

ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE

March 29, 2010

1:16 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. 337

"An Act relating to interest on certain underpayments or overpayments for the oil and gas production tax, to certificates for certain oil and gas production tax credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 337

SHORT TITLE: OIL AND GAS PROD. TAX: CREDITS/INTEREST

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/10/10	(H)	READ THE FIRST TIME - REFERRALS
02/10/10	(H)	RES, FIN
03/10/10	(H)	RES AT 1:00 PM BARNES 124
03/10/10	(H)	Heard & Held
03/10/10	(H)	MINUTE(RES)
03/27/10	(H)	RES AT 10:00 AM BARNES 124

03/27/10 (H) Heard & Held
03/27/10 (H) MINUTE(RES)
03/29/10 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

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

POSITION STATEMENT: During the hearing on HB 337, answered questions.

PAT GALVIN, Commissioner
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Reviewed the differences between HB 337 as originally introduced and the proposed committee substitute, Version R.

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

POSITION STATEMENT: During the hearing on HB 337, answered questions.

ACTION NARRATIVE

[1:16:31 PM](#)

CO-CHAIR CRAIG JOHNSON called the House Resources Standing Committee meeting to order at 1:16 p.m. Representatives Seaton, P. Wilson, Olson, Edgmon, Guttenberg, Tuck, Kawasaki, Neuman, and Johnson were present at the call to order.

HB 337-OIL AND GAS PROD. TAX: CREDITS/INTEREST

[Contains discussion of HB 308]

[1:17:32 PM](#)

CO-CHAIR JOHNSON announced that the only order of business is HOUSE BILL NO. 337, "An Act relating to interest on certain underpayments or overpayments for the oil and gas production

tax, to certificates for certain oil and gas production tax credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

[1:17:45 PM](#)

CO-CHAIR JOHNSON noted that two proposed committee substitutes have been drafted for the committee to choose from [Version R, labeled 26-GH2057\R, Bullock, 3/29/10, and Version E, labeled 26-GH2057\E, Bullock, 3/29/10]. He explained both versions are identical, except Version R would provide the Alaska Retirement Management (ARM) Board with the ability to purchase the tax credit certificates. He pointed out, however, that according to a [3/28/10] memorandum from [Mr. Don Bullock of] Legislative Legal and Research Services, Version R violates the single-subject clause. He said his preference is to adopt Version E and add the ARM Board provision as an amendment, but that he will yield to the committee's preference.

[1:19:26 PM](#)

REPRESENTATIVE SEATON noted [Mr. Bullock's] memorandum states "may" expose the enactment to legal challenge. He distributed a 4/7/08 memorandum from [Mr. Alpheus Bullard of] Legislative Legal and Research Services which details the Alaska Supreme Court decisions in this regard. To support his opinion that the two subjects are congruous because both relate to the proposed tax credits, Representative Seaton read the following portions of the 4/7/08 memorandum [original punctuation provided]:

The standard adopted by the Alaska Supreme Court in regard to the single-subject requirement states that an "act should embrace some one general subject; and by this is meant, merely, that all matters treated of should fall under some one general idea, be so connected with or related to each other, either logically or in popular understanding, as to be parts of, or germane to, one general subject." ... The Alaska Supreme Court has held that the purpose of this constitutional provision is to guard against ... "the practice of 'deliberately inserting in one bill several dissimilar or incongruous subjects....'"

Alaska's single-subject rule has been interpreted by the Alaska Supreme Court to permit very broad subject matter in a bill without violating the single-subject requirement. In construing the single-subject rule, the court will "resolve doubts in favor of validity." ... Specifically, the court has held that bills relating to such broad themes as "civil actions", "taxation", "transportation", and "land" are acceptable.

[1:22:19 PM](#)

CO-CHAIR JOHNSON stated he had both versions drafted because it is difficult to project what the courts will do.

REPRESENTATIVE KAWASAKI suggested that if an amendment has not already been drafted for inserting the ARM Board provision into Version E, it may be easier to start with Version R and delete the ARM Board provision if the committee so chooses.

CO-CHAIR JOHNSON agreed this would also be appropriate, but said he still prefers to start with Version E.

[1:23:18 PM](#)

REPRESENTATIVE GUTTENBERG pointed out that while the legal opinion is simple the listing of who can do something then raises the question of whether that means everyone else is excluded. He inquired whether listing the ARM Board in this particular case would prohibit anyone else from being able to purchase the credits.

DONALD BULLOCK JR., Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, responded he thinks the maxim being referenced is that when a list of things is put into statute, the implication is that there are other similar things that may be added to that list. He said this particular case, however, has to do with the authority of the ARM Board to enter into negotiations to buy the credits at a discount and then sell them to the Department of Revenue for full fare.

[1:25:43 PM](#)

REPRESENTATIVE GUTTENBERG asked whether authorizing the ARM Board to do this would exclude any other state entity from also

doing the same thing. He maintained that listing who can do this infers that those not listed cannot do it.

MR. BULLOCK replied in this case it is not a list; it is specific authority being granted to the ARM Board.

[1:26:05 PM](#)

MR. BULLOCK, in response to Representative Seaton, stated he is very familiar with the concepts and broadness addressed in [Mr. Bullard's] 4/7/08 memorandum. He said the concern expressed in his [3/28/10] memorandum is that this case has to do with the authority of the ARM Board to do something. While it happens to deal with tax credits, the substantive part of the ARM Board-related sections in Version R deal with the power of the ARM Board. Since the revenue from taxes is used throughout the state, the question is where to draw the line as to what is put into it because this is a revenue-related bill. Therefore, in his opinion, Version R raises a serious single-subject problem.

CO-CHAIR JOHNSON understood Mr. Bullock to be saying it is not because it relates to taxes, but because it is expanding the power of a board.

MR. BULLOCK answered right; the substance of it is to give a power to the ARM Board.

[1:27:49 PM](#)

REPRESENTATIVE SEATON said the 4/7/08 memorandum comes from a previous bill dealing with scallop and crab licenses and Alaska Regional Development Organizations (ARDORs) that came before the House floor. It was ruled that this was not a violation of the single-subject rule because ARDORs have some tie to economic or potential economic functions across the state. He said he believes this issue is much more closely related than scallop and crab licenses and ARDORs.

REPRESENTATIVE SEATON moved to adopt the proposed committee substitute (CS) for HB 337, labeled 26-GH2057\R, Bullock, 3/29/10 ("Version R"), as the work draft. There being no objection, Version R was before the committee.

[1:29:37 PM](#)

PAT GALVIN, Commissioner, Department of Revenue, reviewed the differences between HB 337 as originally introduced and the

proposed committee substitute, Version R. He said Conceptual Amendment 1 presented to the committee on 3/27/10 [and included in Version R], would make two changes to the governor's original bill. It would put infield drilling credits under AS 43.55.023, the capital credit section of law, rather than putting them under AS 43.55.025, the exploration incentive credit, as originally proposed. This new language is the same language used in HB 308. The types of activities the administration had intended to address are still addressed, but just structured differently within the statute. The administration was concerned about how to describe the eligible expenditures if the credit was put under AS 43.55.023; however, HB 308 was subsequently amended to tighten the language of AS 43.55.023 to intangible drilling expenditures, a well-established principal under federal tax law that the department can comfortably implement. Two other types of wells are added that were not included in the governor's original bill - injection wells and stratigraphic test wells - to those eligible for the proposed additional credit. The implication remains the same as the governor's original concept in terms of what is being provided this additional incentive.

[1:31:55 PM](#)

COMMISSIONER GALVIN said Conceptual Amendment 1 also includes provisions dealing with the calculation of interest rates for the underpayment or overpayment of previous tax liabilities. The rate under current law is the higher of 11 percent or the Federal Reserve rate plus 5 percent. Under HB 308, the 11 percent would be removed and the float above the Federal Reserve rate would be lowered to 3 percent. Conceptual Amendment 1 would remove the 11 percent floor and keep the Federal Reserve rate plus 5 percent. This particular interest rate section of the tax code also deals with other tax categories, he explained. A previous alteration of the interest rate was not completely captured by the conforming amendment in HB 308, so Conceptual Amendment 1 would conform Sections 1 and 2 to existing law; other sections make the reference clear that it is to this particular method of calculating the tax.

COMMISSIONER GALVIN noted that in addition to the aforementioned, Version R would add measures regarding the ARM Board, along with conforming amendments to marry the different concepts together.

[1:34:31 PM](#)

COMMISSIONER GALVIN, in response to Representative Tuck, confirmed that the interest rate provision is under Section 4 of Version R. In further response, he confirmed that the language on page 3, line 1, Version R, which deletes 5 percent above the Federal Reserve rate and inserts 3 percent is a mistake that was missed and is not the administration's intent.

CO-CHAIR JOHNSON observed that this error is in both Version R and Version E. In response to Commissioner Galvin, he agreed that a correcting amendment is needed.

1:36:00 PM

CO-CHAIR NEUMAN voiced his concern about the single-subject clause and asked whether having the ARM Board in the bill title will affect the Department of Revenue.

COMMISSIONER GALVIN declined to comment on the single-subject issue, saying that that issue is for the committee and its attorneys to discuss. Regarding the provision in Version R that would remove the obligation for a small producer to continue making investments to qualify for state purchase of its credit certificates, he said the intent is to provide a new entrant the ability to get full value for its credit and not have to sell it at reduced value to an existing producer. This provision would provide full reimbursement for just about every credit certificate that the small producer could not take off of existing production. He said he therefore does not anticipate that the small producer would have to go to the ARM Board to sell the certificate at a discount when it can come to the Department of Revenue and receive full dollar-for-dollar value.

1:38:59 PM

CO-CHAIR NEUMAN understood Commissioner Galvin to be saying that to take advantage of these credits it would be better for the small producer to not sell the certificates to the ARM Board.

COMMISSIONER GALVIN replied it is up to the taxpayer receiving the certificate to decide what to do to get value for it. He said he would anticipate that if a taxpayer had the option of submitting the certificate to the Department of Revenue for 100 percent of the value or going to the ARM Board to have the board buy the certificate for up to 92 cents on the dollar, that the taxpayer would choose the former. The only situation where that might not be the case is if the taxpayer had other tax obligations to the state that the Department of Revenue would be

obligated to offset before payment could be made. He said he thinks that would be a rare instance given the types of companies that would likely come forward with this type of credit certificate, and therefore he does not anticipate the ARM Board provision being utilized much, if at all.

[1:40:24 PM](#)

CO-CHAIR NEUMAN said HB 337 is a very important bill to both the governor and the chair because the intent is to help create job opportunities. He inquired whether a reviser's bill in the House Rules Standing Committee would be a better way to do this.

COMMISSIONER GALVIN answered he does not know if the reviser's bill would be a place to put an ARM Board authorization to buy tax credits. While he can speak to his anticipation of what value a taxpayer will be looking for, he said the committee needs to talk to Mr. Bullock regarding the question about the risk of legal exposure.

CO-CHAIR NEUMAN asked whether there are better places besides the title of HB 337 to provide opportunities to expand the purchase of the different production credits.

COMMISSIONER GALVIN responded he is unaware of any other bill in the body right now that adjusts the powers of the ARM Board. He said the remainder of HB 337 is about as close as one can get for providing a market for tax credits.

[1:43:08 PM](#)

CO-CHAIR NEUMAN inquired whether Commissioner Galvin thinks taxpayers would take advantage of selling these credits if there was new legislation that expanded ARM Board authorities.

COMMISSIONER GALVIN replied the other provisions of HB 337 establish the state as the primary market for these certificates at full value on the dollar. He said he does not think there is a particular need to expand the market by including the ARM Board, so including the ARM Board as a provision in either this bill or another bill would not make it any more attractive.

[1:44:40 PM](#)

REPRESENTATIVE SEATON said House Bill 48, a bill that passed the House but died in the Senate, would have provided for the ARM Board to buy these tax credits. At that time, as now,

statements were made that the state would buy enough so that another vehicle was unnecessary. He reminded members of recent statements before the committee that people trying to sell these credits could not get them reimbursed through the state fast enough and the credits could not even be sold elsewhere for 50 cents on the dollar.

COMMISSIONER GALVIN recalled House Bill 48 was considered in February 2007, but it was not until the following fall under Alaska's Clear and Equitable Share (ACES) that a change was made to allow the state to buy back a certain portion of the certificates. A caveat of that change was that the taxpayer had to continue its investment, so the department is required to hold the certificates until the taxpayer demonstrates that additional spend and this is what creates the lag time in terms of a taxpayer's ability to have the state buy the credits. The intention of HB 337 is to remove all restrictions to quick processing of the certificates. He allowed that the ability to get the certificates filled is a valid concern, so he does not think it is damaging to the issue to provide taxpayers with [the ARM Board] alternative. However, he said he does not think it is likely because he believes the department is the place where taxpayers will want to sell their certificate.

[1:47:20 PM](#)

REPRESENTATIVE SEATON noted the committee has received testimony that there is a problem with speed of audits being available; he surmised that that would be the certificate issuance. He understood there is a \$25-million-per-year limit for the state to purchase credits.

COMMISSIONER GALVIN answered no, not any longer. In further response, he said the ACES legislation removed the limit entirely.

CO-CHAIR JOHNSON added he thinks the ARM Board provision does not do anything and may jeopardize the future of the bill. An amendment may be made to take out the provision, he advised.

[1:48:36 PM](#)

REPRESENTATIVE GUTTENBERG, referenced page 2 of the Department of Revenue's 4-page 3/29/10 handout and noted that well-related credits are something new.

COMMISSIONER GALVIN said right, they are a separate, additional credit for all wells.

REPRESENTATIVE GUTTENBERG understood the graph on page 2 shows what the production tax revenue would have been in fiscal years (FY) 2008 and 2009 had this credit been in place, along with the projected revenue for fiscal years 2010-2013.

COMMISSIONER GALVIN replied all figures are approximations. [The numbers depicted on the graph for production tax revenue and the amount of additional well-related credits, respectively, are approximately: FY 2008 - \$2.4 billion and \$245 million; FY 2009 - \$3.1 billion and \$255 million; FY 2010 - \$2.1 billion and \$297 million; FY 2011 - \$2.4 billion and \$327 million; FY 2012 - \$2.6 billion and \$336 million; FY 2013 - \$2.9 billion and \$390 million.]

[1:49:45 PM](#)

REPRESENTATIVE GUTTENBERG noted that over \$1 billion in [additional] credits is projected for fiscal years 2010-2013. He asked what assumptions are built into those credits; for example, increased production or the price of oil or both.

COMMISSIONER GALVIN answered the Department of Revenue's fiscal note for HB 337 puts an indeterminate number on the impact of the credits because the department did not incorporate those potential changes in the amount of production; it is not the price that determines this. Using the figures from fiscal years 2008 and 2009, the department estimated the operating expenditures it believed would qualify for the credit, which was 25 percent, and did the same for capital expenditures. Those approximated percentages were then applied to the department's current projections for operating and capital expenditures for fiscal years 2010-2013 to derive the numbers shown on page 2. Because the department would expect there to be additional investment as a result of these [new] credits, which would result in additional production, there would be a potential change from these numbers. There would be more expenditures than what the department is currently projecting, which would create more credits, but the at same time there would be more production which would create more state revenue, which is why the fiscal note was left as indeterminate in terms of the actual impact on state revenue. However, the department wanted to show committee members what the magnitude of this proposed new credit might be, based upon current projections.

1:52:20 PM

REPRESENTATIVE GUTTENBERG inquired whether the information used for these estimations came from the old standard deduction.

COMMISSIONER GALVIN responded no, other data became available to the department to calculate those projections. He pointed out that this is getting into the realm of confidential data.

REPRESENTATIVE GUTTENBERG surmised these numbers could be significantly lower or higher without increase in production.

COMMISSIONER GALVIN replied correct. These numbers are based strictly upon the expected expenditure levels and what the resulting credits would be. They are not intended to represent the potential change in revenue, so they are not affected by production.

REPRESENTATIVE GUTTENBERG presumed that without being affected by production, the expense of the credit being applied for could be greater or less regardless of production in any given year.

COMMISSIONER GALVIN answered correct.

1:54:18 PM

REPRESENTATIVE KAWASAKI said he believes the word "incurred" should be added to page 6, line 26, after "expenditure", given it is the department's intent that the credit be for well-related expenses incurred between the six years after June 30, 2010, and before July 1, 2016. In response to Co-Chair Johnson, he said he is comparing the wording of Version R and Conceptual Amendment 1 that was discussed on 3/27/10, and the word "incurred" is missing from Version R.

COMMISSIONER GALVIN recommended the word "incurred" be included in Version R.

CO-CHAIR JOHNSON requested Representative Kawasaki to make note that an amendment is needed for this because the intent is to do what was agreed upon.

1:57:00 PM

CO-CHAIR NEUMAN, in regard to there being several effective dates and the department's workload, asked whether the effective

dates in the sections applicable to ACES should be February 28, 2007, and the other effective dates should be January 1, 2010.

MARCIA DAVIS, Deputy Commissioner, Office of the Commissioner, Department of Revenue, responded that Version E [and Version R] did pick up the portions of ACES that needed to be retroactive to ease the department's workload. The date that was not pushed back was the tax credit itself, which is in Section 19, page 9, lines 5-6, of Version R. She said the insertion of subsection AS 43.55.023(m) is the proposed new ACES capital credit, so it would be helpful to the department for that date to remain at July 1, 2010, because it is the expenditures incurred from that date forward that are being talked about. In further response, she said the credit is to induce new and additional investment and that past behavior cannot be changed by making the credit retroactive.

[2:00:04 PM](#)

CO-CHAIR NEUMAN inquired about the retroactive effective date of January 1, 2010, for Section 9 in Version R.

MS. DAVIS noted that Section 9 relates to the current requirement that credits be split over two years. She said the effective date of January 1, 2010, is set where it needs to be set because it enables the credits that happen in 2010 to be good in 2010. For credits that happened in 2009, half were good in 2009 and half were good in 2010, so making those credits retroactive would not change any financial impact on the taxpayer. In further response, she said the effective dates in Version R for Sections 7-9 should be okay. The retroactive date [for Section 7] goes back to the beginning of ACES and the petroleum production profits tax (PPT), and is the provision that would give the department the ability to waive interest on an underpayment of tax during the time when there was not a regulation.

CO-CHAIR NEUMAN said he has talked to other members of the administration who felt otherwise about the dates.

[2:02:07 PM](#)

COMMISSIONER GALVIN, in response to Representative Tuck, confirmed the production tax depicted on page 2 of the 3/29/10 handout is expressed in millions of dollars. He further confirmed the scale shown for fiscal year 2010 is the same as that for fiscal years 2008 and 2009. He clarified that the

number in the box [on top of the blue bar] does not correspond to the entire bar; it only represents the amount of credit.

[2:03:11 PM](#)

REPRESENTATIVE TUCK understood this graph depicts the expected capital credits that are both capital and operating expenditures, and has nothing to do with the potential production increase with those credits.

COMMISSIONER GALVIN replied correct. He pointed out that page 3 of the handout provides a breakdown of the capital and operating expenditures that went into the boxes on page 2. The numbers do not directly track because page 3 deals with the calendar year 2009 as opposed to the fiscal year 2009. The blue bar on the left of page 2 represents the capital expenditures for that year [about \$2 billion], the small grey box represents the 20 percent capital credits that accrue from the blue bar [\$370 million], and the white box represents what the department estimates to be the additional credits that would be created by the proposed 30 percent infield credit [\$90 million]. Regarding the bars depicted on the right of page 2 for operating expenditures [totaling about \$1.9 billion], he explained that there is no [grey] box next to the blue bar because there is currently no capital credit for operating expenditures. However, a portion of the operating expenditures would qualify for the proposed new credit and that would generate the additional \$150 million shown in the white box. Thus, the \$90 million and \$150 million boxes would correspond to a box on page 2 if there was a box for calendar year 2009. In further response, he confirmed that the reason for the differences [in the white boxes] on the two pages is that one is for fiscal year and one is for calendar year.

[2:06:09 PM](#)

COMMISSIONER GALVIN, in response to Representative Seaton, clarified that of the capital and operating expenditures the department expects to qualify for this credit, an additional credit beyond what is in current law will be generated, and this additional amount is depicted in the white boxes [on page 2 of the 3/29/10 handout]. Thus, for fiscal year 2009, it is not that \$255 million of the expenditures qualify for the credits; it is that of the expenditures that qualify, the result will be an additional \$255 million in credit above what those expenditures qualified for previously.

[2:07:23 PM](#)

REPRESENTATIVE SEATON asked whether there is anything depicting the approximate amount of well-related expenses for those years.

COMMISSIONER GALVIN directed attention to page 3 of the handout and noted that of the \$370 million in credit generated from 2009 capital expenditures, an additional \$90 million of credits would be created. This means about \$900 million of the total capital expenditures would be expected to qualify for this additional credit because the proposed credit would add an additional 10 percent. For the operating expenditures, \$150 million of additional credit would be created; this would be about \$500 million in operating expenditures because the credits would go from 0 percent to 30 percent.

[2:08:56 PM](#)

REPRESENTATIVE SEATON inquired where the operating credits that would apply from this are located in Version R. He said he thought that in the earlier bill there were credits for well-related expenditures and that operating expenditures were amended out of the bill.

COMMISSIONER GALVIN explained that under the current system, capital expenditures and operating expenditures are separated based upon a particular definition of what qualifies as a capital expenditure. However, HB 337 would use the definition of intangible drilling expenditures to determine which expenditures qualify. This definition includes some capital expenditures and some operating expenditures and under HB 337 all intangible drilling expenditures would qualify for this 30 percent credit. Thus, there is no section of HB 337 that says operating expenditures do not qualify for the proposed new credit. The charts in the handout are based upon past tax returns and depict that portion of current capital expenditures the department expects will qualify for this new credit and what the implication of the new definition would be for the current division between capital and operating expenditures.

[2:11:45 PM](#)

COMMISSIONER GALVIN, in response to a further question from Representative Seaton, explained that the numbers depicted in the handout are nearly the same whether for Version R or the governor's original bill, which would have made the provision under AS 43.55.025. The difference is that well workovers and other activities that increase production will be eligible for

this proposed credit and there is not a distinction as to whether they are operating or capital expenditures. The language in HB 337 gives this additional credit, whether in AS 43.55.025 under the original bill or in AS 43.55.023 under Version R. Therefore, it is not a function of whether it is production or development.

[2:14:03 PM](#)

COMMISSIONER GALVIN, in response to Representative Tuck, confirmed that page 7, lines 13-21, where well-related expenditure is defined, is what is being referred to. In further response, he said this would not include disposal wells.

[2:15:06 PM](#)

REPRESENTATIVE GUTTENBERG inquired whether the Department of Revenue has talked with the Department of Natural Resources to determine whether any of this work is already scheduled to be done to stem the decline in the production rate. Or, he asked, is all of the work being talked about meant to increase production above that line.

COMMISSIONER GALVIN said he does not think there is a straightforward answer as to whether it would increase or decrease the line. All of the expenditures the department would expect to qualify for this are intended to result in production.

[2:16:26 PM](#)

REPRESENTATIVE GUTTENBERG asked whether credit would be given for something that is already scheduled to be done.

COMMISSIONER GALVIN answered there has been conversation with the Department of Natural Resources regarding whether there is a distinction to be made between what is planned to be done and what is not, and DNR's plans do not get to the "granularity" where the Department of Revenue can use them for that purpose. The issue the department faces with trying to target incentives to only incremental additional production is that there is no baseline with which to compare it to, that if there is no additional investment there would be a decline curve that is much steeper than what the department projects.

[2:17:34 PM](#)

REPRESENTATIVE GUTTENBERG inquired whether that is the expectation with going ahead without any additional well work or with what is already scheduled, or is this meant to incentivize work above that to increase that.

COMMISSIONER GALVIN responded the issue faced by the department is that production forecasts are based upon what the companies have provided the department in terms of their expected production profiles based upon their expected investment rules; it is not detailed on a well-by-well basis. For that reason, HB 337 makes an across-the-board proposal for an economic incentive to do this type of drilling. He said he fully anticipates there are going to be expenditures that qualify for these additional credits that would have been done anyway. However, there are workovers and additional wells that will be drilled that would not have been done without this additional boost. The department believes it is in the state's interest to provide a credit targeted for the work it is trying to incentivize, which would result in more jobs and more production.

[2:20:01 PM](#)

REPRESENTATIVE GUTTENBERG allowed that some wells need rework just to stay even. He asked whether there is some way to hook this credit onto increased production.

COMMISSIONER GALVIN replied one thing that can be relied upon is that companies are going to be investing in this type of expenditure solely because of the expectation it will result in more production than if they did not do the investment.

CO-CHAIR JOHNSON opened public testimony.

The committee took an at-ease from 2:22 p.m. to 2:28 p.m.

[2:28:11 PM](#)

CO-CHAIR JOHNSON left public testimony open after ascertaining no one wished to testify today.

REPRESENTATIVE SEATON moved to adopt Amendment 2, labeled 26-GH2057\R.1, Bullock, 3/29/10, written as follows [original punctuation provided]:

Page 7, line 2:
Delete "that expenditure"

Insert "the expenditures during a calendar year that exceed the average annual well-related expenditures for the calendar years 2008, 2009, and 2010; the producer or explorer shall submit the amount of well-related expenditures for each of the years 2008, 2009, and 2010 at the time an election is made to apply the credit authorized by this subsection"

CO-CHAIR JOHNSON objected for discussion purposes.

[2:29:26 PM](#)

REPRESENTATIVE SEATON explained the figures for the 20 percent capital expenditure credit show that a significant amount of work goes on in the oil fields. He observed that the proposed additional credit would be almost twice as large for operating expenditures as for capital expenditures. Amendment 2 would incentivize the additional work that is being talked about. The current level of expenditures has been fully economic at 20 percent capital, he maintained, so Amendment 2 would stimulate the desired activity without expending money for those things that have been economic to date.

[2:31:05 PM](#)

CO-CHAIR JOHNSON said he does not think it is obvious that anything has been economic.

COMMISSIONER GALVIN recognized that the objective of Amendment 2 covers the earlier discussion with Representative Guttenberg about whether there is a mechanism that could parse out the work that would be done anyway from the work that would be incentivized. He said he thinks this is a difficult exercise to pursue or achieve, and creates complications and anomalies with regard to individual taxpayers that would be counter to the intent of the bill. From a structural standpoint, it creates a circular math equation that would need to be worked out in terms of averaging the 2008, 2009, and 2010 calendar years since the bill would become effective July 1, 2010.

REPRESENTATIVE SEATON moved Conceptual Amendment 1 to Amendment 2 to strike "and 2010" from lines 4 and 6 of the amendment. Thus, the average would be for the years 2008 and 2009. There being no objection, Conceptual Amendment 1 to Amendment 2 was passed.

[2:34:19 PM](#)

CO-CHAIR JOHNSON asked when a workover in 2008 would be planned and budgeted for.

COMMISSIONER GALVIN responded he does not know because it would be different for each company, although it would probably be shorter than the timeframe for exploration and new development.

REPRESENTATIVE SEATON reminded members that in previous testimony companies stated they continuously look at a number of projects to decide what is economic. Infield drilling projects do not have the same kind of reservoir risks and are the shortest terms, he opined, which is why the amendment does not include the year 2007, the year that ACES started.

[2:35:47 PM](#)

REPRESENTATIVE GUTTENBERG said Representative Seaton's point about 2007 is well taken. He asked whether taxpayers applying for this proposed credit would be able to go back and amend their tax returns to add work that was not eligible for the credit at that time.

COMMISSIONER GALVIN replied no, the additional credit is only available for expenditures that are incurred from July 1, 2010, forward.

[2:36:52 PM](#)

REPRESENTATIVE GUTTENBERG inquired whether that would still be the case if there is a two-year average under this amendment.

COMMISSIONER GALVIN explained that a difficulty in implementing Amendment 2 would be the new definition of well-related expenditures in HB 337, which cuts expenditures along a different line than current statute. By default, taxpayers would have to provide updated information to describe what they believe would qualify as a well-related expenditure in 2008 and 2009 because a significant portion of that will be operating expenditures that did not qualify for credit then and so would not have been quantified in that way in those tax years. To have something to compare it to on a go-forward basis, the taxpayers will have to give additional data for 2008 and 2009 to define what the well-related expenditures are for those years.

[2:38:51 PM](#)

REPRESENTATIVE SEATON said defining these credits for well-related expenditures does not mean the companies would receive credits for those, just that they must do the corollary of pulling out the capital and operating expenditures for 2008 and 2009.

COMMISSIONER GALVIN pointed out that taxpayers would be motivated to define 2008 and 2009 as extremely small investment years. They will want to define everything out of those years to make that number small since it is the difference between those years and 2010 forward that qualifies. That will put the Department of Revenue in the inverse of the standard deduction situation where the department will have to audit the 2008 and 2009 claims of well-related expenditures to try to say there are other costs the taxpayers did not claim that should have been included. Amendment 2 would thus be difficult administratively.

[2:41:30 PM](#)

CO-CHAIR NEUMAN presumed the July 1, 2010, effective date for Section 11, which is the section Amendment 2 deals with, would add another layer of complication.

COMMISSIONER GALVIN answered it would require the department to do a lot of interpreting through regulations or other means to understand what the intent would be.

CO-CHAIR JOHNSON said he cannot support Amendment 2 because of the additional work it would put on the Department of Revenue and because it is splitting hairs. He maintained his objection to Amendment 2.

[2:43:14 PM](#)

REPRESENTATIVE SEATON said Amendment 2, as amended, would mean that any additional well-related activities above a taxpayer's average expenditures in 2008 and 2009 would receive the additional enhanced tax credit. This way the state would not be giving additional credit for the same amount of work a taxpayer has been doing infield.

REPRESENTATIVE P. WILSON understood that if Amendment 2 passes, the state will be paying less than it would otherwise.

CO-CHAIR JOHNSON clarified the state is issuing credit and is not actually paying anything.

REPRESENTATIVE P. WILSON pointed out that that still results in less revenue to the state.

CO-CHAIR JOHNSON agreed.

A roll call vote was taken. Representatives Seaton, Guttenberg, Kawasaki, and Tuck voted in favor of Amendment 2, as amended. Representatives Olson, Edgmon, P. Wilson, Neuman, and Johnson voted against it. Therefore, Amendment 2, as amended, failed by a vote of 4-5.

[2:45:42 PM](#)

REPRESENTATIVE GUTTENBERG explained that the amendment he wishes to move is conceptual because it was for a different version of HB 337. He moved to adopt Conceptual Amendment 3, labeled 26-GH2057\A.1, Bullock, 3/29/10, written as follows [original punctuation provided]:

Page 1, line 2:
Delete ","
Insert "**and**"

Page 1, lines 3 - 4:
Delete "**, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax**"

Page 3, line 7:
Delete "**AS 43.55.025(f)** [AS 43.55.025(f)(2)]"
Insert "AS 43.55.025(f)(2)"

Page 3, line 9:
Delete "**AS 43.55.025(f)** [AS 43.55.025(f)(2)]"
Insert "AS 43.55.025(f)(2)"

Page 4, line 5, through page 9, line 5:
Delete all material.

Re-number the following bill sections accordingly.

Page 9, lines 11 - 25:
Delete all material.

Re-number the following bill sections accordingly.

Page 10, lines 2 - 6:
Delete all material.

Renumber the following bill sections accordingly.

Page 10, line 19:
Delete "Sections 4 - 12 of this Act take"
Insert "Section 5 of this Act takes"

Page 10, line 20:
Delete "sec. 17"
Insert "sec. 9"

REPRESENTATIVE GUTTENBERG said HB 337 would give credits for doing well-related work, which the state has never done before, and Conceptual Amendment 3 would eliminate the credit for all well-related work that is in the bill.

[2:47:37 PM](#)

REPRESENTATIVE P. WILSON objected and asked whether all the definitions would have to be changed.

REPRESENTATIVE GUTTENBERG stated that previous to HB 337, well credits did not exist. Conceptual Amendment 3 would take out the well-related credits in this bill, making things as they were before this bill. In further response, he confirmed the amendment would mean that HB 337 would not have any tax credits for well-related work.

CO-CHAIR JOHNSON said what is being talked about is infield drilling, which is the major purpose of HB 337. The intent of the bill is to increase production and jobs in the places where it is known that there is oil.

[2:48:54 PM](#)

CO-CHAIR NEUMAN understood that Conceptual Amendment 3 would remove any credits for the reworking of wells.

REPRESENTATIVE GUTTENBERG replied yes.

CO-CHAIR NEUMAN maintained there would have been a terrible impact on the amount of oil through the Trans-Alaska Pipeline System (TAPS) had many of the wells not been reworked to date. The ability of new technology to produce more oil from those wells is why they are being reworked; plus, it is much cheaper

to rework wells than to drill new ones. Producing more oil from existing wells creates jobs and more revenue, probably more revenue than the state's cost for the increase in credits. He said taking away the proposed incentive for reworking wells is inappropriate, so he cannot support the amendment.

[2:51:02 PM](#)

REPRESENTATIVE GUTTENBERG explained he is introducing Conceptual Amendment 3 because the purpose of HB 337 is to incentivize well rework using a new definition and a new credit, but there is no guarantee written into the bill that any rework, jobs, or increased production will happen. Since the first well was drilled at Prudhoe Bay, industry knew that after a certain period of time it would need to rework the wells because these things were defined in the development plans for Prudhoe Bay, Kuparuk, and elsewhere. When the state put out these leases many years ago, there was an expectation that this work would happen. Had Alaska exercised its sovereignty, the work would have been done at the start of the decline. Instead, industry was in harvest mode and uninterested. Now, industry is interested because it has to be; both industry and the state have a large vested interest in keeping the facilities pumping and oil moving through the pipeline. Industry did not undertake this work during the years of the economic limit factor (ELF) when there were no taxes. Now, taxes are moderate and industry is looking to erode them for work it would be doing anyway.

[2:54:40 PM](#)

REPRESENTATIVE GUTTENBERG continued, saying he would like to see industry do something new for the credits, but instead HB 337 would give credits for those things industry was already expected to do. The analysis of revenue is incomplete because the production increase is unknown. The bill would give away over \$1 billion, and possibly more, in the next four years. While the bill gives industry more money, it would not benefit the state because there is no guarantee of increased production or jobs. He said he would like to hear discussion on why it is thought that HB 337 will incentivize industry when past incentives have not resulted in the desired changes.

[2:57:06 PM](#)

CO-CHAIR NEUMAN commented that these things will only happen if it is economical. The state must create an environment that industry will thrive in or else industry will go elsewhere since

these are global companies. Almost 30 percent of all the jobs in Alaska are somehow connected to what is happening in Prudhoe Bay because the producers look to Alaska companies to do this work. The intent of HB 337 is to spur new jobs through new production and exploration, which has been lacking. He inquired how many people working in Prudhoe Bay are employed by [Alaskan] subcontractors.

COMMISSIONER GALVIN responded he does not have those numbers with him, although these numbers were looked at during earlier versions of the bill.

[2:59:29 PM](#)

CO-CHAIR NEUMAN said he is trying to ensure that most of the companies doing this rework are Alaskan. He asked whether the lack of new investment was the original intent of the bill.

COMMISSIONER GALVIN replied the intent of HB 337 is to target the state's tax incentives, in terms of reducing the tax burden on the taxpayer, to those that are actually doing the work and to ensure that it is tied to the amount of work the taxpayer does. The more investment, the more jobs created, the more tax benefit the taxpayer will receive.

[3:00:23 PM](#)

CO-CHAIR NEUMAN surmised this is based upon the department's internal information and is a strategic move within the administration after weighing the tax incentives and the value they would create for the state.

COMMISSIONER GALVIN answered the general reaction to the current tax structure was an increase in the total amount of expenditures, along with an increase in the number of jobs, although there has since been some level of decline. However, there was a decrease in the number of wells being drilled, so the department looked to a bill that would target this issue and that is why HB 337 increases the amount of credits available for well-related work. He said the department believes the overall tax structure still provides a very attractive investment climate for new development projects and exploration plays, but the department is trying to increase the incentivizing nature of the tax towards drilling more wells.

[3:02:03 PM](#)

CO-CHAIR JOHNSON inquired how much money would need to be invested to rebate \$1 billion.

COMMISSIONER GALVIN responded that dependent upon whether the expenditures are for operating or capital, between \$5 and \$10 billion in additional spending would generate a \$1 billion rebate for the additional credits that would result from HB 337.

REPRESENTATIVE GUTTENBERG, at the request of Co-Chair Johnson, withdrew Conceptual Amendment 3 so the committee could adjourn without any business before it. There was no objection to the amendment being withdrawn.

[HB 337 was held over.]

[3:04:05 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:04 p.m.