

SENATE FINANCE COMMITTEE

March 1, 2013

9:05 a.m.

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CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair
Senator Kevin Meyer, Co-Chair
Senator Anna Fairclough, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Donny Olson

MEMBERS ABSENT

Senator Lyman Hoffman

ALSO PRESENT

Senator Cathy Giessel; Michael Pawlowski, Advisor, Petroleum Fiscal Systems, Department of Revenue; Susan Pollard, Senior Assistant Attorney General, Oil, Gas and Mining, Department of Law; Mary Hunter Gramling, Assistant Attorney General, Department of Law; Senator Giessel; Barry Pulliam, Managing Director, Econ One Research, Inc.; Dan Stickel, Assistant Chief Economist, Tax Division, Department of Revenue.

SUMMARY

SB 21 OIL AND GAS PRODUCTION TAX

SB 21 was HEARD and HELD in committee for further consideration.

SECTIONAL PRESENTATION

FISCAL NOTES PRESENTATION

ECON ONE PRESENTATION

#sb21

SENATE BILL NO. 21

"An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; 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; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

SECTIONAL PRESENTATION

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MICHEAL PAWLOWSKI, ADVISOR, PETROLEUM FISCAL SYSTEMS, DEPARTMENT OF REVENUE (DOR), introduced himself.

SUSAN POLLARD, SENIOR ASSISTANT ATTORNEY GENERAL, OIL, GAS AND MINING, DEPARTMENT OF LAW (DOL), introduced herself.

MARY HUNTER GRAMLING, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, introduced herself.

Ms. Pollard discussed the PowerPoint, "Departments of Revenue and Law: Sectional Review, CSSB 21(RES) 28-GS1647\C" (copy on file).

Mr. Pawlowski shared that there was a detailed Sectional Analysis included in the members' packets.

Ms. Pollard looked at slide 2, "Main Provisions."

-Corporate Tax Credit for Qualified Oil and Gas Service Industry Expenditures

-Production Tax Rate: 35 percent flat rate, no progressivity

-Tax Credits

Eliminates current 20 percent capital expenditure tax credit for North Slope activities but establishes a North Slope tax credit applicable to production tax liabilities.

Extends the small producer tax credit and provides a \$5 per barrel of oil tax credit.

Expands the exploration well tax credit.

-Gross Value Reduction

Establishes 30 percent reduction from the gross value at the point of production for oil and gas produced from new units, new participating areas, and expanded portions of participating areas.

-Oil and Gas Competitive Review Board

-Hold Cook Inlet and Middle Earth harmless

Ms. Pollard highlighted slide 3, "Sec. 2 - Qualified Oil and Gas Industry Service Expenditure Tax Credit."

-Amends AS 43.20, the Alaska Net Income Tax Act, by adding a new section.

-Provides a 10 percent tax credit for qualified oil and gas industry service expenditures incurred in the state.

-A taxpayer may not apply more than \$10,000,000 in tax credits under this section for a tax year regardless of whether the taxpayer earned the tax credit or received the tax credit by transfer.

-Expires if not used against a tax liability within seven calendar years.

-Qualified oil and gas service industry expenditure must be directly attributable to in-state manufacture or modification of tangible personal property that has

a useful life of three years or more used in the exploration, development, or production of oil or gas.

Mr. Pawlowski emphasized that the direction of the tax credit was to the modifications of the actual expenditures. He remarked that the tax credit was not on the actual value of the asset, but rather the value of the work performed in state.

Vice-Chair Fairclough wondered if businesses that were currently performing in Alaska would qualify for the credit, if they were manufacturing for the industry. Ms. Pollard replied that those businesses would qualify for the credit.

Ms. Pollard discussed slide 4, "Sec. 3 - Tax Rate"

-AS 43.55.011(e) is amended to levy an annual flat tax rate of 35 percent.

-AS 43.55.011(g), the monthly progressivity tax, is repealed.

-This change applies to oil and gas produced after December 31, 2013.

-Effective date of January 1, 2014.

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Mr. Pawlowski explained that the Senate Resources Committee expressed concerns over the regressivity of the proposal. In order to develop a progressive proposal, where the state took slightly more at the higher end of the price range, one had to start with an increase in the base rate in order to develop the proper progressive line. He stressed that the slide represented the first step in developing that proposal.

Co-Chair Meyer surmised that the base rate was raised to 35 percent, and was offset by the \$5 per barrel production tax credit proposal. Mr. Pawlowski agreed, and added that the presentation would later highlight the location of the \$5 per barrel credit as written in the bill.

Ms. Pollard displayed slide 5, "Sec. 1- Community Revenue Sharing Fund."

-Amends AS 29.60.850(b) to change the source of revenue that funds the community revenue sharing fund to AS 43.20.030(c), the Alaska Net Income Tax Act, from progressivity under AS 43.55.011(g) (repealed in this bill).

-Effective date of January 1, 2014

Mr. Pawlowski that the slide represented a provision that was included in the governor's bill, which was maintained by the Senate Resources Committee. He remarked that there was a substantive change from current line on page 2, line 4, where the brackets point out that the language that was being removed was an amount equal to 20 percent of the money received. That limitation was put on the original state, which limited the amount available for appropriation to a maximum of 20 percent of the progressivity revenues.

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Ms. Pollard highlighted slide 6, "Sec. 8 - Qualified Capital Expenditure Tax Credit."

-AS 43.55.023(a)(3) is a new provision limiting the 20 percent qualified capital expenditure tax credit for expenditures incurred to explore for, develop, or produce oil and gas deposits on the North Slope to expenditures incurred before January 1, 2014.

-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 furthered that the effect of this change would be to limit the qualifications of capital expenditures, at 68 degrees north latitude, which was the dividing line for the North Slope. He remarked that the provision only applied to expenditures that occurred on the North Slope.

Co-Chair Meyer remarked that companies could be stressed if they were counting on that 20 percent capital credit. Mr. Pawlowski replied that there would be a situation regarding

how much obligation the additional investment creates in liability and exposure to the state. He stressed that the longer the credits are carried forward, the longer the state was susceptible to that impact.

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Vice-Chair Fairclough requested a model from Econ One and PFC Energy that put this particular provision against the gross revenue exclusion at different companies' price points and production points benefit. She remarked that the \$5 per barrel would impact the calculation regarding industry profit and the expansion of the gross revenue exclusion. Mr. Pawlowski agreed to provide that information

Senator Hoffman wondered what the new section would cost the state compared to the anticipated \$1 billion in the current year. Mr. Pawlowski responded that the repeal of the credit was a revenue generator, because the state was no longer paying the credits. He shared that the administration found that there was a difference in timing of obligation to the state. He stated that expenditures occurred in the development of the field, and production occurred later. As the production on the North Slope declined, the ability of the state to manage the increasing obligations as more money was spent was a central balance of the bill. He explained that the impact was found in the fiscal note.

Ms. Gramling highlighted slide 7, "Sec. 9 - Carried-Forward Tax Credit AS 43.55.023(b)." She explained that the title of the slide actually referred to Section 10, not Section 9.

- Amends AS 43.55.023(b) to retain a tax credit of 25 percent for a carried-forward annual loss for adjusted lease expenditures incurred outside of the North Slope.

- Provides a tax credit of 35 percent for a carried-forward annual loss for adjusted lease expenditures incurred after December 31, 2013 on the North Slope, subject to the requirements in new subsections (p)-(u).

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Mr. Pawlowski explained that the amendment was added in the Senate Resources Committee, which had two parts. The base rate on the North Slope had increased from 25 percent to 35 percent, so the net-loss carry-forward credit was increased for North Slope expenditures to match the base rate of 35 percent.

Co-Chair Meyer remarked that there may be further discussion regarding the carry-forward credit at a later date.

Ms. Pollard explained that the loss carry-forward did not need to equal the tax rate, but there was no legal reason to match the loss of the carry-forward.

Senator Hoffman wondered why the North Slope was the focus, and did not include the Kuparuk and Prudhoe Bay basins. Ms. Pollard responded that the bill included any areas 68 degrees north latitude and higher, so she assumed that those areas would be included.

Senator Hoffman remarked that there was a difference between the legacy fields and other fields on the North Slope. Mr. Pawlowski clarified that the 35 percent credit was meant for a loss carry-forward, so in order to qualify for the credit there would have to be a loss.

Ms. Gramling highlighted slide 8, "Sec. 16 - North Slope Carried-Forward Tax Credit AS 43.55.023(p) - (u)."

Key characteristics:

- 10 year time limit on use.
- Must be applied on a first-earned, first used basis.
- Reporting requirements to the Department of Revenue.
- May only be used to reduce production tax liability under AS 43.55.011(e), limited transferability, not redeemable for cash.
- May apply a 15 percent annual increase to the 35 percent tax credit base.

AS 43.55.023(p) requires producers to file an annual statement with the Department of Revenue under new subsection AS 43.55.030(g) to use the tax credit two years after incurring expenditures. The tax credit may

not be used more than 10 calendar years later than the date the expenditures were incurred.

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Mr. Pawlowski stated that the purpose of the new provision was to adjust the current law. Under current law, the loss carry-forward credit may be turned into the state and converted to a cash payment from the state. The bill states that the credit was required to be carried forward to when there was a tax liability and the credit is used against the liability.

Vice-Chair Fairclough requested a model of the annual 15 percent increase. She also asked if the outline was for a new explorer. Mr. Pawlowski responded that the outline was not necessarily for a new explorer. He stated that it was for anyone that had a "loss", or someone whose expenditures offset their production.

Vice-Chair Fairclough requested a model that outlined what a loss might look like as an impact to the state in comparison to paying it in cash. Mr. Pawlowski agreed to provide that information.

Senator Hoffman suggested that the model also include various interest rates. Mr. Pawlowski agreed to include that in the model.

Ms. Gramling discussed slide 9, "Sec. 16 - North Slope Carried-Forward Tax Credit : AS 43.55.023(q)."

- "First earned, first used" rule.
- Applies to expenditures after December 31, 2014.
- Assures credits earned in earlier calendar years are used up before later earned credits.

Ms. Pollard displayed slide 10, "Sec. 16 - North Slope Carried Forward Tax Credit: AS 43.55.023(r)."

- Increases at 15 percent annually if compliance with new AS 43.55.030(g).
- Increase begins January 1st of the second calendar year after credit earned.
- Increase stops December 31st of calendar year before credit used.

- Increase has no value except as applied to 43.55 taxes
- 2015 → 2017 (Increase begins January 1, 2017 unless used against 2016 or 2017 taxes).

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Mr. Pawlowski displayed slide 12, "Sec. 16 - North Slope Carried-Forward Tax Credit: AS 43.55.023(t)."

Ms. Pollard discussed slide 12.

AS 43.55.023(t) provides exceptions to allow for the limited transfer of the tax credit:

- Transfer is limited to a person that acquires an interest in the lease or property upon which the credit is based.
- Transferee's use of credit subject to rules in subsection (u).
- The Department of Revenue must be notified of the transfer.
- Transferee subject to audit by the Department of Revenue.

Mr. Pawlowski stated that if one company purchased property from another company, they could buy the loss carry-forward credits that were created. He explained that the bill limited the purchaser's use of the credits to a function of the value of the production that came from the lease or property. In order for the purchased credits to activate, the purchaser must take the property into production to generate production that generates revenue. The limitation is put on the purchaser's use of the credit, as opposed to the seller of the credit.

Co-Chair Meyer wondered how 20 percent was determined. Mr. Pawlowski replied that the 20 percent was determined after analyzing the overall government take numbers. He stated that they looked for a number that was low enough to not exceed the actual potential tax revenue from the state. He remarked that it was an arbitrary number to some degree, but one must be sure there was not an overly generous ability to apply the purchased credits.

Vice-Chair Fairclough asked if the property could transfer ownership more than once in a ten-year period before it expired. Ms. Pollard responded that there was no limit.

Mr. Pollard looked at slide 14, "Sec. 17 - Small Producer Tax Credit."

- Amends AS 43.55.024(d) to extend the tax credit for small producers (under 50,000 a day average BTU equivalent barrels) by six years, the later of either 2022 or the ninth calendar year after production for production before May 1, 2022.

- The tax credit is not transferable and any unused portion may not be carried forward for use in a later calendar year.

Mr. Pawlowski stated that the provision was on page 18, line 21. The provision existed in current law, but was set to sunset in 2016. He explained that the bill included an extension of a producer's ability to qualify for the credit.

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Ms. Pollard stressed that the credit was not based on expenditures, but was based on the amount of production.

Ms. Pollard discussed slide 15, "Sec. 19 - \$5 Per Oil Barrel Tax Credit."

- Amends AS 43.55.024 by adding a new a tax credit of \$5 for each barrel of oil subject to tax under AS 43.55.011(e) applicable to the producer's tax liability for the year the oil was produced.

- The tax credit is not transferable, any unused portion may not be carried forward for use in a later calendar year and it may not be applied to reduce the producer's tax liability to below zero.

Mr. Pawlowski explained that the provision was the balance that was struck in the Senate Resources Committee Substitute to offset the increase in the base rate to 35 percent, which the committee heard in a previous meeting. He stressed that the provision was based on production, was

non-transferrable, and could not be used to reduce a tax payer's liability below zero.

Co-Chair Meyer wondered if the value eroded over time, and whether it should be inflation proof. Mr. Pawlowski replied that the inflation adjusting conversation was valid, but stressed that there was a cautiousness regarding the relationship between oil prices and inflation versus the actual cost and inflation. He felt that there should be a focus on what actually happens to the value of \$5 during that time period. He remarked that DOR was willing to work with consultants to develop an inflation proof system.

Co-Chair Meyer felt that the law should be in place for 10 to 20 years, to the impact should be inflation proof.

Senator Hoffman wondered why 5 percent was not considered, because it would provide \$5 per barrel at \$100 per barrel. Mr. Pawlowski replied that the fixed dollar amount provided less benefit to the producer at high oil prices, therefore more benefit to the state.

Senator Hoffman surmised that the reason for the \$5 was to provide less benefit to the oil companies. Mr. Pawlowski agreed with that summation.

Ms. Pollard highlighted slide 16, "Sec. 20 - Alternative Tax Credit for Oil and Gas Exploration."

-The sunset provision in AS 43.55.025(b) is extended from July 1, 2016 to July 1, 2022.

-AS 43.55.025(c), relating to exploration wells, is amended by deleting the 3 mile distance requirement for exploration wells outside Cook Inlet in AS 43.55.025(c)(2)(B).

-New subsection (q) provides expenditures claimed for a tax credit under AS 43.55.025 may not also be claimed for a tax credit under AS 43.55.023 or another provision of AS 43.55.025.

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Mr. Pawlowski stated that the provision was a change made in the Senate Resources Committee based on testimony they had received from some of the explorers. The testimony stated that the credit in the high risk exploration phase of development were important for the risky activity of

drilling the exploration wells. While the governor had maintained this credit, industry had expressed that the three mile limit made the credit very difficult to use within the central North Slope.

Ms. Pollard stated that the provision was outlined in Section 22 of the bill. She stressed that the limitation applied to the loss carry-forward credit.

Mr. Pawlowski explained that the exploration credit was not based solely on expenditures, but there were further limitations. A company must come to DNR, and prequalify for the credit. The company must demonstrate that it was a reasonable new target, and was an exploration expenditure and well. Then DNR receives data on the findings of the exploration. He stressed that there were benefits to the state, and a gate for the credit.

Co-Chair Meyer surmised that a company would not receive the tax credit, if they did not share the tax credit. Mr. Pawlowski responded that the credit could be turned into the state for reimbursement.

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Ms. Gramling looked at slide 17, " Sec. 30 - Gross Revenue Exclusion for North Slope Oil and Gas."

-Provides that for the determination of the annual production tax value of oil and gas produced north of 68 degrees North latitude, that the gross value at the point of production is reduced by 30 percent for the oil or gas:

- 1) Produced from a lease or property that does not contain a lease that was within a unit as of January 1, 2003;
- 2) Produced from a participating area established after December 31, 2011 that was within a unit formed under AS 38.05.180(p) before January 1, 2003, if the participating area does not contain a reservoir previously established in a participating area;
- 3) Produced from the expanded acreage of an existing participating area that was expanded by

the Department of Natural Resources after December 31, 2011 provided the producer demonstrates to the Department of Revenue the volumes of oil and gas produced from the expanded acreage.

Mr. Pawlowski stressed that the final point was added in the Senate Resources Committee, and he remarked that DNR would be available later to discuss the participating areas. He stressed that the intent of the original bill was to be careful about the application of the gross revenue exclusion (GRE). He remarked that the GRE should only apply to new oil that was not currently under development.

Senator Bishop agreed that DNR should explain the benchmark that they use to identify "new oil."

Vice-Chair Fairclough wondered how long "new oil" would be considered "new oil." She felt that eventually all oil would be considered new, and all oil would qualify for the GRE. She encouraged the committee to consider that implication.

Senator Olson looked at Section 1, and queried the net effect of municipal revenue sharing. Mr. Pawlowski responded that the net effect would potentially enable more money to be added to the revenue sharing fund, to meet the \$60 million or \$180 million.

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Senator Olson wondered how to ensure revenue sharing was protected. He felt that the bill stated that one could do less than 20 percent, if it were removed, so there would be less money for the communities. Mr. Pawlowski replied that the appropriation was the choice of the legislature. The 20 percent referred to a situation that pertained to low progressivity.

Ms. Gramling stated that Section 1 would only amend AS 29.60.850B.

Mr. Pawlowski discussed slide 18, "Oil and Gas Competitiveness Review Board AS 43.98.040-070."

-AS 43.98.040 establishes a 9 member board

- Governor designates chair every two years. Governor may replace and remove members.
- Members serve 6 year terms, may be reappointed.
- The Board meets four times a year to review investment, fiscal systems and to identify factors that affect oil and gas investment.
- The Board reports annually to the Legislature with recommendations.
- The Board sunsets December 31, 2022.

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Senator Dunleavy asked for a fiscal analysis of the CS at 35 percent to 25 percent of the tax. Mr. Pawlowski indicated that he would provide that information.

Senator Dunleavy asked for page 8 and a fiscal analysis for the above incremental increases instead of the entire production. Mr. Pawlowski indicated that he would provide that information.

Senator Dunleavy queried how the CS incentivized investment into active production of the non-conventional oils. Mr. Pawlowski responded that the incentives subject to the gross revenue solution.

ECON ONE PRESENTATION

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BARRY PULLIAM, MANAGING DIRECTOR, ECON ONE RESEARCH, INC., presented "Analysis of Alaska's Tax System, North Slope Investment and The Administration's Proposal SB 21/SRES CS SB 21" (copy on file). He looked at slide 1, "Econ One: Who We Are."

Economic Research and Consulting Firm

-We Provide Economic Analysis In Energy and Other Industries

We Have Advised the State of Alaska on Petroleum Related Matters For Over Two Decades

We Have Worked With the Cowper, Hickel, Knowles, Murkowski, Palin, and Parnell Administrations

We Assisted the Legislature Between 2005 and 2008 on Tax and Gas Development Issues

Our Energy-Related Work Outside Alaska

- State Governments: Texas, Louisiana, New Mexico, Oklahoma, California

- Federal Government Agencies: Department of Interior, Federal Trade Commission

- Energy Companies: Producers, Refiners, Mid-Stream Services, Pipelines, Chemicals

Mr. Pulliam looked at slide 4, "Alaska North Slope Discovered Resources by Discovery Year (1969 - 2010)."

- The North Slope Has Produced 16.2 Billion Barrels to Date

- Approximately 5.6 Billion Barrels of Economically Recoverable Resources Remain in Known Fields

- Significant Additional Resources Still Remain to be Discovered

Mr. Pulliam slide 5, "Alaska North Slope Production and Resources."

- Many North Slope Fields are Now at Mature Stages. However, Less Than Half of its Potential Economic Oil Resources Have Been Produced to Date

- In Total, the North Slope Contains Approximately 40 Billion Barrels of Additional Estimated Economic Recoverable Resources at Today's Prices

Mr. Pulliam discussed slide 6, "Estimated Undiscovered Conventional Oil Resources on Alaska North Slope." He stressed that state property held resources that were much different than what had been discovered to date. He explained that Alaska production was dominated by several very large fields. He explained that the remaining

locations held much smaller accumulations. He stated that the USGS estimated that the typical field size that had yet to be discovered on the central North Slope was in the \$30 to \$60 million barrel range.

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Mr. Pulliam discussed slide 7, "Estimated Undeveloped Unconventional Oil Resources on Alaska North Slope." stated that much was not yet discovered in Alaska. He spoke about where the one billion barrels located, and thought that the number could be very different going forward. He spoke about viscous and heavy oil and estimated that 15 percent was recoverable.

Co-Chair Meyer asked for insight about the possibility of shale oil production in Alaska. Mr. Pulliam replied that he did not have much insight regarding shale production, and suggested that DNR provide that information.

Mr. Pulliam discussed slide 8, "Crude Oil Production, Alaska North Slope vs. United States and OECD Countries 2003-2012." He stated that Alaskan production declined at an average of 7 percent a year.

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Mr. Pulliam discussed slide 9, "Estimated Capital Spending for Exploration and Development Alaska North Slope vs. United States and Worldwide Spending 2003-2012." He stated that spending rose consistently until 2007, while spending in the rest of the world trended higher. He added that spending continued to rise in the rest of the world, where Alaska remained flat. The slide distilled some basic concerns about production and investment.

Vice-Chair Fairclough referred to slides 8 and 9. She stated that Alaska compared themselves to other regimes, and wondered what regimes were the best to compare Alaska against. Mr. Pulliam replied that the UK was the best regime to compare against Alaska.

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Vice-Chair Fairclough wondered about provinces producing 1 million barrels. She thought that the bar charts and wondered if volume affected the tax regime. Mr. Pulliam

agreed that the comparison, and furthered that Alaska's production was approximately 0.5 million barrels per day. He explained that Alaska's regime was roughly the size of Australia's regime.

Vice-Chair Fairclough felt that there should be a comparison between the United States and other regimes, which included the threshold of 1 million barrels per day. She felt that Alaska should be included in that group.

Mr. Pulliam continued with slide 11, "How ACES Works."

Tax is Calculated on "Net Value" of Taxable Production

- Taxable Production is Total Production Less Royalties
- Net Value is Gross Wellhead Value Less Cost of Production
- Costs of Production are Capital Expenses, Operating Expenses and Property Tax Payments

Base Tax Rate of 25 percent

Progressive Tax Rate of 0.4 percent Per \$1/Barrel (4 percent Per \$10/Barrel) Increase Over \$30/Barrel Net Value and 0.1 percent Per \$1/Barrel (1 percent Per \$10/Barrel) Over \$92.50, Capped at 50 percent Total

Example:

Taxable Value = \$100/Barrel "Production Tax Value" Base Rate = 25 percent
Progressive Rate = $(\$92.50 - \$30) \times 0.4$ percent + $(\$100 - \$92.50) \times 0.1$ percent = 25.75 percent
Total Rate = 25 percent + 25.75 percent = 50.75 percent

Credit of 20 percent for Capital Expenditures (Taken Over 2 Years)

Small Producer Credit of \$12 Million Per Year (Phased Out for Production over 50 MBD)

State Purchases Credits and Net Operating Losses (NOLs) From Companies Without Tax Obligation

-Equals 45 percent of Capital Expenditures and 25 percent of Operating Expenditures

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Mr. Pulliam discussed slide 12, "Calculation of ACES Taxes: Varying Prices." He explained the spreadsheet and created comparisons regarding progressive tax.

Mr. Pulliam discussed slide 13, " Calculation of ACES Tax: Varying Costs \$100 West Coast ANS Price."

Mr. Pulliam discussed slide 14, "Calculation of ACES Tax: Varying Costs \$80 West Coast ANS Price."

Mr. Pulliam discussed slide 15, "Calculation of ACES Tax: Additional Capital Spending." The graph depicted a producer producing 50 million barrels per year, with ac capital expenditure of \$250 million. He pointed out the middle column where the tax rate was 37 percent prior to the expenditure and after it would be 25 percent.

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Mr. Pulliam discussed slide 16, "Effective Tax Rates For New Development Under ACES Additional Tax as percentage of Production Tax Value: Incumbent Producer."

Lower Cost: \$16 Per Barrel Development Capex; \$14 Per Barrel Opex; 16.67 percent Royalty Rate; 50 MMBO New Development by Existing Owner With Initial Ongoing Production of Approximately 100 MBD and Costs Consistent with Prudhoe Bay/Kuparuk River Units

Higher Cost: \$25 Per Barrel Development Capex; \$14 Per Barrel Opex; 16.67 percent Royalty Rate; 50 MMBO New Development by Existing Owner With Initial Ongoing Production of Approximately 100 MBD and Costs Consistent with Prudhoe Bay/Kuparuk River Units

Very High Cost: \$34 Per Barrel Development Capex; \$21 Per Barrel Opex; 16.67 percent Royalty Rate; 50 MMBO New Development by Existing Owner With Initial Ongoing Production of Approximately 100 MBD and Costs Consistent with Prudhoe Bay/Kuparuk River Units

Mr. Pulliam discussed slide 17, "The Economics of Higher Cost Oil Development." He explained the graphs.

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Mr. Pulliam discussed slide 18, "The Economics of Very High Cost Oil Development." He stated that the slide represented what may occur if there were a very cost for development.

Co-Chair Meyer suggested that an example of very high cost oil development would be heavy oil. He felt that the heavy oil areas would be locations that the industry would pursue, because the state was picking up so much of the cost. Mr. Pulliam agreed and noted that the development was difficult with today's technology. He compared the lower forty eight.

Co-Chair Meyer stated that ACES incentivized heavy oil. Mr. Pulliam.

Mr. Pulliam discussed slide 19, "DOR Forecast Levels of Production FY 2015-FY2022." He stated that the average annual decline was 6 percent.

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Mr. Pulliam discussed slide 20, "Production With Development of 150 MMB of Reserves Annually FY 2015-FY 2022." He explained that different fields were all declining, but would balance out in the forecast, so there would be an annual decline of zero percent from FY 15 to FY 22.

Co-Chair Meyer asked how much industry would spend to stop the decline. Mr. Pulliam responded that the assumption \$3 billion dollar investment. He noted that the pace of spending worldwide would show the expense of \$3 billion per year.

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Mr. Pulliam discussed slide 21, "Forecast Levels of Capital Credits and NOLs FY 2015 - FY 2019."

Mr. Pulliam discussed slide 22: "Capital Credits and NOLs Assuming Development of Additional 150 MMB of Oil Per Year Over Forecast By New Participant."

Co-Chair Meyer encouraged a discussion regarding the difference between GRE versus capital credits and which one was better for the state.

Vice-Chair Fairclough wished to see the issue modeled. She wondered if one had a greater advantage. Mr. Pulliam agreed to model the comparison. He stated that both credits provided forms of incentives. He stressed that the current system was tied to spending and the GRE was tied to production.

Vice-Chair Fairclough remarked that each community was unique. The Senate Resource Committee had hoped to generate more viscous oil, which presented no benefit to the legacy fields. Mr. Pulliam sensed that the intent was to offer the GRE to the more challenged areas. Producers could find out how barrels could work, and thought that the language may accomplish the intent.

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Mr. Pulliam discussed slide 23, "Capital Credits and NOLs Assuming Development of Additional 150 MMB of Oil Per Year Over Forecast 50 Percent and 50 percent by Incumbent."

Co-Chair Kelly commented that the graphs were making him angry. He did not like public debate that went without the vetting required. He stated that the lack of professional curiosity was lacking, and ACES was a more than the \$2 million giveaway.

Mr. Pulliam discussed slide 25, "Summary of Production Profiles Examined For Alaska and Benchmark Developments." He discussed developments in the Lower 48 and compared them to Alaska with a variety of different cost ranges. He noted that the \$16 range along with the technology, and chart described a production profile.

Mr. Pulliam discussed slide 26, "Summary of Investment Measures (New Participant)." All Alaska scenarios were under ACES. He stated that the first section showed the MPV per barrel at \$80 west coast price. He noted that columns two and three were noted and the economics were worse for the new participants. Some were \$34 per barrel mark or technology not quite ready.

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Mr. Pulliam continued with slide 26. He stated that the government takes were higher in Alaska than elsewhere.

Co-Chair Meyer asked what could be applied from the information on the slide. Mr. Pulliam responded that the UK GRE and \$5 per barrel production allowance could be considered. Producers came and applied for the existing credit. He explained that producers could also apply for the allowance to prove that the project was new reserves and additional production. The process would occur to qualify for a GRE. .

Mr. Pulliam discussed slide 27, "Summary of Investment Measures (Incumbent Participant)." He discussed the spread sheet and the MPV, which remained consistent. He mentioned that Eagle Ford was better than Alaska, with the assumed best case scenario.

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Mr. Pulliam discussed slide 29, "Key Aspects of Administration's Proposal (SB 21)."

Establishes 25 percent Flat Net Tax Rate; No Progressivity

Eliminates Capital Credit and State Purchase of Losses

Establishes 20 percent Gross Revenue Exclusion (GRE) to Incent Production of New Oil

Losses May be Carried Forward and Applied Against Tax Obligation When Production Occurs

Extends New Entrant Credits Through 2022

No Change Outside of North Slope

Mr. Pulliam discussed slide 30, "Key Aspects of Administration's Proposal (cont'd)."

Provides Balance Between State and Producers

-Reduction of Tax Rates at High Prices, Balanced with Elimination of Credits

-State Continues to Receive Largest Percentage of Oil Production Revenues at Any Price

Simplifies Tax System and Provides Clarity for Planning

-Eliminates Question of Marginal Tax Rate / Take for Investment Planning

-Eliminates Incentives for "Gold Plating" Caused by High Marginal Rates

Maintains Alignment Between State and Producer Incentives

-Net Tax Allows for Deduction of Costs Against Tax

Provides Incentive for Development of New Resources Without Taxing State Treasury

-GRE Provides Lower Effective Tax Rate for New Development

-New Developers can Recover Costs of Development Once Production Begins

-Does Not Require State to Fund Development Costs Through Potentially Expensive Credit Purchases

Extremely Positive Message to Potential Investors

-Will Encourage Broader Participation in Development of Alaska's North Slope

-Economics of New Participants Closer to Incumbents'

Senator Bishop compared the GRE to ACES. He appreciated the analogy. He asked if the state will quit spending \$12 million to make \$10 billion. Mr. Pulliam concurred. He commented that the credit was made with actual production, rather than anticipated production.

Mr. Pulliam discussed slide 31, "Key Changes to SB 21 from Senate Resources CS."

Base Tax Rate Increased from 25 percent to 35 percent

\$5/Bbl Production Allowance (Credit)

GRE Raised to 30 percent

Allows Producers to Apply for GRE in Legacy Units for Targeted Development of New Oil

Relaxes Current Restriction on Exploration Credits

Mr. Pulliam detailed slide 32, "Key Attributes of Senate Resource CS SB21."

Results in Slightly Progressive Government Take Overall Without Problems Associated with "Progressivity"

Reduces Effective Tax Rate and Government Take at Low Prices, While Increasing Tax Rates and Government Take at Higher Prices

Effect of Fixed \$/Bbl Allowance is to Provide Support at Low Prices Where Needed, Diminishing as Prices Rise

Provides System in Competitive Range for Taxpayers/Investors

Provides Simple, Straightforward and Understandable Tax Framework

Allows DOR/DNR to Address Individual Circumstances as Needed

Allows for Significant Investment on North Slope Without Taxing State Treasury

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Mr. Pulliam discussed slide 33, "Illustration of Tax Calculation Under Senate Resources CS for SB 21." He stated that the total tax obligation had reduced to 33 percent as a result of the tax allowance. The slide was simple and straight forward, but noted that the relief was tapered.

Mr. Pulliam discussed slide 34, "State Outlays Prior to Production Associated With Development of 50 MMBO by Non-Taxpayer Under ACES and SRES CS SB21." He stressed that the difference included \$379 million, but the right side of graph showed a higher tax field.

Mr. Pulliam discussed slide 35, "Expected Annual State Outlays Necessary to Replace Current Production by Non-Taxpayer Under ACES and SRES CS SB21." He pointed out the lower tax rate on back end and exposure on the front end.

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Mr. Pulliam highlighted slide 36, "Average Government Take at \$100 per Barrel

Mr. Pulliam discussed slide 37: " Average Government Take ACES v. SB21/HB72 and SRES CS SB21 for All Existing Producers (FY2015-FY2019) and Other Jurisdictions."

Vice-Chair Fairclough discussed slide 37 and asked for analysis for the federal government take. She specifically asked if production tax was higher, would the structure be affected. She wondered if the calculation was misinformed. Mr. Pulliam responded that the analysis included the federal tax rate, but the federal effective tax rate was probably less, because nominal tax rate was 35 percent.

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Vice-Chair Fairclough replied that if companies under federal tax returns might show something different. She wondered if Conoco Phillips would show regarding various tax levels. Mr. Pulliam responded that tax paid in Alaska was a deduction for federal taxes.

Co-Chair Meyer asked about the red line. or average all jurisdictions per PFC. He noted that everything between the green lines was a small percentage. He noted that the numbers in the range provided an average.

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Mr. Pulliam discussed slide 38, "Average Government Take and Tax Rate ACES vs. SB21/HB72 and SRES CS SB21 for All Existing Producers (FY 2015)."

Mr. Pulliam discussed slide 39, "Summary of Investment Measures for New Participant Lower Cost Alaska Oil Development ACES and SRES CS SB21 vs. Benchmark Areas." The project became attractive with the marginal government take of over 60 percent, which was competitive.

Mr. Pulliam discussed slide 40, "Summary of Investment Measures for Incumbent Lower Cost Alaska Oil Development ACES and SRES CS SB21 vs. Benchmark Areas."

Mr. Pulliam discussed slide 41, "Summary of Investment Measures for New Participants Higher Cost Alaska Oil."

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Senator Bishop looked at slide 40, and wondered if the GRE would make Alaska more competitive than North Dakota. Mr. Pulliam responded that Alaska would look better than North Dakota, on an MPV basis.

Senator Bishop asked if he would not have to hear any more about North Dakota. Mr. Pulliam replied that North Dakota would continue to be a part of the conversation, because it was a large opportunity for investors in the industry.

Co-Chair Meyer asked if the majority of oil to be produced in Alaska was higher or lower cost oil. Mr. Pulliam replied that it was of the higher cost variety.

Co-Chair Meyer suggested recoverable oil was heavy oil. Mr. Pulliam agreed. He stated that Canadian oil was too expensive initially, but he had seen advances in drilling efficiency.

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Mr. Pulliam continued onto slide 43, "Summary of Investment Measures for New Participant Very High Cost Alaska Oil Development ACES and SRES CS SB21 vs. Benchmark Areas."

Mr. Pulliam continued with slide 46, "Country/Area Profile Alaska North Slope."

Vice-Chair Fairclough referred to slide 46 regarding capital spending. She was interested in a 2013 or 2014 projection. Capital spending was increasing and she wanted to know why. Mr. Pulliam stated that DOR's forecast would provide the information.

Vice-Chair Fairclough wondered about viewing the past year's forecast. She stated that the chart was based on the DOR's revenue forecast book.

Vice-Chair Fairclough showed that the forecast was published for the general public and she wished to acquire the forecast.

[3:36:50 PM](#)

FISCAL NOTES PRESENTATION

DAN STICKEL, ASSISTANT CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, presented a PowerPoint presentation, "Fiscal Note Slide - CSSB21 (RES)."

Mr. Stickel discussed slide 2, "Introduction."

1. 12 key provisions analyzed
2. Total fiscal impact under Fall 2012 forecast
3. Hypothetical additional production scenarios

Mr. Stickel discussed slide 3, "1: Repeals Progressive Surcharge."

-Progressive surcharge at AS 43.55.023(g) repealed

-Progressive surcharge is an additional tax that is added to base tax

-Progressive surcharge increases tax rate at production tax values of greater than \$30 / barrel

-Progressive surcharge may add up to 50 percent to the total tax rate at very high prices for a maximum total tax rate of 75 percent

-Fiscal Impact = varies by fiscal year, up to \$1.8 billion per year under our Fall 2012 forecast

Mr. Stickel discussed slide 4, "Impact of Progressive Surcharge." The provision eliminated the green part of the graph.

Mr. Stickel discussed slide 5, "2. Increases base production tax rate."

- Base tax rate increased to 35 percent from 25 percent under ACES

- Base tax rate of 35 percent applied to production tax value

- The higher base tax rate increases revenue from the base tax

- The higher base tax rate provides greater protection to the state at low oil prices

- Fiscal Impact = varies by fiscal year, up to \$1.1 billion per year under our Fall 2012 forecast

Mr. Stickel discussed slide 6, "3. Limitations on Capital Credits."

- Production tax credits under AS 43.55.023(a) for qualified capital expenditures are limited to expenditures incurred before January 1, 2014 for the North Slope

- 20 percent capital credit eliminated for North Slope after 1/1/2014 (replaced with new mechanisms that incentivize production, not spending).

- ACES provisions are unchanged for Cook Inlet and Middle Earth and they retain 20 percent capital credit

- Since capital credits are taken against liability or refunded, fiscal impact is on both revenue and budget

- Likely fiscal impact is summarized on next slide

Mr. Stickel discussed slide 7, "4. Changes to Net Operating Loss credit."

-Companies that incur net losses from leases or properties on the North Slope will earn a credit of 35 percent of those losses.

-May be carried forward for a 10-year maximum period.

-Net loss carry-forwards will increase at an annual rate of 15 percent beginning on January 1 of the second calendar year following the year of the loss.

-Taxpayer must have production and tax liability to use credit - not refundable

-The revenue impact of this provision is confidential under our forecast, however,

-Impact is expected to be minimal.

-In an increased development or low price scenario, protects state because NOLs can't be refunded.

Mr. Stickel discussed slide 8, "Estimated Fiscal Impact for limitations on credits as compared to Fall 2012 Forecast (\$millions)."

[3:41:34 PM](#)

Mr. Pawlowski explained that the slide was based on the forecast expenditures. If more development happens with additional spending, the fiscal impact of the provision would be greater, because the spending would create more credit obligation for the state.

Mr. Stickel detailed slide 9, "5. Establishes Gross Revenue Exclusions."

-Excludes a 30 percent of gross revenue, from taxable value for qualifying production

-Cannot reduce tax liability below zero

-Qualifying production is any of the following:

Land was not in a unit on 1/1/2003

New PA, in units formed before 1/1/2003

Area added to an existing PA after 12/31/2011

-CSSB21 (RES) increased GRE from 20 percent to 30 percent, and added the expansion of an existing PA to qualifying production

-Fiscal Impact = Indeterminate, under \$50 million / year under Fall 2012 forecast

-GRE benefit would apply almost entirely to "New Production" not currently in our forecast

Mr. Stickel discussed slide 10, "6. Extends small producer credit."

-The small producer credit at AS 43.55.024 is extended to the later of:

2022, or,

the ninth calendar year after the calendar year that the producer first has commercial production.

-This provision extends the small producer credit six years from the original sunset date of 2016 to 2022.

-The revenue impact based on the current revenue forecast is minimal.

Mr. Stickel discussed slide 11, "7. Eliminates requirement that credits be taken over two years."

-Capital credits and Net Operating Loss credits earned had to be split across two years under ACES

-This provision allows credits to be used in the year they were earned

-This provision aligns credit treatment on the North

-Slope with credit treatment in all other parts of the state

-Fiscal impact is neutral - simply shifts a future obligation to FY14.

-\$400 million total obligation shifted to FY14: \$250 million revenue impact; \$150 million operating budget impact

Mr. Stickel discussed slide 12, "8. Changes funding for community revenue sharing."

-The community revenue sharing fund is amended to allow the legislature to make appropriations from the tax revenue collected under AS 43.20, as opposed to revenue collected under the provision that is proposed to be repealed - AS 43.55.011(g).

-Corporate income tax revenue under AS 43.20 is adequate to provide the maximum annual appropriation of \$60 million or the amount to bring the fund up to \$180 million.

Corporate income tax has exceeded \$500 million every year for the last 8 years.

-Provision substitutes eliminated revenue source for appropriations, with another adequate source.

Mr. Stickel detailed slide 13, "9. Establishes per oil barrel tax credit."

\$5 credit against tax liability for each taxable oil barrel produced

-Ties credit to production

-Cannot be saved, does not accrue interest, is not transferable

-Removes regressive nature of tax system

-Specifies barrel of "oil"

Likely fiscal impact is summarized on next slide

Mr. Stickel discussed slide 15, "10. Creates service industry expenditures credit."

New Corporate Income Tax Credit for oil and gas service companies

Credit is 10 percent of qualifying in-state expenditures:

- Manufacturing of oil and gas equipment
- Modification of oil and gas equipment
- For in-state spending only

Maximum \$10 million per taxpayer per year, transferrable

This provision was added in CSSB21 (RES)

Fiscal Impact = Indeterminate

Difficult to estimate due to lack of data

If \$500 million to \$1 billion of qualifies ...

Impact could be \$50 to \$100 million / year

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Mr. Stickel discussed slide 18, "Expanded exploration credit allows additional wells to qualify." The twenty five mile range around the existing units qualified for the credit.

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Mr. Pawlowski moved on to slide 21, "Production Scenarios."

Operators of existing units add 4 drill rigs to current plans

Each rig adds 4,000 bbls/day in new production each year

-Which each then decline at 15 percent per year

Does not qualify for GRE

Mr. Stickel detailed slide 23, "Projected revenues under production scenario - at \$90 / barrel ANS." He further explained the graph. He noted that the information was more repressive, and noted the lower revenue generated from ACES.

4:00:45 PM

Mr. Stickel discussed slide 24, "Projected revenues under production scenarios - at \$100 / barrel ANS." He stated that 2019 displayed slightly less revenue under ACES.

Mr. Pawlowski stressed that the ACES did not have the assumption of new production.

Mr. Stickel discussed slide 25, "Projected revenues under production scenario - at \$120 / barrel ANS."

Mr. Pawlowski hoped to discuss the figures which were bases on near term options with. He clarified that the analysis was from legacy fields, and department wished to remain realistic.

Mr. Stickel discussed slide 26, "Projected revenues under production scenarios - at forecast ANS price."

Senator Olson wondered if DOR anticipated that the corporate income tax would continue to remain the same. Mr. Stickel replied that it was projected that there would be over \$600 million per year in only the petroleum income tax. He furthered that there would be an additional approximately \$100 million for the non-petroleum income tax.

SB 21 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

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The meeting was adjourned at 4:06 p.m.