

HOUSE FINANCE COMMITTEE  
April 6, 2013  
9:04 a.m.

[9:04:44 AM](#)

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Mark Neuman, Vice-Chair  
Representative Mia Costello  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lindsey Holmes  
Representative Scott Kawasaki, Alternate  
Representative Cathy Munoz  
Representative Steve Thompson  
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

Representative Beth Kerttula; Michael Pawlowski, Advisor, Petroleum Fiscal Systems, Department of Revenue; Susan Pollard, Oil, Gas, and Mining Section, Department of Law; Joe Balash, Deputy Commissioner, Department of Natural Resources.

SUMMARY

CSSB 21(FIN) am(efd fld)  
OIL AND GAS PRODUCTION TAX

CSSB 21(FIN) am(efd fld) was HEARD and HELD in committee for further consideration.

#sb21

CS FOR SENATE BILL NO. 21(FIN) am(efd fld)

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

[9:05:26 AM](#)

Representative Costello MOVED to ADOPT the HCS CSSB 21(RES) as a working document. There being NO OBJECTION, it was so ordered.

[9:06:39 AM](#)

MICHAEL PAWLOWSKI, ADVISOR, PETROLEUM FISCAL SYSTEMS, DEPARTMENT OF REVENUE, provided the Power Point, "Department of Revenue Sectional Review HCS CSSB 21(RES) April 5, 2013" (copy on file).

[9:07:30 AM](#)

AT EASE

[9:07:57 AM](#)

RECONVENED

Co-Chair Stoltze requested that members to hold questions until the end of each section.

Mr. Pawlowski turned to Slide 2, "Main Provisions", which listed the items of discussion in the order they would be presented:

•Interest Rate for Delinquent Tax Payments and Refunds of Overpayments of Taxes

•Income Tax Credit for Qualified Oil and Gas Service Industry Expenditures

•Production Tax Rate - 33%

•Repeal of Progressivity

•Gross Value Reduction

o Establishes 20 % reduction from the gross value at the point of production for North Slope oil and gas produced from

1) new units,

2) new participating areas in existing units and,

3) expanded acreage.

•Tax Credits

o Eliminates current 20% capital expenditure tax credit for North Slope after December 31, 2013.

o Increases tax credit for carried-forward annual losses to 33% for the North Slope after December 31, 2013.

o Establishes a \$5 per barrel of oil tax credit for some production.

o Establishes a sliding scale credit for production not qualified for the \$5 credit.

o Extends small producer credit.

o Revenue report to legislature in 2016

o Lease expenditures and joint interest billings

o Oil and gas infrastructure fund in AIDEA

Mr. Pawlowski turned to Slide 3, "Interest Rate Delinquent Taxes." He noted that members could find the provision on Page 3, lines 9 through 19 of the bill:

\* Sec. 5. AS 43.05.225 is amended by adding a new subsection to read:

(b) On and after January 1, 2014, unless otherwise provided,

(1) when a tax levied in this title becomes delinquent, it bears interest in a calendar quarter at the rate of three percentage points above the annual rate

charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter compounded quarterly as of the last day of that quarter;

(2) the interest rate is 12 percent a year for

(A) delinquent fees payable under AS 05.15.095(c); and

(B) unclaimed property that is not timely paid or delivered, as allowed by AS 34.45.470(a).

Mr. Pawlowski continued with Slide 3:

**Amends AS 43.05.225(1)** to set the interest rate at 3% points above the annual rate charged member banks for advances by the 12th Federal Reserve District compounded quarterly.

oCurrently, the interest rate is the greater of either 5% points above the annual rate charged member banks for advances by the 12th Federal Reserve District OR the annual rate of 11% compounded quarterly.

- Eliminates the 11% alternate annual rate.
- Applies to many tax types.
- Applies against the State for refunds of overpayments of taxes.

- Interest rate change as of January 1, 2014.

Mr. Pawlowski stated that if a company overpaid its taxes the state would owe the company a refund, and if it underpaid, the state would be owed the difference according to the interest rate. He relayed that the bill would simplify the tax structure so that the rate would no longer be a greater than or less than scenario, but a fixed floating percentage rate of 3 percent above the federal funds rate. He said that the rate applied to many different tax types.

[9:11:50 AM](#)

Representative Holmes asked whether the new rate could cause businesses to withhold money because more money could be made elsewhere.

Mr. Pawlowski replied that upstream oil and gas activities typically had high hurdle rates. He said that overpaying a tax in order to get a refund from the state, at 3 percentage points above a lower amount, would not be beneficial to companies. Conversely, the 3 percentage points, was close to what the Internal Revenue Service (IRS) applied and seemed more feasible.

Representative Gara discussed when Alaska's Clear and Equitable Share (ACES) had been passed people had expressed concern that companies would not accurately report profits. He wondered if removing the 11 percent rate would take away the incentive for companies to accurately report profits. He asked whether more underpayments or overpayments had been made.

Mr. Pawlowski answered that historically there had been more underpayments than overpayments. He said that the concern about accurate profit reporting had been discussed in the previous committee. He warned that being punitive for things that were often outside of a company's control, when the state had not had the ability to execute decisions quickly, could be stifling to the business climate.

[9:14:30 AM](#)

Co-Chair Stoltze asked if the tax provision was the same provision employed in the Carlson case.

SUSAN POLLARD, OIL, GAS, AND MINING SECTION, DEPARTMENT OF LAW, responded the tax provision was an issue in the Carlson case; the Supreme Court had to decide whether the provisions of AS 43.55.225 would apply to the damage award in the case. The decision in the case was that the provision would not apply.

Co-Chair Stoltze understood that the case of the Carlson decision the interest rate had been egregiously placed on the state.

Ms. Pollard replied that the state had argued that the 11 percent rate in AS 43.05.225 did not apply to the Carlson case. She furthered that the penalty provisions were well within statute and separately assessed. She said that unlike other tax provisions where a tax could be settled, interest accrued and could not be compromised.

Co-Chair Stoltze relayed that the Carlson case involved out-of-state fishermen who had sued the state because they believed they had been treated unfairly because their licensure rate for participating in exclusive use fisheries was higher than the rate for in-state fishermen.

Co-Chair Stoltze recognized Representative Kerttula in the room.

[9:18:09 AM](#)

Mr. Pawlowski highlighted Section 8 of the bill:

Sec. 8. AS 43.20 is amended by adding a new section to read:

**Sec. 43.20.049. Qualified oil and gas service industry expenditure credit.**

(a) For a tax year beginning after December 31, 2013, a taxpayer may apply a credit against the tax due under this chapter for a qualified oil and gas service industry expenditure incurred in the state. The total amount of credit a taxpayer may receive in a tax year may not exceed the lesser of 10 percent of qualified oil and gas service industry expenditures incurred in the state during the tax year or \$10,000,000.

(b) A taxpayer may not apply more than \$10,000,000 in tax credits under this section in

a tax year. A tax credit or portion of a tax credit under this section may not be used to reduce the taxpayer's tax liability under this chapter below zero. Any unused tax credit or portion of a tax credit under this section may be applied in later tax years, except that any unused tax credit or portion of a tax credit may not be carried forward for more than five tax years immediately following the tax year in which the qualified oil and gas service industry expenditures were incurred.

(c) An expenditure that is the basis of the credit under this section may not be the basis for

- (1) a deduction against the tax levied under this chapter;
- (2) a credit or deduction under another provision of this title; or
- (3) any federal credit claimed under this title.

(d) Notwithstanding any contrary provision of AS 40.25.100(a) or AS 43.05.230(e), for a year that three or more taxpayers claim a tax credit under this section, the department may publish the aggregated amount of tax credits claimed under this section and a description of the qualified oil and gas service industry expenditures that were the basis for a tax credit under this section.

(e) In this section,

(1) "manufacture" means to perform substantial industrial operations in the state to transform raw material into tangible personal property with a useful life of three years or more for use in the exploration for, development of, or production of oil or gas deposits;

(2) "modification" means an adjustment, equipping, or other alteration to existing tangible personal property that has a useful life of three years or more and is for use in the exploration for, development

of, or production of oil or gas deposits; "modification" does not include minor product alterations or inventory activities;

(3) "qualified oil and gas service industry expenditure" means an expenditure directly attributable to an in-state manufacture or in-state modification of tangible personal property used in the exploration for, development of, or production of oil or gas deposits, but does not include components or equipment used for or in the process of that manufacturing or modification.

Mr. Pawlowski shared that the provision had been added to the governor's original bill with the intent of incentivizing activity outside of the direct focus of the bill. He asserted that a vibrant service industry was critical to support a vibrant oil and gas industry. He relayed that the goal behind the credit was to focus on giving a benefit to companies that were doing manufacturing or modification work in-state that supported the oil and gas industry.

Mr. Pawlowski spoke to Slide 4:

Amends the Alaska Net Income Tax Act by adding a new section, AS 43.20.049.

- Provides a tax credit for the lesser of 10 % of qualified oil and gas industry service expenditures incurred in the state or \$10,000,000.
- Applies against tax liability, may be carried-forward for no more than 5 tax years after the expenditures were incurred.
- Qualified oil and gas service industry expenditure must be directly attributable to the in-state manufacture or modification of tangible personal property that has a useful life of 3 years or more used in the exploration, development, or production of oil or gas.

Mr. Pawlowski stated the "qualified oil and gas service expenditure" was defined on Page 5, lines 3 through 15. In

order to qualify for the credit the company first had to be a tax payer. Several companies in the state, due to their corporate organization were not subject to the tax. The credit was directly targeted to companies that were tax payers and only allowed companies to use the credit against their tax liability. The credit was not transferable but was a direct benefit to companies doing work in the state that was directly tied to the manufacturing and modification of the type of large infrastructure necessary to support the oil and gas industry.

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Representative Wilson asked for an example of what would qualify under the credit.

Mr. Pawlowski replied the "hot oil" units and modules had been considered. He mentioned the fabrication that occurred in the Interior; value added work that built infrastructure.

Representative Holmes understood that the credit applied not to people buying the products but to the people manufacturing them.

Mr. Pawlowski pointed to Page 4, lines 25 through 27:

- (1) a deduction against the tax levied under this chapter;
- (2) a credit or deduction under another provision of this title; or
- (3) any federal credit claimed under this title.

He elaborated that there was a limitation on double qualifying the expenditures. If an integrated oil company, doing its own fabrication work wanted to claim the credit, the fabrication work expenditures could not be used as a deduction under the production tax. The intent was to focus the credit on the companies that were supporting the industry, as the logistical support was an important piece for an overall healthy industry.

Representative Holmes asked if a company was not paying taxes in year one, could the credit be carried forward into future years when taxes would be paid.

Mr. Pawlowski responded in the affirmative.

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Representative Holmes wondered if the credit would be aimed at attracting new work in the state or would it apply to work that had already been done in the state.

Mr. Pawlowski replied that the intent was to increase work. He offered that it would benefit some of the work currently happening in the state. The intent of the credit was to give the production and manufacturing facilities in the state a leg up to compete against outside work.

Representative Gara believed that everyone on the committee would like to see increased work; however, the credit was not incentivizing new work but giving a 10 percent credit to work that was already happening.

Mr. Pawlowski rebutted that there was work currently being done in the state. The hope was that as industry investment grew Alaskan businesses would be competing for a larger amount of the work.

Representative Gara wondered what percentage of the work was already being done in the state.

Mr. Pawlowski replied that he did not know the percent. He stated that it would be difficult to determine the number.

Vice-Chair Neuman asked about a scenario related to the building of a liquid natural gas (LNG) facility.

Mr. Pawlowski did not believe a facility would qualify under the credit. He added that if the facility was manufactured in the state then it would qualify; however, the company would have to be manufacturing the facility itself and not the actual outcome of the product that the plant produced, in order to receive the credit.

Vice-Chair Neuman asked whether an existing LNG export facility or manufacturing facility could qualify for the credit.

Mr. Pawlowski replied in the negative. He relayed that the LNG was not tangible personal property with a useful life of three years or more, but rather was a product that was used immediately.

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Co-Chair Austerman understood that the liquification plant that was planned for the LNG project in Fairbanks was a module that would be developed, created and built in-state and would be eligible for the credit.

Mr. Pawlowski replied that if the actual plant was fabricated and assembled in the state then the plant would qualify.

Co-Chair Austerman asked whether \$10 million was the maximum benefit.

Mr. Pawlowski responded that the benefit was 10 percent of the qualified expenditures as a lesser of \$10 million.

Mr. Pawlowski continued to Page 6, lines 11 through 13:

(2) on and after January 1, 2014, the tax is equal to the annual production tax value of the taxable oil and gas as calculated under AS 43.55.160(a) multiplied by 33 percent.

Mr. Pawlowski stated the change would move away from the current sum of a 25 percent tax plus the progressive tax. He spoke to Slide 5:

- AS 43.55.011(e) is amended to levy an annual flat tax rate of 33%. Applies to oil and gas produced after December 31, 2013.
- AS 43.55.011(g), the monthly progressivity tax, is repealed as of January 1, 2014.
- Producers of oil and gas still make estimated monthly installment payments.

Co-Chair Stoltze handed the gavel to Co-Chair Austerman.

Representative Gara spoke to the decision to get rid of the progressive tax. He understood that most of the current progressivity tax was paid by Exxon, Conoco Phillips and British Petroleum. He asked whether any of the corporations were obligated to spend any of the progressivity tax credits in Alaska.

Mr. Pawlowski replied no; there was no direct statutory requirement in the bill that any tax reduction must be spent in-state.

Representative Gara asked whether any analysis had been done as to what portion of the money would be spent in Alaska.

[9:32:20 AM](#)

Mr. Pawlowski replied that the intent was for a broader improvement of the economics in the state. He said that instead of focusing solely on the small, zero sum game of the revenues generated that would be used in the state, the administration had looked at improving the overall economics to attract more outside capital. The analysis had been developed with consultants from both the Department of Revenue and the legislature.

Representative Gara clarified that there had been no analysis done that would determine what portion of the money would be spent in-state.

Mr. Pawlowski hoped that the companies would reinvest more in-state than they earned, and that opportunities in the state would become more attractive in order to draw in more capital. He shared that the administration wanted investors to see Alaska as a destination for investment.

[9:33:54 AM](#)

Co-Chair Austerman requested that the administration address and provide detail concerning the language on Page 6 of the bill.

Mr. Pawlowski explained that the production tax was currently divided into two separate taxes: the base 25 percent tax and the additional tax rate added to the base, which was referred to as a progressivity tax. The tax was calculated monthly based on a mathematical equation that stated that above 30 dollars a barrel of btu equivalent production tax value, or the profit before tax per barrel, the tax rate itself increased four tenths of a percent. Currently, the mathematical equation determined percentage changed each month based on oil price, company spending, and oil production. The base tax rate of 25 percent was increased to 33 percent in the current legislation. Rather

than having a base tax and adding a tax rate, the bill would increase the tax and allow that to be the flat tax rate.

Representative Wilson asked whether the department would outline the differences between all versions of the bill.

Mr. Pawlowski replied in the affirmative.

Representative Wilson asked if there was a requirement that corporations spend a certain amount of tax credits in-state.

Mr. Pawlowski replied no. He felt that the tax rate, tax credits and tax deductions had to be examined together in order to understand the integrated system and the way it would affect the economics.

[9:37:25 AM](#)

Representative Gara quoted a statement by the governor in 2010:

"I am not interested in choosing progressivity so they (the companies) can take that money and invest it somewhere else. If they are willing to invest it here I am open to considering it but I am standing up for Alaskan's in this and not some other country."

Representative Gara wondered what had changed the governor's analysis of the situation.

JOE BALASH, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, referred to a presentation given to the committee the prior day regarding investment relative to other places in the world, as prices had varied. He said that the ability to make decisions was only as good as the most recent period of data reported. He relayed that there was a drop in oil prices after the spike in 2008, and that the gap between Alaska and other oil producing states had significantly increased.

[9:39:24 AM](#)

Representative Gara understood that the states where production had increased since 2008 were using newly

developed fracking technology and that there had not been an increase in conventional oil production.

Mr. Balash replied that he had been speaking to investment dollars and not to production. He elaborated that the relative pace at which the state had been attracting investment was the issue at hand. He stressed that the 2009 benchmarking study showed that Alaska had been in-line with the rest of the U.S. and the globe; in the years since the evidence was overwhelmingly in the opposite direction.

Representative Munoz inquired about the projected revenue implications connected to the shift from 35 percent to 33 percent.

Mr. Pawlowski replied that as a general rule of thumb, before credits or the application of other pieces of the bill, each one percent move in the tax rate was equivalent to approximately \$100 million.

Representative Munoz asked how the 33 percent in the new system compared to ACES at lower prices.

Mr. Pawlowski replied that ACES was 25 percent less the certain amount of tax as prices rose. As oil prices fell he 33 percent would become a tax increase at lower prices. He said that the number was off-set at some price levels by other pieces in the legislation. He offered that 33 percent at many price levels at the lower end of price ranges would be a higher tax rate than the current 25 percent under ACES.

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Representative Costello queried any discussion that had occurred related to bracketing versus the elimination of progressivity.

Mr. Balash replied that the best summation of the oil tax problem had come from the legislative consultant PFC Energy, which had identified five key issues with ACES; in each case the line could be drawn back to progressivity. In attempting to address progressivity in current law the department had found that progressivity created problems in a company's ability to plan. One of the significant problems that had been identified was that if the current mechanism was converted from a function to a bracket there

would still be a net trigger; there would still be rates that changed from month to month. The HCS CSSB 21(RES) version addressed the per barrel credit by bringing a more progressive system. The administration did not have a problem with a progressive system, but progressivity as a mechanism was an unfixable problem requiring the removal of progressivity altogether.

[9:45:52 AM](#)

Representative Costello wondered what other sections of the bill were most important looking at the 33 percent rate. She noted that the 33 percent was not the rate that companies would be paying in the future.

Mr. Pawlowski answered that it was important to consider the tax rate in conjunction with the removal of the qualified capital expenditure credit, the carry forward loss credit, the small producer credit, the gross revenue exclusion, the sliding per barrel credit and the basic development of a net system. All of the items combined formed the government take. He explained that the tax system under discussion was one element of the total burden that industry paid to the state. When looking at the tax rate, the impact of credits and the gross revenue exclusion had to be considered because the combination created an effective tax rate.

Co-Chair Stoltze relayed that PFC Energy would address the committee later in the day.

[9:48:35 AM](#)

Representative Kawasaki questioned whether the investment of capital expenditures by corporations in Alaska had increased.

Mr. Balash replied that the issue was how much investment the state was attracting in comparison to the global investment pool.

Representative Kawasaki asserted that the states that were attracting more investment were using hydraulic fracking, which was not a practice in Alaska. He questioned whether it was a fair comparison.

Mr. Balash replied that fracking was not taking place all over the world. When the larger, global considerations were taken into account the state was simply not competing with global market. He stated that Alaska was not competing for the growth in capital spending for upstream oil and gas investment around the world. He admitted that the advent of hydraulic fracking had made an improvement to the production of tight resource formations but pointed out that higher oil prices were also a factor.

[9:52:19 AM](#)

Representative Kawasaki asked how amending AS 43.55.011(e) would address the issue.

Mr. Balash replied that the base tax rate was a key driver of the marginal influences on investment decisions made by companies.

Mr. Pawlowski added that around the world increasing oil prices, coupled with increased innovation and technology, was driving investment that was leading to increased production; Alaska was not experiencing the same growth trend. The administration believed that the reason Alaska was falling behind was due to a tax rate that increased as prices rose. The tax increases under ACES was diminishing the effect that increasing prices had on driving investment behavior. The flat tax would allow the price signal to follow into the system and benefit the state, as it does in the rest of the world.

Co-Chair Austerman hoped that the conversation would respond to the question of what percentage the state would take. He believed the point was of particular interest to the public.

Mr. Pawlowski replied that the intent of the afternoon meeting was to allow members to understand where in the bill the various mechanisms that the consultants would integrate into an economic picture for Alaskans could be found.

[9:56:18 AM](#)

Representative Thompson wondered how much of the money being spent on the North Slope was related to locating and

producing new oil compared to investment in the maintenance of continued oil flow.

Co-Chair Stoltze hoped industry would be able to answer the question later. He believed that the committee accepted the concept that tax policy influenced behavior.

Mr. Pawlowski continued to Slide 6:

- Amends AS 29.60.850(b) to eliminate the reference to AS 43.55.011(g) and substitutes the corporate income tax.
- Statute directs appropriation not to exceed \$60,000,000 or amount when added to fund balance, equals \$180,000,000.
- No change is made to the eligibility determinations for community revenue sharing payments or to authority of legislature to appropriate any amount.

Mr. Pawlowski pointed to Page 2, lines 9 through 16 of the legislation. He shared that current revenues from the progressivity surcharge were softly dedicated directly to the community revenue sharing fund. He remarked that in the original version of the bill the community revenue sharing fund was targeted back to the Alaska net income tax, which included corporate income tax on oil and gas tax payers as well as the broader economic activity of all corporate income tax payers.

Co-Chair Stoltze hoped the issue would be a smaller part of the committee's discussion.

[10:00:28 AM](#)

Mr. Pawlowski clarified that no changes would be made in the eligibility determinations or to the authority of the legislature to appropriate any amount to the fund. The intent was to maintain the system under which communities had been operating. The current version of the bill relinked the community revenue sharing back to the corporate income tax as a source of funding.

Mr. Pawlowski discussed slide 7: "Qualified Capital Expenditure Tax Credit."

- The 20 percent qualified capital expenditure tax credit is limited to expenditures incurred before January 1, 2014 to explore for, develop, or produce oil and gas deposits on the North Slope.
- Tax credits for expenditures incurred to explore for, develop, or produce oil and gas deposits south of the North Slope are not impacted.
- The full amount of a tax credit certificate may be issued in a single year.

Mr. Pawlowski spoke to Page 14, line 17 of the legislation. Under current law when a company made a qualified capital expenditure credit on the North Slope, two tax certificates were issued; the credit had to be divided and taken over two years. The spending itself generated the credit and then the credit was spread out in order to smooth the fiscal impact on the state. The general obligation was created by the act of spending. The legislation would allow the capital credits to be taken in a single year. The change would close out the 20 percent capital expenditure credit for the North Slope in the calendar year 2013. Expenditures made during 2013 would still generate the 20 percent capital credit, but expenditures after January 1, 2014 would no longer generate the credit.

Co-Chair Stoltze asked if the provision could result in a loss of revenue to the state.

Mr. Pawlowski replied that the provision would become an increase in revenue for the state because the state would no longer be paying the credits.

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Representative Holmes understood that the underlying concept of the provision was that the state had been incentivizing spending rather than production.

Mr. Pawlowski responded that when the administration began the process to repeal progressivity it was discovered that the repeal of progressivity was balanced by the repeal of the credits. The administration wished to simplify the tax rate as well as reduce the obligation for the state of the credits.

Representative Holmes hoped for a deeper public discussion that included the credits outstanding and the obligations of the state

[10:05:19 AM](#)

Representative Munoz asked about the increase in tax filers who were not tax payer. She noted the provision that stated that the tax filers were not owed a tax liability to the state.

Mr. Pawlowski stated that 19 tax payers were currently filed, 6 actually paid tax and 13 received enough in tax credits that their tax liability was zero. An additional 33 companies in the state had not produced oil but had filed for tax credits. He noted that the information could be found in the tax division's annual report.

Co-Chair Stoltze asked if the report listed the taxpayers by name.

Mr. Pawlowski replied that they were listed as anonymous filers.

Representative Munoz requested a copy of the report.

Mr. Pawlowski said he would provide a copy to the committee.

[10:07:09 AM](#)

Representative Costello queried the state's outstanding obligation for the qualified capital expenditure credit.

Mr. Pawlowski clarified that the question was for the current FY14 fiscal year.

Representative Costello requested the total potential liability to the state through the credit.

Mr. Pawlowski responded that the estimate for FY15 was approximately \$850 million.

Representative Costello wondered whether the credits were the driving force behind new exploration that had occurred in recent years.

Mr. Pawlowski stated that industry found credits important, but that the credits needed to be balanced by the tax rate. He said that if the state had a punitive tax system the credits would not be enough to overcome the tax system. The Brooks Range had given statements concerning the challenges faced which seeking out financing for new developments.

10:09:39 AM

Representative Kawasaki asked if Department of Revenue had a copy of the audited capital expenditures available to the committee members.

Mr. Pawlowski responded that the department regularly audited before credits were issued. He understood that the committee would need to go into executive session or sign a confidentiality agreement in order to see confidential tax payer information.

Representative Kawasaki recalled that when the original bill was drafted the intent had been to incentivize more exploration, production and development. He expressed concern that there were only 500 wells on the North Slope compared to most other hydrocarbon basins, such as Wyoming, which had 20,000 wells.

Representative Gara asked how many tax payers there were prior to ACES.

Mr. Pawlowski clarified that the numbers were not in reference to before ACES, rather that there were currently 19 potential tax payers, 6 of which actually paid tax. The remaining 13 received enough in tax credits to reduce their tax liability to zero. He added that there were an additional 33 that filed and received the exploration credits.

Representative Gara noted the major oil companies had testified that they were not interested in exploring outside of their units. He understood that the future of the state involved incentivizing new exploration and new fields online. He suggested that the extra 46 companies trying to get oil into the pipeline was beneficial to the state, even though the companies were not paying taxes, because they generated activity.

Mr. Pawlowski replied that the activity in the state was not as beneficial when put into the context of the activity occurring worldwide. The HCS CSSB 21(RES) did not repeal the exploration credit.

[10:14:26 AM](#)

Representative Gara believed that ACES was poorly worded. He wondered why the state could not rewrite the credit so that it related to direct well activity.

Mr. Pawlowski replied that a common statement made by companies was that Alaska often tended to micromanage development. He had observed during the evolution of the legislation a departure from trying to narrowly define what was incentivized. Rather than trying to design an incentive that generated targets toward wells or facilities the legislation would give a credit per barrel of oil. Instead of trying to incentivize what might result in production the benefit should be directly tied to the barrel of oil produced.

[10:16:16 AM](#)

Representative Gara recalled from previous testimony that one out of every 20 wells that were drilled proved useless. Taking away the credit for companies to spend money on wells could deter investment and other production related activity.

Mr. Pawlowski explained that the exploration incentive credit could still be used by qualifying companies. He said that there was a loss carried-forward credit in the legislation would generate a credit for companies that spent the money to drill an exploration well, and had no tax liability, that could be turned into the state for cash. He explained that the reason that the credit was lower than under ACES was because the bill reduced taxes overall.

Vice-Chair Neuman asked whether moving to a base qualified capital expenditure tax credit would simplify the tax code.

Mr. Pawlowski replied that that base tax rate was the primary simplification to the system. He reiterated that the administration wanted to focus the incentive on production.

10:21:07 AM

Mr. Pawlowski addressed Slide 8, "Carried-Forward Tax Credit AS 43.55.023(b)":

- Based on the amount of a producer's or explorer's adjusted lease expenditures that were not deductible in calculating the annual production tax values for that year.
- Retains 25% credit for a carried-forward annual loss for adjusted lease expenditures incurred outside of the North Slope.
- Provides a tax credit of 33% for a carried-forward annual loss for adjusted lease expenditures incurred after December 31, 2013 on the North Slope.

Mr. Pawlowski directed members to Page 15, line 14 of the bill. The previous qualified capital expenditure credit was based on qualified capital expenditures and was available to the major producers or a small producer that did not have a tax liability. The loss carried-forward credit was targeted specifically to companies that were spending more than they were earning, which narrowed the range of eligible companies. He stated that the administration believed that matching the 33 percent tax rate was an important policy objective because it would keep the new investors with the companies that were already in production. He encouraged the committee to keep the loss carry-forward consistent with the base tax rate.

Mr. Pawlowski continued to Slide 9, "AS 43.55.024 Credit":

- Extends the small producer credit to 2022 (from 2016) for producers of less than 100,000 BTU equivalent barrels of daily production.
- Non-transferable, only applies against AS 43.55.011(e) tax.
- Establishes a \$5 per barrel credit for each barrel of taxable oil that qualifies for a gross revenue exclusion.
- Establishes a sliding scale credit from \$8 to zero based on monthly gross value of oil produced on the North Slope that does not qualify for the gross revenue exclusion. Not applicable against the minimum tax.

Mr. Pawlowski explained that the credit was a \$12 million credit per company and provided a base level of support for smaller producers in the state. The credit was non-transferrable and only applied against the production tax.

Representative Gara queried the definition of a small producer based on the number of barrels produced in a day.

Mr. Pawlowski clarified that the \$12 million credit was for a producer with 50,000 barrel equivalent or less per day, but that the credit itself went up to less than 100,000, with a phase out between the two.

Vice-Chair Neuman asked about the ramifications of returning to a btu equivalent measurement.

Mr. Pawlowski replied that the btu equivalent in AS 43.55.011(g) was the progressivity function that determined the tax rate. The reference to btu equivalent barrels was retained in the small producer credit section of the legislation and was a production volume for the purposes of determining a fixed tax credit.

[10:26:38 AM](#)

Co-Chair Austerman requested further clarification concerning the \$12 million fixed credit.

Mr. Pawlowski replied that the small producer credit was a fixed amount per company and not per project. The small producer received a fixed annual credit of \$12 million until the point above 50,000 btu equivalent was reached, at which time the value of the credit itself would decline.

Co-Chair Austerman asked for more detail.

Mr. Pawlowski believed it would decline to \$6 million and then down to zero. He noted the equation in Section 43.55.024(c), subsection 2. He stated that no changes were being made to the way in which the credit functioned in current law, but was extending the time period with which a company could enter production and qualify for the credit. The legislation included an addition to the 02.4 credits; the credits were non-transferrable and only usable by the company that was generating the credit. He directed attention to Page 18 of the legislation which listed the per barrel credits:

Sec. 26. AS 43.55.024 is amended by adding new subsections to read:

(i) A producer may apply against the producer's tax liability for the calendar year under AS 43.55.011(e) a tax credit of \$5 for each barrel of oil taxable under AS 43.55.011(e) that meets one or more of the criteria in AS 43.55.160(f) and that is produced during a calendar year after December 31, 2013. A tax credit authorized by this subsection may not reduce a producer's tax liability for a calendar year under AS 43.55.011(e) to below zero.

(j) A producer may apply against the producer's tax liability for the calendar year under AS 43.55.011(e) a tax credit in the amount specified in this subsection for each barrel of taxable oil under AS 43.55.011(e) that does not meet any of the criteria in AS 43.55.160(f) and that is produced during a calendar year after December 31, 2013, from leases or properties north of 68 degrees North latitude. A tax credit under this subsection may not reduce a producer's tax liability for a calendar year under AS 43.55.011(e) to below the amount calculated under AS 43.55.011(f). The amount of the tax credit for a barrel of taxable oil subject to this subsection is

(1) \$8 for each barrel of taxable oil if the average gross value at the point of production for the month is less than \$80 a barrel;

(2) \$7 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$80 a barrel, but less than \$90 a barrel;

(3) \$6 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$90 a barrel, but less than \$100 a barrel;

(4) \$5 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$100 a barrel, but less than \$110 a barrel;

(5) \$4 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$110 a barrel, but less than \$120 a barrel;

(6) \$3 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$120 a barrel, but less than \$130 a barrel;

(7) \$2 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$130 a barrel, but less than \$140 a barrel;

(8) \$1 for each barrel of taxable oil if the average gross value at the point of production for the month is greater than or equal to \$140 a barrel, but less than \$150 a barrel;

(9) zero if the average gross value at the point of production for the month is greater than or equal to \$150 a barrel.

[10:31:03 AM](#)

Representative Wilson wondered if it would be an oversimplification to make all of the credits by-the-barrel credits.

Mr. Pawlowski responded that the easy oil was gone. He said that the economics of production required a variety of styles of credits in order to support the more expensive development.

Representative Wilson wondered whether more credits could be given to companies working with the harder to produce oil.

Mr. Pawlowski replied that the structure in the bill had come from the previous committee in an attempt to increase the effective tax rate at higher prices.

Representative Wilson requested a written response highlighting the advantages and disadvantages of a simple per barrel credit.

Co-Chair Stoltze remarked that the administration was presenting an agnostic and clinical view of the changes made by another committee; the administrations original bill was not before the committee.

Mr. Pawlowski appreciated the clarification.

[10:34:43 AM](#)

Mr. Balash communicated that a later presentation would highlight how the GRE would be the most effective tool for new production.

Representative Gara asked how the \$8 to zero sliding-scale "mini-progressivity" element shown on Slide 9 compared to progressivity under ACES. He shared that currently, after \$30 of profit was made on a barrel, progressivity was .4 percent per dollar.

Mr. Pawlowski deferred the question to economists and consultants. He furthered that slides would be developed that would best illustrate an answer.

[10:37:41 AM](#)

Representative Gara asked for verification that the \$5 per barrel credit only related to new oil.

Mr. Pawlowski replied in the affirmative.

Representative Gara remarked that the way the credit was currently designed it applied to leases given in 2003 for oil that had gone in to the pipeline in the past. He argued that the legislation would incentivize something that had already been done.

Co-Chair Stoltze remarked that the question would be held for later.

Mr. Pawlowski relayed that the next slide in the presentation would provide further information.

Co-Chair Austerman quoted Page 6 of a presentation from the previous day:

"At the year-end 2010 the Energy Information Agency and the Federal Department of Energy put remaining North Slope reserves at 3.7 billion barrels of oil."

Co-Chair Austerman assumed that the fields mentioned were legacy fields. He probed the determination of the percentage of new oil versus old oil in the legacy fields. He wondered how much of the 3.7 billion barrels of oil the sliding scale could be applied to.

[10:40:02 AM](#)

Mr. Balash answered that the 3.7 billion was cited for the year-end 2010; production since had brought the number down to 3.3 billion barrels. He thought that for comparison purposes; the central North Slope, on-shore, mostly state land, undiscovered resource estimated to be recoverable was approximately 3.1 billion barrels that should qualify under the GRE. He observed that the sliding scale credit, when oil was \$110 per barrel, offered a lot of incentive for a company to produce oil reserves already in the ground. He said that the 3.3 billion barrels estimated by the department could produce for decades.

Mr. Pawlowski clarified that the 3.3 billion that started off as the 3.7 billion estimated in the slide was not generally seen as eligible for the targeted incentives toward the geologically new production.

[10:43:38 AM](#)

Representative Costello wondered what would be the lowest effective tax rate and the highest for both the current and proposed tax systems.

Mr. Pawlowski spoke specifically to the legacy fields because they were the easiest to calculate. Under ACES, the lowest effective tax rate was essentially zero because credits could be used to off-set the minimum tax. The highest effective tax rate was the 75 percent, which was a combination of the 25 percent base rate plus the potential 50 percent of progressivity. He qualified that the 75 percent rate kicked in at extremely high oil prices. Under the bill the highest effective tax rate would be 33 percent. He offered that having a fixed tax rate benefited companies because the company could plan around the tax rate using credits to off-set expenses. Under 33 percent and the \$8 top zero sliding scale the 4 percent gross minimum would raise to a maximum of 33 percent on the net; under ACES it could go from zero to 75 percent.

Representative Costello believed that the discussion should take into account lower oil prices. She requested a comparison of the effect of progressivity at higher prices versus the sliding scale.

Mr. Pawlowski replied that the administration would address the issue later in the day. He appreciated the recognition

that there was a difference between a progressive tax and progressivity.

Representative Holmes expressed concern that if oil prices dropped under ACES the state would be in financial trouble. She asked whether the credits would go into negative at the expense of the state if there was no minimum effective tax rate under ACES.

Mr. Pawlowski replied that it was true. He stated that in low prices, high spending, and many credits being generated could set the stage for a negative tax liability situation. Incumbent producers would not have the ability to turn the credits into the state for a cash payment, the credits would be carried forward. The impact would be negative and would erode the state revenues into the following year.

[10:48:09 AM](#)

Representative Gara understood that at the highest price possible the tax rate would only rise to 33 percent.

Mr. Pawlowski replied in the affirmative. The credit would be used to offset taxes, similar to the capital credit under ACES.

Representative Gara hypothesized that the highest tax rate, at the highest price of \$200 per barrel, would be 33 percent under the sliding scale.

Mr. Pawlowski replied in the affirmative.

Representative Gara wondered whether the 4 percent minimum could go lower.

Mr. Pawlowski replied that a small producer or exploration credit could be used against the sliding scale, but the aforementioned credits were targeted and specific credits.

Representative Gara asked if a company's tax payment could be below zero under the credits that the bill left on the books.

Mr. Pawlowski said that he would get back to the committee. He stated that the sliding scale was targeted to specific production; the reality of the 4 percent minimum tax was still large when compared to a zero tax. He said he would need to add up all of the possible credits that would

remain under the system to conclude if the number could be taken to zero.

Representative Gara questioned whether the state had been in a situation under ACES where less than a 25 percent tax had been collected.

Mr. Pawlowski stated that he would follow up with the committee with the information.

[10:50:56 AM](#)

Mr. Balash thought that a review of several months in 2009 might reveal that the state did fall below 25 percent on a monthly basis.

Representative Munoz asked if the administration anticipated a problem with the nominal dollar figure verses a percentage in the per barrel scenario.

Mr. Pawlowski replied that it would be an issue in long-term economics. He stated that it was, more often than not, a benefit to the state. He said that the fear had been adding an additional level of complication by adjusting for the payments. He thought that lowering the per barrel credit would be a larger issue.

[10:55:36 AM](#)

RECESSED

[12:21:23 PM](#)

RECONVENED

Mr. Pawlowski discussed slide 10: "Gross Revenue Exclusion for North Slope Oil and Gas (Gross Value Reduction):

- For oil and gas produced north of 68 degrees North latitude, the gross value at the point of production is reduced by 20 percent for the oil or gas produced from:

1) Leases in a unit established after January 1, 2003;

2) New reservoirs in an expanded participating area within a unit formed before January 1, 2003;  
or

3) Acreage added to an existing participating area with approval by the Department of Natural Resources.

Mr. Pawlowski stated that the GRE was technically a reduction in the gross value. He noted that the provision could be found on Page 24, line 24 of the legislation. The provision would examine new developments both within and outside of existing units in an effort to reduce the gross production tax value by 20 percent of the gross value of the particular oil and gas that was produced. Under the current system the state did not distinguish between multiple different fields or different types of oil and gas being produced when taxing a company. In the spirit of simplicity, the mechanism focused on the barrel rather than investment or spending. The bill defined where the barrels came from and then counted them differently at the level of the gross value.

[12:25:35 PM](#)

Mr. Pawlowski discussed the distinctions.

Mr. Balash stated that when oil fields were explored and discoveries were made the fields generally covered more than a single lease, at which time the leases were brought together in a unit. Within the unit existed a two dimensional boundary and a new unit that was brought into production would be easy to count as new oil. Only two units producing presently would qualify on the unit test: Ooguruk and Nakiachuk. In both cases those units were brought forward by companies that were making investment commitments with a great degree of uncertainty. The decision to include them in the proposal had been made in an attempt to be fair. He relayed that when a company came to the state and made a discovery, and then took the step of unitizing, as they moved into production they identified for the Division of Oil and Gas what their participating area would be; the parts of the reservoir that would contribute to production from the wells that would be drilled in the plan of development. Once a company moved into production there was the possibility that another oil producing reservoir might be found. Multiple participating areas could exist in the unit proper and a new participating area in a legacy field would be considered new oil.

12:31:43 PM

Mr. Balash discussed the expansion of an area included in an existing field. He said that when the areas were established they were based on the expectation of how production would occur based on the technology available at the time. As time has passed technology has advanced to the point that companies could access further out and drive production from the extended areas, which required companies to apply for an expansion of the participating area. If a participating area expanded in a legacy field, the area could qualify for the GRE if the company was able to satisfy the department concerning the accountability of the production.

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ADJOURNMENT

12:34:12 PM

The meeting was adjourned at 12:34 p.m.