

SENATE FINANCE COMMITTEE  
February 10, 2011  
9:02 a.m.

[9:02:40 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 a.m

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Lesil McGuire, Vice-Chair  
Senator Johnny Ellis  
Senator Dennis Egan  
Senator Donny Olson  
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Bruce Tangeman, Deputy Commissioner, Department of Revenue;  
Lennie Dees, Audit Master, Tax Division, Department of Revenue.

SUMMARY

^Presentation on Oil and Gas Tax Credits by the Department of Revenue

[9:03:13 AM](#)

Co-Chair Stedman discussed the agenda for the morning. He explained that today's meeting was a continuation of last week's January 25th meeting. He noted that the same presentation would be delivered again for the House Finance Committee.

[9:06:12 AM](#)

BRUCE TANGEMAN, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE introduced himself.

LENNIE DEES, AUDIT MASTER, TAX DIVISION, DEPARTMENT OF REVENUE, explained his background in accounting and with the Department of Revenue (DOR). He explained that the master audit position was created with the (ACES) laws.

[9:09:59 AM](#)

Mr. Dees introduced the PowerPoint presentation "Production Tax Credits" (copy on file).

Mr. Dees continued with Slide 3: "Types of Production Tax Credits,"

Credits which may be taken against oil and gas production taxes include:

- Capital Expenditure Credits
- Alternative Tax Credits for Oil and Gas Exploration
- Net Operating Loss ("NOL") Carry Forward Credits
- Transitional Investment Expenditure ("TIE") Credit
- Additional Nontransferable Tax Credits
- Well Lease Expenditures Credit
- Cook Inlet Jack-up Rig Credit

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Mr. Dees introduced Slide 4: "Timelines for Production Tax Credits." He described the graph and its various components regarding the credits timelines.

Co-Chair Stedman asked for details regarding the various credits. Mr. Dees explained that the first credit listed 43.55.023(a) was for Qualified Capital Expenditures (QCE). He added that 43.55.023(b) the Net Operating Loss (NOL) Carry Forward Credit (CFAL) occurs when a company occurs a net operating loss (a company's expenditures exceed the amount of revenue) employing a formula using the revenue from the oil and deducting the incurred lease expenditures. The section allows the company to take the net operating loss and convert it to a credit for a future tax liability. The credit was updated under ACES to a 25 percent credit.

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Mr. Dees introduced the Well Lease Expenditure credit or 43.55.023(1), which was fairly new with little activity. The credit provides companies a 40 percent credit for expenditures related to intangible drilling costs associated with the drilling of wells. The credit's inception was last year. The credit is only available in areas south of 68 degrees north latitude.

Mr. Dees detailed the Transitional Investment Expenditure (TIE) credit 43.55.023(i), which under the Petroleum Production Tax (PPT) allowed a credit for expenditures incurred between April 1, 2001 and May 31, 2006. The credit was altered during ACES and was no longer available to existing tax payers.

[9:17:00 AM](#)

Mr. Dees discussed the non-transferable tax credits, (43.55.024). The \$6 million credit is used against tax liability and cannot be converted to cash or carried forward.

Mr. Dees addressed the Small Producer Credit, 43.55.024(c). The credit is granted based on the company's production. The credit can only be used to offset tax liability and cannot be carried forward or turned into a cash certificate. The credit expires in 2016; however, some circumstances permit extension.

Mr. Dees discussed 43.55025 or the alternative credit for oil and gas exploration. He noted that the credit originated in 2003 for companies drilling exploratory wells and performing seismic work. One requirement was that the work occurred at a certain distance from an existing unit or well. Initially the credit was either 20 to 40 percent, but has since been revised to 30 and 40 percent through ACES. The credit is referred to as the exploration credit.

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Mr. Dees finished with the Cook Inlet Jack-up Rig Credit which will grant the first three unaffiliated persons using a jack-up rig in the Cook Inlet and targeting a specific zone, up to 100 percent of the first \$25 million of exploration expenditures. If the company using the credit has a successful well, then 50 percent of the credit will be paid to the state over a period of 10 years.

Co-Chair Stedman commented that the FY12 budget proposes a total of \$850 million in tax credits. He highlighted the magnitude of the issue.

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Mr. Dees discussed Slide 5: "Types of Production Tax Credits,"

Capital Expenditure Credits - (AS 43.55.023(a)(1))

- ❑ 20% of qualified capital expenditures (QCE)
- ❑ QCE include drilling, construction of facilities, new equipment, etc.
- ❑ Same expenditures may also qualify for NOL Carry Forward Credit
- ❑ Same expenditures do *not* qualify for exploration credit
- ❑ Must be spread over 2 years (except for expenditures incurred south of 68 degrees North latitude - effective July 1, 2010)
- ❑ Credits may be cashed or transferred

Mr. Dees discussed Slide 6: "Types of Production Tax Credits,"

Exploration Credits

- ❑ Two Main Types
  - Capital Credit for Exploration Activity 43.55.023(a)(2) (20%)
  - Alternative Tax Credits for Oil and Gas Exploration 43.55.025 (30%-40%)

Mr. Dees informed about Slide 7: "Types of Production Tax Credits,"

Capital Credit for Exploration Activity  
43.55.023(a)(2)

- ❑ 20% of qualifying expenditures
- ❑ Qualifying expenditures related to geologic and geophysical exploration, or in connection with an exploration well
- ❑ Must be spread across 2 years (except for expenditures incurred south of 68 degrees North latitude - effective July 1, 2010)
- ❑ Same expenditures may also qualify for NOL Carry Forward Credits

- ☐ Credits may be cashed or transferred

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Mr. Dees explained Slide 8: "Types of Production Tax Credits,"

Exploration Credits

- ☐ Two Main Types
  - Capital Credit for Exploration Activity under 43.55.023(a)(2) (20%)
  - Alternative Tax Credits for Oil and Gas Exploration under 43.55.025 (30%-40%)

Mr. Dees described Slide 9: "Types of Production Tax Credits,"

Alternative Tax Credits for Oil and Gas Exploration - 43.55.025

- ☐ 30% - 40% of qualified expenditures depending on well location and proximity to existing wells and unit boundaries
- ☐ Qualified expenditures include certain expenses associated with seismic and geophysical exploration work, and exploration well drilling
- ☐ Same expenditures may also qualify for NOL Carry Forward Credit
- ☐ Same expenditures do *not* qualify for Capital Expenditure Credit
- ☐ To receive credit, taxpayer must provide certain well data to DNR
- ☐ Expires 2016
- ☐ Credits may be cashed or transferred

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Mr. Dees discussed Slide 10: "Types of Production Tax Credits,"

NOL Carry Forward Credit - 43.55.023(b)

- ☐ 25% of net operating loss
- ☐ Applied against tax liability in following year

- ❑ Credit based on adjusted lease expenditures which include both operating and capital expenses
- ❑ Includes capital expenditures which also qualify for qualified capital expenditure credit under 43.55.023(a)(1) and exploration credit under 43.55.023(a)(2)
- ❑ Credits may be cashed or transferred

Mr. Dees described Slide 11: "Types of Production Tax Credits,"

Transitional Investment Expenditure (TIE) Credits  
43.55.023(i)

- ❑ Credit equals 20% of qualifying capital expenditures:
  - incurred between March 31, 2001 and April 1, 2006, and
  - not exceeding 10% of the capital expenditures incurred between March 31, 2006 and January 1, 2008.
- ❑ Revised under Aces to cover only producer or explorer not having production prior to January 1, 2008
- ❑ Credits are *not* transferable and may *not* be carried forward beyond 2013
- ❑ Same capital expenditures may *not* qualify for exploration credit under 43.55.025

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Mr. Dees detailed Slide 12: "Types of Production Tax Credits,"

Additional Nontransferable Tax Credit- 43.55.024(a)

- ❑ Referred to as "New Area Development" credit
- ❑ Up to \$6 million
- ❑ Available for companies producing from leases or properties outside of Cook Inlet and North Slope
- ❑ Credit can only be applied against tax liability
- ❑ Expires 2016 or 9 years after first commercial oil or gas production if before May 1, 2016
- ❑ Credits may *not* be cashed or transferred or carried forward

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Mr. Dees discussed Slide 13: "Types of Production Tax Credits,"

Small Producer Credit - 43.55.024(c)

- ❑ Available for companies producing less than 100,000 bbl/day of oil BTU-equivalent
- ❑ Up to \$12 million, depending upon level of production
- ❑ Production not restricted by region
- ❑ Credit can only be applied against tax liability
- ❑ Expires 2016 or 9 years after first commercial oil or gas production if before May 1, 2016
- ❑ Credits may *not* be cashed or transferred or carried forward

Mr. Dees discussed Slide 14: "Types of Production Tax Credits,"

Well Lease Expenditure Credit - 43.55.023(1)

- ❑ 40% of well lease expenditures incurred in the state south of 68 degrees north latitude
- ❑ Must be intangible drilling costs or geological / geophysical exploration
- ❑ Credit may be applied against tax liability, or certificated and cashed or transferred to another taxpayer

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Mr. Dees discussed Slide 15: "Types of Production Tax Credits,"

Cook Inlet Jack-Up Rig Credit - 43.55.025(1)

- ❑ Credit of 100%/90%/80% of up to \$25 million each of exploration expenditures for first 3 unaffiliated persons drilling wells using the same jack up rig penetrating and evaluating prospects in the pre-Tertiary zone.
- ❑ Taxpayer obtaining credit may not claim .023 credit for same expenditures

- 50% of credit to be repaid over 10 year period if well yields sustained production

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Co-Chair Hoffman asked if the 50 percent repayment in the Cook Inlet jack-up rig credit is the only repayment received by the state. Mr. Dees concurred.

Mr. Dees discussed Slide 17: "Credits Applied Against Production Tax Liability,"

Credits may be redeemed in two ways:

(1) All Credits may be applied against production tax liability

- Capital Expenditure and Capital Exploration Credits split over two years (except south of 68 degree North latitude - eff. July 1, 2010)
- NOL, TIE, Small Producer and Alternative Tax Credits for Oil and Gas Exploration may all be applied against tax liability in total in a single year

(2) Some Credits may be converted into a transferable Tax Credit Certificate

- Capital Expenditure, Capital Exploration, NOL, and Alternative Tax Credits for Oil and Gas Exploration are convertible to tax certificates
- Capital Expenditure, Capital Exploration and NOL Tax Credit Certificates must be applied over two years (except south of 68 degrees North latitude - passed 2010)
- Alternative Tax Credits for Oil and Gas Exploration Certificates can be used in single year

Mr. Dees detailed the figures on Slide 18: "Production Tax Credits Applied Against Tax Liability (Fiscal Year)." He explained that companies with sufficient production and revenue to contribute tax revenue for the state offset the payments. Credits are taken before the tax payments hit the treasury. He encouraged the tracking as a benefit.

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Co-Chair Stedman explained that the budget summaries do not readily exhibit the credits. He expressed concern regarding the communication and education for existing legislators.

Mr. Dees pointed out that the majority of the credits applied against tax liabilities fall into QCE, which are based on the level of capital expenditure dollars incurred

by taxpayers. He explained the timeframe for the credits incurred as exhibited by the table on Slide 18.

Co-Chair Hoffman asked if extrapolation for 2011 exhibits the highest year for credits. He wondered if a correlation with exploration exists. Mr. Dees clarified that capital spending is the basis for the figures. Mr. Tangeman added that true figures for the capital will not be known until an audit is completed.

Co-Chair Hoffman asked if 2011 is estimated to be the highest fiscal year for tax credits. Mr. Dees replied yes, based on the forecasted data.

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Mr. Dees continued with Slide 19 "Production Tax Credits Applied Against Tax Liability (Fiscal Year). The bar graph represents the figures presented in Slide 18.

Senator Thomas asked if the transitional credits exist now for those producers or explorers without production prior to January 1, 2008. He wondered if the production for Nikiachuk would emerge in this information. Mr. Dees replied that a capital expenditure between the period of April 1, 2001 and March 31, 2006 would qualify.

Co-Chair Hoffman asked if the largest portion of QCE credits will not expire until 2017. Mr. Dees stated that the QCE credits do not expire. The only credits that expire are the 43.55.024 and 43.55.025 credits.

Co-Chair Hoffman asked if the QCE credits are available indefinitely.

Co-Chair Stedman added that the tables address dollars in the millions.

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Mr. Dees discussed Slide 21: "Timeline for processing of Transferable Credit under AS 43.55.023(a). He explained that the first bar in the graph illustrates the taxpayer incurred expenditures. A company can apply for a credit on a quarterly or annual basis. The department has a 120 day time line for processing the claim. Once an application is processed and the credit certificate is administered, additional expenditures must be incurred prior to resale. The processing of applications is ongoing for DOR.

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Mr. Dees explained Slide 22: "Timeline for processing a Transferable Tax Credit Certificate under AS 43.55.023(b)."

He explained that the graph illustrated months in the timeline.

Mr. Dees described Slide 23: "Timeline for Application for AS 43.55.025 Alternative Credit for Oil and Gas Exploration." He explained that the company must apply for the credit within six months of completion of the drilling or seismic activity. The graph estimates a nine month drilling season. The company then has six months to apply for the credit. The department audits the application for an exploration and then issues a certificate. An audit can take a year or more to complete. The credit is the only one requiring a full audit prior to the issuance of a certificate. When a company applies for the credit with a tax liability, they may choose to apply it to the tax liability and potentially owe the state money following the audit.

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Mr. Dees described Slide 24: "Transferable Tax Credit Certificates,"

Companies may also claim tax credits by applying for a Transferable Tax Credit Certificate (TTCC)

- ❑ Available to companies (explorers) with no tax liability to which credits can be applied
- ❑ Tax Credit Certificates under 43.55.023(a) and (b) must be split or applied over two years (except credits issued for expenditures incurred south of 68 degrees North latitude effective July 1, 2010)
- ❑ May be transferred to another taxpayer or cashed with the state

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Mr. Dees discussed Slide 25: "Production Tax Credits Under AS 43.55 Claimed by FY (\$M). He explained that the companies have no tax liability and apply for the certificates to either convert them into cash or sell them to other companies. The "Pre-2007" column includes the exploration credits which occurred prior to PPT in 2003. He explained that the department has received requests for \$1.2 billion worth of transferable tax credit certificates.

Co-Chair Stedman asked about Slide 18's total of approximately \$1.9 billion. He asked if the total impact includes a combination of the \$1.9 and the \$1.2 billion. Mr. Dees replied yes, although the \$1.2 billion listed in Slide 25 illustrates the amount requested, not granted.

Co-Chair Hoffman asked if the state has \$3 billion worth of "skin in the game" since inception.

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Mr. Dees illustrated Slide 26: "Transferable Tax Credit Certificates." He explained that the chart illustrates the capital expenditure credits and the NOL carry forward credits.

Co-Chair Stedman pointed out that 2011 does not suggest an implosion. Mr. Dees agreed that the graph charts only applications received up to a certain date and a forecast is not a component of the presentation. The chart shows the number of applications received through January. Additional applications will come forward in March of FY11.

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Mr. Dees discussed Slide 27: "Transferable Tax Credit Certificate Activity by Fiscal Year (\$M)." Co-Chair Stedman added that he requested this information because of a concern that the industry may bank the credits.

Mr. Dees agreed and added that the companies with the transferable tax credit certificates can now turn the credits around immediately.

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Co-Chair Hoffman asked about correlations between the increase in the refunds and the increase in exploration. Mr. Tangeman responded that the department views the difference in the tax credit used, whether they are tax credits applied against the tax liability or those turned in for cash.

[10:05:13 AM](#)

Mr. Dees discussed Slide 29: "Cash Refunds History."

Cash Refunds Governed by AS 43.55.028:

- To cash must be usable against tax liability
- Must show subsequent (24 months) QCEs or lease bids equal to cash sought (repealed in 2010)
- Have a zero tax owed in current and past years
- Have no more than 50,000 BOE/d

Mr. Dees discussed Slide 30: "Cash Refunds History." He explained the breakdown by fiscal year of the amount refunded by the state for tax credit certificates. These amounts are shown through 2/4/2011. The history indicates that the state paid \$851.6 million for tax credit certificates.

Mr. Dees discussed Slide 31: "Cash Refunds History." He pointed out that \$904 million has been appropriated since the inception of the fund. The balance was \$75 million as of two weeks prior to the meeting.

Mr. Dees discussed Slide 32: "Impact of Production Tax Credits Total State Stimulus." He detailed the bar graph and commented that the estimate for 2011 is based on incomplete information and \$450 million will be offset against tax liabilities. The graph illustrates the total state stimulus by fiscal year since the inception of the tax credits.

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Co-Chair Stedman requested separate information for the Cook Inlet Jack-Up Rig credit. He stated that the assumption was for all credits to be active in 2012. Mr. Dees concurred.

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Mr. Dees concluded with Slide 33 "Capital Expenditures by Year (\$M). The graph describes the expenditures estimated by year based on actual tax filings and forecasted data.

Co-Chair Stedman asked about the individual capital expenditures and fields to further clarify the disclosure information. Mr. Tangeman stated that the presented information regarding capital expenditures is limited for DOR. He recommended Department of Natural Resources (DNR) as another resource for information.

[10:12:53 AM](#)

Senator Thomas struggled with the charts on Slides 18 and 25 and the amount of money spent in different categories. Mr. Dees explained that the figures on Page 25 reflect activities from companies that are not taxpayers, but instead explorers seeking credits through the application process. He referred to Slide 18, which illustrates activity from companies that report tax information via filings. He mentioned that the companies shown on Slide 25 exhibit applications but not details about expenditures applied for in the credits. He noted that companies applying for credits must provide details about the expenditures claimed. He added that the details are not provided until the auditing process.

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Senator McGuire requested further clarification of the two categories. She suggested distinguishing between credits

associated with new drilling and activity and those connected to maintenance and upgrading of facilities. She understood that even under the credit of new exploration, an older field would include a mixing of different expenditures if audited. Mr. Dees agreed and stated that the credits are available to everyone without the distinguishing factors.

Co-Chair Stedman understood that the audit for 2006 was complete. He asked about the statutory deadline for the completion of the 2007 audit. Mr. Dees stated that the department has 6 years to complete the audit. The intention is to complete the process much more quickly. Many changes affected 2007 including those in statute with PPT and progressivity.

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Co-Chair Stedman struggled with the issue presented by Senator McGuire due to the substantial delay in the audit.

Co-Chair Hoffman recalled several charts regarding Alaska and the tax structure as compared to other countries and parts of the nation. He asked if the schedules reflect the total tax and whether they include credits. Mr. Tangeman responded that survey reports do include the credit system.

Co-Chair Hoffman asked if tax credits are reflected in the total tax structures. Mr. Tangeman believed so.

Co-Chair Hoffman requested verification. Mr. Tangeman agreed to provide the verification.

Co-Chair Stedman recalled similar distortions during prior testimony.

Senator Ellis commented on legislators' impressions that the state does not participate and incentivize the industry in new exploration. He noted that the industry reports little exploration, but instead spending on the necessary facility upgrades. He suggested that the industry may be providing a bill to the state for routine maintenance in comparison to new development which was the initial goal of the tax credits. He believed that the tax credits would lead to new production as opposed to necessary maintenance of existing facilities. He opined that the fault may be in the statutes as they do not clearly delineate between new exploration and routine maintenance.

Co-Chair Stedman added that the PPT process included a 13 cent per barrel exclusion for capital expenditures, which amounts to \$59 million to help protect the state from normal maintenance on an aging field.

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Senator Ellis added that the next step is to invite industry to meetings. Co-Chair Stedman agreed and stated that questions and concerns exist.

Senator McGuire appreciated the thoughtful approach of the chairman. She pointed out that another arbitrary change in the tax code would provide an unstable fiscal regime. She explained the various divisions of credits. She advocated for crafting and redefining credits into maintenance and new investment in a clearly articulated method. She understood the questions regarding progressivity.

Senator Thomas asked if the figures presented in Slide 33 were gross numbers. Mr. Dees replied yes, the tax credits were not applied to the presented numbers.

Mr. Dees pointed out that timing between tax credit activities and when they are cashed out can be different. Co-Chair Stedman added that he had a document displaying an explanation of the FY 12 credit, which is spread over two years.

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#  
ADJOURNMENT

The meeting was adjourned at 10:33 AM.