

SENATE FINANCE COMMITTEE

March 14, 2012

9:04 a.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:04 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

Senator Joe Paskvan; Senator Hollis French; Bryan Butcher, Commissioner, Department Of Revenue; Dan Stickel, Economist, Tax Division, Department of Revenue; Bruce Tangeman, Deputy Commissioner, Tax Division, Department of Revenue; Senator Cathy Giessel

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

SB 192 was HEARD and HELD in committee for further consideration.

#sb192

SENATE BILL NO. 192

"An Act relating to the oil and gas production tax; and providing for an effective date."

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BRYAN BUTCHER, COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself.

Commissioner Butcher displayed the PowerPoint Presentation, "Comments on CSSB 192; Presentation to the Senate Finance Committee Department of Revenue (DOR) 3-14-12" (copy on file).

Commissioner Butcher looked at slide 2, "Presentation Organization."

- DOR position on bill and individual components of bill.
- Comparison to the Alaska Clear and Equitable Share Act (ACES) and CS HB 110 (FIN).
- Suggested improvements to bill.

Commissioner Butcher explained that his presentation would outline the steps to achieving the governor's recommended trigger point for oil tax revenue.

Commissioner Butcher discussed slide 3 "Components of CSSB 192."

- Progressive surcharge
- Allowance for production increases
- Gross minimum tax
- Petroleum information system
- Decoupling some oil and gas

Commissioner Butcher looked at slide 4, "CS SB 192: Changes to progressive surcharge."

1. Changes the progressivity rate over \$30 per barrel production tax value from 0.4 percent to 0.35 percent.
2. Changes the trigger point that slows the rate of progressivity to 0.1 percent, from \$92.50 to \$101.43 per barrel production tax value .
3. Changes the maximum production tax rate from 75 percent to 60 percent (would apply over \$201.43 per barrel production tax value).
4. Based on our Fall 2011 forecast, reduces revenue by \$125 million in FY 13, \$230 million in FY 14, and \$200 million per year in FY 15.

Co-Chair Stedman queried the definition of PTV. Commissioner Butcher replied that Production Tax Value (PTV) was the value of a barrel of oil that the tax was applied to; after the operating expenses, capital expenses, and transportation had been subtracted.

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Co-Chair Stedman requested an explanation of the PTV in dollars. Commissioner Butcher replied that it would be around \$6 billion.

Commissioner Butcher discussed slide 5, "Effective Production Tax Rates: ACES and CSSB 192 (progressivity only)." He stated that the current price of oil was approximately \$120 per barrel; and there was a small reduction in what the companies would pay to the State. He furthered that the tax rate would be slightly lower under CS SB 192 as the price of oil rose to approximately \$240 per barrel.

Co-Chair Stedman noticed that the FY 12 numbers were being used, and wondered why the capital expenditure (capex) number was specifically \$10.25. Commissioner Butcher deferred to Dan Stickel.

DAN STICKEL, ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, responded that the \$10.25 capex represented the deductible capital expenditures by the companies that had a tax liability per barrel of taxable oil. He stated that number came from Appendix D of the Revenue Sources Book, and the total capital expenditures that were deductible in FY 12 were approximately \$1.8 billion. He explained that the \$1.8 billion was divided by the 176 taxable barrels to determine the \$10.25.

Co-Chair Stedman surmised that the rate was not the homogenized rate of all producers, but the average rate of the three major producers. Mr. Stickel replied that the rate was the average price per barrel of those companies that had a tax liability, who were able to deduct their capital expenditures.

Co-Chair Stedman recalled that Exxon Mobil, ConocoPhillips, and British Petroleum were the only three producers that had a significant tax liability. He wondered if there were any other producers that had a similar liability. Mr.

Stickel replied that multiple companies had a tax liability in any given year.

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Co-Chair Stedman wondered what fields were represented in the chart on slide 5, and specifically wondered if Prudhoe Bay was included in the chart. Mr. Stickel replied that the majority of the revenue was coming from Prudhoe Bay, Kuparuk, and Alpine. He stated that if the companies had operations in other fields, the capital expenditures would be deductible by the companies, because the tax was company-specific.

Co-Chair Stedman used Exxon Mobil as an example and noted that they had substantial expenditures at Point Thomson, and wondered if Point Thomson was included in the chart. Mr. Stickel replied that if a company were to have existing production in major fields, and then invest in a new field, the costs would be deductible.

Co-Chair Stedman wondered if the total numbers from all participants were used, would the tax percentages increase or decrease. Mr. Stickel replied that if the averages from all companies were used, including those that were not able to deduct their expenditures, the curve would shift to the right. The average price would be slightly higher. He stated that the general trend between the two tax systems would remain the same.

Co-Chair Stedman felt that the shift should be down or up, based on the tax. Mr. Stickel agreed, but clarified that the display was based on the west coast price per barrel. In terms of displaying the graph on a production tax value basis, the numbers would remain the same as what was displayed.

Co-Chair Stedman requested further research regarding the major fields versus the overall aggregate effect of every company.

Senator Thomas looked at the title of the slide, and wondered if the graph included the base tax. Commissioner Butcher replied that the graph only displayed the progressivity aspect, comparing current law and CS SB 192.

Co-Chair Stedman requested a definition of "effective tax." Mr. Stickel replied that the effective production tax rate was determined by total production tax paid, including the base tax and the progressivity tax; but minus capital credits. The effective tax looked at the ratio between the net production tax received to the total production tax value to determine the effective tax rate for production tax after credits. He stated that the presentation was an analysis each of the components of the bill, and slide 5 looked at the change in progressivity in CS SB 192. He noted that the other components were modeled in separate slides in the presentation.

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Co-Chair Stedman stressed that the graph did not isolate other components in the bill. Commissioner Butcher affirmed Co-Chair Stedman's observation.

Co-Chair Stedman noted that there was discussion regarding the marginal tax rate, and wondered why there was not a 90 percent rate. Mr. Stickel replied that there were various ways to determine the tax rates. He explained that the effective tax rate looked at the total tax paid by the companies divided by the total tax base. He clarified that the marginal tax rate was determined by the tax paid on an additional dollar of value. He stressed that the Alaska Clear and Equitable Share Act (ACES) held a marginal tax rate of 90 percent.

Co-Chair Stedman looked at a slide that showed Alaska North Slope (ANS) west coast oil prices from 60 to 300 a barrel. He understood that DOR had "frozen" capital and operating expenditures, and were "sliding" the oil price. He wondered why the graph was displayed in that manner. Mr. Stickel replied that the intent of the slide was to present a "snapshot" of one year (FY 12). He explained that if a company had made their capital and operating commitments, and if the price were to change from one level to another over the short term, there would not be a significant change in costs. He furthered that if there was a move to \$60 or \$300 per barrel over the long-term, the cost of business would change accordingly. The purpose of the current presentation focused on the "snapshot" of the lease expenditures.

Co-Chair Stedman anticipated a request that the "x-axis" be lowered to \$160 or \$200 per barrel, which would be a more "normal" range. He understood the value of looking forward to \$300 per barrel, but the operating and capital expenditures look much different than the current level of \$100 per barrel. Commissioner Butcher agreed that there would be a "lag" in the increase over time.

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Commissioner Butcher presented slide 6, "Progressive Surcharge."

1. Changes do not do enough to provide a meaningful change that would influence investment decisions.
2. The biggest benefit from this provision comes at very high prices, from the change in maximum tax rate.
3. Suggestions:
 - Keep the lower maximum tax rate; consider a 50% cap on maximum rate.
 - Consider a bracketed approach, so that higher rates apply only to additional profit and not to the first dollar of profit.
 - Or, consider further reductions in slope of progressivity to provide a meaningful change.

Commissioner Butcher looked at slide 7, "Allowance for production increases."

- Describe allowance
- Revenue impact
- Examples
- Does not create an incentive that would alter an investment decision
- Does increase complexity for DOR and taxpayers
- Suggestion: New field incentives, or provide allowance by means of a credit

Co-Chair Stedman noted that North Dakota had a tax and royalty system, and Alaska had a concession system. He felt that a concession system could not be set up as simple as a tax and royalty system. Commissioner Butcher agreed, and did not suggest that Alaska follow North Dakota's system. He stressed that the concession system was not "investor friendly."

Commissioner Butcher discussed slide 8, "CS SB 192: Allowance for production increases."

- Allowance for each additional barrel sent down TAPS, over prior year's level.
- Effectively reduces PTV by \$10 per additional barrel, only for the base rate of 25 percent equals \$2.50 per additional barrel.
- Not part of production tax calculation; benefit is calculated and refunded by DOR.
- Based on our Fall 2011 forecast, reduces revenue by less than \$25 million total for all companies, for all years.

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Commissioner Butcher presented slide 9, "Allowance for production increases: Example."

- Major producer with 200,000 barrels per day.
- Invests \$1 billion per year to achieve modest decline rate in legacy fields.
- Invests an additional \$5 billion to develop several marginal fields and in-field projects in legacy fields.
- Increases production 5 percent to 210,000 barrels per day, and maintains that level for several years.
- First year benefit is \$9.1 million.
- Benefit in following years is ZERO.

Commissioner Butcher discussed slide 10, "Allowance for production increases."

1. Allowance does not provide a meaningful change that would influence investment decisions.
2. A very small benefit, for only one year, with no benefit for maintaining production.
3. Mechanism requires DOR to track and calculate the benefit.
4. Suggestions:
 - Consider replacing this incentive with reduced tax rates for new fields or incentives for in-field development.
 - If this concept is furthered, use a credit as the mechanism as it would be easier to administer.

-If this concept is furthered, acknowledge that maintaining production would be a significant accomplishment for some producers.

Commissioner Butcher looked at slide 11, "Cs SB 192: Gross Minimum Tax."

- 10 percent gross minimum tax for certain fields.
- Applies only to units with over 1 billion barrels cumulative production and over 100,000 barrels per day in most recent year.
- Effectively applies only to Prudhoe and Kuparuk.
- “Hard floor” - credits cannot be used to reduce tax for these fields below 10% of gross value.
- Also changes community revenue sharing provisions
- Based on our Fall 2011 forecast, increases revenue by less than \$25 million per year.
- At \$40 per barrel, increases revenue by over \$400 million per year.

Commissioner Butcher discussed slide 12, "Gross Minimum Tax vs. Status Quo: FY 2013 ACES revenue with and without 10 percent gross floor for PBU/KPU." He stated that the graph displayed the gross minimum tax versus the current law; and production tax revenue in million dollars. He noted that there was a small tax increase at the high end, but the low end also showed a large tax increase to companies.

Co-Chair Stedman wondered what caused that tax increase at the low end. Commissioner Butcher replied that it was because the companies were required to pay taxes, and not receive any credits. He stressed that when the price of oil is so low, the amount of tax credits that a company qualified for could surpass what the companies paid in tax. He stressed that a company would always pay some taxes regardless of what their tax credits might be for that particular year.

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Co-Chair Stedman clarified that in FY 2012, the State had granted approximately \$400 million in tax credits, which was half of the credits available. He stressed that the credits erase the tax revenue, and could result in negative tax revenue. Commissioner Butcher explained that CS SB 192 would increase taxes at the low end, and slightly increase taxes on the high end.

Commissioner Butcher looked at slide 13, "Community Revenue Sharing."

1. This bill impacts appropriations to the community revenue sharing fund
2. Currently 20 percent of revenue from progressivity
3. Would change to lesser of:
 - 20 percent of progressivity revenue, or
 - Difference between 25 percent of PTV from fields subject to 10% minimum tax, and minimum tax for those fields.
4. Maintains existing limit on revenue sharing: \$60 million or the amount that brings fund balance to \$180 million.
5. Increases complexity of the calculation, but not likely to materially impact the amount of revenue appropriated.
6. If this change ever would make a difference it would be to the detriment of municipalities.

Co-Chair Stedman suggested clarity related to the reason that PPT was "driven under water", he wondered how the credits were handled and "carried forward." Commissioner Butcher replied that DOR was able to work with the committee to discuss the changes in each aspect of the tax law.

Commissioner Butcher discussed slide 14, "Gross Minimum Tax."

1. Provision will impact some companies at current prices.
2. Provision creates a substantial tax increase at lower prices (less than \$60 per barrel).
3. Creates a disincentive to investment in Prudhoe and Kuparuk, Alaska's most important fields.
 - Including development drilling, expansions such as new pads and facilities, and heavy oil development
4. Mechanism requires DOR to track and calculate the benefit.
5. Suggestions:
 - Remove this provision as it represents a tax increase.
 - If this concept is furthered, allow credits to be applied against minimum tax so there is still some incentive to invest at lower prices.

-If this concept is furthered, consider removing the change to community revenue sharing language.

Commissioner Butcher looked at slide 15, "CS SB 192: Petroleum Information System."

1. New information system to be implemented by AOGCC.
2. Operational before January 1, 2014.
3. Suggestions:
 - Consider need in context of DOR efforts to make more information available.
 - Defer to AOGCC on challenges with this provision.

Co-Chair Stedman stated that the Alaska Oil and Gas Conservation Commission (AOGCC) would be presenting to the committee at a later date, and there may need some work on the language in CS SB 192.

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Commissioner Butcher discussed slide 16, "CS SB 192: Decoupling Some Oil and Gas."

1. Identical to SB 305.
2. Creates 2 separate progressivity calculations:
 - Oil, Cook Inlet gas, and gas used in state.
 - Gas other than Cook Inlet and used in state.
3. Allocates lease expenditures based on Gross Value
4. Revenue impacts:
 - Less than \$10 million per year prior to major gas sale.
 - Could increase revenue by over \$1 billion per year with major gas sale.

Co-Chair Stedman requested a definition "decoupling." Commissioner Butcher replied that currently oil and gas was combined, and this aspect of the bill would "decouple" the oil and gas. He stated that if there was a major gas sale, the State of Alaska could potentially bring less revenue than it would from stand-alone oil taxes.

Co-Chair Stedman queried the magnitude of the current dilution affect. Commissioner Butcher replied that the dilution affect was approximately \$80 million.

Co-Chair Stedman stressed that there was currently an \$80 million dilution, without any gas sales. He pointed out

that if there were a large gas sale, the number would grow drastically.

Co-Chair Stedman stated that the committee would continue to work with DOR, and the discussion of decoupling oil and gas would occur at the committee table.

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Co-Chair Hoffman queried DOR's position on the decoupling component. Commissioner Butcher replied that the governor had serious concerns with the proposed language in CS SB 192. He stated that DOR was working with Co-Chair Stedman to develop language that would accomplish decoupling oil and gas, while being more revenue-neutral.

Senator Olson queried the governor's position on delineation between Cook Inlet gas and gas produced elsewhere in the state. Commissioner Butcher agreed to provide that information.

Commissioner Butcher looked at slide 17, "Comparison to ACES and CS HB 110 (FIN)." He explained that the columns showed the differences in progressivity, differences in maximum tax rate, new production incentives, and a minimum tax.

Co-Chair Stedman requested a brief history of HB 110. Commissioner Butcher replied that HB 110 was Governor Parnell's bill that was introduced during the previous legislative session. He stated that he was referencing HB 110, because it would provide the administration's perspective regarding substantive change in oil tax law.

Co-Chair Stedman requested the original submission of HB 110 to the comparison and graphing. Commissioner Butcher agreed to provide that information. He noted that the major components were the same, but had been smaller alterations in the legislative process.

Commissioner Butcher discussed slide 18, "Effective Production Tax Rates: ACES, CS SB 192, and CS HB 110 (FIN)." He stated that the graph referred to the fields that were currently producing on the North Slope.

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Co-Chair Stedman noted some testimony from consultants that stated that there did not need to be significant changes in the current production tax structure. He felt that there was a "spread" between the blue and red lines on the graph, and consultants had suggested that the current problem was with incremental increases. He wondered how that issue would be rectified. Commissioner Butcher stated that DOR disagreed with Pedro Van Meurs on that particular aspect of the tax structure issue. He felt that the tax structure was too high for current and future production.

Co-Chair Stedman noted that there was concern about the incremental production over the 6 percent decline curve, and the cost in capital dollars. He furthered that the current tax structure, when price per barrel exceeded \$100, was a major problem.

Commissioner Butcher looked at slide 19, "ACES, CS SB 192, and CS HB 110 (FIN): Impact of 10 percent gross tax." He explained the setup of the graph. He noted that when the price of oil drops, CS SB 192 would allow for the percentage of the tax rate that a company would pay rises, eventually reaching 100 percent.

Commissioner Butcher discussed slide 20, "Marginal Government Take: ACES, CS SB 192, and CS HB 110 (FIN)." He explained the setup of the chart displayed on the slide.

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Co-Chair Stedman wondered why the chart would not have validity at \$300 per barrel. Commissioner Butcher replied that there would eventually be a cap, and there would be no increase in government take.

Co-Chair Stedman felt that if the price of oil spiked to \$300 per barrel, capital expenditures and operating expenditures would rise too rapidly. Commissioner Butcher agreed.

BRUCE TANGEMAN, DEPUTY COMMISSIONER, TAX DIVISION, DEPARTMENT OF REVENUE, remarked that a rapid spike from \$40 to \$140, would not allow enough time for capex to respond to the sudden increase.

Co-Chair Stedman wondered how the time window was calculated. Mr. Stickel replied that the tax was payable on

a monthly basis, which was based on the monthly share of the annual cost. He furthered that taxes are paid each month from the company, and the progressivity portion would be calculated by the price and the production tax value in the month.

Co-Chair Stedman stated that the tax was determined by the monthly average, over a 12-month period. Mr. Stickel affirmed. He stressed that the tax was a monthly tax, but had an annual reconciliation.

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Co-Chair Hoffman looked at the lower end of HB 110, and wondered why the administration was so set on bracketing, rather than the current system under ACES or CS SB 192. Commissioner Butcher stated that virtually every jurisdiction used progressivity brackets. Because Alaska did not have a progressivity bracket tax system, a company would be discouraged from investing in Alaska. He explained that the bracket system was similar to how the federal tax system was set up.

Co-Chair Hoffman asked if the intent of the bracket system was to act like every other jurisdiction. Commissioner Butcher responded that the bracket system provided a benefit to those other jurisdictions, and Alaska was not taking advantage of that same benefit.

Co-Chair Stedman felt that the marginal tax rate could be modified in numerous ways by changing the slope of progressivity or the base tax. Commissioner Butcher responded in the affirmative and that the marginal rate was so high because Alaska did not have a bracket system.

Mr. Tangeman said that other jurisdictions had indicated the State's tax system was not simple, and DOR had chosen to stay with the \$30 and chose to adjust the bracket and cap.

Co-Chair Stedman asked if HB 110 came out of DOR. Commissioner Butcher responded that HB 110 came from DOR and the Department of Natural Resources (DNR).

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Co-Chair Stedman stated the consultants had declared that if there was not much adjustment at the government take number, the bracketing system would decrease the government take. Therefore, something else needed to be adjusted to maintain the State's revenue. He queried who received the net cash flow between the state, the federal government, and industry. He stressed that the focus should be on the cash flow. Commissioner Butcher replied that if there was a focus on maintaining the status quo, he agreed that some other aspect needed to change.

Mr. Tangeman said that the "pendulum had swung out too far under ACES" and the goal was to increase production by reducing revenue to the state and giving more to producers.

Co-Chair Stedman commented that progressivity was intended to neutralize the regressive tax structure. The legislature was unable to base it on a rate of return. Commissioner Butcher responded that DOR was comfortable with progressivity, but felt that certain adjustments were needed to the current tax structure.

Commissioner Butcher discussed slide 21, "Share of Profit under ACES." He stated that the graph included the total gross value of oil less the transportation costs and lease expenditures, including royalty oil. He explained what each line represented. He stressed that the State took in 56 percent, the federal government took 15 percent, and the companies took 27 percent under current law.

Co-Chair Stedman asked for a clarification regarding the federal tax. Mr. Stickel responded that DOR used a nominal rate of 35 percent to determine the federal income tax. He furthered that using nominal rates would simplify comparisons to other jurisdictions.

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Co-Chair Stedman observed that it was hard to believe that the federal government actually took 35 percent. He stated that the consultants recommended a 75 percent take on our existing fields and that there was concern that above 75 percent would be too much take for the state. His understanding was that a big concern industry had was that when the price of oil rose above \$90 dollars a barrel the companies' cut dropped considerably.

Commissioner Butcher stressed looking at the difference between a reasonable government take and a reasonable company take. He noted that when specifically looking at company take, many companies felt saw greater company take in jurisdictions outside of Alaska.

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Co-Chair Stedman stressed that Mr. Van Meurs suggested a 75 percent for what he perceived as our competitive environment to justify his numeric to the committee. Commissioner Butcher replied that Alaska was not competitive in company take percentage-wise. Mr. Tangeman furthered that PPT to ACES was not a huge "delta" when ACES was introduced.

Co-Chair Stedman surmised that DOR suggested that the government take should be 67 percent. Mr. Tangeman replied that the government take should be whatever is appropriate to make Alaska competitive.

Co-Chair Stedman wondered what price range oil should be to make Alaska competitive. Commissioner Butcher replied that the governor hoped to keep the rate between 60 and 80 percent.

Co-Chair Stedman felt that the administration should have a similar perspective to Pedro Van Meurs. Commissioner Butcher responded that there was no perfect tax rate number. He stressed that conversations needed to occur with the companies to determine the best tax rate.

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Co-Chair Stedman requested running the chart with the 35 percent tax, and adjust it at 25 percent and 20 percent. Commissioner Butcher agreed to provide that information, but wondered what the 20 percent would be based on. Co-Chair Stedman replied that the 20 percent would be based on "the wind."

Co-Chair Stedman wondered if the chart included the credit from FY 12: \$400 million. Commissioner Butcher replied in the affirmative.

Co-Chair Stedman suggested that the numbers be determined in a homogenized manner, which included the explorers and

all other companies. He noted that the slide represented the three major producers, and felt that the rate from the three major producers did not reflect the rate to the treasury. Commissioner Butcher explained that the slide was from the point of view of a company that had a tax liability to the state.

Co-Chair Hoffman noted that much of North Dakota's land was privately owned, and taxed by royalty to private owners. He wondered how North Dakota could be a fair comparison to Alaska. Commissioner Butcher stressed that it was difficult to compare Alaska to other regimes, but furthered that it was important that Alaska be competitive.

Co-Chair Hoffman wondered if there was a way to make a fair comparison with other regimes. Commissioner Butcher replied that there were different ways to make comparisons. He stressed that North Dakota had more roads, more work days, and an abundant work force.

Co-Chair Stedman felt that an important aspect of the discussion was prospectivity of the hydrocarbon basin. Commissioner Butcher agreed, and felt that a company would be more likely to invest in a larger reservoir, rather than a small reservoir.

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Co-Chair Stedman wondered if Alaska's hydrocarbon reserves were equal to North Dakota. Commissioner Butcher replied that Alaska was far in excess to North Dakota, and added that Alberta was the only province or state that had reserves greater than Alaska.

Co-Chair Stedman commented that North Dakota had approximately 250 to 300 feet of shale oil, and Alaska had approximately 1000 feet of shale oil. Commissioner Butcher agreed, but added that it was anticipated that North Dakota surpass Alaska in production.

Co-Chair Hoffman wondered how quick North Dakota would use up their reserves. Commissioner Butcher replied that North Dakota's reserves would decline, but were expected to rise over many years. He stressed that North Dakota's reserves would decline before Alaska's reserves decline.

Co-Chair Stedman suggested that DOR continue with their presentation.

Commissioner Butcher looked at slides 21 to 23, and stated that the slides made a comparison between the share of profit. He stated that slide 21 represented the current law, and slide 22 represented CS SB 192.

Co-Chair Stedman requested the slides in terms of dollars. Commissioner Butcher agreed to provide that information.

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Commissioner Butcher discussed slide 24, "Suggested Improvements."

- Bracketed progressivity.
- Lower cap on progressivity.
- Reduced tax for new fields.
- Increased credits for in-field drilling.

Commissioner Butcher discussed slide 25, "Bracketed Progressivity."

- ACES and CSSB 192 apply progressive tax rate to the entire production tax value.
- Tax on the first \$1 of value can vary from 25 percent to 75 percent (ACES) or 60 percent (CSSB 192).
- Bracketed approach applies progressive tax only to the incremental value.
- Other jurisdictions with price progressive systems use a bracketed approach.
- Companies have committed \$5 billion under this tax change.

Co-Chair Hoffman wondered if the bullet points on the slide were prioritized. Commissioner Butcher replied that each aspect was important, but felt that progressivity should be the focus.

Co-Chair Hoffman noted two issues on progressivity: bracketing and lowering the cap. He wondered which issue was the focus. Commissioner Butcher replied that brackets would have a substantial effect on investment, but putting a cap on high prices would benefit investors.

Co-Chair Stedman remarked that the bracket system was intended to fix a problem, and queried the problem. Commissioner Butcher replied that the government was taking a higher price of the profit share, and companies were investing in places where they could receive a higher return.

Co-Chair Stedman felt that the focus should be in solving that problem not adjusting the tax structure. Commissioner Butcher replied he was uncomfortable splitting the issues apart.

Co-Chair Stedman stressed that the cash flow to the State was the most important issue. Commissioner Butcher agreed.

Commissioner Butcher continued to discuss slide 25, and felt that the bracketed progressivity would be a great benefit to Alaska.

Commissioner Butcher looked at slide 26, "Bracketed Progressivity: Marginal Tax Rate (Production Tax Post-Credits." He stated that the graph displayed current law, but in bracketed form.

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Co-Chair Stedman moved back to slide 25, requested a discussion regarding gold-plating and excessive tax credits. Mr. Stickel replied that the concept of gold-plating was the inverse of a marginal tax rate.

Co-Chair Stedman stressed that gold-plating was a major issue for the Senate Finance Committee to discuss. Commissioner Butcher explained that it was a matter of looking at numbers and exposure, and determining the benefit to the State.

Co-Chair Hoffman wondered if gold-plating was a concern to the administration. Commissioner Butcher replied that it would be a concern if there was a situation that was detrimental to the State of Alaska, without getting an excessive corresponding benefit.

Co-Chair Hoffman surmised that DOR had concerns but no solution. Commissioner Butcher stated that the discussion was more conceptual, and would be happy to provide examples regarding specific situations.

Commissioner Butcher looked at slide 27, "Bracketed Progressivity: Effective Production Tax Rate (Post-Credits)." He stated that the graph showed a slope, but much more gradual than current law.

Co-Chair Stedman wondered what a simplified system, with a tax on gross would look like to equate the same amount of dollars in the tax structure. Commissioner Butcher agreed to provide that information. Co-Chair Stedman furthered that he would like that information to exclude royalties Commissioner Butcher agreed to provide more specific information. Co-Chair Stedman requested data regarding the \$120 per barrel intersect on the graph. Commissioner Butcher agreed to provide that information.

Commissioner Butcher discussed slide 28, "Lower Cap on Progressivity."

- Part of a bracketed or non-bracketed approach.
- Provides the "upside potential" companies need to make investments attractive at higher prices.
- 60 percent cap in CSSB 192 would only apply at prices over \$240 percent barrel.
- 50 percent cap in CSSB 192 would apply at prices over \$140 per barrel.

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Co-Chair Stedman noted some discussion in the previous committee regarding analysis of revenue from previous fields. Commissioner Butcher agreed to provide that information.

Commissioner Butcher looked at slide 29, "Lower cap on progressivity: Effective Production Tax Rate (Post-Credits)." He explained that the black line represented 25 percent, the red line represented the reduction to 60 percent, and the blue represented a cap at 50 percent.

Co-Chair Stedman requested the government take analysis with the slide. Commissioner Butcher agreed to provide that information.

Commissioner Butcher discussed slide 30, "Reduced tax for new fields."

- Provide a lower tax rate to incentivize new fields over the life of the project.
- No fiscal impact for many years.
- Would apply primarily to production that is not even in our current forecast - the state has "nothing to lose."

Co-Chair Stedman felt that it was irresponsible to assume that just because the money was not currently in the reserves already, that it would not be missed in the future. Commissioner Butcher agreed.

Commissioner Butcher looked at slide 31, "Reduced tax for new fields: Effective Production Tax Rate (Post-Credits)." He explained that the blue line represented new field tax compared to current fields, which was approximately 10 percent less.

Co-Chair Stedman wondered what was used in the credit analysis. Commissioner Butcher agreed to provide that information.

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Commissioner Butcher discussed slide 32, "Increased credits for in-field drilling."

- Existing 40 percent credit for well-related lease expenditures outside North Slope.
- Recommend extending credit to include North Slope.
- Makes in-field development work more attractive to companies.
- Improves economics of developing new North Slope fields, and increasing production from existing fields.

Co-Chair Stedman noted that consultants had stated that Alaska had too many tax credits. Commissioner Butcher replied that companies should have an opportunity to express what the credits mean for their revenue.

Co-Chair Stedman felt that if a company was offered a 40 percent return on capital expenditures, there would be few companies who would not encourage credits. Commissioner Butcher agreed.

Commissioner Butcher looked at slide 33, "Increased credits for in-field drilling: Effective Production Tax Rate (Post-Credits)."

Commissioner Butcher discussed slide 34, "Summary: Effective Production Tax Rates: ACES, CS SB 192, and CS SB 192 with recommended changes." He explained that the black line represented current line, the red line was CS SB 192, and the blue line was the administration's recommended changes for unitized changes with the new fields represented by the dotted blue line.

Co-Chair Stedman requested the slide with non-unitized fields represented. Mr. Stickel explained that the blue line was more hypothetical tax structure.

Co-Chair Stedman would like to delete the dashed line, and surmised that the red line represented the inclusion of all companies. Mr. Stickel replied that the forecast did not include tax liability being incurred from fields that would qualify under the non-unitized fields for the next decade.

[10:50:36 AM](#)

Co-Chair Stedman noted the effect of the tax rate, because that credits pull \$400 million from the treasury. Mr. Tangeman noted that the slide was from the tax-payers' perspective.

Co-Chair Stedman felt that all impacts should be considered, including tax credits. Mr. Tangeman replied that there could be an additional slide representing a non-producing, non-tax-payer would be irrelevant. The slide would be geared toward the government perspective, rather than a tax-payer perspective.

Co-Chair Stedman felt that the committee should not be narrowly focused on the unitized fields, because the financial impact to the state was the main concern.

Co-Chair Hoffman remarked that Pedro Van Meurs had focused on the harvesting in the North Slope. He wondered if the administration would still support the legislation, if there was a significant discovery on the North Slope. Commissioner Butcher replied that he benefit to the State of Alaska would be minimal if there was a discovery on the federal land in the North Slope.

10:54:02 AM

Co-Chair Hoffman noted that if there were major finds in the North Slope, additional investment would occur. Commissioner Butcher agreed that a discovery on the North Slope would be beneficial to the investment climate. He stated that there were other factors to consider, when determining investment projections. He felt that DNR would be able to conduct a better analysis.

Co-Chair Hoffman wondered if there were a major find off-shore of the North Slope, would the administration would still recommend HB 110. Commissioner Butcher replied that the administration would still support HB 110, because there could be more opportunities on state land, if the investment climate were better.

Senator Thomas looked at slide 9, and wondered if there could be further information regarding which projects would cause the increases displayed. Co-Chair Stedman stated that there would be a couple of days focusing on the slide subject.

Senator Thomas wondered if there was some way to add an incremental profit share similar to the incremental share in the federal government, between the state and the industry.

SB 192 was HEARD and HELD in committee for further consideration.

Co-Chair Stedman discussed the following meeting's agenda.

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ADJOURNMENT

10:58:09 AM

The meeting was adjourned at 10:58 AM.