

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 21, 2012

1:07 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Paul Seaton, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Alan Dick  
Representative Neal Foster  
Representative Cathy Engstrom Munoz  
Representative Berta Gardner  
Representative Scott Kawasaki

**MEMBERS ABSENT**

Representative Bob Herron

**COMMITTEE CALENDAR**

HOUSE BILL NO. 360

"An Act enacting the Interstate Mining Compact and relating to the compact; relating to the Interstate Mining Commission; and providing for an effective date."

- MOVED HB 360 OUT OF COMMITTEE

HOUSE BILL NO. 365

"An Act relating to the rapid response to, and control of, aquatic invasive species."

- MOVED CSHB 365(RES) OUT OF COMMITTEE

OVERVIEW(S): OIL & GAS TAXES & CREDITS

- HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 360

SHORT TITLE: INTERSTATE MINING COMPACT & COMMISSION

SPONSOR(S): STATE AFFAIRS

02/24/12	(H)	READ THE FIRST TIME - REFERRALS
02/24/12	(H)	RES, FIN

03/19/12 (H) RES AT 1:00 PM BARNES 124  
03/19/12 (H) Heard & Held  
03/19/12 (H) MINUTE(RES)  
03/21/12 (H) RES AT 1:00 PM BARNES 124

BILL: HB 365

SHORT TITLE: AQUATIC INVASIVE SPECIES  
SPONSOR(S): RESOURCES

03/14/12 (H) READ THE FIRST TIME - REFERRALS  
03/14/12 (H) RES  
03/19/12 (H) RES AT 1:00 PM BARNES 124  
03/19/12 (H) Heard & Held  
03/19/12 (H) MINUTE(RES)  
03/21/12 (H) RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

CHARLES SWANTON, Director  
Division of Sport Fish  
Alaska Department of Fish & Game (ADF&G)  
Juneau, Alaska

**POSITION STATEMENT:** Answered questions related to HB 365.

BRUCE TANGEMAN, Deputy Commissioner  
Office of the Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint overview of Alaska's oil and gas tax and credit structure.

CHERYL NIENHUIS, Commercial Analyst  
Anchorage Office  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to the overview of Alaska's oil and gas tax and credit structure.

LENNIE DEES, Audit Master  
Production Audit Group  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to the overview of Alaska's oil and gas tax and credit structure.

JOHN LARSEN, Audit Master  
Production Audit Group  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to the overview of Alaska's oil and gas tax and credit structure.

JOHANNA BALES, Deputy Director  
Anchorage Office  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to the overview of Alaska's oil and gas tax and credit structure.

DAN STICKEL, Acting Chief Economist  
Anchorage Office  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to the overview of Alaska's oil and gas tax and credit structure.

#### **ACTION NARRATIVE**

[1:07:45 PM](#)

**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:07 p.m. Representatives Foster, Gardner, P. Wilson, Seaton, and Feige were present at the call to order. Representatives Dick, Munoz, and Kawasaki arrived as the meeting was in progress.

#### **HB 360-INTERSTATE MINING COMPACT & COMMISSION**

[1:08:02 PM](#)

CO-CHAIR FEIGE announced that the first order of business would be HOUSE BILL NO. 360, "An Act enacting the Interstate Mining Compact and relating to the compact; relating to the Interstate Mining Commission; and providing for an effective date."

CO-CHAIR SEATON reported that two constituents called him to say they supported HB 360. He thanked Co-Chair Feige for holding the bill until he could hear from constituents. He moved to

report HB 360 out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, HB 360 was reported from the House Resources Standing Committee.

### **HB 365-AQUATIC INVASIVE SPECIES**

[1:09:51 PM](#)

CO-CHAIR FEIGE announced that the next order of business would be HOUSE BILL NO. 365, "An Act relating to the rapid response to, and control of, aquatic invasive species." In response to Representative Gardner, Co-Chair Feige requested Mr. Swanton of the Alaska Department of Fish & Game (ADF&G) to address the status of the department's 2002 Alaska Aquatic Nuisance Species Management Plan.

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CHARLES SWANTON, Director, Division of Sport Fish, Alaska Department of Fish & Game (ADF&G), explained that ADF&G's 2002 Alaska Aquatic Nuisance Species Management Plan was primarily put together because such a plan was required under the National Invasive Species Act [of 1996] to receive federal funding for [invasive] species. The plan resulted in the state receiving approximately \$1.7 million in federal funds. Noting that the noxious weeds identified in the plan are under the purview of the Department of Natural Resources (DNR), he specified that ADF&G's primary focus has been on northern pike because that is the most pervasive issue ADF&G has had to deal with. He said the department has been reasonably successful at addressing northern pike - the most recent eradication efforts being in and around Yakutat, along with a fair amount of work on northern pike in and around the Anchorage area and the Kenai Peninsula. He added that the 2002 plan is fairly comprehensive and in some respects the authorities are well beyond what ADF&G has to implement; however, as a guiding document it allows ADF&G to focus its attentions, which the department has done.

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CO-CHAIR SEATON asked how the 2002 plan was implemented to address the *Didemnum vexillum* (D. vex) situation in Sitka's Whiting Harbor.

MR. SWANTON replied he is unsure about D. Vex in relation to the plan. He said the D. Vex issue was discovered in 2010 through a "bioblitz" conducted by a wide number of agencies. While the

2002 plan references a wide array of invasives, it does not identify D. vex or tunicates. The plan has offered ADF&G some guidance for addressing D. vex, but by and large that issue was relatively unique and has required time to focus on what needs to be done to move forward.

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REPRESENTATIVE P. WILSON noted it has been two years since the D. Vex was identified and voiced her hope that a plan has been put in place to ensure it does not spread. She said she would be very upset to find ADF&G has let it go and has no plans for the future.

MR. SWANTON responded ADF&G has systematically addressed the issue as best it can with the limited funding available. He said ADF&G has requested a capital project within the governor's budget specifically to Whiting Harbor and D. vex. That budget will allow ADF&G the necessary funds to eradicate the species and do some follow-up monitoring for several years after the eradication to ensure that all of it was eradicated.

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REPRESENTATIVE P. WILSON expressed her concern that D. Vex eradication was not been included in the operating budget and stated that it will take more than one-time funds since this invasive has not been eradicated and has dispersed over quite an area. Regarding the capital budget, she asked whether someone has informed the other body that this is an emergency and is not a one-time funding thing.

MR. SWANTON answered ADF&G has identified this as a priority on the capital side and the department has had discussions throughout the course of legislative hearings in terms of the department's budget. He presumed folks are aware of what ADF&G is trying to do with this capital project and the intent.

REPRESENTATIVE P. WILSON expressed her deep disappointment.

[1:17:58 PM](#)

CO-CHAIR SEATON stated that this discussion shows the importance of HB 365. He said D. vex is an invasive species that could be extremely damaging to the economy of mariculture and to all Southeast Alaska fisheries, yet the apparent authority was not there to do an emergency response. The right emphasis is not

being put on the extreme importance of failing to give priority to an invasion in a limited geographic area and HB 365 will provide this priority. He shared in Representative P. Wilson's deep disappointment about the response to the D. vex issue.

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CO-CHAIR FEIGE asked why this emergency was not included in the supplemental budget request. He said ADF&G is not jumping up to take care of what could be a pretty serious problem. The committee did not know there was a capital request, which tells that the issue has not received much emphasis; HB 365 will therefore send the department a message.

CO-CHAIR SEATON added that while the committee heard a presentation last year, that presentation was at the committee's request after it learned about the issue from Representative P. Wilson; the department did not come to the committee saying it had an emergency that needed to be addressed right away. He said the purpose of HB 365 is to tell ADF&G it needs to act.

REPRESENTATIVE P. WILSON pointed out that this D. vex issue was enough of an emergency that it went to a nationwide alert with involvement from the National Oceanic and Atmospheric Administration (NOAA), the Smithsonian Institute, and the University of Alaska. Many people knew how critical it was, yet ADF&G said it did not have the money and could not do anything. The state cannot let this happen because it could lead to the devastating result of quarantined harbors. The state must have something in place to provide direction so that a department cannot say it has no money and will therefore not do anything.

1:23:29 PM

REPRESENTATIVE KAWASAKI noted HB 360 was amended to cut out [freshwater aquatic species] so it now deals only with marine aquatic species. He inquired whether ADF&G would want this rapid response authority to address all aquatic species, if the department believes it does not already have this ability.

MR. SWANTON replied he thinks ADF&G's ability to respond rapidly has all to do with the circumstances surrounding the particular species, the area, and the threat to other resources and the economy. He said the revised fiscal note addresses the three marine species that ADF&G should be paying attention to and developing a plan for.

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REPRESENTATIVE KAWASAKI, noting that northern pike is one of the six [freshwater] species that would be excluded from the bill as amended, asked whether that means northern pike would not be identified as a priority invasive species.

MR. SWANTON responded that northern pike has been a priority in the freshwater aquatic environment through the department's planning exercise that took place in 2002 and the subsequent document. The department has had several successful eradication efforts around the state and will continue to use the resources it has sequestered for that particular instance.

[1:26:12 PM](#)

REPRESENTATIVE KAWASAKI pointed out that the bill deals with rapid response because the department felt it did not have the ability to rapidly respond to an invasive species. For example, flooding of the Salcha River near Fairbanks occurs regularly, sometimes spilling water into the Harding Lake tributary system. Given that ADF&G stocks Harding Lake with silver salmon and rainbow trout, he inquired whether the department would have the ability under HB 365, as amended, to respond rapidly if pike got into the Harding Lake area from one flooded season.

MR. SWANTON answered he believes ADF&G has the ability, especially along the road system, to address those issues fairly rapidly, as opposed to other areas of the state even in marine waters. Regarding the aforementioned Harding Lake scenario, he said he feels comfortable that ADF&G would have the ability to take care of those issues.

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REPRESENTATIVE MUNOZ asked what the current situation is in Whiting Harbor and whether there is evidence that D. Vex is still there or has been eradicated.

MR. SWANTON replied ADF&G has not undertaken eradication efforts, but has removed from the water the nets for oyster spatter that were the most contaminated and that were not on the sea floor. Some of the superstructure has been cleaned up, he continued, and most of the tunicate currently exists on the sea floor fairly prominently in the head of that bay. Mapping has been done and the invasive species coordinator has made in-roads as to what permits are going to be necessary in preparation of

hopefully receiving this capital project to conduct the eradication efforts, which will start in earnest as soon as the funding is available.

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CO-CHAIR FEIGE, regarding the fiscal note mentioned by Mr. Swanton, inquired what has changed in the current fiscal note as opposed to the original one.

MR. SWANTON responded ADF&G has removed three of the six species it was going to develop rapid response plans for. In essence, the original note has been carved in half because those rapid response plans would not be referenced. Should HB 365 pass and funding become available, ADF&G would develop rapid response plans for the invasive tunicate, European green crab, and Spartina cordgrass. In further response, Mr. Swanton said the revised amount would be \$430,000 for fiscal year 2013 and \$215,000 for fiscal year 2014 for finalization of those plans.

REPRESENTATIVE MUNOZ understood the fiscal note is to help ADF&G develop the plan and identify information around each of the species. She asked what the capital amount is for the eradication efforts.

MR. SWANTON answered that this fiscal note does not reflect any cost with implementing any plans if ADF&G does find any of these species for eradication. This fiscal note is solely to develop plans that would allow for the various agencies and interested parties to understand their roles in removing that threat.

[1:31:43 PM](#)

MR. SWANTON, in response to Co-Chair Feige, said the current capital request for eradicating D. vex in Whiting Harbor is \$500,000. In response to Co-Chair Seaton, Mr. Swanton said the mechanism for this eradication has yet to be determined. There has been some success within the literature, he continued, that suggests some sort of matting structure to cover the substrate and choke off the invasive. The department is planning to put it out for bid as soon as possible to a qualified contractor to conduct the eradication. In response to Representative Gardner, Mr. Swanton said ADF&G believes the matting will likely be the best approach and will take care of most of the eradication; the department is suggesting the contractor use other methods to clean up the other spots. The remainder of the money will be used for monitoring to ensure the invasive does not resurface.

[1:34:17 PM](#)

REPRESENTATIVE KAWASAKI, noting that D. vex is not included in ADF&G's 2002 Alaska Aquatic Nuisance Species Management Plan, asked whether the plan will be updated.

MR. SWANTON replied the 2002 plan is not a rapid response plan; rather, it is a broader perspective plan put together for purposes of securing federal funding for invasive species work. He said ADF&G has received about \$1.4-\$1.7 million in federal funding to implement elements of the plan, primarily focused on northern pike. He reiterated that he cannot speak to the noxious weeds elements in the plan [because that falls under the purview of the Department of Natural Resources].

REPRESENTATIVE KAWASAKI commented that page v of the 2002 plan's executive summary states that protocols shall be developed for early detection, rapid response to, control and management of new invasive species. Therefore, he said, some of this might be redundant and the fiscal note should reflect this.

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CO-CHAIR SEATON moved to report HB 365, as amended, out of committee with individual recommendations and the accompanying pending fiscal notes. There being no objection, CSHB 365(RES) was reported from committee.

CO-CHAIR FEIGE added that HB 365 is being reported from committee with the understanding to ADF&G that it has some work to do on the plan as well as the general approach to those things that threaten Alaska's economy and environment.

The committee took an at-ease from 1:37 p.m. to 1:39 p.m.

**OVERVIEW(S): Oil & Gas Taxes & Credits**

[1:39:45 PM](#)

CO-CHAIR FEIGE announced that the next order of business would be an overview of Alaska's oil and gas taxes and credits by the Department of Natural Resources (DNR). He said the overview is a refresher for committee members in anticipation of receiving a bill in this regard from the other body.

[1:40:38 PM](#)

BRUCE TANGEMAN, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), explained his presentation will be separated into two parts: a high level overview of the state's system and a review of the statutory language [slide 2]. He said reference documents prepared by the Tax Division include a one-page table of tax credits [dated 3/19/12 and entitled "Table of Tax Credits under AS 43.55 - The Alaska Oil and Gas Production Tax"] and an eight-page summary of tax credits under AS 43.55 [dated 1/17/12 and entitled "Summary of Tax Credits under AS 43.55 - The Alaska Oil and Gas Production Tax"].

MR. TANGEMAN pointed out that investors consider two parts of a tax system: simplicity and stability. However, he related, it has been stated by both the administration and companies that Alaska's Clear and Equitable Share (ACES) is definitely not simple; it is one of the more complicated tax structures in the world. Additionally, with the changes that have taken place since 2006, the stability has also come into question.

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MR. TANGEMAN explained there are four parts to the oil and gas revenue in Alaska [slide 4]. The production tax rate varies with the value of production after expenses are deducted. The royalty rates are generally a straight percentage assessed on most oil and gas production, based on lease terms, which are the contracts signed by the state and lessee. The corporate income tax is up to 9.4 percent of net profits of oil and gas production as apportioned to Alaska. The statewide property tax of 20 mills [or 2 percent] is assessed on the value of oil and gas property. He added that roughly 90 percent of Alaska's general fund revenue comes from these four sources.

MR. TANGEMAN said slide 5 is a table from page 4 of the executive summary of DOR's Revenue Sources Book and that details for this table can be found starting on page 25 of Chapter 4. He reported that the production tax is by far the biggest source of revenue. The total unrestricted revenue for 2011 was just under \$7.7 billion. The estimate for fiscal year 2012 is just under \$9 billion, and for fiscal year 2013, which is not shown on slide 5, the estimate is about \$8.2 billion. He pointed out that the Revenue Sources Book is a good document that addresses all the revenues in the state.

[1:45:46 PM](#)

REPRESENTATIVE FOSTER requested an explanation of the price per barrel of oil as well as the non-oil revenue shown on slide 5.

CHERYL NIENHUIS, Commercial Analyst, Anchorage Office, Tax Division, Department of Revenue (DOR), replied the average fiscal year price for fiscal year 2011 was \$94.49 per barrel and the number of barrels averaged for fiscal year 2011 was about 603,000 per day. Non-oil revenue includes the mining license tax, tobacco tax, charges for services, fines and forfeitures, licenses and permits, and rents and royalties. She advised that a detailed explanation of non-oil revenue sources can be found in Chapter 5 of the Revenue Sources Book.

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MR. TANGEMAN, resuming his presentation, said production tax is a tax on the producing or severing of a non-renewable resource - oil or gas - from the state (slide 6). Authorized under AS 43.55, it is administered by DOR and is applied to all production in the state, including three miles off-shore and federal on-shore acreage; however, production tax is not payable on state or federal royalty production. He explained that under the ACES tax system, the production tax value (PTV), otherwise known as the net amount, is the market price less transportation costs and allowable lease expenditures [slide 7]. While there are other net tax systems in the world, he noted, most of the Lower 48 states are based on a gross tax system. The base rate for ACES is 25 percent and there is a progressive surcharge rate of 0.4 percent for every dollar up to \$92.50 PTV. In response to Representative P. Wilson, he elaborated that the base rate of 25 percent is the kick-off point at \$30 PTV - for every dollar increase in oil price, the progressive surcharge rate kicks in at 0.4 percent per dollar and is continuous up to \$92.50 PTV. Unique with the ACES system is that as the price of oil goes up \$1, that new percentage is then applied to the entire amount, which is different from the governor's bill which had a bracketed system.

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REPRESENTATIVE P. WILSON surmised the surcharge would incentivize oil companies to keep their production lower so the tax rate would not be as high.

MR. TANGEMAN responded he does not think keeping oil production low is an incentive for anyone; this is price driven.

REPRESENTATIVE P. WILSON further surmised that a company could keep production low [in Alaska] and increase its production in other areas of the world.

MR. TANGEMAN answered that at these high oil prices, if a company reduced its production by a barrel it would still pay a lot of money on a lot of barrels given Alaska is flowing between 550,000-600,000 barrels a day. Therefore, he did not think reducing production is an incentive to either the producers or the state. The main goal for any private business is to generate revenue for its shareholders and at these high oil prices a company is incentivized to take advantage of the high prices. Because prices can go up and down drastically, he said he did not think a company's business plan would be to try to game the market such that it would reduce production when prices are high and increase production when prices are low.

CO-CHAIR SEATON interjected that built into the ACES system is the incentive to reduce a barrel of oil's production tax value by investment in Alaska. The investment cost lowers the tax on the entire value of the oil because the company can write the investment off as a cost in the initial year of the investment; thus, the investment is considered just like an expense.

MR. TANGEMAN concurred with Co-Chair Seaton.

[1:53:20 PM](#)

MR. TANGEMAN returned to his overview of ACES [slide 7], noting that there is also a tax credit system in place. He pointed out that ACES is a company specific tax - so the price is what it is, but the tax depends on a company's production and its investment capital expenses and operating expenses. Reviewing the basic calculation for the production tax owed [slide 8], he said the production tax value (PTV) is multiplied by the base tax rate of 25 percent to get the base tax. Added to this is the progressive surcharge rate of anything above that 25 percent \$30 kickoff. This arrives at the pre-credit tax bill. The tax credits are then deducted against the tax liability to arrive at the final tax bill of the total production taxes owed. He then moved to a brief explanation of each of the aforementioned sections of the production tax.

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MR. TANGEMAN said the four main components of the production tax calculation are production, price, lease expenditures, and tax credits [slide 9]. Moving to slide 10 he noted that the fiscal year 2011 production tax calculation shown on this slide can be found on pages 102-104 of DOR's Revenue Sources Book. The first calculation is determining the value of the total annual production: at the fiscal year 2011 average price of \$94.49 per barrel and an approximate production of 602,000 barrels a day, the total value per day comes to \$56.9 million and the total annual production is just under 220 million barrels; royalty and federal barrels are not included in the tax calculation, so these are subtracted to arrive at a total of about 190.5 million taxable barrels for a total annual value of just under \$18 billion. The net value at the point of production [production tax value (PTV)] is then calculated by deducting the expenditures from the gross value: per barrel transportation costs include \$2.45 for Alaska North Slope (ANS) marine transportation, \$4.02 for the Trans-Alaska Pipeline System (TAPS) tariff, and \$0.70 for other costs, for a total fiscal year transportation cost of \$7.17 per barrel; per barrel lease expenditures include an average of \$13.22 for operating expenditures and an average of \$8.52 for capital expenditures. The tax liability is then calculated from this PTV [of \$65.58 per barrel].

[1:57:53 PM](#)

CO-CHAIR SEATON inquired whether the [total lease expenditure] of \$21.74 [\$13.22 operating expenditures plus \$8.52 capital expenditures] is the actual average of Alaska's combined taxpayers.

MR. TANGEMAN replied this number is a snapshot for one look at the state so does not quite tell the whole story. He deferred to Ms. Nienhuis for further explanation.

CO-CHAIR SEATON related that ConocoPhillips Alaska, Inc. recently stated in a publication that its average cost for producing a barrel of oil in Alaska is \$15.48. He said he is therefore trying to see how the state's estimate squares with that of ConocoPhillips.

MS. NIENHUIS explained the deductions shown in the income statement are primarily the expenditures that would be allocated to companies that have a tax liability in the state; so expenditures that companies are making on currently nonproducing properties are excluded from this income statement. This was

done because DOR was asked to prepare this income statement to mirror as closely as possible the actual tax calculation; since those expenditures are not actually part of the tax calculation, the department excludes those. In regard to ConocoPhillips Alaska, Inc., Ms. Nienhuis said she was at that presentation and offered her belief that the company's chief economist was speaking about operating and transportation costs.

2:00:35 PM

CO-CHAIR SEATON inquired whether the independents/explorers were separated from the producers since Alaska's tax system is based on company-wide. He surmised that expenditures for currently nonproducing areas, such as Point Thomson, are excluded from the aforementioned calculations.

MS. NIENHUIS replied correct; expenditures for properties not currently producing are not included in this because there is not a tax liability calculated from that.

MR. TANGEMAN clarified that this is for taxpayers, so companies not having a tax liability would not be included.

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CO-CHAIR SEATON said he is confused because one very important aspect of Alaska's tax system as it was developed was that it would be on a company-wide basis so expenditures in nonproducing areas would be written off against a company's corporate production so as not to ring fence those. However, it seems that this calculation has ring fenced producing and nonproducing areas, an absolute juxtaposition of what was trying to be done in an effort to stimulate those investments.

MS. NIENHUIS responded that the basis for leaving those off is DOR was trying to make this calculate as close as possible to what the state actually receives in production tax. When a company has production on the North Slope and exploration expenditures, there is no ring fencing of those expenditures in this system. There are occasions where there is ring fencing that has to do with segments of the state; however, North Slope operations that are not contributing at all to the basis of calculating a company's tax are not included here unless they are somehow deducted from the company's tax liability. It is not necessarily just the explorers. There are companies developing fields that are still in the early initial phases of development and many of those companies are still not

experiencing a tax liability. So that is the reason DOR put this together in that way. The department has on request prepared tables showing all expenditures, she added. She further advised that the basic data table on page 31 of the fall 2011 Revenue Sources Book includes all of the expenditures. In further response to Co-Chair Seaton, Ms. Nienhuis confirmed that if the expenditures were experienced by a company that has a tax liability, then those expenditures would be included [in the calculations on slide 10].

[2:05:47 PM](#)

MR. TANGEMAN, resuming his overview, explained that the taxable value is derived via a netback calculation under AS 43.55.150 (slide 11). The destination value - ANS West Coast value - less marine transportation, less TAPS transportation, equals the gross value at the point of production (GVPP). Operating and capital lease expenditures [AS 43.55.165 - AS 43.55.170] are subtracted from the GVPP to arrive at the production tax value (PTV) [AS 43.55.160]. He noted that this is a different way of getting to the PTV line depicted on the chart on slide 10.

[2:06:31 PM](#)

MR. TANGEMAN next discussed Alaska's suite of tax credits available to both explorers and producers and which have generated quite a buzz from the new companies that are not yet producing but are hoping to be some day [slide 12]. He said the qualified capital expenditure credit provides a 20 percent credit for qualified capital expenditures; for well lease expenditures outside the North Slope it provides a 40 percent credit. The carried-forward annual loss credit is a 25 percent credit for carried-forward annual loss. The small producer/new area development credit provides up to \$12 million per year for small producers and up to \$6 million per year for production outside the North Slope and Cook Inlet. The alternative credit for exploration is 30 percent or 40 percent of eligible exploration expenditures if certain criteria are met, mainly having to do with new targets or distance from existing wells. The Cook Inlet jack-up rig credit is an 80-100 percent credit for the first three exploration wells drilled using a jack-up rig in Cook Inlet.

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MR. TANGEMAN explained that for the aforementioned credits the state can either purchase the tax credit certificate from

somebody without a tax liability or reduce tax revenue for a taxpayer with a tax liability [slide 13]. He noted that some people say ACES is working and some say not and said he thinks this has to do with where someone is at in the process of becoming a developer, explorer, or producer. As a new explorer incurs these costs it can turn in its tax credit certificate for cash; companies with a tax liability generally apply the certificate to their tax liability rather than taking cash. In both cases the state is an investor and shares the risk borne by the active investor. The ACES credit system aims to incentivize investment because the state bears some risk and reduces the cost to explorers and producers. Along with the net-based structure, tax credits make the state an investor in exploration and new development activities in the state.

[2:10:09 PM](#)

MR. TANGEMAN pointed out that DOR regulation 15 AAC 55.375 prescribes the order in which tax credits should be applied against a producer's tax liability, saying the order was derived to provide the maximum benefit of the credits. A taxpayer can choose to apply credits in a different order than under 15 AAC 55.375, he noted, in which case a separate schedule setting out the order of the credits must be submitted.

REPRESENTATIVE GARDNER asked under what circumstances a taxpayer would choose a different order.

LENNIE DEES, Audit Master, Production Audit Group, Tax Division, Department of Revenue (DOR), replied the reason for prescribing a particular order is to ensure that a taxpayer is able to take advantage of those credits that are not allowed to be converted to cash or that can only be used against the tax liability. If a taxpayer qualifies for a small producer credit or the new area development credit there is no benefit to applying credits in any other order because then the taxpayer would not get the benefit of those credits. The credits that are subject to refund or cash from the state could be used in that manner. He said he could think of no discernible reason for a taxpayer doing it in any other order than what is prescribed. In further response, Mr. Dees said that to his knowledge no one has chosen a different order.

[2:14:30 PM](#)

MR. TANGEMAN continued addressing tax credits, explaining the limits for which the application of certain tax credits cannot

exceed [slide 15]. Only 50 percent of a tax credit for which a transferable tax credit certificate has been received may be applied in a single year; this limitation includes the qualified capital expenditure credits under AS 43.55.023(a) but does not include AS 43.55.023(l), which is the 40 percent well lease expenditure credit. Another limit is that a holder of a transferable tax credit certificate may not use the credit to reduce the transferee's tax liability to less than 80 percent of the tax that would otherwise be due without applying the credit [AS 43.55.011(e)]. He related that the other body has discussed how the tax liability is calculated and then how additional tax credits might also affect a taxpayer. However, he pointed out, existing statutes provide that a credit cannot be used to create a negative PTV.

[2:16:16 PM](#)

CO-CHAIR SEATON inquired whether someone who has zero tax liability but who has expenses could fall into the loss carry forward that can be converted to credit at the 25 percent base rate. Rephrasing his question, he surmised someone could apply tax credits to get to a zero production tax value (PTV) and still have expenses, thereby creating a net loss carry forward situation that would then convert to credits at the 25 percent base tax level.

JOHN LARSEN, Audit Master, Tax Division-Production Audit Group, Department of Revenue (DOR), responded that if a company is at the point where its production tax liability has been determined and is applying the tax credits, then that would mean that all of the lease expenditures have already been accounted for. Therefore, in the situation described, no additional AS 43.55.023(b) carry forward loss credits would be available.

[2:17:51 PM](#)

CO-CHAIR SEATON asked whether expenses could, in a situation of zero tax liability, be carried forward into the next year for use against the tax liability in that next year.

MR. LARSEN answered that if lease expenditures exceed the production tax value, the lease expenditures cannot be carried forward into the next year. If a company's lease expenditures exceed its revenues, it can get an AS 43.55.023(b) credit from that. But at the point where a company's production tax value has been determined, then all of the company's lease expenditures have been accounted for. A company can apply the

credits that it has available against its production tax liability down to zero liability, but the production tax liability cannot be taken below zero.

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MR. TANGEMAN, returning to his presentation, stated that slide 16 depicts the order of applying credits. [The order from first to eleventh is: any credit under AS 43.55.024(a), any credit under AS 43.55.024(c), any credit under AS 43.55.019, any credit under AS 43.55.025, any credit under AS 43.55.023(i), any credit under AS 43.55.023(a), any credit under AS 43.55.023(l), any credit under AS 43.55.023(b), any credit under AS 41.09.010, any credit under AS 38.05.180(i), any credit under AS 43.55.023(e).]

[2:21:14 PM](#)

MR. TANGEMAN said another source of state revenue is royalties [slide 17]. He specified that, currently, almost all oil and gas production in Alaska comes from state lands leased for exploration and development. Leases issued by the Department of Natural Resources (DNR) are legal contracts and cannot be altered or amended without the consent of all parties to the contract. As an aside he noted that in the recent past it has been suggested that royalty rates be reduced to make something economic instead of the production tax. He allowed that is a knob that can be turned, but pointed out that royalties are what feed the permanent fund. If royalty rates are reduced the amount coming into the state may increase, but the amount going into the permanent fund is decreased. Continuing his overview, he said that as the landowner the state earns revenue from leases as upfront bonuses, annual rent, and royalty interest in oil and gas production.

[2:22:47 PM](#)

REPRESENTATIVE GARDNER, in regard to the option for applying for a waiver or reduction on [royalty] by a company, asked whether the state compares other tax regimes or looks just at Alaska to determine whether something is or is not economic.

MR. TANGEMAN replied that royalty rates and royalty relief are issues for the Department of Natural Resources to address.

[2:24:09 PM](#)

REPRESENTATIVE P. WILSON inquired what percentage of the royalties goes into the permanent fund.

MS. NIENHUIS responded it is currently 25 percent on certain leases, although some leases were written during a time period when the rate was at 50 percent; therefore, the current combined rate is about 35 percent. In further response, she said she did not know how many leases are still at the 50 percent rate, but that there are leases let in the early 1970s to which the 50 percent still applies. She said she will get back to the committee on the number of leases at 50 percent.

[2:26:18 PM](#)

MR. TANGEMAN resumed his overview, noting that typically state leases are issued based on a competitive bonus bid system [slide 18]. He said the state generally retains a royalty interest of 12.5 percent, although some leases carry rates as high as 27 percent and some leases also have a net profit-share production agreement. Currently the vast majority of production comes from leases where the state retains a 12.5 percent royalty interest.

REPRESENTATIVE P. WILSON inquired where, in addition to the permanent fund, the royalty interest goes within the state.

MS. NIENHUIS replied the 12.5 percent is the amount of total royalty collected from those leases that have a royalty at that rate. The state takes a percentage of that 12.5 percent and it is a combined percentage of around 30-31 percent of that 12.5 percent that goes to the permanent fund.

MR. TANGEMAN clarified that the 12.5 percent is the oil that Alaska can take in-kind or in cash, and that is the part that is divvied up between the different funds.

[2:28:08 PM](#)

REPRESENTATIVE MUNOZ asked why some leases carry a higher royalty rate than 12.5 percent.

MR. TANGEMAN responded this is a question for DNR.

CO-CHAIR FEIGE said that was the royalty rate negotiated at the time the lease agreements were established. For example, the rate is about 16 percent for a recent discovery by Brooks Range Petroleum Corporation. The state was able to negotiate a higher royalty for this area because the ground was more prospective.

In further response, he confirmed that the royalty rate is negotiable and the 12.5 percent is not set in statute.

CO-CHAIR SEATON believed some of the aforementioned was a component of bonus bids.

[2:29:36 PM](#)

MR. TANGEMAN, continuing his overview, addressed the petroleum corporate income tax (slide 19). He said "an oil and gas company's corporate income tax liability in Alaska depends on the relative size of its Alaska and worldwide activities and the corporation's total worldwide net earnings. The company's taxable income in Alaska is derived by apportioning its worldwide taxable income to the state based on three factors as they pertain to the corporation's Alaska operations: 1) tariffs and sales; 2) oil and gas production; and 3) oil and gas property."

MR. TANGEMAN moved to slide 20, specifying that "similar to the production tax, corporate income tax collections vary greatly along with oil prices and oil industry profits. In fiscal year 1994, the oil and gas corporate income tax generated approximately \$17.8 million. For the past several years, revenues from the oil and gas corporate income tax have benefitted from high oil prices and high oil industry profits. In fiscal year 2010, revenue collections from this tax totaled \$446 million; in [fiscal year 2011] it was \$542 million." He added that according to DOR's Revenue Sources Book, fiscal year 2012 revenue is estimated at \$662 million and fiscal year 2013 revenue is estimated at \$728 million.

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MR. TANGEMAN next reviewed the petroleum property tax, noting that it is the only statewide property tax (slide 21). He said this tax is annually levied on the full and true value of property taxable under AS 43.56. Three classes of property are valued and taxed for property tax purposes: exploration property, production property, and pipeline transportation property. He said pages 41-42 of the Revenue Sources Book provide more detail on this tax.

REPRESENTATIVE MUNOZ inquired whether lands in the North Slope region are also taxable at the borough level.

JOHANNA BALES, Deputy Director, Anchorage Office, Tax Division, Department of Revenue (DOR), replied that the municipalities where the property is located can levy a tax. This tax is then credited against the state tax so the companies only pay tax one time on that property.

CO-CHAIR FEIGE noted the municipality that levies its own tax cannot levy that tax rate just on those oil-related properties; the municipality must levy that tax rate on all the property owners within the municipality. In response to Representative P. Wilson, he confirmed that a company would deduct the amount of property tax paid to a municipality from the amount of property tax that it owed to the state.

[2:33:26 PM](#)

MR. TANGEMAN, resuming his overview, directed attention to the graph on slide 22 depicting the absolute profit split under Alaska's Clear and Equitable Share (ACES). He pointed out that at higher oil prices the state's take increases significantly more than does the take by the producer; in other words, the upper end is taken away by the state. He said slide 23 depicts the share of profit under the current ACES tax system.

[2:34:52 PM](#)

MR. TANGEMAN next reviewed the statutes for Alaska's oil and gas tax structure in an effort to provide members with an idea of the enormity of what is considered under the state's tax system (slides 25-56). He said that under AS 43.55.011(e), all state, federal, and private lands within the state are subject to oil and gas production tax [slide 25]. Regarding tax on royalties, he explained that royalties from private land within the state are taxed at a reduced rate under AS 43.55.011(i) and that no tax is levied on royalties from state or federal production [slide 27]. He reminded members that for a company's income statement the total barrels minus the royalty barrels equals the gross value at the point of production, which is the starting point for deductions.

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CO-CHAIR SEATON noted that Alaska's congressional delegation is seeking a split with the federal government on outer continental shelf (OCS) lands. He inquired whether the aforementioned calculation would be made on OCS lands should the delegation be successful.

MR. LARSEN responded the state would not receive any share of OCS production. Regarding production from other federal lands, he asked whether Co-Chair Seaton is referring to revenue sharing as it is done for some offshore locations in the Gulf of Mexico.

MR. TANGEMAN interjected that the revenue sharing to Alaska is currently next to nothing, if anything at all, and the congressional delegation is working on that. He believed that the revenue sharing in the Gulf of Mexico was increased to 37 percent. He asked Mr. Larsen whether that revenue sharing would be applied to the OCS should Alaska's congressional delegation be successful.

MR. LARSEN answered that if the delegation succeeded in increasing the royalty share going to the state, the state would get that revenue; however, he did not think that would be taxable because that is not land within the state. In further response to Mr. Tangeman, he understood it would just be addressed through the royalties, not the production.

[2:39:04 PM](#)

CO-CHAIR FEIGE inquired as to what properties the royalty tax under AS 43.55.011(i) would apply to.

MR. LARSEN replied private lands would be lands held by any individual or corporation that is not the state or federal government. In further response, he confirmed that Native regional corporation land would be private land. By and large, he continued, the State of Alaska owns almost all of the subsurface rights in Alaska except for certain lands that are held by either private individuals or companies. For example, a private landowner putting a well in his or her backyard would not have the subsurface rights to any production from that well if the state owned the minerals under that land. He allowed, however, that under the Homestead Act there may be some homesteaders who own the subsurface rights.

MR. LARSEN, in response to Co-Chair Seaton, said he will get back to the committee regarding whether mental health lands are categorized as private or state land.

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REPRESENTATIVE P. WILSON asked why Alaska does not have the same opportunity as in the Gulf of Mexico.

MR. LARSEN understood that originally the Gulf of Mexico was considered outside of state lands for Louisiana and other gulf states; however, the delegations for those states successfully argued that those states should receive a greater share of the offshore revenues. He offered his belief that this greater share of royalties is for dealing with the impact of staging operations, which is what the Alaska delegation is working on right now as well.

[2:43:04 PM](#)

MR. TANGEMAN, returning to his overview, said the minimum tax applies only to oil and gas production north of 68 degrees north latitude, which is the North Slope, except for royalty production and gas used in-state (slide 29). He said the minimum tax is based on the average price for Alaska North Slope (ANS) crude on the U.S. West Coast, which uses several reported prices [Platt's, Reuters, and Dow Jones monthly average]. He added that this is a "soft" floor, meaning a company can use tax credits to get below the minimum tax. In response to Co-Chair Feige, he confirmed that going below the minimum tax floor is not currently a concern given today's [high] oil prices.

MR. TANGEMAN explained that AS 43.55.160 is the progressivity statute, which is what he has been talking about throughout this presentation (slide 31). He said the 25 percent rate kicks off at \$30 per barrel production tax value (PTV), climbs at 0.4 percent for every \$1 increase in PTV up to \$92.50, at which time it decreases to 0.1 percent for each \$1 [increase] in PTV. The maximum progressivity tax is up to 50 percent of PTV; combined with the 25 percent base tax, this means tax is capped at 75 percent [before application of credits]. Progressivity is based on the British Thermal Unit (BTU) per barrel - for oil one barrel equals one barrel and for gas it is the amount of gas that has a heating value of 6 million BTUs (side 32).

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CO-CHAIR FEIGE requested an explanation of the relationship between 6 million BTUs of gas and a barrel of oil and asked why this was done.

MR. LARSEN responded that the definition for the 6 million BTUs is under AS 43.55.903. He offered his belief that it is a rough approximation of the number of million cubic feet (MCF) that it takes to equate to a barrel of oil for the heating value of the

gas. In further response, he said 6 million BTUs is the rough equivalent of one barrel [of oil] and confirmed that 1 million BTUs is about 1 MCF of gas.

CO-CHAIR FEIGE noted the current Henry Hub price for gas is a little over \$2 per MCF and calculated that 6 million BTUs would go for roughly \$13 if it is gas and about \$120 if it is oil.

MR. TANGEMAN concurred.

MR. LARSEN also concurred.

REPRESENTATIVE GARDNER inquired whether wet gas and dry gas have different BTUs and if so whether they sell for different prices.

MR. TANGEMAN deferred to the Department of Natural Resources for an answer.

[2:47:41 PM](#)

CO-CHAIR FEIGE said his point is that the \$13 is for the same amount of energy that is \$120. Given Alaska's tax system is based on the BTU equivalent, he asked what would happen if the state started to export a considerable amount of gas.

DAN STICKEL, Acting Chief Economist, Anchorage Office, Tax Division, Department of Revenue (DOR), answered that this gets to the dilution effect in regard to progressivity. The progressive surcharge applied to the oil produced on the North Slope is based on a statewide progressivity rate that is calculated using all oil and gas produced in the state. In a situation where gas is relatively low valued and oil relatively high valued, a major gas sale would decrease the progressivity surcharge on the oil, which, under today's prices, could result in the state taking in less revenue with a gas sale than without it.

[2:49:10 PM](#)

CO-CHAIR FEIGE inquired what would happen to the State of Alaska's revenue with a [gas] pipeline like the one planned to go to Valdez of roughly three billion cubic feet per day.

MR. STICKEL replied the revenue impact would be highly dependent on the price of oil and the price of gas when the sale took place. He said DOR has run a range of scenarios showing different possible prices and the revenue impact could be

positive or negative to the state depending on the prices of the oil and gas.

CO-CHAIR FEIGE asked what the impact to the state would be at today's prices.

MR. STICKEL responded that no modeling has been done specific for a pipeline to Valdez; the modeling done to date typically assumes an export pipeline through Alberta. He offered to run some scenarios for a pipeline to Valdez. In further response, he said that at today's prices and a 4.5 billion [cubic foot per day] pipeline to Alberta, the state would take in about \$1.8 billion less with a coupled tax system versus a non-coupled tax system.

[2:51:31 PM](#)

CO-CHAIR FEIGE, in response to Representative Foster, said 1 MCF of gas is equal to 1 million BTUs and confirmed that 6 MCF is 6 million BTUs; so at just over \$2 per MCF, multiplying 1 MCF by 6 equals \$13.

[2:52:18 PM](#)

REPRESENTATIVE MUNOZ returned to slide 22, observing that at a price of \$115 [per barrel] (roughly today's price), the State of Alaska's share is \$9.93 billion, which includes the production, royalty, property, and corporate taxes; the federal share is \$2.69 billion, and the company share is \$4.99. She asked whether this same graph has been run for HB 110 and [SB 192].

MR. TANGEMAN confirmed DOR has done so. In further response, he agreed to provide the graphs for HB 110 and [SB 192].

[2:54:09 PM](#)

MR. TANGEMAN returned to his review of the progressivity calculation, noting it is a several-step process to calculate the monthly payment for all leases or property segments (slides 33-35). Step 1 enters the gross value at the point of production (GVPP). Step 2 enters one-twelfth of the annual lease expenditures for the year. Step 3 subtracts the lease expenditures from the GVPP to determine if the gross production tax value (PTV) is greater than zero. Step 4 enters the amount of BTU equivalent barrels for taxable production of oil and gas. In Step 5, if the production tax value in Step 3 is greater than 0, the gross PTV is divided by the total amount of taxable BTU

equivalent barrels [Step 4] to derive a per barrel production tax value. Step 6 determines the percent of taxable volume on BTU equivalent barrels by dividing the amount of BTU equivalent barrels in Step 4 for each lease or property by total amount of BTU equivalent barrels for a producer for all taxable barrels produced in all areas of the state. He pointed out that both the state and each taxpayer has an army of auditors responsible for making sure these calculations are correct. He further pointed out under North Dakota's gross tax system it is a certain percentage above \$60 per barrel and below \$60 per barrel it is a different percentage and only one person does the calculations for North Dakota's taxes as compared to Alaska's 30 or 40 people.

[2:57:22 PM](#)

CO-CHAIR FEIGE announced that Mr. Tangeman's overview would be continued at the committee's next meeting. He encouraged members to review the rest of the presentation in the meantime.

REPRESENTATIVE P. WILSON, regarding the 3/19/12 Table of Tax Credits under AS 43.55 in the committee packet, observed that three sets of credits still have no regulations written and asked why.

MR. TANGEMAN answered it is an ongoing process and said he believes DOR has implemented over 80 regulations since ACES was put into effect. The department has had to staff-up over the last four or five years; additionally, the department must hold workshops to implement each regulation. He assured that if any credits have not been addressed, they will be.

REPRESENTATIVE P. WILSON inquired whether DOR needs more people to get this done.

MR. TANGEMAN said he believes DOR has a handle on this and no new staff is needed. As new changes are made, he continued, new regulations are required, but the biggest lift was getting from gross to net under the petroleum production profits tax (PPT) and then the additional changes under ACES, which is where the bulk of those 80 regulations are.

[3:00:05 PM](#)

**ADJOURNMENT**

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