

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

January 30, 2012

3:33 p.m.

MEMBERS PRESENT

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Lesil McGuire
Senator Hollis French
Senator Gary Stevens

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel

COMMITTEE CALENDAR

STATUS OF INTEGRATED TAX MANAGEMENT SYSTEM & OIL AND GAS TAX
REPORTING UPDATE BY COMMISSIONER BRYAN BUTCHER, DEPARTMENT OF
REVENUE

- HEARD

REVIEW OF COMPREHENSIVE PLAN AND FEASIBILITY STUDY BY FAST
ENTERPRISES

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

BRYAN BUTCHER, Commissioner
Department of Revenue (DOR)
Anchorage, AK

POSITION STATEMENT: Gave presentation on the history of the
state's tax management system, PPT to ACES to today.

BRUCE TANGEMAN, Deputy Commissioner
Department of Revenue (DOR)
Anchorage, AK

POSITION STATEMENT: Presented timeline for the completion of the tax revenue management system (TRMS).

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

POSITION STATEMENT: Answered auditing questions about the TRMS.

ACTION NARRATIVE

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CO-CHAIR JOE PASKVAN called the Senate Resources Standing Committee meeting to order at 3:33 p.m. Present at the call to order were Senators Stedman, Stevens, Wielechowski, French, Co-Chair Wagoner and Co-Chair Paskvan.

Status of Integrated Tax Management System and Oil and Gas Tax Reporting Update by Commissioner Bryan Butcher, Department of Revenue

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CO-CHAIR PASKVAN announced as background to the Fast Enterprises study by the Department of Revenue (DOR) the department released its oil and gas tax status report to the legislature on January 18, 2011. The executive summary stated under Item 6:

The department continues to write regulations for the new tax system and the first audits under the net profit tax have been completed. The department has, however, been hampered in its tax reporting and compliance effort by a lack of a centralized data base to house and manage the large volumes of oil and gas data it receives.

Later in the report on pages 6 and 7 it indicates:

While capital expenditures over the five-year period in (2006-2010) since the implementation of a net profits tax with credits for capital expenditures have increased each year, we have limited data as to the nature of the expenditures. The Department of Revenue has extremely limited data from which to determine the

nature of the capital expenditure increases. In part, this raises the question which was raised last Friday: 'What has the State of Alaska received for the billions of dollars we have invested in the oil industry with our capital credits? What is Alaska's return on that investment? How does the Department of Revenue measure what we get for those capital investments?'

CO-CHAIR PASKVAN said these questions have concerned him deeply for the last year. However, even a year ago he didn't fully appreciate the magnitude of the problem. Only after the conclusion of the 2011 legislative season did he discover the Comprehensive Plan and Feasibility Study that was prepared by the Department of Revenue by Fast Enterprises of Denver Colorado. This study cost \$300,000 and its executive summary of was alarming.

He said that a representative of the Fast Enterprise Group was invited to present the study to this committee; however he respectfully declined because they might bid on a future contract with the State of Alaska and that would present a conflict. So he asked the Department of Revenue to discuss this comprehensive plan and feasibility study that he believed was one of the most important issues facing the legislature in the 2012 session.

CO-CHAIR PASKVAN said he discovered two other documents while studying this issue. First was a memo from Marcia Davis that was sent to all legislators in 2007. The memo included an analysis by Spencer Hosie requested by the Alaska Department of Law about "issues the state is likely to experience in enforcing and collecting tax under a net tax regime." Mr. Hosie talked about the need to "vigilantly audit Alaska North Slope taxpayers under any tax, gross or net" and emphasized that "audit should be conducted on a yearly basis and if an issue arises, it should be dealt with promptly." He advised that:

To be clear, all else equal, a net tax will be more complex to administer and enforce than a gross tax. If the past is any guide, the taxpayers may well game costs, for example, suddenly allocating an inappropriately large percentage of joint or common costs to their Alaska businesses. The state can discourage overly creative cost accounting by vigilantly auditing and enforcing the statute and regulations from the outset.

CO-CHAIR PASKVAN said he looked forward to the commissioner's perspective on these important issues that are facing Alaska going forward.

The second document was a September 2008 document prepared by then Revenue Deputy Commissioner, Marcia Davis, and Tax Division Director, John Iverson, and Tax Division Deputy Director, Johanna Bales. It is titled "Commercial Off-the-Shelf (COTS) Revenue Management System, the Future of Revenue Administration." One slide that stood out was on page 10, which indicates, "What do we want to avoid? A train wreck." It says, "Our ability to officially administer tax programs, maximize revenue, and meet our mission will be derailed if we don't act now."

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CO-CHAIR PASKVAN said with this information the question is, "Where are we now?" He asked the commissioner to answer how the legislature knows what DOR information is reliable and not reliable.

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SENATOR MCGUIRE joined the committee.

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COMMISSIONER BRYAN BUTCHER, Department of Revenue (DOR), said he would first go a little bit into the first half of the presentation dealing with the history of the tax management system, then go to PPT to ACES and to today, and then pass the presentation along to Bruce Tangeman, who would go into specifics on where we are today and what the timeline looks like for the completion of the tax revenue management system (TRMS). He would then go into the Comprehensive Plan and the Feasibility Study leading up to where we are today.

He said a lot of discussion in today's debate compared to previous attempts to look at our tax structure in PPT and ACES has been about needing information, having better systems in place and taking a look at significant changes. He wanted to point out that although the department is certainly hampered with the current tax management system, they get the job done and responsibly. But they are not able to turn the information around quickly; the manual work is a tremendous time waster. He said they are taking a system "that is doing what has to be done and not a whole lot more and turning it into a system that can

work for the state as well as the policy makers on a lot higher level than it has before.

COMMISSIONER BUTCHER said the information available during PPT/ACES debates wasn't the same that it is today. Because the state was switching from a gross to a net tax, it had fairly limited information for modeling, projections and a lot of assumptions. As a result, the focus was more on modeling and what the experts said than what it is now when they have a snapshot of what has been going on in the oil patch.

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SENATOR FRENCH asked him what position he held during that time and to quantify what he means by "more information."

COMMISSIONER BUTCHER replied that he worked with the Alaska Housing Finance Corporation (AHFC) during that time and he was not working on this issue. Most of the work he did other than observing on this issue has been the year of having his position as commissioner. He said they have a lot more information in terms of operating capital and a lot more of an idea of what the money is going into. They would prefer to have more information, but they have more now than was available during the PPT and ACES debates.

SENATOR FRENCH said that should have been laid out in the slide because it appears that he is claiming they were "flying blind" when they passed PPT and ACES and he resented that implication. He said he sat through hours and hours of hearings and collected vast volumes of information and asked the commissioner to be more specific when he says they don't have information.

COMMISSIONER BUTCHER replied that he did not intend to make it sound like they were flying blind, but to say that they simply have more information today than they had then. As an example, when PPT and ACES debates were occurring, the DOR fiscal notes went up to a high of \$80 a barrel and prices haven't been there for quite some time; it's been in the triple digits for the last few years. So, they are now historically able to see how the tax works at the high price levels that currently exist.

SENATOR FRENCH said he didn't know if modern information qualified as more information. In 2007, they didn't know what the oil price would be in 2012, but that's not more information; it's just a new piece of data. He said the commissioner would find himself in semantic quibbles with members of the committee if he wasn't careful how he construed that. He stated that the

industry is doing well at these high prices, just as the state is.

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COMMISSIONER BUTCHER responded that was just one example. They worked on a five-year look-back to connect tax credits to see specifically what the state was getting.

SENATOR FRENCH said, "That's productive."

SENATOR STEDMAN recalled under PPT the administration was working at \$60 a barrel oil and below. And the legislature was looking a little bit north of that and under ACES they were looking at the \$200 range. It was working with much broader price swings than the administration was.

BRUCE TANGEMAN, Deputy Commissioner, Department of Revenue (DOR), agreed that the whole point of these bullets is the type of information that the department is able to work with. Months of work by very intelligent and qualified economists and contractors went into putting PPT together. But they really couldn't look backwards and say how a net tax would affect Alaska. A short year later, when the ACES debate geared up, months of work went into that, too. But you still couldn't look back over one year to see how the net tax worked, because such a short time had elapsed between the two changes. The price went up even more during the ACES debate. Finally, now in 2012 they can look backwards at five years of oil prices including high ones, which is *the* piece of information in comparing Alaska to other oil producing regions.

SENATOR WIELECHOWSKI said he pulled some of his binders from the ACES debate and found a field-by-field analysis that he had found helpful at that time. They talked about the duty to produce and the responsibilities that parties incur when they take out a lease. They heard from Spencer Hosie, the state's attorney in the Amerada Hess case, that his concept is if the companies can make a reasonable profit they have an obligation to produce. So based on that, they ran a series of hypothetical fields - heavy oil, conventional oil, satellite fields - and determined at that time at \$40/barrel and at \$60/barrel under ACES, under ACES with a gross floor, under PPT, under a variety of structures, that under ACES there were very high net present values (good profits to be made) at \$40/barrel and even more good profits at \$100/barrel. He didn't know that the analysis changes a whole lot because if you've got a duty to produce and \$40/barrel you still have that duty at \$100/barrel.

He thought it would be helpful to the committee to see net present value and rate of return data on specific fields under both ACES and the new proposed tax structure. But the reality is if the company can make a reasonable profit under ACES, they have a duty to produce.

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On a slightly different topic, Senator Wielechowski said a presentation last year by Gaffney & Kline had a quote saying "relative to other regimes Alaska is handicapped in its decision-making by the small amount of either confidential or reliable public data on energy operations." He asked the commissioner if he felt the state was handicapped by the lack of data.

COMMISSIONER BUTCHER replied yes, they could have more information, but they have progressed from where they were in 2006/07/08. No question about it.

SENATOR WIELECHOWSKI asked if he would want laws on the books that get us more information as part of this legislation - at least provided to him and the legislature on a confidential basis.

COMMISSIONER BUTCHER replied that he would be happy to work with the committee on that. They believe this TRMS system is going to be one big piece of doing that.

CO-CHAIR PASKVAN said the top bullet line says the rally cry has been "need more information," and he hoped he wasn't saying that factual information was bad for the process.

COMMISSIONER BUTCHER replied, "Absolutely not." It could have been worded better, but the point is that they are in a better place than they were three or four years ago, but improvements still need to be made.

CO-CHAIR PASKVAN asked what he meant by saying "double standard" in the next bullet line.

MR. TANGEMAN replied that this goes back to the information that was used during the PPT and ACES debates - the theoretical modeling they had been speaking of. They didn't get a good chance last year to really delve into the modeling, but they are ready to go down to that field-by-field analysis and compare

that with other regimes around the world and opportunities from an oil company's perspective.

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SENATOR WIELECHOWSKI said, "I just want to let you know your attorney disagrees with you on that." Spencer Hosie said that is the wrong analysis; he says when you take out a lease in the State of Alaska, you have an obligation to develop when you can make a reasonable profit. It doesn't matter what you can make elsewhere. Senator French said he thought they needed to have a hearing on the duty to produce.

MR. TANGEMAN replied that he agreed "100 percent" that duty to produce is clearly an important standard; the Alaska Oil and Gas Conservation Commission (AOGCC) has a role in that, the Department of Natural Resources (DNR) has a role in that and the Department of Law has a role in that. But he said don't confuse duty to produce with duty to invest, because there is no such thing as a duty to invest in statute. If companies are following what is in their lease agreements under the duty to produce section and are meeting those standards that is what they need to meet. But he wants them to invest above and beyond their duty to produce line.

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SENATOR STEDMAN commented that he didn't want the public to think the state's hydrocarbon basin is so simple that it just comes down to the rate of return comparison. On a broader perspective, there is the prospectivity in the basin, the existing reserves and reserves potential, how easy is it to get to and who has control of it. Alaska has one of the richest hydrocarbon basins in the western hemisphere. And if you look at the rate of return issue, it goes beyond that into your present value, your cash flows and other opportunities available. They will build on those complexities, but it's far more complicated than making a 12 percent return and a 24 percent return somewhere else. Alaska doesn't have an open access basin; it has a controlled dominated basin with three major players and that won't change.

He said they also need to keep in mind that having a high tax burden with large credits - and if you don't reinvest in our basin you will walk into a high tax environment - was a policy put forward by the administration. These were direct policy calls made by the state. They can get into fine tuning them and review the volumes of data and presentations, but it's not just a marginal tax discussion.

COMMISSIONER BUTCHER agreed and explained they focused this presentation on working towards the information they have and going forward with it. But many issues need to be discussed on a bigger scale to determine what changes need to be made.

SENATOR STEDMAN followed up commenting on the bullet on slide 3 showing North Dakota, Alberta and Texas all booming and Alaska in a decline. He said a lot of technological improvements in shale oil advanced North Dakota, not tax changes; Alberta also had technological improvements and the same with Texas. But the slide doesn't really advance the discussion of what they need to get on the table.

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COMMISSIONER BUTCHER explained that slide was making a point that as they are gathering information they need to look at a bigger picture, not just Alaska. He was right, North Dakota is working to reduce their taxes right now, but their taxes weren't reduced for that to occur. It occurred mostly because of the price of oil and secondarily because of the technological advances. Fracing has been around for a long time, but it wasn't economic until oil was over \$70 or \$80 a barrel.

CO-CHAIR PASKVAN said North Dakota and Texas have a gross tax system with no credits and higher royalty than Alaska and he asked if the department was advocating returning to a gross tax with no credits and higher royalty.

COMMISSIONER BUTCHER replied no; they were pointing out things that need to be discussed in the future. It wasn't the focus for today.

CO-CHAIR PASKVAN asked if he agreed generally that North Dakota and Texas have a gross tax with no credits and a higher royalty than Alaska.

COMMISSIONER BUTCHER answered for the most part that is correct. It varies a little bit because they work with private land holders.

MR. TANGEMAN said one of the challenges going forward would be trying to compare apples to apples, because Alaska's tax system is more complicated than that.

COMMISSIONER BUTCHER reviewed slide 4, legislative history, saying the PPT legislation became effective April 1, 2006, and

primarily changed from a gross tax system to a net tax. ACES passed in late 2007 with many provisions effective on July 1, 2008 and some retroactive to July 1, 2007.

CO-CHAIR PASKVAN asked if the 2006 audit was four months of the ELF system and eight months of PPT.

MR. TANGEMAN replied three and nine, actually.

CO-CHAIR PASKVAN said, so the first full year of PPT was 2007 and no audit has been completed of 2007.

MR. TANGEMAN responded that they are currently auditing 2007. ACES made retroactive changes back to July 1, 2007. He explained they would have gotten the trued up tax statements from industry on March 31, 2008, so it will be four years in a couple of months. Statute says six years, so they are well within the statutory guidelines. It's key to remember that going from ELF to PPT was a huge change and one short year later another change was made. He said he was proud of the job the Tax Division is doing to be where they are in the audit process. Every time a change was made allowed the taxpayer the opportunity to amend their tax returns. That is why 2006 was held open so long. The year 2007 is under two different tax structures, so it's another complicated audit. But based on changes that have been made, the lack of a system that the division had to deal with, the manual processes they had to use, it's an incredible accomplishment to be where they are. Going forward, they are getting better and more comfortable with the net tax system. Once the TRMS is on line in two to five years they will be even more comfortable.

CO-CHAIR PASKVAN said the short answer is that there has been no audit from 2007 to date.

MR. TANGEMAN replied correct.

SENATOR STEDMAN recalled that the department was extremely aggressive in pursuing the changes in ACES and asked why would they do that if they couldn't keep up?

COMMISSIONER BUTCHER replied they can't speak for whatever the previous administration pursued in terms of tax changes; they can just speak from the perspective of 2012, seeing what occurred and what they heard occurred previous to 2011. He equated developing the process of moving from gross to net to reaching the top of the mountain, and now they are coming back down the other side of the mountain. It's the same distance, but

they expect it to go considerably faster than it did before because of the work they have done setting everything in place. They aren't having to reinvent the wheel.

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SENATOR WIELECHOWSKI asked if the state had missed any statute of limitations deadlines on any of its royalty or tax auditing.

COMMISSIONER BUTCHER replied not from the Department of Revenue's perspective, but he didn't know about the Department of Natural Resources.

MR. TANGEMAN said the royalty was not in their purview.

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JOHANNA BALES, Deputy Director, Tax Division, Department of Revenue (DOR), agreed that the department had not missed any oil and gas production tax audits statute of limitations.

CO-CHAIR PASKVAN asked the first time the commissioner had knowledge of a completed Fast Enterprises study.

COMMISSIONER BUTCHER replied the first couple of weeks he started his job in early 2011.

CO-CHAIR PASKVAN asked if there was some reason that report was not shared with the legislature at the start of the 2011 session.

COMMISSIONER BUTCHER replied that it was funded in the capital budget and wasn't a secret. He certainly didn't make a decision to not share it.

CO-CHAIR PASKVAN asked why the DOR requested funds for the Fast Enterprise study.

COMMISSIONER BUTCHER replied that he would get to that answer in a little more detail going through the slides. Or did the Chairman want him to start now?

CO-CHAIR PASKVAN asked him to go into it now.

COMMISSIONER BUTCHER said touching on it briefly, the state was in a gross tax system from 1997 to 2006; it was the FoxPro System that collected and reported volume and tax payment data; the data was automatically loaded into excel spreadsheets annually by staff. There wasn't an electronic filing capacity

and it had outlived its usefulness and was no longer compliant with standards that had been set by the State of Alaska.

At that point, there were significant and sweeping changes to the oil and gas production taxes from gross to net. Monthly information reports were coming consisting of millions of lines of data, audit information consisting of millions of lines, and they needed the ability to track credits and automated systems, and antiquated tax systems began to fail. He said the Tax Division had long been aware of its need to update its current systems for tracking and managing tax returns and other taxpayer information. That became an even more serious issue after the passage of PPT and ACES. In the spring of 2007, after PPT had passed but pre-ACES, the department contracted with the Alaska Information Technology Group for a study to evaluate its current oil and gas tax systems. The preliminary requirements for a system were published in October 2007; the remainder of the study was completed and published in January 2008.

He said the study recommended a custom-built solution with an estimated cost of \$2.6 million. During the 2008 legislative session, the department requested the \$2.6 million to create an automated system to track oil and gas tax returns, credits and data. Funding was provided during the 2008 legislative session in FY2009. The study and system requirements were to create a system to calculate monthly and annual tax obligations, accept payments, collect and validate data, audit support through reporting and tracking, forecast future tax revenue, data analysis and reporting and to interface with newly created systems and existing Tax Division systems.

COMMISSIONER BUTCHER provided a breakdown of what the department did with the money; under the net profits tax system it set up a credits tracking system and an on-line tax information system (OTIS) that allows for on-line payment and uploading of reports (although they don't upload into a database, which it will do with the new system). Those two systems were put together internally by Tax Division programmers. An IT contractor came in and created the off-take volume reporting (OVR), which tracks wellhead production data and provides economic research unit forecasting data. However, he said data is still manually entered into the OVR by staff. It also developed an economic monthly report, which provides information for economic forecasting models, and here once again, data would be manually entered.

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He related that after ACES passed, the department in the fall 2008 realized \$2.6 million was insufficient to fund an integrated revenue management system after it conducted its own study. The governor's proposed FY10 capital budget included \$23.4 million for a tax revenue management system, a project that got zeroed out. In fall 2009, the DOR requested \$34 million for a tax revenue management system to be included in the governor's 2011 capital budget.

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SENATOR STEDMAN asked for clarity about why the FY10 capital budget didn't include the funds.

COMMISSIONER BUTCHER replied that he didn't know.

SENATOR STEDMAN asked who included the \$34 million in the 2011 budget.

COMMISSIONER BUTCHER replied that it was submitted by the legislature.

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SENATOR STEDMAN said the governor didn't submit it - the point being that the legislature stepped in to fund this project "to get us off a potential train wreck." Dealing with billions of dollars is a serious issue and it's abnormal for the legislature to put in a request of \$34.6 million and let the administration work its way through that process. He said it is a concern that when we have this type of a challenge in our record keeping that we're not more aggressive in getting to a solution.

COMMISSIONER BUTCHER said he was talking about the fall of 2009 after the project was deleted. Then the department came back to the governor with a different number.

Review of Comprehensive Plan and Feasibility Study by Fast Enterprises

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CO-CHAIR PASKVAN referenced the executive summary of the Fast Enterprises report and asked if the excerpt from page ii (7) of the summary is accurate as follows:

The Department of Revenue tax cannot easily produce reports required by the legislature and policy makers because the current systems prevent timely, complete and correct extraction of data. Reports can be

inaccurate and misleading due to incorrect and incomplete data and human error.

COMMISSIONER BUTCHER responded that is what the report says, and that is why it was in the governor's budget in the previous year.

CO-CHAIR PASKVAN said his point is if the rallying cry is "needs more information," connecting that with this seems to indicate that one should be hesitant to accept the reliability of the DOR's numbers because of human error.

MR. TANGEMAN replied that is why the timeline is about PPT to ACES and then to where we are today. Systems were in place, but the systems put in place since PPT and ACES are a significant improvement and they won't compare to where the TRMS system will take us. The information they are generating today, especially with the monthly reports, weren't even available during the PPT and ACES debates. Significant steps have been made.

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CO-CHAIR PASKVAN asked if Fast Enterprises completed its study in October 2010.

MR. TANGEMAN replied yes.

CO-CHAIR PASKVAN said that study indicates that the vast majority of our oil and gas production tax system is done manually and asked if he agreed.

MR. TANGEMAN replied yes, but it's a better system than what was in place years before that.

COMMISSIONER BUTCHER said that as a result in 2010, due to the increased request of over \$10 million from the previous request, the governor included \$300,000 in his FY2011 budget for a TRMS study. That was funded in FY2011, which resulted in the FAST study.

He related that in July 2010, a request for proposal (RFP) was put out for a study to determine the feasibility, scope and estimated cost. Fast Enterprises in Denver was awarded the contract, and conducted its study in fall 2010 and it came out in October 2010. He said the funding for the TRMS was put in during 2011 session and enacted during FY2012. A simple breakdown of the timeline was on slide 12 and the Comprehensive

plan and Feasibility Study Major Findings was on slide 13 as follows:

The DOR/TAX manages over \$3 billion in Oil and Gas Tax revenue using an eclectic mix of home-grown side-systems that include multiple databases and unsecured, unstable spreadsheets stretched well beyond their intended use. A lot of manual information is still put into these taking up more staff time than they would prefer.

The 17 systems used to administer different taxes and functions have been pieced together over the past 15+ years without integration or an overall architecture.

The DOR/TAX constructed the current tax systems as silos of information pertinent to only the specific tax types they serve. Sharing data with other tax systems is difficult, requiring customized interfaces, or manual processes.

The vast majority of the agency's business processes are done manually and as a result, TAX employees spend a higher proportion of their time compiling, organizing, and reconciling data than actually auditing, examining, analyzing, forecasting, or managing tax programs.

The limitations and inflexibility of existing systems impose a burden on taxpayers. It's not easy for them to get the information to the department; there isn't a set format to put every tax into a central database.

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CO-CHAIR PASKVAN said the last two were critical points. The last one is from the taxpayer's standpoint and is an expression of frustration so to speak, because of dealing with the DOR's inefficiencies and before that is an expression of frustration by the DOR employees that they are spending all their time compiling, organizing and reconciling "without actually auditing, examining, analyzing, forecasting or managing the tax program." He asked him to explain the impact of that to the department and the taxpayers.

COMMISSIONER BUTCHER replied the things that need to get done in terms of auditing, examining, analyzing and forecasting are getting done, but they are not being able to give nearly the

amount of time they would like to, because a lot of auditors, including high level auditors, spend time reconciling and compiling data when their time would be better spent digging in and going a little bit deeper in areas they are qualified and educated to do.

COMMISSIONER BUTCHER said one of their happiest days was finding out this had been funded.

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MR. TANGEMAN said they had started to standardize a lot of the forms; the taxpayers are beginning to see it. Information will be coming in through a single portal and be uploaded into the TRMS system. It has been a good learning experience.

SENATOR WIELECHOWSKI said he expected a debate on credits this session and asked if he was at a point in their system where they could provide the legislature with accurate data that shows how it has been working in recent years.

COMMISSIONER BUTCHER replied they are not exactly there, but they are getting closer. For example, they know very little about a lot of credits in the last five years, because they weren't asking for it - more because the focus was on the application and administration of the tax.

He said the department began a five-year look back on what companies were spending to qualify for the credits and not every company submitted information, but most had. Going forward will be a much easier process of getting the information than compiling it in a five-year look back.

CO-CHAIR PASKVAN said the COTS September 2008 presentation has a chart about Idaho's experience. For each year their system was in place the benefit was greater than the cost to that jurisdiction and he asked if the State of Alaska should receive more than the cost that it has invested in this management system.

COMMISSIONER BUTCHER replied it is very likely that will happen. He explained that auditors are focused on getting information for the legislature over the course of the session, which takes their focus off of other things for almost a quarter of a year. It will help to have the information in a more manageable format.

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SENATOR MCGUIRE held up a US Department of Energy picture of a simplified barrel of crude oil divided into the various products that are made from it by percentage and said it would be helpful as they move forward to see visuals like it from the state. It would be good for both lawmakers and the public to really understand in a visually simplified way what is being taxed and credited out of a single barrel of oil in Alaska - at some point field by field. It would include: CAPEX, OPEX, tariffs, royalties, severance taxes, property taxes at each of the municipal layers, federal taxes and the profits.

Secondly, she said embedded in SB 85 is a bill she introduced asking to have a Competitiveness Review Commission. That idea came from Alberta that went through a very similar kind of process. They had an ELF at one point, something like a PPT, and then high oil prices hit. They enacted a windfall profit tax; the government was recalled and they went through the journey they are on now of reforming that system to make it more competitive. To do that they launched a competitiveness review with people from the private sector - accountants, petroleum engineers, mom and pops.

COMMISSIONER BUTCHER agreed that it is a challenge to get accurate data to where it is easily understood. The complexity of our tax system makes it even harder.

SENATOR MCGUIRE pointed out the previous Friday presentation showed \$4 billion in credits and remarked, "Why are we even looking at our ACES system? I mean this is outrageous!" If you're a member of the public and see that, you're going to pick up the phone and call your lawmaker and say that without completely understanding the complexity.

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CO-CHAIR PASKVAN said in addition to credits, there is a question from the public as to what the state gets for allowing a deduction of the cost compared to going with a gross system. This is somewhat referenced in the October 2007 memo from Marcia Davis, Deputy Commissioner, Department of Revenue in which Spencer Hosie expressed the complexity of a net tax system.

COMMISSIONER BUTCHER agreed and said he thinks about it every single day. The net system puts the possibility of gaming in place that probably doesn't exist to nearly the same extent in a gross system (that deals with just price times production).

MR. TANGEMAN said the audit looks at what the expenses are, but there is also a high penalty of 11 percent on the books now to discourage gaming the system. He wouldn't apply comments in a five-year old memo to what is being experienced today.

CO-CHAIR PASKVAN said they need to know not only what the state gets for its credits but what it gets by allowing a deduction of capital and operating expenditures in one year.

CO-CHAIR WAGONER went back to slide 3 that showed Alberta, North Dakota and Texas booming and asked if any of them have a net tax system.

COMMISSIONER BUTCHER replied no. In fact, Alberta makes almost all of its revenue off of royalties.

CO-CHAIR WAGONER asked if any state in the United States have a net tax system.

MR. TANGEMAN replied no. The net tax with credits is unique in Alaska and it's the most complicated.

CO-CHAIR WAGONER asked if no one else has made a net system work, why Alaska is continuing down this path. He working on the PPT and the only reason they went to a net system was to get a gasline.

COMMISSIONER BUTCHER said those are good questions.

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SENATOR STEDMAN said his understanding is that mostly North America is on tax and royalties; the rest of the world is on production sharing and concession systems. He asked the department to take a broader view than just comparing Alaska to other states in the Union and one province in Canada. It's a much larger issue not only in the magnitude of the resources but in their ownership. It's also misleading to the public to hear comments like Alaska is the only anomaly on the planet.

MR. TANGEMAN responded the document they distributed a few days ago called "Alaska's Oil and Gas Fiscal Regime" was their attempt to start putting that discussion in perspective. It is a first step to comparing oil producing regions from a competitiveness perspective.

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SENATOR STEDMAN said he wasn't referring to that document, but he was referring the comments comparing Alaska to other states. The comparison should be broader than that. Alaska is the only state in the Union that owns the subsurface rights in common. That is a huge difference; we're the only state that has a concession system like this. And Alaska is not abnormal in the major oil basins around the world.

COMMISSIONER BUTCHER agreed.

SENATOR STEDMAN said he recognized the value of the document, but he wanted people to recognize the conversation is going to be broader than that.

MR. TANGEMAN added that they will build on the work done by economists and contractors during PPT and ACES. They did a lot of solid work.

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COMMISSIONER BUTCHER said the department agrees with most of the study's findings; it showed a lot of the positives about the implementation. It has given them a clear roadmap on how best to proceed moving forward starting out with preparation for procurement, to writing of the RFP, to preparing for the overall project with an emphasis on project management et cetera. They have also reached out to numerous states that have done this recently to get their advice on what it actually means to implement something this large. Another finding is trying not to expedite a five-year project into 18 months, because that's where errors are made.

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CO-CHAIR PASKVAN went to page 31 of the Fast Enterprise study regarding returns that says "Some tax types have no system at all including the oil and gas production tax." He asked if that was accurate.

MS. BALES said that was a true statement as far as automated systems go. The tax returns themselves are a manual system. Even though they have electronic uploads of information that come in, that information doesn't go into a database until an auditor finds the data and pulls it into an excel spreadsheet and manipulates it that way. Some automated systems for the monthly economic reports, for instance, help them with forecasting area rather than the audit area.

CO-CHAIR PASKVAN went to page 47 that said the Tax Division "lost a lot of expertise" and asked him to comment.

COMMISSIONER BUTCHER responded that in one year one auditor with 31 years of experience retired in the last month. He said they had done a very effective job of filling out a lot of the high level positions that were empty when he came before the committee before. They still have one audit master position yet to be filled.

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MS. BALES added that the expertise loss has been in auditing. They currently have a staff of 15 or 16 auditors; one has more than 20 years of experience and the rest have less than six years of experience. They had quite a few retirements.

COMMISSIONER BUTCHER added that like many different areas of state government they end up being the training ground for auditors that then move to much higher paying positions in the private sector.

CO-CHAIR PASKVAN said it seems to follow up with what is set forth on page 48 of the Fast Enterprise study, which in conclusion said, "The word is out. Taxpayers know Alaska's tax system is broken."

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COMMISSIONER BUTCHER agreed that companies are aware the department is using an antiquated system. And they are looking forward to being able to work with something that is easier to work from on their side almost as much as we are on ours.

SENATOR WIELECHOWSKI asked how many documents auditors are dealing with referencing 3(a) on page 31.

MS. BALES answered that going to a net tax system, both operating and capital, opens up a whole new realm of data that needs to be looked at including joint interest billings. One auditor told her one report can actually be millions of lines of data for one taxpayer for one tax year.

SENATOR WIELECHOWSKI said the state would start running into the six-year statute of limitations from the initial documents on April 1 and the electronic system won't be up and running for several years and asked how we deal with the system between now and when it is up and running.

COMMISSIONER BUTCHER replied they will continue doing things the way they have been. Because they have switched from gross to net they expect the process to speed up a little bit. Implementation of over the 22 different tax types will take two to five years. He couldn't promise that the oil and gas production tax would be the first piece, but it will be done as early as possible.

CO-CHAIR PASKVAN asked for a "two-minute where are we at" in terms of how audits and statute of limitations can be handled.

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MR. TANGEMAN replied that the presentation was meant to be brief and a catch up of what has happened since the \$34.7 million was put into the capital budget last spring. A COTS has been implemented in dozens of states in the nation and it seemed having a third-party project manager was the best way to go. So, they have two companies assisting as the project managers and their biggest lift right now is putting the RFP together to bring a vendor on board that will actually implement the COTS system. The goal is to have that out in February and to select the vendor by August 1, 2012. Then they start walking down this road of phasing in the 22 systems 4 or 5 at a time.

CO-CHAIR PASKVAN asked where they are money-wise and if he will need more people.

MR. TANGEMAN replied that would be the challenge for the next two to five years. They are keeping the current systems going and on a parallel track they are setting up a new system. Once a vendor gets on board he could tell them more. Ideally, they will be able to use contract help to assist keeping the antiquated systems plugging along. They are happy with the funds, but he anticipated using temporary contract assistance to keep the systems going.

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CO-CHAIR PASKVAN thanked everyone for participating and adjourned the Senate Resources Standing Committee at 5:02 p.m.