edgmon, P. Wilson, Olson, Neuman, and Johnson voted in favor of Amendment 3. Representatives Guttenberg, Kawasaki, Tuck, and Seaton voted against it. Amendment 3 was therefore adopted by a vote of 5-4.

2:23:20 PM

REPRESENTATIVE SEATON moved to adopt Amendment 4, labeled 26-LS1328\P.4, Bullock, 3/25/10, written as follows:

Page 2, following line 22:
Insert a new bill section to read:

"*** Sec. 5.** AS 43.55.011(f) is repealed and reenacted to read:

(f) This subsection applies to a taxpayer that produces more than 100,000 BTU equivalent barrels of oil and gas a day north of 68 degrees North latitude. Notwithstanding any contrary provision of law, a producer may not apply tax credits to reduce the producer's 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 total tax rate determined under (e)(1) and (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 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 the following bill sections accordingly.

Page 4, lines 6 - 23:
Delete all material and insert:

"(B) for oil and gas produced from leases or properties subject to AS 43.55.011(f), **1/12 of the amount due for the calendar year of the tax amount due under AS 43.55.011(f)** [THE GREATEST OF

(i) ZERO;

(ii) ZERO PERCENT, ONE PERCENT, TWO PERCENT, THREE PERCENT, OR FOUR PERCENT, AS APPLICABLE, OF THE GROSS VALUE AT THE POINT OF PRODUCTION OF THE OIL AND GAS PRODUCED FROM ALL LEASES OR PROPERTIES DURING THE MONTH FOR WHICH THE INSTALLMENT PAYMENT IS CALCULATED; OR

(iii) THE SUM OF 25 PERCENT AND THE TAX RATE CALCULATED FOR THE MONTH UNDER AS 43.55.011(g) MULTIPLIED BY THE REMAINDER OBTAINED BY SUBTRACTING 1/12 OF THE PRODUCER'S ADJUSTED LEASE EXPENDITURES FOR THE CALENDAR YEAR OF PRODUCTION UNDER AS 43.55.165 AND 43.55.170 THAT ARE DEDUCTIBLE FOR THOSE LEASES OR PROPERTIES UNDER AS 43.55.160 FROM THE GROSS VALUE AT

THE POINT OF PRODUCTION OF THE OIL AND GAS PRODUCED FROM THOSE LEASES OR PROPERTIES DURING THE MONTH FOR WHICH THE INSTALLMENT PAYMENT IS CALCULATED];"

Page 10, line 23:
Delete "sec. 8"
Insert "sec. 9"

Page 10, line 31:
Delete "sec. 8"
Insert "sec. 9"
Delete "sec. 9"
Insert "sec. 10"

Page 11, line 1:
Delete "sec. 10"
Insert "sec. 11"

Page 11, line 5:
Delete "sec. 8"
Insert "sec. 9"

Page 11, line 7:
Delete "sec. 9"
Insert "sec. 10"

Page 11, line 8:
Delete "sec. 10"
Insert "sec. 11"
Delete "sec. 13"
Insert "sec. 14"

Page 11, line 11:
Delete "secs. 1, 2, 4, and 6 - 19"
Insert "secs. 1, 2, 4, and 7 - 20"

Page 11, line 13:
Delete "AS 43.55.011(g)"
Insert "AS 43.55.011(f), as repealed and reenacted by sec. 5 of this Act, and AS 43.55.011(g)"
Delete "sec. 5"
Insert "sec. 6"
Delete "takes"
Insert "take"

Page 11, line 14:
Delete "secs. 1, 2, 4, and 6 - 19"

Insert "secs. 1, 2, 4, and 7 - 20"

Page 11, line 15:
Delete "secs. 20 and 21"
Insert "secs. 21 and 22"

CO-CHAIR JOHNSON objected.

The committee took an at-ease from 2:23 p.m. to 2:27 p.m.

2:27:09 PM

REPRESENTATIVE SEATON moved to adopt Conceptual Amendment 1 to Amendment 4, written as follows:

Page 1, line 8:
Delete "within the unit or nonunitized reservoir"

Page 1, lines 10 and 11:
Insert "producer's total tax liability under (e) of"

Page 1, line 12, [after] "section":
Delete "produced from all of the producer's"
Insert "for oil and gas produced from"

CO-CHAIR NEUMAN objected.

CO-CHAIR JOHNSON objected.

2:27:48 PM

REPRESENTATIVE SEATON explained that Conceptual Amendment 1 [adopted at the previous meeting and withdrawn at the start of today's meeting] had provisions that delineated by field. Several sections in that amendment were by taxpayer's producing over 100,000 British Thermal Unit (BTU) equivalent barrels of oil and gas per day, and in Amendment 4 these sections did not get changed to the tax liability. On page 1, line 8, "within the unit or nonunitized reservoir" should be deleted because Amendment 4 is now talking about a taxpayer instead of a taxpayer's production from a field or unit. This is the same throughout, so Conceptual Amendment 1 to Amendment 4 would delete the references to a field or unit and insert the producer's total tax liability.

2:28:59 PM

CO-CHAIR NEUMAN noted that oil is currently selling on the market for about $80 [West Coast price per barrel] and gas is selling at about $4 [per thousand cubic feet]. He inquired whether those prices would be considered the gross values of that oil and gas.

MS. DAVIS responded no, the gross value is a term of art used at the point of production, which on the North Slope is Pump Station 1. The gross value is determined by taking the selling price and deducting the marine and pipeline transportation costs that are incurred starting at Pump Station 1. In further response, she said the Department of Revenue uses roughly $6.50 to $7.00 for the transportation cost, so the gross value of the oil in this example would be $73 [per barrel].

2:31:41 PM

REPRESENTATIVE SEATON, in response to Representative P. Wilson, again explained that Conceptual Amendment 1 to Amendment 4 is conforming language to ensure it is the taxpayer's liability that is talked about and not oil and gas produced from a specific unit or reservoir.

CO-CHAIR JOHNSON withdrew his [objection to the amendment to the amendment], but said this does not in any way indicate he supports the pending amendment.

REPRESENTATIVE TUCK objected to ask if the reason for the amendment to the amendment is because there could be more than one taxpayer on a particular reservoir.

REPRESENTATIVE SEATON responded that rather than a specific unit or field, what is being talked about is a taxpayer that produces over 100,000 [BTU equivalent barrels] in total production and this total production is the taxpayer's tax base.

2:33:27 PM

CO-CHAIR NEUMAN withdrew his objection. There being no further objection, Conceptual Amendment 1 to Amendment 4 was adopted.

CO-CHAIR JOHNSON maintained his objection to Amendment 4.

REPRESENTATIVE SEATON stated that industry has asked to receive more of the upside through reduced progressivity or other means of taking less tax on the upside. Under ACES, a balance was

struck using a floor mechanism whereby the state took the risk through no taxes on the downside in return for taking more tax on the upside. Now, the legislature is recalculating the taxes and credits so that industry receives more of the upside. To restore the balance, Amendment 4 would provide that the state receive tax when prices are low.

2:35:55 PM

CO-CHAIR NEUMAN inquired what the BTU equivalent is for a standard cubic foot of methane.

MS. DAVIS responded the amount of gas it takes to create 6,000 BTU's of energy is called one barrel equivalent, although the conversion factor is not exactly 1 because it depends upon the gas field.

2:37:03 PM

CO-CHAIR NEUMAN pointed out that in the coming years as more and more miscible fluids are injected into wells to keep up oil production, the oil will become less and less valuable because of its decreased BTU value. He further noted that propane has a BTU value two and a half times that of methane, so a 100,000 BTU equivalent of gas could be as little as 10-14 cubic feet of gas.

MS. DAVIS replied she thinks that as used in Amendment 4, 100,000 BTU equivalent barrels of oil and gas refers to the definitional section and is not taking the BTU in isolation. Rather, BTU equivalent barrel is a term of art, and for gas that will always be the amount of gas that has a heating value of 6 million BTUs. A BTU equivalent barrel equilibrates the differences between propane, natural gas liquids, and liquefied natural gas.

2:39:35 PM

CO-CHAIR NEUMAN said [Amendment 4] is about all oil and gas produced north of 68 degrees."

MS. DAVIS answered it applies only to the North Slope, as she reads it, and it only applies to a taxpayer that on any average day of a year has at least 100,000 barrels of oil equivalent in production credited to its account. This minimum tax would only apply to those specific tax payers regardless of whether this production is all oil, or a mixture of oil and gas, or all gas.

2:40:22 PM

CO-CHAIR NEUMAN stated that would be just about all producers north of 68 degrees.

MS. DAVIS responded that this minimum tax would apply only to a taxpayer whose various interests in the North Slope added together average 100,000 barrels of oil equivalent a day. Under AS 43.55.024, a producer eligible for the $6 million credit is defined as one that does not have more than 50,000 barrels of equivalent average per day. This statute also has a $12 million credit and to qualify for that credit a producer cannot have more than 100,000 barrels of oil equivalent a day. She said she therefore thinks the 100,000 was intended to draw a line between the last entity that could be a small producer and the others.

MR. DICKINSON interjected that three producers would currently meet that qualification - "ExxonMobil, BP, and ConocoPhillips." No other producer comes close.

2:42:11 PM

CO-CHAIR NEUMAN offered his belief that the language [in Amendment 4, page 1, lines 6-7] that states "Notwithstanding any contrary provision of law, a producer may not apply tax credits to reduce the producer's total tax liability under (e) of this section...." would basically kill HB 308.

MS. DAVIS explained (e) is a reference to AS 43.55.011 and deals with the base tax and progressivity tax, so (e) is the tax liability. This first part of Amendment 4 would provide that a large producer's tax liability under the production tax for its North Slope oil cannot be less than 10 percent of the gross value at the point of production, a large producer being one with more than 100,000 barrels [of oil equivalent a day]. The second part of Amendment 4 is about credits and would provide that credits can draw down a large producer's tax liability no further than 10 percent of the gross value. Thus, credits could not be used to bring a large producer's tax liability down to zero, and any credits that could not be used would then be carried forward.

2:44:29 PM

CO-CHAIR NEUMAN noted that Amendment 4 would insert a new Section 5 that would repeal AS 43.55.011(f) and reenact it with new language. He read this new Section 5 aloud as it would read

amended by Conceptual Amendment 1. He understood that if $80 is the oil price and the transportation cost is deducted to arrive at a gross value of $73 at the point of production, then no more than $7.30 could be taken off of that for the total tax on that produced value.

MS. DAVIS replied it is correct that $7.30 is 10 percent of the gross value; however, that represents the minimum tax that would be paid by one of these large producers for its production. If ACES is higher, this does not get implicated; but, if for some reason the tax liability is calculated using ACES, it cannot fall below the $7.30. Likewise, a producer could not have a higher tax liability under ACES and then apply all its credits to draw it down below $7.30. The $7.30 would be the floor in tax that would be paid on those barrels at $80 West Coast price.

2:48:36 PM

CO-CHAIR NEUMAN understood "Notwithstanding any contrary provision of law" to be royalties.

MS. DAVIS answered no, it would be the production tax section.

CO-CHAIR NEUMAN reiterated his belief that being unable to use credits to reduce the tax liability would kill HB 308.

MS. DAVIS responded the provision does not say that credits cannot be used, it says the credits cannot be used to drive down the tax liability to less than $7.30 per barrel in this hypothetical example.

MR. DICKINSON agreed with Ms. Davis's characterization of how this provision would work. He noted a minor correction that could be made to the amendment, explaining that the law being replaced talks about tax subject to (i) and tax subject to (o). As currently framed, Amendment 4 would put a double tax on gas used in the state because it is not exempted from one. That is a technicality because here the liability under (e) is compared against the total gross value at the point of production. So, gross value at the point of production would include everything, while the value under (e) does not include a tax on the royalty portion of private royalties and gas used in the state. He said it is a very minor point because very few dollars are attached to it, but it is one correction.

2:50:52 PM

CO-CHAIR JOHNSON asked whether "few dollars" means $100 million or $10 million.

MR. DICKINSON replied that at $73 the floor typically would not apply, but it would if oil prices declined to the $10 range. He said he believes this would only occur when there are very low prices, like the low prices for gas now, so what is being talked about is hundreds of thousands of dollars. However, for several small taxpayers it would be critical that they understand what their obligation was.

CO-CHAIR JOHNSON clarified that Amendment 4 would take the floor out and protect the state on the down side while sharing more on the upside. He asked whether it is correct that the downside would be around $10.

MR. DICKINSON answered it would occur when the gross value at the point of production is about 1.6 times the lease costs. For example, at a lease cost of $20 this provision would be triggered at 1.6 times $20, which would be about $32. Therefore, this would not be triggered at today's prices of nearly $80, but it would be triggered earlier than $10.

2:52:46 PM

MR. DICKINSON, in response to Representative Seaton, explained that for the $26 figure used in Department of Revenue publications, $20 was the upstream cost and $6 was from the destination value in the Lower 48 to the gross value at the point of production.

REPRESENTATIVE SEATON, in response to Co-Chair Johnson, confirmed that the remaining language in Amendment 4, page 2, line [19] onward, is conforming amendments.

2:54:29 PM

CO-CHAIR JOHNSON withdrew his objection.

CO-CHAIR NEUMAN maintained his objection, saying he does not believe the changes made by Amendment 4 are appropriate.

CO-CHAIR JOHNSON said he will look into this, but at his point he does not have a terrible objection to the amendment.

A roll call vote was taken. Representatives Guttenberg, Kawasaki, Tuck, P. Wilson, Olson, Seaton, Edgmon, and Johnson

voted in favor of Amendment 4, as amended. Representative Neuman voted against it. Therefore, Amendment 4, as amended, was adopted by a vote of 8-1.

2:56:39 PM

CO-CHAIR JOHNSON opened public testimony on HB 308.

MS. DAVIS offered testimony on behalf of the Department of Revenue. She provided a 5-page handout and said that the last page entitled, "Comparison of Progressivity Impacts," dated 2/24/2010, captures the upside that would be shifted back to producers just by the proposed progressivity change. She noted that the calculations for fiscal years 2008 and 2009 are based on actual data and the calculations for fiscal years 2010, 2011, and 2012 are based on the department's fall 2009 revenue forecasts. The column for Version E shows the impact of changing the progressivity from 0.4 to 0.2 percent. The column for Version P shows the impact of keeping the progressivity curve at 0.4 percent but starting the progressivity after $30. The numbers in these columns are the reduction in current production tax revenue that the state would receive during those fiscal years; the figures are expressed in millions of dollars as well as percentages. She related that the administration under the governor is keen to give credits if the state will receive value in the form of increased production or increased employment, but the change in progressivity under HB 308 is not necessarily tied to those elements.

2:59:35 PM

MS. DAVIS said another area of concern for the Department of Revenue is the interest rate which the bill would set at 3 percent above the Federal Reserve rate. With the Federal Reserve rate currently wavering between 0.5 and 0.75 percent, DOR is very much concerned that the state may not get paid because most companies could not borrow money at 3.75 percent; if there are disputes or issues the companies will hang on to the money and potentially make money on the difference. If the 11 percent rate is changed, she said the department would suggest adjusting the rate to 5 percent.

MS. DAVIS, in regard to the statute of limitations, related she has received calls from a company that is very anxious to get its credits processed and cashed out. The company is moving from the exploration and development phase to production, but needs the cash flow to do so. Unfortunately, the auditor who

has the account for that company is tied up trying to complete a three-year statute of limitation, so she must tell this company that it will have to wait for its credits to be processed. She cautioned that if HB 308 passes and all of the six-year statute of limitations become three-year, all the efforts to create credits for returning money back to investors will not be realized because the department does not have the manpower to process a three-year audit limitation and get the credits out because both are done by the same people. She said she could hire more staff if it was politically popular and financially doable, but that is not the situation right now.

CO-CHAIR JOHNSON stated he is "not wrapped around the axle on the statute of limitations" and if the bill passes out of this committee he will work with the House Finance Committee in this regard to help provide the department what it needs.

3:02:28 PM

MS. DAVIS, in response to Representative Seaton, explained that the $300 million in impact for Version P in the fiscal year 2010 [page 5 of Ms. Davis's handout] represents actual data for the month of January and the other 11 months are what were forecasted for fall 2009.

REPRESENTATIVE SEATON observed that over the past three years, Version P would have reduced the state's revenue by over $1.7 billion in actual income. In response to Co-Chair Johnson, he pointed out that the chart compares the impacts of Version E and Version P to current law under ACES.

3:04:03 PM

REPRESENTATIVE SEATON further observed that the chart does not include the impact to state revenue of the proposed credits; thus, the total decrease in revenue to the state from HB 308 would be well over $2 billion. He pointed out that there has been no identification as to what would be cut from the state's budget as a result of this revenue decrease. For example, would forward funding of education or university capital construction be cut out?

CO-CHAIR JOHNSON responded it would mean the state would only have $11 billion in reserve instead of the current $12 billion, so he does not think anything would be cut and instead there would be less surplus.

3:05:06 PM

REPRESENTATIVE SEATON argued that the forward funding of education is part of what the co-chair is calling the surplus. Just this year the state finally repaid what it owed the constitutional budget reserve fund, so when talking about what things could be swept out, such as the Alaska Housing Finance Corporation (AHFC), that is true. He said he needs to look more at the economic impact of the bill.

CO-CHAIR JOHNSON replied there will be that opportunity in the House Finance Committee and on the House floor.

3:05:54 PM

REPRESENTATIVE SEATON maintained that more information is needed. He moved to table HB 308.

A roll call vote was taken. Representatives Kawasaki, Tuck, Seaton, Edgmon, and Guttenberg voted in favor of tabling HB 308. Representatives Olson, P. Wilson, Neuman, and Johnson voted against it. Therefore, HB 308 was tabled by a vote of 5-4.

3:07:08 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:07 p.m.