

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 4, 2013
12:00 a.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Mike Hawker
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Geran Tarr
Representative Chris Tuck

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE 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."

- MOVED HCS CSSB 21(RES) OUT OF COMMITTEE
[See 4/3/13 minutes for the call to order and action prior to 12:00 a.m.]

PREVIOUS COMMITTEE ACTION

BILL: SB 21
SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/16/13 (S) READ THE FIRST TIME - REFERRALS
01/16/13 (S) TTP, RES, FIN
01/22/13 (S) TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/22/13 (S) Heard & Held
01/22/13 (S) MINUTE(TTP)
01/24/13 (S) TTP AT 3:30 PM BUTROVICH 205
01/24/13 (S) Heard & Held
01/24/13 (S) MINUTE(TTP)
01/29/13 (S) TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/29/13 (S) Heard & Held
01/29/13 (S) MINUTE(TTP)
01/31/13 (S) TTP AT 1:00 PM BUTROVICH 205
01/31/13 (S) Heard & Held
01/31/13 (S) MINUTE(TTP)
02/05/13 (S) TTP AT 3:30 PM BUTROVICH 205
02/05/13 (S) Heard & Held
02/05/13 (S) MINUTE(TTP)
02/07/13 (S) TTP AT 3:30 PM BUTROVICH 205
02/07/13 (S) Moved SB 21 Out of Committee
02/07/13 (S) MINUTE(TTP)
02/08/13 (S) TTP RPT 1NR 4AM
02/08/13 (S) NR: DUNLEAVY
02/08/13 (S) AM: MICCICHE, GARDNER, FAIRCLOUGH,
MCGUIRE
02/08/13 (S) LETTER OF INTENT WITH TTP REPORT
02/09/13 (S) TTP AT 10:00 AM BUTROVICH 205
02/09/13 (S) Meeting if needed.
02/11/13 (S) RES AT 3:30 PM BUTROVICH 205
02/11/13 (S) Heard & Held
02/11/13 (S) MINUTE(RES)
02/13/13 (S) RES AT 3:30 PM BUTROVICH 205
02/13/13 (S) Heard & Held
02/13/13 (S) MINUTE(RES)
02/15/13 (S) RES AT 3:30 PM BUTROVICH 205
02/15/13 (S) Heard & Held
02/15/13 (S) MINUTE(RES)
02/18/13 (S) RES AT 3:30 PM BUTROVICH 205
02/18/13 (S) Heard & Held
02/18/13 (S) MINUTE(RES)
02/20/13 (S) RES AT 3:30 PM BUTROVICH 205
02/20/13 (S) Heard & Held
02/20/13 (S) MINUTE(RES)
02/22/13 (S) RES AT 3:30 PM BUTROVICH 205
02/22/13 (S) Heard & Held
02/22/13 (S) MINUTE(RES)

02/25/13 (S) RES AT 3:30 PM BUTROVICH 205
02/25/13 (S) Heard & Held
02/25/13 (S) MINUTE(RES)
02/27/13 (S) RES AT 3:30 PM BUTROVICH 205
02/27/13 (S) Moved CSSB 21(RES) Out of Committee
02/27/13 (S) MINUTE(RES)
02/28/13 (S) RES RPT CS 3DP 1DNP 2NR 1AM NEW
TITLE
02/28/13 (S) LETTER OF INTENT WITH RES REPORT
02/28/13 (S) DP: GIESSEL, MCGUIRE, DYSON
02/28/13 (S) DNP: FRENCH
02/28/13 (S) NR: MICCICHE, BISHOP
02/28/13 (S) AM: FAIRCLOUGH
02/28/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
02/28/13 (S) Heard & Held
02/28/13 (S) MINUTE(FIN)
03/01/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/01/13 (S) Heard & Held
03/01/13 (S) MINUTE(FIN)
03/01/13 (S) RES AT 3:30 PM BUTROVICH 205
03/01/13 (S) Moved Out of Committee 2/27/13
03/01/13 (S) MINUTE(RES)
03/02/13 (S) RES AT 10:00 AM BUTROVICH 205
03/02/13 (S) Moved Out of Committee 2/27/13
03/02/13 (S) MINUTE(RES)
03/04/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/04/13 (S) Heard & Held
03/04/13 (S) MINUTE(FIN)
03/04/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/04/13 (S) Heard & Held
03/04/13 (S) MINUTE(FIN)
03/05/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/05/13 (S) Heard & Held
03/05/13 (S) MINUTE(FIN)
03/05/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/05/13 (S) Heard & Held
03/05/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/06/13 (S) Heard & Held
03/06/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/06/13 (S) Heard & Held
03/06/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 3:00 PM SENATE FINANCE 532
03/06/13 (S) -- Public Testimony --
03/11/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/11/13 (S) FIN AT 1:30 PM SENATE FINANCE 532

03/12/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
 03/12/13 (S) Bills Previously Heard/Scheduled
 03/12/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
 03/12/13 (S) Heard & Held
 03/12/13 (S) MINUTE(FIN)
 03/12/13 (S) FIN AT 4:00 PM SENATE FINANCE 532
 03/12/13 (S) Heard & Held
 03/12/13 (S) MINUTE(FIN)
 03/13/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
 03/13/13 (S) Heard & Held
 03/13/13 (S) MINUTE(FIN)
 03/13/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
 03/13/13 (S) Heard & Held
 03/13/13 (S) MINUTE(FIN)
 03/14/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
 03/14/13 (S) Moved CSSB 21(FIN) Out of Committee
 03/14/13 (S) MINUTE(FIN)
 03/18/13 (S) FIN RPT CS 2DP 1DNP 1NR 3AM NEW
 TITLE
 03/18/13 (S) DP: KELLY, MEYER
 03/18/13 (S) DNP: HOFFMAN
 03/18/13 (S) NR: FAIRCLOUGH
 03/18/13 (S) AM: DUNLEAVY, BISHOP, OLSON
 03/18/13 (H) RES AT 1:00 PM BARNES 124
 03/18/13 (H) Scheduled But Not Heard
 03/19/13 (S) RLS AT 9:00 AM FAHRENKAMP 203
 03/19/13 (S) <Teleconference Listen Only>
 03/20/13 (H) RES AT 1:00 PM BARNES 124
 03/20/13 (H) Scheduled But Not Heard
 03/21/13 (S) TRANSMITTED TO (H)
 03/21/13 (S) VERSION: CSSB 21(FIN) AM(EFD FLD)
 03/22/13 (H) READ THE FIRST TIME - REFERRALS
 03/22/13 (H) RES, FIN
 03/22/13 (H) RES AT 1:00 PM BARNES 124
 03/22/13 (H) Heard & Held
 03/22/13 (H) MINUTE(RES)
 03/25/13 (H) RES AT 1:00 PM BARNES 124
 03/25/13 (H) Heard & Held
 03/25/13 (H) MINUTE(RES)
 03/26/13 (H) RES AT 6:00 PM BARNES 124
 03/26/13 (H) Heard & Held
 03/26/13 (H) MINUTE(RES)
 03/27/13 (H) RES AT 1:00 PM BARNES 124
 03/27/13 (H) Heard & Held
 03/27/13 (H) MINUTE(RES)
 03/28/13 (H) RES AT 6:00 PM BARNES 124
 03/28/13 (H) Heard & Held

03/28/13	(H)	MINUTE(RES)
03/29/13	(H)	RES AT 1:00 PM BARNES 124
03/29/13	(H)	Heard & Held
03/29/13	(H)	MINUTE(RES)
04/01/13	(H)	RES AT 1:00 PM BARNES 124
04/01/13	(H)	Heard & Held
04/01/13	(H)	MINUTE(RES)
04/02/13	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
04/02/13	(H)	Scheduled But Not Heard
04/02/13	(H)	RES AT 9:00 AM BARNES 124
04/02/13	(H)	Heard & Held
04/02/13	(H)	MINUTE(RES)
04/02/13	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
04/02/13	(H)	Scheduled But Not Heard
04/02/13	(H)	RES AT 6:00 PM BARNES 124
04/02/13	(H)	Heard & Held
04/02/13	(H)	MINUTE(RES)
04/03/13	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
04/03/13	(H)	<Pending Referral>
04/03/13	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

MATTHEW FONDER, Director
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager
Office of the Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

SUSAN POLLARD, Assistant Attorney General
Oil, Gas & Mining Section
Civil Division (Juneau)
Department of Law (DOL)
Juneau, Alaska

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

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

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

MARIE EVANS, Tax Counsel
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

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

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

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

POSITION STATEMENT: During the hearing on CSSB 21(FIN) am(efd fld), answered questions regarding proposed amendments to the proposed committee substitute, HCS CSSB 21, Version K.

ACTION NARRATIVE

SB 21-OIL AND GAS PRODUCTION TAX

[This is a continuation of the April 3, 2013, meeting during the course of the discussion of Amendment 31, the text for which is provided at the end of this document.]

12:00:23 AM

MATTHEW FONDER, Director, Anchorage Office, Tax Division, Department of Revenue (DOR), agreed with Ms. Pollard's testimony, although he said he would have to research the question to provide an answer with 100 percent confidence.

CO-CHAIR SADDLER asked what the actual fiscal impact of this would be.

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager, Office of the Commissioner, Department of Revenue (DOR), replied he does not believe DOR has a "fiscal impact understanding around this particular provision." The central issue is about the treatment of transportation costs for a taxpayer that is also an owner and an affiliated shipper on a pipeline. An example would be when one of the taxpayers owns a piece of the pipeline or transportation system used for shipping the oil; this is the issue in the current law.

CO-CHAIR SADDLER recalled the contentiousness of the Trans-Alaska Pipeline System (TAPS) tariff case.

REPRESENTATIVE TUCK noted there has been no testimony on this issue and over several years no concerns have been raised; therefore, he said he would vote against the amendment.

REPRESENTATIVE TARR asked under what circumstances the state would be able to collect taxes if an adjustment was warranted.

12:03:34 AM

SUSAN POLLARD, Assistant Attorney General, Oil, Gas & Mining Section, Civil Division (Juneau), Department of Law, restated Representative Tarr's question: If a tariff is later adjusted and then the transportation costs change, can the state collect the adjusted amount? She said the answer is yes.

LENNIE DEES, Audit Master, Production Audit Group, Tax Division, Department of Revenue (DOR), further explained that if a tariff changes after a taxpayer has filed, as authorized by AS 43.55.075, the taxpayer is required to refile if there is a change in the tax due, which is a common occurrence when a tariff has been disputed before the Federal Energy Regulatory Commission (FERC) or the Regulatory Commission of Alaska (RCA). A ruling from either commission to lower the tariff will impact the taxable value of the oil. He described the current process

of calculation under ACES, and advised that an effect of Amendment 31 would be a decrease in the amount of taxes.

CO-CHAIR FEIGE asked whether reasonable costs of transportation have typically been lower or higher.

MR. DEES clarified that the taxpayer deducts the lower of actual or reasonable costs; if the reasonable cost of transportation calculated by DOR is lower than actual cost, taxpayers are only allowed to deduct the reasonable cost. This only occurs with taxpayers that have affiliated carriers. As referred to by Representative Hawker, prior to ACES, three conditions were required to be true for reasonable costs of transportation to apply; however, under ACES only one condition has to be true. A number of taxpayers in Alaska have ownership in pipelines, and are required to meet the "reasonable cost of transportation test."

[12:07:41 AM](#)

REPRESENTATIVE SEATON directed attention to Amendment 31, page 2, line 5, which directs that transportation costs will be fixed by what is on file, instead of what has been adjudicated as just and reasonable by RCA or another agency. He surmised this means if a company is shipping on its own pipeline, it can "jack up the rate in the pipeline" and pay the rate, thereby reducing the value of the oil and lowering taxes. Or, if one owns the tankers, instead of paying what another would pay for shipping, the owner could pay more and subtract the higher "supposed value." This would artificially create a higher transportation cost. Representative Seaton recalled this is the situation that cost the state about \$6 billion in the settlement of TAPS tariff litigation. He said allowing companies to have higher rates on file for affiliates, allows them to value their oil lower at the wellhead. He said he would vote against adopting the amendment.

[12:10:14 AM](#)

CO-CHAIR FEIGE agreed that owners of the pipeline could increase their actual costs; the amendment says that the reasonable costs of transportation are actual costs, except when the parties are affiliated, or when the contract is not an arm's-length transaction. For example, BP Exploration Alaska Inc. has an ownership share in the pipeline, and if shipping its oil, reasonable costs would rule, as opposed to actual costs.

REPRESENTATIVE HAWKER said he did not believe the circumstances as previously described are accurate, and invited testimony from an expert witness to explain the industry's perspective on - and rationale for - the amendment.

[12:12:24 AM](#)

MARIE EVANS, Tax Counsel, ConocoPhillips Alaska, Inc., recalled a long-standing practice that existed in law under the Economic Limit Factor (ELF) [enacted in 1977] and the Petroleum Production Tax (PPT) bill [enacted in August 2006] changed under Alaska's Clear and Equitable Share (ACES) [enacted in November 2007]. At the time of the ELF and PPT statutes, the requirement to refile was in regulation, but was moved from regulation into AS 43.55.075. If a company were to "jack up the tariff," the state and shippers have the right to protest the rates, and after the rates are settled or adjudicated, the taxpayer is required to refile taxes. Interest is paid from the date due, even though the litigation process may be very long. Ms. Evans urged the committee to keep in mind that this situation creates uncertainty at the time taxes are filed. As a taxpayer, there is no choice other than to deduct what is paid and, if prices are changed, refile relative to the refund from the carrier companies to the shippers. Also, although DOR was diligent during the regulation process, the regulations are long and extremely difficult to understand, which leaves the final interpretation open to DOR's discretion. She concluded that, ideally, a self-assessed tax should be known and calculable by the taxpayer at the time it is due.

[12:17:14 AM](#)

CO-CHAIR FEIGE asked whether Ms. Evans worked for ConocoPhillips Alaska under the previous set of statutes.

MS. EVANS said she came to work for ConocoPhillips Alaska as in-house counsel after ACES passed, thus her experience with the previous tax policy was gleaned while working on appeals. In further response to Co-Chair Feige, she opined that adopting the amendment will result in less challenge and more certainty when the tax is calculated.

REPRESENTATIVE HAWKER expressed his concern that the bill is asking taxpayers to file taxes - that are subject to audits - following regulations "nobody quite understands." He restated that prior to ACES there was a mechanism in place that worked for everyone; this amendment replaces that mechanism. The

amount that a taxpayer actually pays is a reasonable amount to pay for a transportation deduction, and pointed out the exception that certain circumstances will lead to a rate that is on file with a regulatory body, and that is subject to change by a regulatory body.

[12:19:47 AM](#)

REPRESENTATIVE SEATON urged the committee to consider that the language deleted is "adjudicated as just and reasonable," and is being replaced with "what you pay yourself." He suggested more testimony is needed from legislative attorneys to advise on tax liability and calculations, and also to advise on the prior litigation that showed that higher charges, in order to reduce gross value at the point of production, occurred.

REPRESENTATIVE HAWKER questioned the aforementioned characterization of the issues surrounding the tax settlement.

REPRESENTATIVE TARR maintained her objection, and said her staff estimates that the cost of the amendment may be over \$150 million per year. She requested DOR to comment on the potential fiscal impact.

MR. PAWLOWSKI indicated that without knowing the actual calculations around the particular tax rate and per barrel allowances in the bill, he was hesitant to respond.

[12:22:35 AM](#)

DAN STICKLE, Assistant Chief Economist, Anchorage Office, Tax Division, Department of Revenue (DOR), said to calculate the fiscal impact he needed to know the potential change in the tariff.

REPRESENTATIVE TARR, in response to Co-Chair Feige, said her estimate was based on information from her staff. She said she is requesting this information because it would be helpful to have some idea of the impact in order to protect the state's interests.

MR. STICKLE, referring to Representative Tarr's estimate, said, "My gut feeling is that's probably on the high end of the range that we would arrive at if we did do a detailed analysis."

MR. PAWLOWSKI asked whether the Tax Division in Anchorage knows what is currently deemed as reasonable transportation cost versus actual transportation cost.

MR. FONDER said his division is unable to run numbers at this time because the employees who work with the reasonable cost of transportation are not present and would need additional time to delve into this issue.

[12:24:33 AM](#)

A roll call vote was taken. Representatives Hawker, Olson, Johnson, and Feige voted in favor of Amendment 31. Representatives Tuck, Seaton, Tarr, P. Wilson, and Saddler voted against it. Therefore, Amendment 31 failed by a vote of 4-5.

[12:26:25 AM](#)

REPRESENTATIVE HAWKER moved to adopt Amendment 32 [text provided at the end of this document].

REPRESENTATIVE TARR objected.

REPRESENTATIVE TUCK asked whether Amendment 32 was drafted by Legislative Legal and Research Services.

REPRESENTATIVE HAWKER said the structure of the amendment drafted by Legislative Legal and Research Services was unsatisfactory; therefore, Amendment 32 is presented with the same language, but "the organization of the language is different." He asked for Amendment 32 to be considered a conceptual amendment and said the purpose of the change in the structure of the amendment is to ensure that this [subsection] of statute is placed as [subsection] (a) instead of [subsection] (m).

REPRESENTATIVE TARR stated that during this session the committee has been following a policy that all amendments must come from Legislative Legal and Research Services. On two occasions she offered amendments that were not accepted by the committee for this reason. At this critical time, she urged that the rule not be broken.

REPRESENTATIVE TUCK recalled he offered an amendment to correct a small drafting error which was denied for the same reason and he was directed to offer an amendment to the amendment. He urged that the committee not accept this conceptual amendment.

REPRESENTATIVE HAWKER said New Amendment 32 is forthcoming.

[12:29:03 AM](#)

The committee took an at-ease from 12:29 a.m. to 12:41 a.m.

[12:41:25 AM](#)

REPRESENTATIVE HAWKER withdrew Amendment 32 as offered. He moved to adopt New Amendment 32, labeled 28-GS1647\K.34, Nauman/Bullock, 4/3/13, [text provided at the end of this document].

REPRESENTATIVE TUCK objected.

[12:42:10 AM](#)

REPRESENTATIVE HAWKER moved to adopt Amendment 1 to New Amendment 32. He explained the purpose of Amendment 1 to New Amendment 32 is to replace New Amendment 32 with the document that was provided to committee members labeled Amendment 32.

REPRESENTATIVE TUCK objected.

REPRESENTATIVE HAWKER expressed his preference for the language in Amendment 32 because it preserves the sequential order of statute, it is more legible and understandable, and it is easier to interpret. The substance of the language in Amendment 32 is identical to the language in New Amendment 32.

REPRESENTATIVE TUCK maintained his objection, saying there have been amendments drafted by Legislative Legal and Research Services that had simple mistakes, but attempts to offer amendments to correct the mistakes were denied. He said Amendment 1 to New Amendment 32 is a way to get around what has been denied to other committee members. Representative Tuck asked for comments from Representative Johnson, chair of the House Rules Standing Committee.

REPRESENTATIVE JOHNSON asked whether Representative Tuck was requested to amend his amendment at the time of the aforementioned incident.

[12:44:49 AM](#)

REPRESENTATIVE TUCK relayed that after the introduction of his amendment was denied, he suggested amending the amendment. However, his suggestion was also denied.

REPRESENTATIVE JOHNSON said the procedure to amend an amendment is proper, and the decision to accept or deny an amendment rests with each individual committee chair.

REPRESENTATIVE SEATON drew attention to Amendment 32, page 1, line 7, with a date of March 31, 2006, and to New Amendment 32, page 1, line 10, with a date of January 1, 2014, and pointed out that the amendments were described as identical.

REPRESENTATIVE HAWKER acknowledged the January 1, 2014, date in the document drafted by Legislative Legal and Research Services is incorrect.

REPRESENTATIVE SEATON said there is also a title change in the document drafted by Legislative Legal and Research Services, and questioned whether there are other substantive changes.

REPRESENTATIVE HAWKER said no.

REPRESENTATIVE TARR asked whether the chair has ruled that the previous requirements of "24-hours" and that all amendments must be drafted by Legislative Legal and Research Services are no longer in place.

CO-CHAIR FEIGE noted the original amendment was drafted by Legislative Legal and Research Services, and the sponsor has offered an amendment to the amendment. This is proper procedure, he said.

REPRESENTATIVE TUCK maintained his objection, pointing out that the amendment was drafted on 4/3/13. To comply with the 24-hour rule, the amendment would have had to be drafted on 4/2/13.

CO-CHAIR FEIGE explained that all of the amendments were returned to Legislative Legal and Research Services to be conformed to the committee substitute, Version K.

[12:48:03 AM](#)

A roll call vote was taken. Representatives Johnson, Olson, Seaton, P. Wilson, Hawker, Saddler, and Feige voted in favor of Amendment 1 to New Amendment 32. Representatives Tarr and Tuck

voted against it. Therefore, Amendment 1 to New Amendment 32 was adopted by a vote of 7-2.

12:48:50 AM

REPRESENTATIVE HAWKER explained that New Amendment 32, as amended, addresses the issue of joint interest billings. The amendment would restore language in AS 43.55.165, on lease expenditures, to what the language was for [subparagraphs] (A), (B), (C), and (D), prior to the passage of ACES. "So we are simply going back to language that was established to define lease expenditures when the original PPT legislation passed," he said. One of the significant changes, for example, is that on page 1, line 12, the language from PPT is restored to "the department shall consider, among other factors," instead of "may consider," which was the language under ACES. He advised that the changes preface allowable lease expenditures to include the ordinary and necessary costs upstream of the point of production, and this relates to the language that says the department "shall consider, among other factors, typical industry practices and standards in the state that determine costs." He directed attention to [subsection] (c), on page 2, beginning at line 17, and paraphrased as follows:

if the department finds that the pertinent provisions of a unit operating agreement or similar operating agreement are substantially consistent with the department's determinations and standards under (a) of this section concerning whether costs are lease expenditures, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures ...

12:51:34 AM

REPRESENTATIVE HAWKER continued to explain that the amendment will enable companies to utilize costs that are incurred by the operator and that are billed from one to another, or that would be billed. As an aside, he characterized the costs that are billed from one operator to another as a reasonable and fundamental determination of the costs of operating in the oil fields. Directing attention to Section 37 of the bill, which is adding (d) back into statute, on page 3, beginning at line 15, he paraphrased as follows:

... if the department makes the finding described in (c) of this section with respect to a unit operating agreement or similar operating agreement and, in addition, finds that at least one working interest party to the agreement, other than the operator, with substantial incentive and ability to effectively audit billings, under the agreement in fact is effectively auditing billings under the agreement, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state only ...

[12:54:45 AM](#)

REPRESENTATIVE HAWKER further explained that the language applies if the department finds that the unit operating agreements are substantially consistent with the department's determinations and standards, and further determines that one party who is not the operator, but that has the incentive and ability to audit the billings, is doing so. He clarified that the agency must find that the agreements are substantially similar, and then that the audit process underway is effective and in place. If the aforementioned two requirements are met, the department may adopt regulations to treat - as a portion of a party's lease expenditures in a calendar year - those costs that are billed in the working interest agreements. He reminded the committee that working interest agreements are the foundation of how the industry on the North Slopes works: two or three producers operate together, with one running a particular development and billing its partners. He said these billings are audited, and there can be no collusion between the parties, because these billings are the manner by which the industry defines and details the sharing of the expenses for operating the fields. In fact, the amendment puts back in place the ability of the department to utilize the audits and consider them among typical industry practices; this is done by replacing "may" with "shall." He restated that the language is not new and was legally crafted and existed in the original PPT legislation. Furthermore, the joint interest billings are used by the oil and gas industry to file federal income tax returns, thus this information is also audited internally, subject to audit by the Internal Revenue Service (IRS), and is certified by senior management of the companies. If the companies agree that these are the correct costs of operating, he suggested that the

legislature is overstepping its authority if the state writes a regulation that does not allow the state to use the costs as a basis to audit producer tax returns. Representative Hawker noted testimony by the oil and gas industry seeking consistent, one-time filing, without multiple sets of books driven by department regulations that are not relevant. He opined the department has been unable to complete audits in a timely manner because it does not rely upon the work of other auditors as was done under PPT. Restoring the prefacing language back into statute on what constitutes a lease expenditure as established in the PPT legislation before ACES will tell the department that it is required to use operating agreements - under the conditions allowed - as guidance for what is typical industry practice for ordinary and necessary costs upstream of the point of production.

1:01:21 AM

REPRESENTATIVE HAWKER continued, saying when ACES passed, the department's interpretation was that it would not use the billings, and that was a change that created a great deal of confusion, multiple bookkeeping, and inconsistency. The present language does not capture typical industry practice, or allow appropriate deductions of ordinary and necessary costs by an operator. He stressed New Amendment 32, as amended, is not a nullification of present regulations, but does require a review of present regulations for consistency, and a recognition and greater acceptance of joint interest billings as a standard upon which to look at costs of production in an easier, more efficient, and more effective way for all of the parties involved. The amendment puts back in place the language in the original PPT legislation, which would be effective from the date of the original PPT legislation.

1:03:32 AM

REPRESENTATIVE P. WILSON ascertained that the current procedure is for the department to audit the operator and each party, but with the passage of this amendment, the department will only audit the operator.

REPRESENTATIVE HAWKER stated that joint interest billings are agreed to and audited amongst the participants. The amendment would allow the department to decide that if the audit is properly executed by a party that is not the operator, the audit can be accepted as a basis of the oil and gas production tax return.

CO-CHAIR SADDLER asked the Tax Division for the advantages and disadvantages of the current system.

1:06:08 AM

JOHN LARSEN, Audit Master, Anchorage Office, Tax Division, DOR, addressed the statement that the department's regulations have no bearing on how industry functions, and the statement regarding the lease expenditure statute. The legislature repealed AS 43.55.165 (c) and (d) as of 7/1/07, thus the department wrote a set of regulations for determining the reasonable costs of allowable lease expenditures. In addition, regulations were necessary in the case of a single operator with no third party auditing of the agreement. Turning to the use of typical industry practices, his professional opinion is that the regulations do account for ordinary and necessary costs of oil field operations for exploration, development, and production. As the regulations were being developed, the department analyzed and compared unit operating agreements, because the joint interest billing is the invoice for the shared cost, which is an industry standard. He pointed out that the department sought to look not only at standard industry practices in Alaska, but also relied on interpretations by the Council of Petroleum Accountants Societies (COPAS), a nationwide organization of companies throughout the industry. The organization is dedicated to the promulgation of fair accounting standards for all companies. Specifically, a COPAS model-form accounting procedure was used as a baseline for the regulations. Mr. Larsen said the department also used the Department of Natural Resources (DNR), Division of Oil & Gas (DOG), net profit share lease (NPSL) regulations. He offered to prepare a matrix that demonstrates the symmetry between the department's regulations and COPAS standards. One of the goals of the department was to establish a single standard of lease expenditure regulations that could be applied throughout the state. Turning to Representative Hawker's comment on IRS filings, he acknowledged that there are IRS standards; however, he pointed out, the IRS audits for income tax and not for oil and gas production taxes.

MR. LARSEN advised that joint venture audits, which are performed by the companies, are audits in the interest of the company, not in the interest of the state, and if the state is bound by the joint interest agreement, it is bound to an agreement of which it is not a party.

1:13:01 AM

CO-CHAIR SADDLER restated his question.

MR. LARSEN said one advantage of using the state's regulations is that a single standard is established throughout the state. He said he would give more thought to the disadvantages of the current system. One advantage to the system proposed by the amendment is the convenience of using joint interest billings; however, he reiterated, the auditors are auditing for the interest of their companies. He further opined the IRS determines allowable costs for income tax, not production audit tax, and there is quite a difference.

[1:15:33 AM](#)

CO-CHAIR FEIGE asked whether the division will be able to audit as effectively on behalf of the state, if New Amendment 32, as amended, is adopted.

MR. LARSEN replied no, because the audit authority is being removed from the department and placed in the hands of the parties of interest.

CO-CHAIR FEIGE understood the amendment provides that the department would be able to audit the books of the operator of a particular development and determine which expenses are allowable, which would pass to the other leaseholders.

[1:17:03 AM](#)

MR. DEES said that is one of the approaches the department could take in the case of joint venture operating agreements; however, there has been resistance from the partners to this approach because each individual company is being assessed a production tax based on its own filing. Therefore, a company may be a partner in several joint ventures, and also have activities in stand-alone operations. The department looks at each company individually in order to maintain confidentiality during an audit. Changing to net tax in a situation where there are taxpayers that are not operators presents challenges, as the details are on the joint interest billings. He opined the amendment does not change current procedures because department regulations do consider several operating agreements within the state. Furthermore, using the department's standards for allowable lease expenditures is to maintain the same set of standards for each taxpayer for consistency. For example, in statute, certain expenditures are not allowable, even though

they are shared costs billed between partners in a joint operating agreement, such as those defined in AS 43.55.165 [subsection] (e). Mr. Dees concluded that the approach taken by the department best serves the statute as written.

[1:20:37 AM](#)

CO-CHAIR FEIGE asked whether the department would be able to process audits more efficiently if the amendment is adopted.

MR. DEES pointed out that lease expenditures are just one part of the activities perused in an audit; other activities audited are revenues and transportation costs. He acknowledged that this approach may accelerate the lease expenditure part of the audit.

REPRESENTATIVE HAWKER disagreed with the implication that the amendment will "allow unallowable expenditures." He said the amendment changes in statute "the department may consider among other factors," and drew attention to the amendment on page 1, line 12, which read:

department shall consider, among other factors,
(1) the typical industry practices and standards in the state that determine the costs, other than items listed in (e) of this section, ...

[1:23:47 AM](#)

REPRESENTATIVE HAWKER explained that [subsection] (e) includes the disallowed costs. He then turned attention to page 3, and said the language directs the department to review and ensure that there is at least one working interest owner party to the agreement, thus there is no issue regarding a single operator. On page 3, beginning at line 18, he paraphrased as follows:

... other than the operator, with substantial incentive and ability to effectively audit and is in fact effectively auditing ... subject to ... regulations adopted by the department, ... other than items listed in (e) of this section

REPRESENTATIVE HAWKER urged that the department should implement the standards the legislature has determined - rather than its own set of standards - on what are allowable lease expenditures. He restated that the mechanism worked well before it was changed under ACES without scrutiny, and said, "We didn't contemplate

that we would be in fact, the legislature, abrogating our policy-making role to regulators in the Department of Revenue." Although still leaving a great deal of power with the department, the amendment directs that the "working billings" will be used as a place to begin an audit, and that they will not be discounted. On page 2, beginning on line 17, he paraphrased as follows:

... if the department finds that the pertinent provisions of a unit operating agreement or similar operating agreement are substantially consistent with the department's determinations and standards under (a) of this section concerning whether costs are lease expenditures, ...

[1:26:28 AM](#)

EPRESENTATIVE HAWKER said (a) is the policy provision that reflects the legislature's intention: Lease expenditures are ordinary and necessary costs upstream of the point of production incurred by a calendar year ... that are direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in the state or, in the case of land in which the producer does not own a working interest, that are direct costs of exploring for oil or gas deposits located within other land in the state.

[1:28:08 AM](#)

REPRESENTATIVE TARR said she objects to the amendment because the state will no longer get needed information from the audit. She compared the effect of the amendment to negotiating on taxes with one's self, which would result in a better position than negotiating with the IRS. She understood that the reason for the change in ACES was because under the PPT tax, the tax revenue was \$800 million less than expected, partly due to larger than expected lease deductions. Therefore, ACES legislation was written to prevent a reoccurrence.

MR. DEES, although he did not have direct experience, agreed the aforementioned may have been a factor. He opined what led to the changes in ACES was related to costs from failures due to deferred maintenance in 2006. In response to Co-Chair Feige, he said the impact of lease expenditures that are higher than expected would be that production tax values are lower than expected.

CO-CHAIR FEIGE said his question is whether the difference was due to the definition of lease expenditure or because of auditing practices.

MR. DEES opined it was not due to auditing practices but to the actual reported expenditures.

REPRESENTATIVE HAWKER noted that the amendment was drafted to include every change to subsection (e) that was made in the ACES legislation. "I'm not trying to go back and change that," he said.

[1:31:51 AM](#)

REPRESENTATIVE TARR asked Mr. Dees for clarification on whether the proposed process would become more complicated when one sole venture operator is in partnership with others in a joint venture, and some exceptions apply but others do not.

MR. DEES suggested that a set of standards for lease expenditures that are applicable to all parties affected by a tax structure is better for the state and the auditors. If the state establishes standards, just because parties to an operating agreement agree to certain costs, would not mean that the costs are lease allowable expenditures.

CO-CHAIR FEIGE expressed his understanding that an auditor who is auditing the operator would make the determination on whether a cost is a deductible cost.

MR. DEES observed that the department audits the operator as a taxpayer, not as an operator. Thus, if a cost is not allowable, it affects that particular taxpayer's assessment, but not that of all of the partners. He relayed companies are resistant to the "operator approach" because taxes are proprietary, and companies do not want the department to apply others' tax assessments on them. He explained that with joint operated costs, one company may capitalize a cost and another may treat it as an expense; therefore, in response to the wishes of the companies, the department audits each taxpayer separately.

[1:35:44 AM](#)

CO-CHAIR FEIGE questioned why there are differences in accounting and how costs are accounted for, when all parties are paying based on the same tax code.

MR. DEES said the IRS views a partnership as a taxable entity; however, in production tax the state does not tax partnerships, and each taxpayer, explorer, or producer is assessed as an individual entity.

REPRESENTATIVE TARR gave an example that an individual taxpayer would have different accounting because of differing state and federal tax codes.

MR. DEES said no; but it could be an internal accounting policy that differs between the joint interest partners.

REPRESENTATIVE TUCK inquired as to the "push back" the department receives from companies.

MR. DEES said he was referring to push back from companies that do not want the department to audit an operator, and then use the results of that audit for assessing others.

[1:38:35 AM](#)

REPRESENTATIVE SEATON was surprised to hear that the audit process worked well under PPT, because no audits were completed. He said his first concern is that the effective date of the amendment is 3/31/06, and questioned whether the developed auditing scheme and regulations, and the recently funded computer system, will have to be revised to apply to joint operating agreements. In addition, he asked whether audits will apply to all parties at once because "we're auditing a company - not a ring-fence operation." In fact, all of the information is needed, thus all of the operators may have to be audited first in order to decide from the joint operating agreements what was disbursed to each individual company.

MR. DEES responded that the operator does not have to be audited first. The department audits all of the activity for that taxpayer and looks at all of its joint interest billings. A reconciliation document between the billings and the lease expenditures that are being deducted, including the excluded costs in accordance with AS 43.55.165 (e), is requested. The tax is not calculated on individual joint ventures; for example, the tax structure identifies segments by areas of the state, and the North Slope is a single segment. So, for a company in several joint ventures that produce oil on the North Slope, the tax is calculated on the totality of its activity. In further response to Representative Seaton, Mr. Dees said two years ago, the department was approved for a tax revenue management system

in order to help the department catch up with voluminous amounts of data, and that system will be operational in two years.

[1:43:43 AM](#)

REPRESENTATIVE HAWKER closed, saying the intent of the amendment is to allow appropriate regulatory oversight for the use of joint interest billings in order to determine how costs are allocated amongst partners in the oil fields. He said one of the reasons to go back to using the billings as an auditing tool is due to the failures and weaknesses that exist in the state internal accounting control systems. He referred to state single audit findings for the fiscal year (FY) ending 6/30/12, [document not provided to the committee] and said:

[The report found] audit findings of material internal accounting control weaknesses in the Department of Revenue. These are considered significant deficiencies and that is, that in years fiscal 08 to 11, significant deficiencies ... in the controls over the Tax Division, severance tax audits, were reported. Control deficiencies included: insufficient audit oversight, lack of standard procedures guiding the audit process, inadequate audit reviews, and untimely tax return reviews and reconciliation. Additionally, the Tax Division lacks standardized templates for the annual tax return. The current position - this is a year later - the Tax Division management has made improvements in audit oversight, written standard procedures, and audit reviews, yes, nevertheless, the control deficiencies identified in prior audits have not been fully addressed.

[1:45:39 AM](#)

EPRESENTATIVE HAWKER then pointed out that although the written standards were implemented in FY 11, the state auditor could not confirm the full implementation of recommended procedures and, as of FY 12, no audits were completed under the new procedures. Also, the audit plan guiding the auditors for tax systems under PPT and ACES legislation was not fully designed at the end of FY 12. He read [from a document not provided to the committee] as follows:

Tax Division management expects the audit plan to be completed in FY 13 and used for audits starting in that year. Although ... no tax return audits were

completed in FY 12 under the new procedures, the division did complete an audit of a 2006 tax return and audits of tax credits.

REPRESENTATIVE HAWKER said legislative assessments found that supervisory reviews by the audit tax master were not documented, and the audit supervisor review checklist was not consistently completed. Further, he said the report he cited also noted that money has been appropriated for management and improvements, and the agency response to the report was that it agreed with the findings. He said the audit division is understaffed and does not have adequate resources to complete its task; the amendment will provide a tool to allow the taxpayer and the tax auditor to work together in a reasonable and responsible manner.

[1:48:14 AM](#)

REPRESENTATIVE TARR maintained her objection, and expressed her understanding that some of the delay was caused by the change to ACES just as the regulations for PPT were developed. She asked whether the delays are due to a failure of the audit department, or because of the course of time needed to facilitate two substantial changes in legislation. She said she was told that "once they get the first year done, then they're going to be able to catch up very quickly."

MR. FONDER agreed. He said his division is currently finalizing 2007 audits; part of the complexity of the 2007 audits is that one-half of the year is computed under the provisions of PPT and one-half of the year is computed under the provisions of ACES. Additionally, the Tax Division has begun audits on 2008 and 2009, and is planning on combining two years at a time when its resources allow.

[1:52:18 AM](#)

A roll call vote was taken. Representatives Hawker, Johnson, Olson, P. Wilson, Seaton, Saddler, and Feige voted in favor of New Amendment 32, as amended. Representatives Tarr and Tuck voted against it. Therefore, New Amendment 32, as amended, was adopted by a vote of 7-2.

A brief at-ease was taken.

[1:52:20 AM](#)

CO-CHAIR FEIGE moved to adopt Conceptual Amendment 33 [text provided at end of this document].

REPRESENTATIVE HAWKER objected for the purpose of discussion.

CO-CHAIR FEIGE remarked:

When we instituted the floating per barrel credit, one of the results was that the tax below [\$60 per barrel] - if you remember from the [Econ One Research] slide Mr. Pulliam showed yesterday evening - the tax actually went to zero. What this amendment will do is make sure that the floating per barrel credit does not, because it is applied after the tax is assessed and calculated, this will make sure that the floating per barrel credit does not run the total tax bill below the minimum tax. So it ensures that our 4 percent minimum tax on the gross is retained - no matter what - within the legacy fields.

[1:54:01 AM](#)

REPRESENTATIVE HAWKER observed that the amendment is clarifying language, and removed his objection. There being no further objection, Conceptual Amendment 33 was adopted.

[1:54:54 AM](#)

REPRESENTATIVE P. WILSON moved to adopt Amendment 34 [text provided at end of this document].

REPRESENTATIVE TARR objected.

REPRESENTATIVE P. WILSON explained Amendment 34 would change the proposed tax rate of 35 percent to 33 percent.

REPRESENTATIVE TARR pointed out that Amendment 34 would also adjust the net operating loss credit down to 33 percent, which, she argued, would disadvantage small producers.

MR. PAWLOWSKI agreed with Representative Tarr that the amendment would adjust the loss carry forward credit. However, he said, it is consistent with previous policy to maintain parity between that and the base rate from which a taxpayer with a tax obligation gets a benefit for their expenditures. The loss carry forward credit also gives the same benefit to a new or incumbent producer. Regarding its effect the economics of a

small producer, the department would have to look at the total economics of the proposed committee substitute to know the impact or to take a position.

[1:57:56 AM](#)

REPRESENTATIVE TARR clarified she meant to say "a non-taxpayer so, a small producer or an explorer in that context. So ... by lowering a tax rate for a taxpayer, that advantages them, but simultaneously disadvantages by lowering the credit for the non-taxpayer."

CO-CHAIR SADDLER surmised the amendment directs adjustments in the base rate for production tax, except on lines 21-23, which direct a change to the net operating loss carry forward.

MR. PAWLOWSKI said correct.

REPRESENTATIVE TARR maintained her objection.

[1:59:13 AM](#)

MR. PAWLOWSKI remarked:

Before we move too far with this I'd just like to point out that we need to reserve the ability to go back and rerun these economics considering the totality of the amendments that have been passed tonight including, in particular, the impact of the 4 percent gross minimum on column (8) [on a slide provided by Econ One Research entitled, "Average Government Take for All Existing Producers (FY2015-FY2019)], which I believe reflects the ... proposed amendment in front of you, which is 33 percent with the sliding scale. But it would have a different impact at the lower prices, given the adoption of the minimum tax."

[1:59:41 AM](#)

A roll call vote was taken. Representatives Olson, P. Wilson, Hawker, Johnson, Saddler, and Feige voted in favor of Amendment 34. Representatives Seaton, Tarr, and Tuck voted against it. Therefore, Amendment 34 was adopted by a vote of 6-3.

[2:00:43 AM](#)

CO-CHAIR SADDLER moved to report House Committee Substitute (HCS) for CSSB 21, Version 28-GS1647\K, as amended, out of committee with individual recommendations and attached fiscal notes.

REPRESENTATIVE TUCK objected.

[2:01:07 AM](#)

The committee took a brief at-ease.

[2:01:38 AM](#)

CO-CHAIR SADDLER withdrew his previous motion.

[2:01:41 AM](#)

CO-CHAIR SADDLER moved to report HCS CSSB 21, Version 28-GS1647\K, as amended, out of committee with individual recommendations and forthcoming fiscal notes.

[2:02:06 AM](#)

REPRESENTATIVE TUCK objected, saying more work needs to be done on the bill. Many hours have been spent in committee hearings and floor sessions, but there has not been an opportunity to think things through. He said his objection to moving the bill is that it has been rushed. In addition, there is other forthcoming legislation on state oil tax policy to consider.

REPRESENTATIVE TARR said her objection to moving the bill is that substantial changes have been made in the early hours of the morning, even though these changes will affect every Alaskan for many years to come. Most of the fiscal impacts are unknown, except for the effect of the committee substitute, which is estimated to be almost \$1 billion in FY 14. However, there is no information on the fiscal impact of the other provisions. She pointed out there are errors in some amendments, and more care should be taken. Finally, the committee has not had an opportunity to hear from its constituents regarding these changes due to the late hour. She opined the public is not well served by these circumstances.

REPRESENTATIVE SEATON appreciated the opportunity to have long discussions on the amendments, although changes may still be incorporated in the future. He said he wanted to ensure that

the previously discussed report includes the language related to the Alaska Industrial Development and Export Authority (AIDEA).

[2:06:29 AM](#)

CO-CHAIR SADDLER expressed his belief that the committee has made good changes from the ACES tax system through the committee process of deliberation. The bill will be further examined in the next committee of referral and on the House floor. He said the need for tax reform in Alaska is clear and the stakes are high.

CO-CHAIR FEIGE thanked members of the committee for their work on tax law, beginning with HB 72. The process has been an exhaustive amount of work for members and their staff, and for Legislative Legal and Research Services, and he deeply commended their efforts.

REPRESENTATIVE TUCK maintained his objection.

[2:09:28 AM](#)

A roll call vote was taken. Representatives Seaton, P. Wilson, Hawker, Johnson, Olson, Saddler, and Feige voted in favor of reporting HCS CSSB 21, Version K, as amended, out of committee. Representatives Tarr and Tuck voted against it. Therefore, HCS CSSB 21(RES) was reported out of the House Resources Standing Committee by a vote of 7-2.

[2:09:27 AM](#)

CO-CHAIR FEIGE announced that Legislative Legal and Research Services has the authority to make technical and conforming amendments to the bill as necessary.

Following are Amendments 31, 32, New 32, Conceptual 33, and 34:

Amendment 31, labeled GS-1647\K.4, Nauman/Bullock, 4/2/13:

Page 1, line 8, following "production;":

Insert "relating to the determination of gross value at the point of production;"

Page 22, following line 5:

Insert new bill sections to read:

"* **Sec. 31.** AS 43.55.150(a) is amended to read:

(a) For the purposes of AS 43.55.011 - 43.55.180, the gross value at the point of production is calculated using the reasonable [ACTUAL] costs of transportation of the oil or gas. The reasonable costs of transportation are the actual costs, except when the

(1) parties to the transportation [SHIPPER] of oil or gas are [IS] affiliated [WITH THE TRANSPORTATION CARRIER OR WITH A PERSON THAT OWNS AN INTEREST IN THE TRANSPORTATION FACILITY];

(2) contract for the transportation of oil or gas is not an arm's length transaction [;] or is not representative of the market value of that transportation; and

(3) method [OR TERMS] of transportation of oil or gas is [ARE] not reasonable in view of existing alternative methods of transportation [OPTIONS].

* **Sec. 32.** AS 43.55.150(b) is amended to read:

(b) If the department finds that the conditions [A CONDITION] in (a)(1), (2), and [OR] (3) of this section are [IS] present, the [GROSS VALUE AT THE POINT OF PRODUCTION IS CALCULATED USING THE ACTUAL COSTS OF TRANSPORTATION, OR THE REASONABLE COSTS OF TRANSPORTATION AS DETERMINED UNDER THIS SUBSECTION, WHICHEVER IS LOWER. THE] department shall determine the reasonable costs of transportation, using the fair market value of like transportation, the fair market value of equally efficient and available alternative modes of transportation, or other reasonable methods. Transportation costs fixed by tariff rates properly on file with [THAT HAVE BEEN ADJUDICATED AS JUST AND REASONABLE BY] the Regulatory Commission of Alaska or other [ANOTHER] regulatory agency [AND TRANSPORTATION COSTS IN AN ARM'S LENGTH TRANSACTION PAID BY PARTIES NOT AFFILIATED WITH AN OWNER OF THE METHOD OF TRANSPORTATION] shall be considered prima facie reasonable."

Renumber the following bill sections accordingly.

Page 29, line 6:

Delete "sec. 31"

Insert "sec. 33"

Page 29, following line 10:

Insert a new subsection to read:

"(d) Sections 31 and 32 of this Act apply to the transportation of oil and gas produced on and after January 1, 2014."

Page 29, line 20:
Delete "sec. 36"
Insert "sec. 38"

Page 29, line 24:
Delete "37"
Insert "39"

Page 29, line 25:
Delete "sec. 31"
Insert "sec. 33"

Amendment 32

Page 25, following line 20

Insert new subsections to read:

* **Sec. 34.** AS 43.55.165 (a) is repealed and reenacted to read:

(a) Except as provided under (c) - (e) of this section, for the purposes of AS 43.55.160, a producer's lease expenditures for a calendar year are the ordinary and necessary costs upstream of the point of production of oil and gas that are incurred during the calendar year by the producer after March 31, 2006, and that are direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in the state or, in the case of land in which the producer does not own a working interest, that are direct costs of exploring for oil or gas deposits located within other land in the state. In determining whether costs are lease expenditures, the department shall consider, among other factors,

(1) the typical industry practices and standards in the state that determine the costs, other than items listed in (e) of this section, that an operator is allowed to bill a working interest owner that is not the operator, under unit operating agreements or similar operating agreements that were in effect before December 2, 2005, and were subject to

negotiation with at least one working interest owner with substantial bargaining power, other than the operator; and

(2) the standards adopted by the Department of Natural Resources that determine the costs, other than items listed in (e) of this section, that a lessee is allowed to deduct from revenue in calculating net profits under a lease issued under AS 38.05.180(f)(3)(B), (D), or (E).

*** Sec. 35.** AS 43.55.165 (b) is repealed and reenacted to read:

(b) For purposes of (a) of this section,

(1) direct costs include

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

(B) payments of or in lieu of property taxes, sales and use taxes, motor fuel taxes, and excise taxes;

(C) a reasonable allowance, as determined under regulations adopted by the department, for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within leases or properties or other land in the state;

(2) an activity does not need to be physically located on, near, or within the premises of the lease or property within which an oil or gas deposit being explored for, developed, or produced is located in order for the cost of the activity to be a cost upstream of the point of production of the oil or gas.

*** Sec. 36.** AS 43.55.165 (c) is repealed and reenacted to read:

(c) Subject to (g) and (h) of this section, if the department finds that the pertinent provisions of a unit operating agreement or similar operating agreement are substantially consistent with the

department's determinations and standards under (a) of this section concerning whether costs are lease expenditures, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state only

(1) the costs, other than items listed in (e) of this section, that are incurred by the operator during the calendar year and that

(A) are billable to the producer by the operator in accordance with the terms of the agreement to which that lease or property is subject;

(B) for a producer that is the operator, would be billable to the producer by the operator in accordance with the terms of the agreement to which that lease or property is subject if the producer were not the operator;

(C) would be billable to the producer by the operator in accordance with the terms of the agreement if that lease or property were subject to the agreement; or

(D) for a producer that is the operator, would be billable to the producer by the operator in accordance with the terms of the agreement if that lease or property were subject to the agreement and if the producer were not the operator; and

(2) a reasonable percentage, as determined under regulations adopted by the department, of the costs that are billable under (1) of this subsection as an allowance for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within the lease or property, to the extent those expenses are not billable under the agreement.

* **Sec. 37.** AS 43.55.165 (d) is repealed and reenacted to read:

(d) Subject to (g) and (h) of this section, if the department makes the finding described in (c) of this section with respect to a unit operating agreement or similar operating agreement and, in

addition, finds that at least one working interest owner party to the agreement, other than the operator, with substantial incentive and ability to effectively audit billings under the agreement in fact is effectively auditing billings under the agreement, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state only

(1) the costs, other than items listed in (e) of this section, that are incurred by the operator during the calendar year and that

(A) are billed to the producer by the operator under the agreement to which that lease or property is subject and are either not disputed by a working interest owner party to the agreement or are finally determined to be properly billable as a result of dispute resolution; or

(B) for a producer that is the operator, would be billable to the producer by the operator in accordance with the terms of the agreement to which that lease or property is subject if the producer were not the operator; and

(2) a reasonable percentage, as determined under regulations adopted by the department, of the costs that are billed under (1) of this subsection as an allowance for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within the lease or property, to the extent those expenses are not billable under the agreement

Renumber following sections accordingly

Page 29, line 20 following "sec."

Delete "36"

Insert "40"

Page 29, line 24 following "and"

Delete "37"

Insert "41"

New Amendment 32, labeled 28-GS1647\K.34, Nauman/Bullock,
4/3/13:

Page 1, line 11, following "**properties;**":

Insert "**relating to the calculation of lease expenditures**"

Page 25, following line 20:

Insert a new bill section to read:

"* **Sec. 33.** AS 43.55.165 is amended by adding new subsections to read:

(m) Except as provided under (e), (o), and (p) of this section, for the purposes of AS 43.55.160, a producer's lease expenditures for a calendar year are the ordinary and necessary costs upstream of the point of production of oil and gas that are incurred during the calendar year by the producer on or after January 1, 2014, and that are direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in the state or, in the case of land in which the producer does not own a working interest, that are direct costs of exploring for oil or gas deposits located within other land in the state. In determining whether costs are lease expenditures, the department shall consider, among other factors,

(1) the typical industry practices and standards in the state that determine the costs, other than items listed in (e) of this section, that an operator is allowed to bill a working interest owner that is not the operator, under unit operating agreements or similar operating agreements that were in effect before December 2, 2005, and were subject to negotiation with at least one working interest owner with substantial bargaining power, other than the operator; and

(2) the standards adopted by the Department of Natural Resources that determine the costs, other than items listed in (e) of this section, that a lessee is allowed to deduct from revenue in

calculating net profits under a lease issued under AS 38.05.180(f)(3)(B), (D), or (E).

(n) For purposes of (m) of this section,

(1) direct costs include

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

(B) payments of or in lieu of property taxes, sales and use taxes, motor fuel taxes, and excise taxes;

(C) a reasonable allowance, as determined under regulations adopted by the department, for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within leases or properties or other land in the state;

(2) an activity does not need to be physically located on, near, or within the premises of the lease or property within which an oil or gas deposit being explored for, developed, or produced is located in order for the cost of the activity to be a cost upstream of the point of production of the oil or gas.

(o) On or after January 1, 2014, subject to (g) and (h) of this section, if the department finds that the pertinent provisions of a unit operating agreement or similar operating agreement are substantially consistent with the department's determinations and standards under (m) of this section concerning whether costs are lease expenditures, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state only

(1) the costs, other than items listed in (e) of this section, that are incurred by the operator during the calendar year and that

(A) are billable to the producer by the operator in accordance with the terms of the agreement to which that lease or property is subject;

(B) for a producer that is the operator, would be billable to the producer by the operator in

accordance with the terms of the agreement to which that lease or property is subject if the producer were not the operator;

(C) would be billable to the producer by the operator in accordance with the terms of the agreement if that lease or property were subject to the agreement; or

(D) for a producer that is the operator, would be billable to the producer by the operator in accordance with the terms of the agreement if that lease or property were subject to the agreement and if the producer were not the operator; and

(2) a reasonable percentage, as determined under regulations adopted by the department, of the costs that are billable under (1) of this subsection as an allowance for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within the lease or property, to the extent those expenses are not billable under the agreement.

(p) Subject to (g) and (h) of this section, if the department makes the finding described in (o) of this section with respect to a unit operating agreement or similar operating agreement and, in addition, finds that at least one working interest owner party to the agreement, other than the operator, with substantial incentive and ability to effectively audit billings under the agreement in fact is effectively auditing billings under the agreement, the department may authorize or require a producer, subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state only

(1) the costs, other than items listed in (e) of this section, that are incurred by the operator during the calendar year and that

(A) are billed to the producer by the operator under the agreement to which that lease or property is subject and are either not disputed by a working interest owner party to the agreement or are finally determined to be properly billable as a result of dispute resolution; or

(B) for a producer that is the operator, would be billable to the producer by the operator in accordance with the terms of the agreement to which

that lease or property is subject if the producer were not the operator; and

(2) a reasonable percentage, as determined under regulations adopted by the department, of the costs that are billed under (1) of this subsection as an allowance for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within the lease or property, to the extent those expenses are not billable under the agreement."

Renumber the following bill sections accordingly.

Page 29, line 1:

Delete "and 43.55.160(c)"

Insert "43.55.160(c), 43.55.165(a), 43.55.165(b), 43.55.165(c), and 43.55.165(d)"

Page 29, line 20:

Delete "sec. 36"

Insert "sec. 37"

Page 29, line 24:

Delete "37"

Insert "38"

Conceptual Amendment 33:

Page 18, line 1, following "2013"

Insert "from leases or properties north of 68 degrees North latitude."

Page 18, line 1, following "not"

Insert "be applied against the tax calculated under AS 43.55.011(f). A tax credit authorized by the subsection may not"

Page 18, line 2, following "below"

Insert "the amount calculated under AS 43.55.011(f)"

Delete "zero"

Amendment 34:

Page 6, line 8:
Delete "35"
Insert "33"

Page 10, line 17:
Delete "35"
Insert "33"

Page 11, line 1:
Delete "35"
Insert "33"

Page 11, line 14:
Delete "35"
Insert "33"

Page 11, line 23:
Delete "35"
Insert "33"

Page 15, line 10:
Delete "35"
Insert "33"

[2:09:58 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting of April 3, 2013, was adjourned at 2:09 a.m. April 4, 2013.