

HB

61

HFIN

FILE

Adopted 4/23/03

23-LS0270\Q
Chenoweth
4/15/03

CS FOR HOUSE BILL NO. 61(FIN)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE FINANCE COMMITTEE

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVES CHENAULT, Kohring, Wolf

A BILL

FOR AN ACT ENTITLED

1 "An Act establishing an exploration and development incentive tax credit for persons
2 engaged in the exploration for and development of gas for sale and delivery without
3 reference to volume from a lease or property in the state; and providing for an effective
4 date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 * **Section 1.** AS 43.20 is amended by adding a new section to read:

7 **Sec. 43.20.043. Gas exploration and development tax credit.** (a) Subject to
8 the terms and conditions of this section, and in addition to any other credit authorized
9 to the taxpayer by this chapter, a taxpayer engaging in the exploration for and
10 development of gas may apply as a credit against the state tax liability that may be
11 imposed on the taxpayer under this chapter, for a tax year beginning after
12 December 31, 2002,

- 13 (1) 10 percent of the taxpayer's qualified capital investment; and
- 14 (2) 10 percent of the annual cost incurred by the taxpayer for qualified

1 services in the state during each tax year for which a credit is allowable for a qualified
2 capital investment under (1) of this subsection.

3 (b) Expenditures qualifying for the taxpayer's qualified investment credit
4 under (a)(1) of this section must be

5 (1) cash expenditures or binding payment agreements entered into after
6 June 30, 2003; and

7 (2) made for assets first placed in service in the state during the tax
8 year in which the credit is claimed; for purposes of this paragraph, "placed in service
9 in the state" means that the first use of the qualified investment is in this state; if the
10 property on which the claim of the credit is based has been used elsewhere in the tax
11 year of acquisition and is brought to this state during that year or a subsequent year,
12 the property does not qualify for the investment credit.

13 (c) The credit per tax year allowed by (a) of this section may not exceed 50
14 percent of the taxpayer's total tax liability, including all taxes, but shall be calculated
15 before the application of any other credits allowed under this chapter. An unused
16 portion of the credit for the tax year

17 (1) may be carried forward into one or more of the following tax years,
18 except that the unused credit from one tax year may not be carried forward for more
19 than five following tax years;

20 (2) shall be applied to the taxpayer's tax liability under this chapter
21 during the following tax year before allowance of a credit allowed by (a) of this
22 section for that following tax year.

23 (d) To obtain the credit allowed by this section, the taxpayer shall, with the
24 taxpayer's tax return, submit, on a form prescribed by the department, information that
25 demonstrates that the taxpayer is eligible for the credit and evidence of the expenses
26 that are the basis of the claim of the credit. The taxpayer has the burden of
27 demonstrating compliance with the requirements of this section to entitle the taxpayer
28 to the claim of and the amount of the credit.

29 (e) A taxpayer entitled to a credit under this section

30 (1) may not convey, assign, or transfer the credit to another taxpayer or
31 business entity unless the conveyance, assignment, or transfer of the credit is part of

1 the conveyance, assignment, or transfer of the taxpayer's business;

2 (2) forfeits the credit to which the taxpayer is entitled during the tax
3 year and any carryover of it under (c) of this section, but does not forfeit the portion of
4 the credit that accrued in a previous taxable year that may be carried over under (c) of
5 this section. if the taxpayer

6 (A) disposes of the qualified capital investment;

7 (B) takes the qualified investment out of service; or

8 (C) transfers the qualified investment out of this state.

9 (f) A taxpayer is not entitled to a credit under this section for expenditures that
10 are made or incurred for the qualified capital investment or for qualified services made
11 for exploration and development of gas that occur in the area of Alaska lying north of
12 68 degrees North latitude or that are made or incurred to transport gas from reserves
13 located in the area of Alaska lying north of 68 degrees North latitude.

14 (g) A taxpayer who obtains a credit under this section may not claim a tax
15 credit or royalty modification provided for under any other title. However, a taxpayer
16 may, at the taxpayer's election, forgo a credit under this section in order to continue to
17 qualify for a credit provided for in another title.

18 (h) For purposes of determining allowable credits under this section, the
19 department shall allow only expenditures and payments that are not inconsistent with
20 the expenditures authorized under 26 U.S.C. (Internal Revenue Code) for exploration
21 and development of natural resources.

22 (i) In this section,

23 (1) "qualified capital investment" means a cash expenditure or binding
24 payment agreement, as described in (b)(1) of this section, for real property or tangible
25 personal property used in this state in the exploration and development of gas reserves
26 in a gas reservoir for which there has not been commercial production if the reserves
27 produce gas for sale and delivery; in this paragraph, "property" includes

28 (A) property used in the operation or maintenance of facilities
29 for exploration or development of gas;

30 (B) property that is placed in use under a capitalized lease or an
31 operating lease; and

1 (C) the following property used for the exploration and
2 development of gas:

3 (i) machinery, appliances, supplies, and equipment;

4 (ii) drilling rigs, wells, gathering lines and transmission
5 lines, pumping stations, compressor stations, power plants, topping
6 plants, and processing units;

7 (iii) roads, docks and other port facilities, and helicopter
8 pads;

9 (iv) maintenance equipment and facilities, and
10 maintenance camps and other related facilities; and

11 (v) communications facilities owned by a person whose
12 principal business in the state is the exploration for or development of
13 gas and whose operation of the communications facilities directly
14 relates to the conduct of that business;

15 (2) "qualified services"

16 (A) means expenditures for labor, seismic, and other services
17 that are directly applicable to a qualified capital investment;

18 (B) does not include lease operating expenses.

19 * Sec. 2. AS 43.20.043 is repealed.

20 * Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to
21 read:

22 CLAIM OF GAS EXPLORATION AND DEVELOPMENT TAX CREDIT
23 CONTINUED. A taxpayer who, on the effective date of repeal of AS 43.20.043 by sec. 2 of
24 this Act, claims the balance of any unused portion of the gas exploration and development tax
25 credit as a carry-forward under AS 43.20.043(c), may, notwithstanding the repeal of that
26 subsection, continue to claim the balance of the credit until the claim of the credit is exhausted
27 or until the tax year ending December 31, 2017, whichever occurs earlier. The provisions of
28 AS 43.20.043 as they read on the day immediately preceding the effective date of the repeal
29 of that section apply to the claim of the credit if carried forward under this section.

30 * Sec. 4. Section 2 of this Act takes effect January 1, 2013.

31 * Sec. 5. Except as provided in sec. 4 of this Act, this Act takes effect immediately under

1 AS 01.10.070(c).

By Chenawit

passed N/O

23-LS0270\Q.4
Chenoweth
4/24/03

AMENDMENT 1

OFFERED IN THE HOUSE

TO: CSHB 61(FIN), Draft Version "Q"

- 1 Page 2, lines 7 and 8, following "in the state":
- 2 Delete "during the tax year in which the credit is claimed"
- 3 Insert "in or before the tax year in which the credit is claimed through the date the
- 4 reserves produce gas for sale and delivery"

by Chenault

adopted N/O

23-LS0270\Q.2
Chenoweth
4/24/03

AMENDMENT

2

OFFERED IN THE HOUSE

TO: CSHB 61(FIN), Draft Version "Q"

- 1 Page 1, line 1:
- 2 Delete "persons"
- 3 Insert "operators and working interest owners directly"
- 4
- 5 Page 1, line 9, following "a taxpayer":
- 6 Insert "that is an operator or working interest owner directly"

by Chenault

passed
NO OBJ

23-LS0270\Q.3
Chenoweth
4/24/03

AMENDMENT

3

OFFERED IN THE HOUSE

TO: CSHB 61(FIN), Draft Version "Q"

- 1 Page 2, line 14, following "liability":
- 2 Delete ", including all taxes,"
- 3 Insert "under this chapter,"

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 61(O&G)
(H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
Title Oil and Gas Tax Credit for Exploration. BRU Oil and Gas Development
Sponsor Chenault, Kohring, Wolf Component Oil and Gas Development
Requestor House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)
HB 61 would authorize the Dept. of Revenue to grant credits against a taxpayer's state corporate income tax liability for certain oil or gas exploration and development investments made in the state.

Prepared by: Mark D. Myers Phone 269-8800
Division Oil and Gas Date/Time 2/4/03 7:46 AM
Approved by: Tom Irwin, Commissioner Date 2/4/2003
Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: CSHB 61(O&G)
 (H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Oil and Gas Tax Credit BRU Revenue Operations
for Exploration / Development Component Tax Division
 Sponsor Representative Chenault
 Requester House Committee on Oil and Gas Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
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TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES () See Analysis

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POSITIONS

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Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill is intended to promote the exploration and development of natural gas south of the Brooks Range, particularly in Cook Inlet. This bill allows a tax credit equal to 10 percent of qualified capital investment -- as well as annual labor, seismic and associated costs -- related to gas exploration and development work to be applied against corporate income tax (AS 43.20) for up to 50% of a corporation's total tax liability. The credit applies only to gas exploration and development of reserves south of the Brooks Range. The credit can only be taken if the reserves produce gas for sale and delivery.

Corporations could use their tax credits under this legislation to reduce taxes paid to the state for North Slope production or production from elsewhere in the state.

Oil and gas corporate income tax collections in FY 2003 and FY 2004 are currently projected at \$160 million and \$200 million per year, respectively.

Prepared by: Chuck Logsdon, Chief Petroleum Economist Phone _____
 Division Tax Division Date/Time 3/11/03 9:46 AM
 Approved by: Larry Persily, Deputy Commissioner Date 3/11/2003
 Agency Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 61(O&G)

ANALYSIS CONTINUATION

It is not easy to evaluate the overall revenue effect of a tax credit. On the plus side, if exploration activity discovers developable reserves, the state could receive royalty and production taxes that more than offset the revenue loss due to the tax credit. And the availability of the credit could enhance the attractiveness of exploring for new oil and gas resources, which may or may not result in creditable expenditures depending on whether discovery and development occurs.

The credit is targeted to natural gas exploration and development activity south of the Brooks Range, while the bulk of current oil and gas corporate income tax against which this credit could potentially be taken is from production and transportation of high-value oil on the North Slope. As a result, an oil and gas corporation that has profitable operations on the North Slope could, by investing in development outside of the Slope, reduce its total oil and gas corporate income tax liability through this new credit provision.

The key state revenue issue with regard to this tax credit is the extent to which the additional incentive is needed to encourage exploration and development. Natural gas price levels are critical in determining the commercial incentive to explore and develop. Natural gas prices probably will be a bigger factor in a commercial venture than the tax credits in this legislation, but this tax credit provision could also play a factor in a corporate decision to invest in exploration and development. A risk to the state is if high gas prices spur development on their own, regardless of the tax credit, the state could be in the position of providing a tax credit that is no longer necessary to promote development.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

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(H) Publish Date: 3/14/03

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Component Oil and Gas Development
Sponsor Chenault, Kohring, Wolf
Requester House Oil and Gas Component No. 439

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Title: Oil and Gas Tax Credit BRU: Revenue Operations
for Exploration / Development Component: Tax Division
Sponsor: Representative Chenault
Requester: House Committee on Oil and Gas Component No.: 2476

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CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	<i>See Analysis</i>
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The key state revenue issue with regard to this tax credit is the extent to which the additional incentive is needed to encourage exploration and development. Natural gas price levels are critical in determining the commercial incentive to explore and develop. Natural gas prices probably will be a bigger factor in a commercial venture than the tax credits in this legislation, but this tax credit provision could also play a factor in a corporate decision to invest in exploration and development. A risk to the state is if high gas prices spur development on their own, regardless of the tax credit, the state could be in the position of providing a tax credit that is no longer necessary to promote development.

STATE OF ALASKA

REPRESENTATIVE
MIKE CHENAULT

Official Business

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HOUSE OF REPRESENTATIVES

Spousor Statement HB 61

HB 61 creates a new income tax credit to encourage increased exploration and development of natural gas reserves south of the Brook Range. While focused primarily on natural gas reserve development, the bill also provides an incentive for the development of marginal oil reserves should they be discovered. For the purpose of this bill, marginal oil production is defined as that which initially produces 150 barrels of oil per day or less. To qualify for the credit, operators must successfully drill and develop hydrocarbon reserves that produce natural gas for sale and delivery. The credit may offset no more than 50% of an operators annual income tax liability and remains in effect for a period of ten years.

The tax credit would amount to 10% of qualified investments (and 100% of services associated with said investment) for each year. For example, an operator who spends \$20 million in a given year successfully developing natural gas reserves would receive an income tax credit of \$2 million – applicable to up to one-half of it's income tax liability for that year. Credits in excess of 50% of the operator's income tax liability can be carried over to future years. This is a successful efforts bill which means that no credits will be given for dry holes.

The Cook Inlet continues to have great potential for additional natural gas development. Other Alaska basins outside of the North Slope have similar potential. However, the combination of exploration risk, high development costs and historic low natural gas prices has created a disincentive to drill for new reserves as compared to other areas of the world. By providing a credit for successful efforts, more exploration will occur in Southern Alaska leading to much needed new natural gas reserves. This will benefit all residents and businesses at no direct cost to the state.

In addition to the benefit of developing new gas reserves, increased Cook Inlet drilling will also aid the general economic status on the Kenai Peninsula and in Anchorage as well as other areas of Alaska. Moreover, increased tax revenue from additional hydrocarbon production will more than offset any fiscal impact from the proposed credit.

STATE OF ALASKA

Scan

**REPRESENTATIVE
MIKE CHENAULT**



Official Business

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HOUSE OF REPRESENTATIVES

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In addition to the benefit of developing new gas reserves, increased Cook Inlet drilling will also aid the general economic status on the Kenai Peninsula and in Anchorage as well as other areas of Alaska. Moreover, increased tax revenue from additional gas production will more than offset any fiscal impact from the proposed credit.

Committee Substitute to HB 61

Changes from Original Introduced Version

Oil and Gas, Resources, and Finance Committees

- **Oil Incentive Eliminated. (CS-O&G)**
- **Reduction in Credit for Qualified Services. (CS-O&G)**
 - The credit for "Qualified Services" has been reduced from 100% to 10%.
- **Credit Applies to all Taxes Paid in a Single Year. (CS-O&G)**
 - The amount of tax credit in a single year must not be greater than 50% of a taxpayers "total" income tax liability for that year and calculated prior to application of any other credits.
- **Elimination of "Double-Up" with other Incentive Programs. (CS-O&G)**
 - If taxpayer elects to participate in this exploration and development program it is not entitled to any other incentive programs such as royalty reductions, etc. However, taxpayers may forego this incentive and still utilize other programs.
- **Definition of "New Gas" to Market more Clearly Specified. (CS-O&G)**
 - New gas now defined as gas reserves in a gas reservoir for which there has not yet been commercial production.
- **Definition of "Qualified Capital Investment" Tightened. (CS-O&G)**
 - Language added to make it clear only *exploration and development* expenses are covered and no ongoing production expenses apply.
 - Property relating to *oil* exploration and development eliminated.
 - Air strips are eliminated and replaced with helicopter pads.
 - Aircraft and motor vehicles eliminated.
- **Definition of "Qualified Services" Tightened. (CS-O&G)**
 - Language added to make it clear that "qualified services" expenditures must be directly attributable to "qualified capital investment".
 - Language added to make it clear that ongoing operating expenses will not be available for the credit.
- **Retroactivity Removed. (CS-RES)**
 - Effective date revised to make it clear no expenditures made by an operator prior to July 1, 2003 qualify. This makes the investment tax credit totally forward looking.
- **Language Added to be Consistent with Federal Rules. (CS-RES)**
 - New section clearly defines that only expenditures and payments consistent with those defined in the Internal Revenue Code for exploration and development of natural resources qualify.
- **Language Added to Eliminate North Slope Gas Pipeline Expenses. (CS-FIN)**
 - Clarifying wording inserted to make it clear no expenses related a future North Slope gas pipeline will qualify.

THE
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Oilfield Services

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Fax: (907) 561 8317

Schlumberger

Representative Kelly Wolf
House of Representatives
Alaska State Capitol, Room 418
Juneau, AK 99801-1182

Re: House Bill 61 (O&G)

Dear Representative Wolf:

This letter is in support of the Act establishing an exploration and development tax credit for persons engaged in the exploration and development of gas south of the Brooks Range in the state of Alaska (HB 61).

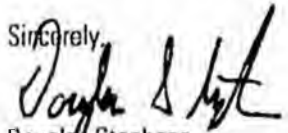
Schlumberger Technology Corporation is a Delaware company with substantial oilfield services operations in Alaska, where we presently employ approximately 500 people, the vast majority of whom are residents of the state, where we have operated for the past 35 years. The services we provide assist Operating Companies, during the exploration, development and production phases of oil and gas exploration.

Alaska's gas exploration and production activities are in need of economic stimulus in order for the state to realize its potential in energy development. The incentives provided by proposed HB 61 are designed to deliver to the State's economy this needed stimulus, with the expected result of increased employment and increased consumer and business spending. The stimulus provided by HB 61 would apply not only to new gas exploration, but also to other economic benefits realizable with respect to marginal reservoirs, which may be discovered while exploring for gas.

HB 61 creates an incentive tax credit to increase exploration and development of natural gas in the Cook Inlet and other prospective Alaskan basins south of the Brook Range. The Cook Inlet reserves have continued to decline over time, due in large part to high exploration and production costs. The Cook Inlet (and the Kenai peninsula) is a mature oil province, where the economics of developing cost effective energy sources have changed, hence the incentive for undertaking additional exploration activity which would result from the passage of HB 61 is critical to the long term viability of the State's gas market, a key component of the Cook Inlet, Kenai and Alaska economies.

Accordingly, we trust you will give your support to HB 61.

Sincerely,


Douglas Stephens
General Manager
Schlumberger Alaska

HB 61 – Investment Tax Credit For Natural Gas Development

Concern of Offsetting Corporate Income Tax Payments from North Slope Operations

Recently, some concern has been raised that oil and gas operators on the North Slope may be able to offset a portion of their corporate income taxes generated from the North Slope even though qualified investments in HB 61 must be south of the Brooks Range. Any investment stimulated by HB 61, regardless of the operator, or the makeup of its operations currently in the state will be good for Alaska.

The provisions of HB 61 require that before any operator receives credits to the corporate income tax, new gas must be discovered and brought to market. Also, no operator may offset more than 50% of tax in any given year. As an example, if a North Slope operator has a corporate income tax liability of \$10 million in a given year, the most it could offset would be \$5 million. *To do that, however, the operator would have to invest at least \$50 million in new exploration and development and be successful in bringing the gas to market.* That new investment would be great for the State of Alaska as it would generate more than ten times the value in royalties and severance tax than the value of the credits. Moreover, if a North Slope operator has a corporate tax liability of \$100 million, the most that could be offset would be \$50 million, requiring new successful investment of at least \$500 million -- which would be tremendous for Alaska.

In summary, the stimulative effects of HB 61 on new natural gas exploration and development and the resulting positive impact on Alaska are the same regardless of the operator's current business makeup in the state. Whether the investor is currently a producer only on the North Slope; only in other parts of the state; or just getting started in investing in Alaska, all new investment will have the same effect.



RESOURCE DEVELOPMENT COUNCIL

Growing Alaska Through Responsible Resource Development

Tadd Owens, Executive Director
Resource Development Council
HB61 Testimony
House Oil & Gas Committee
February 27, 2003

Thank you, Mr. Chairman. For the record my name is Tadd Owens, I am the executive director of the Resource Development Council. RDC is a private, non-profit, business association representing individuals and companies from Alaska's oil and gas, mining, timber, tourism and fisheries industries. Our mission is to help grow Alaska's economy through the responsible development of the state's natural resources.

RDC supports House Bill 61 and we ask the House Oil & Gas Committee to move the legislation forward. HB61 provides a tax credit for exploration and development of natural gas reserves and small oil deposits south of the Brooks Range. The legislation will have a major impact on natural gas exploration and development in Cook Inlet.

As the Committee has already heard, this legislation is needed to help offset the continuing decline in Cook Inlet's proven natural gas reserves. At this time,

reserves in Cook Inlet are not being replaced annually. In addition, as this committee has heard from Agrium Corp. in testimony regarding House Bill 57, there is not enough gas currently available to feed low-price consumers in the region. In fact, rising natural gas prices in Cook Inlet threaten to greatly increase both the cost of living and the cost of doing business in southcentral Alaska.

As with all of Alaska's resource industries, Cook Inlet oil and gas projects compete for capital investment with other projects around the globe. HB61 would stimulate additional exploration and development activity in Cook Inlet by leveling the playing field with other worldwide business opportunities.

Attracting additional private-sector investment capital to Alaska is exactly what the state needs to encourage a market sustainable economy — one that relies primarily on growing our exports and replacing our imports as opposed to one that depends on state and federal transfer payments and low-paying, low-skill jobs.

The tax credit defined by HB61 would apply to 10% of a company's qualified capital investment and 100% of qualified expenses. In any given year, the credit is

capped at 50% of a company's corporate income tax liability. Perhaps most importantly, the credit will only apply to successful exploration and development projects. No reward will be granted to dry holes.

By providing incentives for successful exploration and development, Cook Inlet natural gas reserves should increase, meaning additional royalty, severance and ad valorem income to the state of Alaska. Increased natural gas reserves in Cook Inlet will also ensure an adequate supply for southcentral communities, utilities and industrial operations, meaning stable jobs and tax revenues for the region.

The bottom line is this — current exploration activity in Cook Inlet is not sufficient to meet future demand for low priced natural gas. HB61 will help provide an attractive business environment for companies looking to increase leasing, drilling and construction activities in Cook Inlet. It is timely and well-conceived legislation and we believe it deserves the committee's support.

Thank you, Mr. Chairman for the opportunity to testify this afternoon.

J. Scott Jepsen
Cook Inlet Asset Manager

P.O. Box 100360 - ATO 1420
Anchorage, AK 99510-0360
Phone 907-263-4348

The logo for ConocoPhillips, featuring the word "ConocoPhillips" in a bold, sans-serif font with a stylized bird-like graphic above the "o" in "Phillips".

Feb. 27, 2003

Representative Vic Kohring
Chairman, House Oil and Gas Committee
Alaska State Capitol, Room 24
Juneau, Alaska 99801

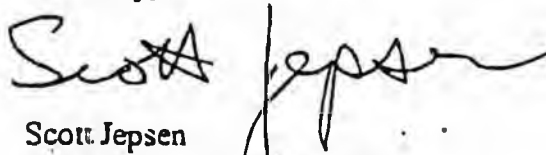
Re: House Bill 61

Dear Rep. Kohring:

ConocoPhillips Alaska would like to express our support for HB 61 - An Act Establishing Oil and Gas Tax Credits for Certain Exploration and Development Projects. We believe that passage of this bill has the potential to spur additional efforts to explore for oil, and in particular gas, in places like Cook Inlet and the surrounding area that have not seen much exploration in recent years.

Thank you for your continued support for our efforts in Alaska. If you have any questions, please call me at (907) 263-4348.

Sincerely,

A handwritten signature in black ink that reads "Scott Jepsen".

Scott Jepsen
Cook Inlet Asset Manager
ConocoPhillips Alaska, Inc.

Cc: Rep. Chenault
Rep. Kelly Wolf

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CSHB 61(O&G)
 (H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title Oil and Gas Tax Credit for Exploration. BRU Oil and Gas Development
 Component Oil and Gas Development
 Sponsor Chenault, Kohring, Wolf
 Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 61 would authorize the Dept. of Revenue to grant credits against a taxpayer's state corporate income tax liability for certain oil or gas exploration and development investments made in the state.

Prepared by: Mark D. Myers Phone 269-8800
 Division: Oil and Gas Date/Time 2/4/03 7:46 AM
 Approved by: Tom Irwin, Commissioner Date 2/4/2003
 Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSHB 61(O&G)
(H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title Oil and Gas Tax Credit BRU Revenue Operations
for Exploration / Development Component Tax Division
Sponsor Representative Chenault
Requester House Committee on Oil and Gas Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	<i>See Analysis</i>
-------------------------------	---------------------

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill is intended to promote the exploration and development of natural gas south of the Brooks Range, particularly in Cook Inlet. This bill allows a tax credit equal to 10 percent of qualified capital investment -- as well as annual labor, seismic and associated costs -- related to gas exploration and development work to be applied against corporate income tax (AS 43.20) for up to 50% of a corporation's total tax liability. The credit applies only to gas exploration and development of reserves south of the Brooks Range. The credit can only be taken if the reserves produce gas for sale and delivery.

Corporations could use their tax credits under this legislation to reduce taxes paid to the state for North Slope production or production from elsewhere in the state.

Oil and gas corporate income tax collections in FY 2003 and FY 2004 are currently projected at \$160 million and \$200 million per year, respectively.

Prepared by: Chuck Logsdon, Chief Petroleum Economist Phone _____
Division Tax Division Date/Time 3/11/03 9:46 AM
Approved by: Larry Persily, Deputy Commissioner Date 3/11/2003
Agency Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 61(O&G)

ANALYSIS CONTINUATION

It is not easy to evaluate the overall revenue effect of a tax credit. On the plus side, if exploration activity discovers developable reserves, the state could receive royalty and production taxes that more than offset the revenue loss due to the tax credit. And the availability of the credit could enhance the attractiveness of exploring for new oil and gas resources, which may or may not result in creditable expenditures depending on whether discovery and development occurs.

The credit is targeted to natural gas exploration and development activity south of the Brooks Range, while the bulk of current oil and gas corporate income tax against which this credit could potentially be taken is from production and transportation of high-value oil on the North Slope. As a result, an oil and gas corporation that has profitable operations on the North Slope could, by investing in development outside of the Slope, reduce its total oil and gas corporate income tax liability through this new credit provision.

The key state revenue issue with regard to this tax credit is the extent to which the additional incentive is needed to encourage exploration and development. Natural gas price levels are critical in determining the commercial incentive to explore and develop. Natural gas prices probably will be a bigger factor in a commercial venture than the tax credits in this legislation, but this tax credit provision could also play a factor in a corporate decision to invest in exploration and development. A risk to the state is if high gas prices spur development on their own, regardless of the tax credit, the state could be in the position of providing a tax credit that is no longer necessary to promote development.

CS FOR HOUSE BILL NO. 61(RES)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE RESOURCES COMMITTEE

Offered: 3/31/03
Referred: Finance

Sponsor(s): REPRESENTATIVES CHENAULT, Kohring, Wolf

A BILL
FOR AN ACT ENTITLED

1 "An Act establishing an exploration and development incentive tax credit for persons
2 engaged in the exploration for and development of gas for sale and delivery without
3 reference to volume from a lease or property in the state; and providing for an effective
4 date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 * **Section 1.** AS 43.20 is amended by adding a new section to read:

7 **Sec. 43.20.043. Gas exploration and development tax credit.** (a) Subject to
8 the terms and conditions of this section, and in addition to any other credit authorized
9 to the taxpayer by this chapter, a taxpayer engaging in the exploration for and
10 development of gas may apply as a credit against the state tax liability that may be
11 imposed on the taxpayer under this chapter, for a tax year beginning after
12 December 31, 2002,

- 13 (1) 10 percent of the taxpayer's qualified capital investment; and
14 (2) 10 percent of the annual cost incurred by the taxpayer for qualified

1 services in the state during each tax year for which a credit is allowable for a qualified
2 capital investment under (1) of this subsection.

3 (b) Expenditures qualifying for the taxpayer's qualified investment credit
4 under (a)(1) of this section must be

5 (1) cash expenditures or binding payment agreements entered into after
6 June 30, 2003; and

7 (2) made for assets first placed in service in the state during the tax
8 year in which the credit is claimed; for purposes of this paragraph, "placed in service
9 in the state" means ~~only~~ the first use of the qualified investment ~~is~~ in this state; if the
10 property on which the claim of the credit is based has been used elsewhere in the tax
11 year of acquisition and is brought to this state during that year or a subsequent year,
12 the property does not qualify for the investment credit.

13 (c) The credit per tax year allowed by (a) of this section may not exceed 50
14 percent of the taxpayer's total tax liability, including all taxes, but shall be calculated
15 before the application of any other credits allowed under this chapter. An unused
16 portion of the credit for the tax year

17 (1) may be carried forward into one or more of the following tax years,
18 except that the unused credit from one tax year may not be carried forward for more
19 than five following tax years;

20 (2) shall be applied to the taxpayer's tax liability under this chapter
21 during the following tax year before allowance of a credit allowed by (a) of this
22 section for that following tax year.

23 (d) To obtain the credit allowed by this section, the taxpayer shall, with the
24 taxpayer's tax return, submit, on a form prescribed by the department, information that
25 demonstrates that the taxpayer is eligible for the credit and evidence of the expenses
26 that are the basis of the claim of the credit. The taxpayer has the burden of
27 demonstrating compliance with the requirements of this section to entitle the taxpayer
28 to the claim of and the amount of the credit.

29 (e) A taxpayer entitled to a credit under this section

30 (1) may not convey, assign, or transfer the credit to another taxpayer or
31 business entity unless the conveyance, assignment, or transfer of the credit is part of

1 the conveyance, assignment, or transfer of the taxpayer's business;

2 (2) forfeits the credit to which the taxpayer is entitled during the tax
3 year and any carryover of it under (c) of this section, but does not forfeit the portion of
4 the credit that accrued in a previous taxable year that may be carried over under (c) of
5 this section, if the taxpayer

6 (A) disposes of the qualified capital investment;

7 (B) takes the qualified investment out of service; or

8 (C) transfers the qualified investment out of this state.

9 (f) A taxpayer is not entitled to a credit under this section for expenditures
10 made or incurred for the qualified capital investment or for qualified services made for
11 exploration and development of gas that occur in the area of Alaska lying north of 68
12 degrees North latitude.

13 (g) A taxpayer who obtains a credit under this section may not claim a tax
14 credit or royalty modification provided for under any other title. However, a taxpayer
15 may, at the taxpayer's election, forgo a credit under this section in order to continue to
16 qualify for a credit provided for in another title.

17 (h) For purposes of determining allowable credits under this section, the
18 department shall allow only expenditures and payments that are not inconsistent with
19 the expenditures authorized under 26 U.S.C. (Internal Revenue Code) for exploration
20 and development of natural resources.

21 (i) In this section,

22 (1) "qualified capital investment" means a cash expenditure or binding
23 payment agreement, as described in (b)(1) of this section, for real property or tangible
24 personal property used in this state in the exploration and development of gas reserves
25 in a gas reservoir for which there has not been commercial production if the reserves
26 produce gas for sale and delivery; in this paragraph, "property" includes

27 (A) property used in the operation or maintenance of facilities
28 for exploration or development of gas;

29 (B) property that is placed in use under a capitalized lease or an
30 operating lease; and

31 (C) the following property used for the exploration and

1 development of gas:

2 (i) machinery, appliances, supplies, and equipment;

3 (ii) drilling rigs, wells, gathering lines and transmission

4 lines, pumping stations, compressor stations, power plants, topping
5 plants, and processing units;

6 (iii) roads, docks and other port facilities, and helicopter
7 pads;

8 (iv) maintenance equipment and facilities, and
9 maintenance camps and other related facilities; and

10 (v) communications facilities owned by a person whose
11 principal business in the state is the exploration for or development of
12 gas and whose operation of the communications facilities directly
13 relates to the conduct of that business;

14 (2) "qualified services"

15 (A) means expenditures for labor, seismic, and other services
16 that are directly applicable to a qualified capital investment;

17 (B) does not include lease operating expenses.

18 * Sec. 2. AS 43.20.043 is repealed.

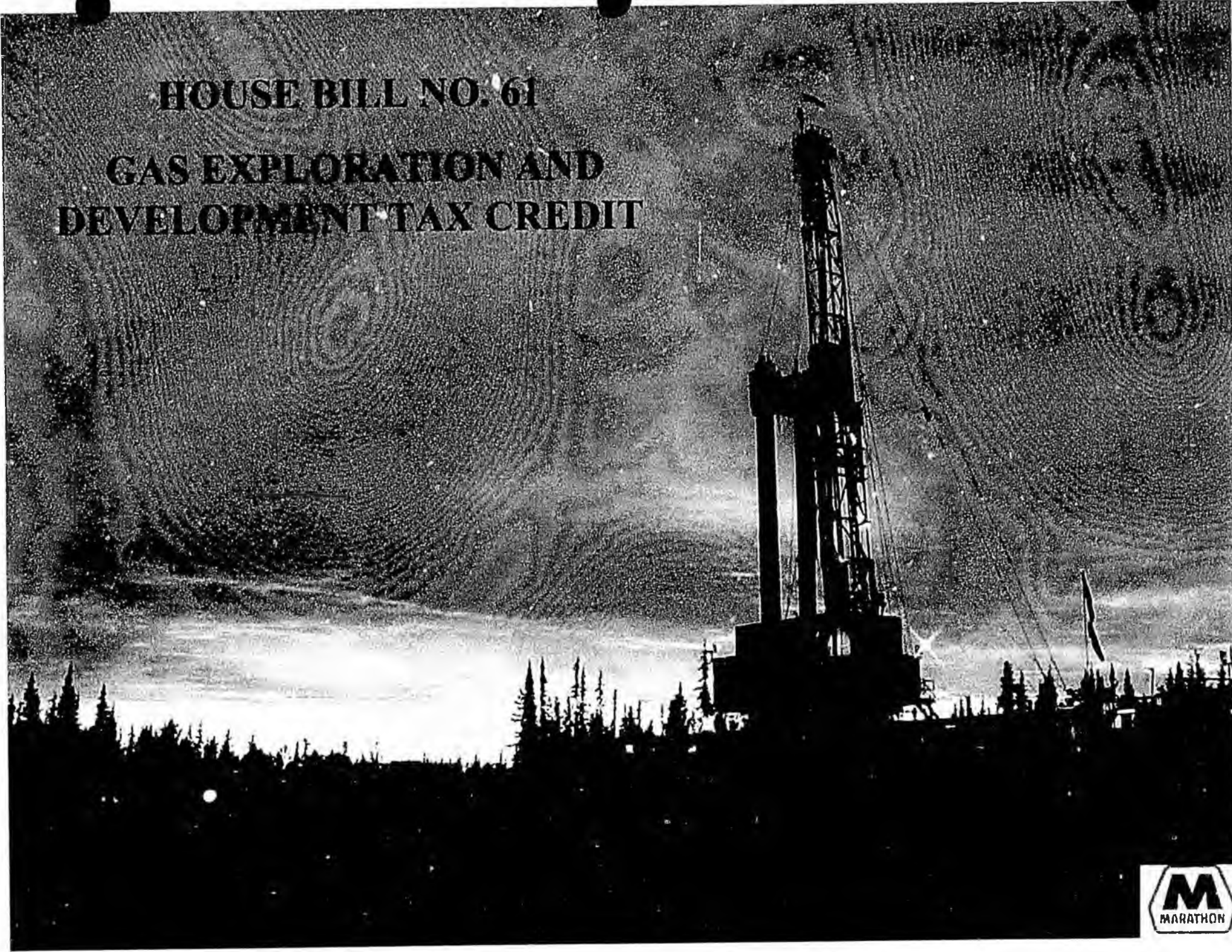
19 * Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to
20 read:

21 CLAIM OF GAS EXPLORATION AND DEVELOPMENT TAX CREDIT
22 CONTINUED. A taxpayer who, on the effective date of repeal of AS 43.20.043 by sec. 2 of
23 this Act, claims the balance of any unused portion of the gas exploration and development tax
24 credit as a carry-forward under AS 43.20.043(c), may, notwithstanding the repeal of that
25 subsection, continue to claim the balance of the credit until the claim of the credit is exhausted
26 or until the tax year ending December 31, 2017, whichever occurs earlier. The provisions of
27 AS 43.20.043 as they read on the day immediately preceding the effective date of the repeal
28 of that section apply to the claim of the credit if carried forward under this section.

29 * Sec. 4. Section 2 of this Act takes effect January 1, 2013.

30 * Sec. 5. Except as provided in sec. 4 of this Act, this Act takes effect immediately under
31 AS 01.10.070(c).

HOUSE BILL NO. 61
GAS EXPLORATION AND
DEVELOPMENT TAX CREDIT





HB 61 – What Does it Do

- Draws more E&P Investments to Alaska
- Creates income tax credit to encourage exploration and development of gas reserves south of Brooks Range
- Primary focus is on Cook Inlet, but applies to other Alaska basins
- Focus is on natural gas.
- Levels the playing field somewhat with other exploration opportunities around the world.



HB 61 – How Does it Work?

- Applies to 10% of Qualified Capital Investment
- Applies to 10% of Qualified Expense
- May offset no more than 50% of corporate income tax in any one year (up to five additional years)
- Only applies to successful efforts.
- Incentive can be factored into project economics.

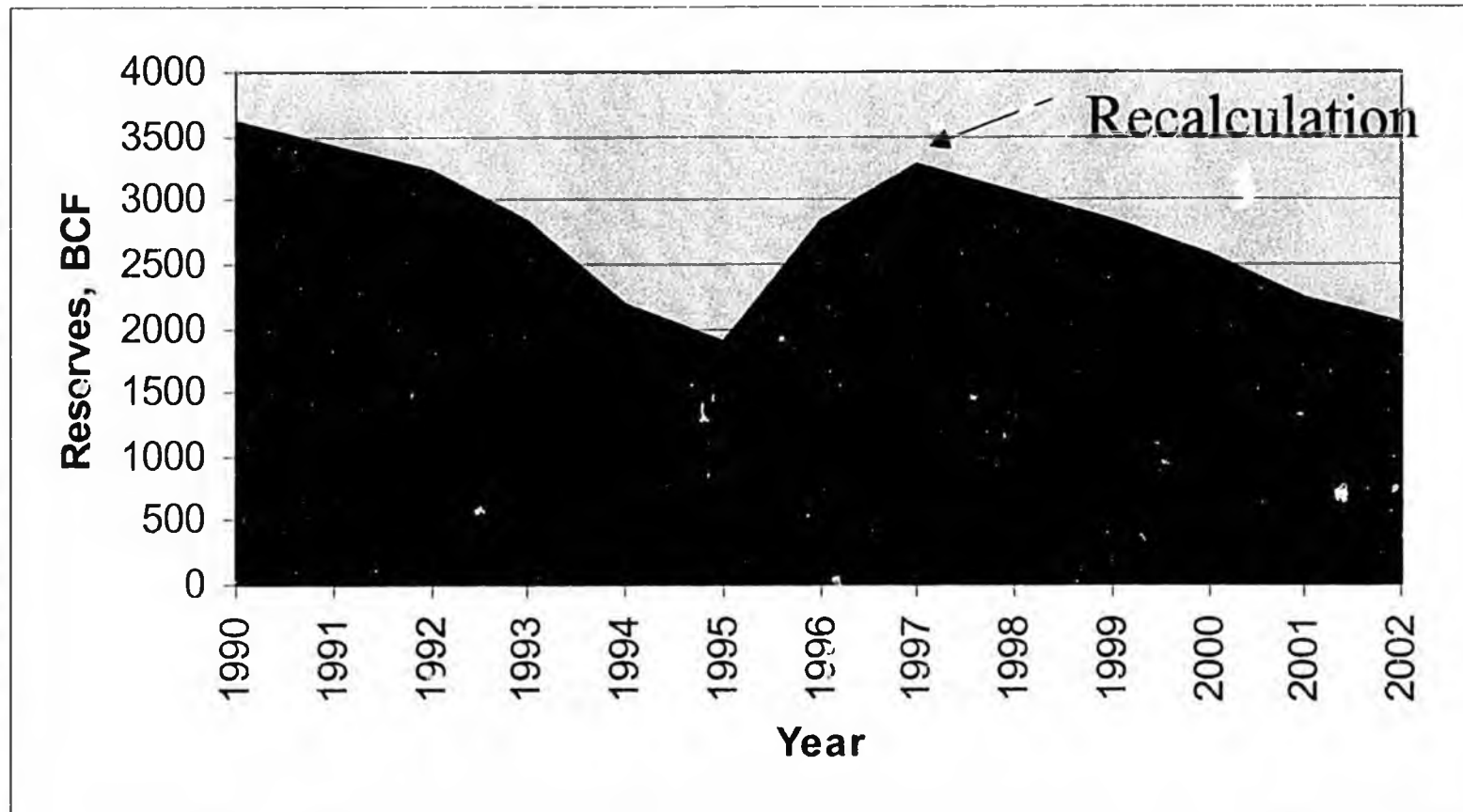


HB 61 – Why is it needed?

- Currently there is not enough Alaska E&P Activity
- Natural Gas Reserves have been and are continuing to decline in the Cook Inlet.
 - Current Cook Inlet proven natural gas reserves are estimated at 2 TCF
 - (Based on DNR DOG 2002 report, less 2002 production)
- Despite recent increase in Cook Inlet exploration activity, reserves are not being replaced on an annual basis



Cook Inlet Proven Gas Reserves



Source: Alaska DNR

April 23, 2003

*Testimony of John A Barnes to House
Finance Committee*



HB 61 – Why is it needed?

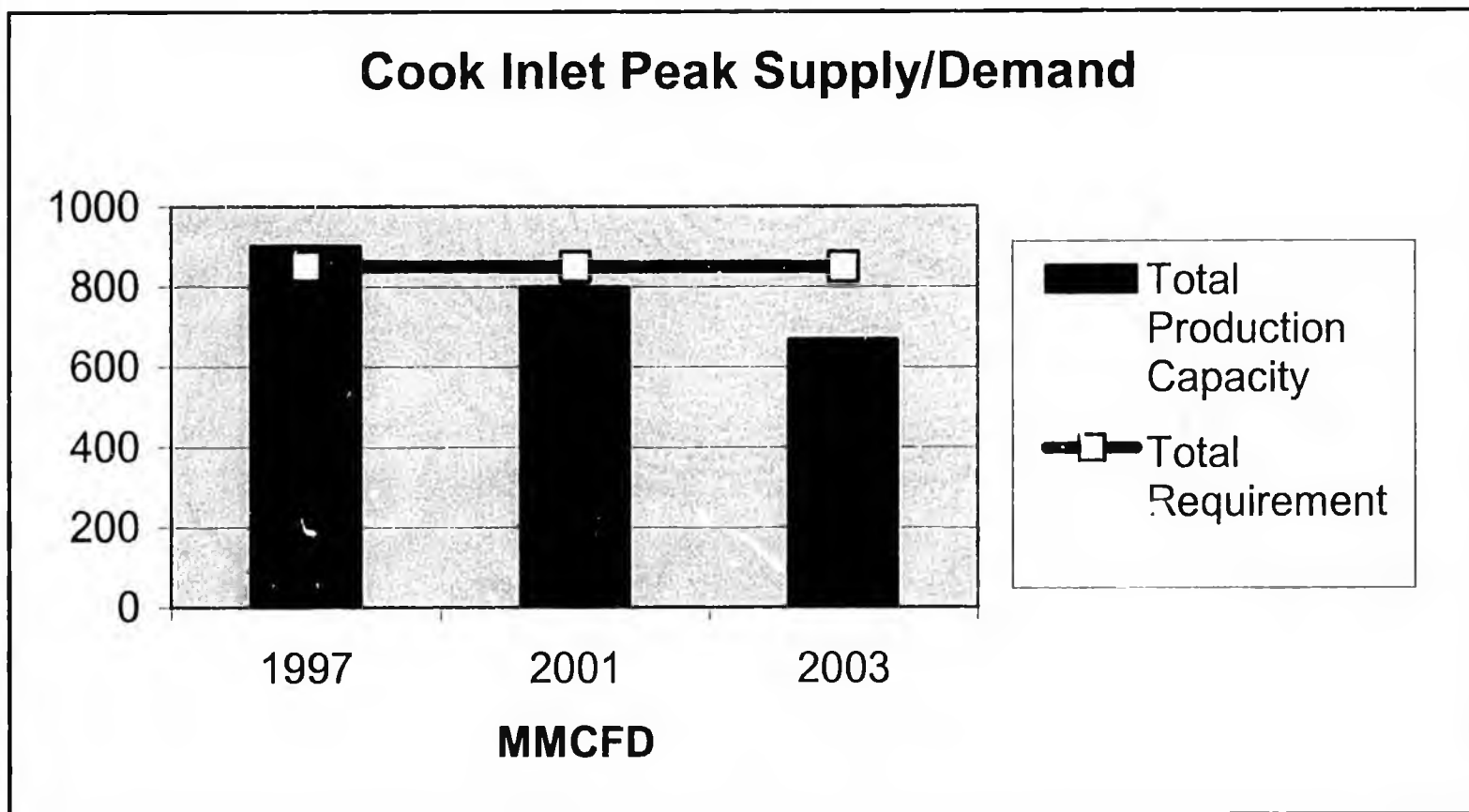
- Cook Inlet deliverability has declined over last several years.



Marathon Oil Company



HB 61 – Why is it needed?



April 23, 2003

*Testimony of John A Barnes to House
Finance Committee*

7



Marathon Oil Company



HB 61 – Why is it needed?

- Supply and demand rationalization is occurring.
 - Not enough gas to feed low price consumer.
 - Gas price increasing
 - Enstar average gas cost (WACOG) \$2.55/mcf
 - Most recent Enstar contract gas price \$2.75 to Henry Hub
 - Henry Hub recently over \$9.00/mcf



Cook Inlet Reserves & Resources

- Current proven reserves – 2000 BCF
 - Approximately 10 year production life, assuming no decline.
- Potential Gas Committee Resource Estimates
 - Probable Reserves – 1050 BCF
 - Possible Reserves – 2100 BCF



Impacts to State of Alaska

- Stimulates Cook Inlet, and potentially other basin exploration.
- Aids in maintaining Cook Inlet 200+ BCF/year production.
 - Equivalent to a 13th month of North Slope Production.
- Provides gas for Cook Inlet utilities, industrials, jobs, royalties, taxes.



Fiscal Impact to State of Alaska

- Incentive will be clearly positive to State of Alaska, factors are...
 - How many developments will be incentivized?
 - How much gas will be discovered?
 - What will be the gas sales price (royalty value)?
 - How much will be spent for exploration and development?
 - Successful efforts driven – no incentives for dry holes



Fiscal Impact to State of Alaska

- Conceptual Estimate of Impact, assumptions:
 - Varied field size from 0 to 500 BCF
 - Development Cost \$0.50/mcf
 - Royalty – 12.5%
 - Severance Tax – 7.5%
 - Ad valorem – 2.7%
 - Gas sales price - \$2.50/mcf



Marathon Oil Company



Fiscal Impact to State of Alaska

Field Size (BCF)	Development Cost	Tax Credit	Gross Revenue	Royalty (12.5%)	Severance (7.5%)	Ad Val	Total Tax
0	0	0	0	0	0	0	0
50	\$25,000,000	\$2,500,000	\$125,000,000.0	\$15,625,000	\$9,375,000	\$1,050,000	\$26,050,000
100	\$50,000,000	\$5,000,000	\$250,000,000.0	\$31,250,000	\$18,750,000	\$2,100,000	\$52,100,000
150	\$75,000,000	\$7,500,000	\$375,000,000.0	\$46,875,000	\$28,125,000	\$3,150,000	\$78,150,000
200	\$100,000,000	\$10,000,000	\$500,000,000.0	\$62,500,000	\$37,500,000	\$4,200,000	\$104,200,000
250	\$125,000,000	\$12,500,000	\$625,000,000.0	\$78,125,000	\$46,875,000	\$5,250,000	\$130,250,000
300	\$150,000,000	\$15,000,000	\$750,000,000.0	\$93,750,000	\$56,250,000	\$6,300,000	\$156,300,000
350	\$175,000,000	\$17,500,000	\$875,000,000.0	\$109,375,000	\$65,625,000	\$7,350,000	\$182,350,000
400	\$200,000,000	\$20,000,000	\$1,000,000,000.0	\$125,000,000	\$75,000,000	\$8,400,000	\$208,400,000
450	\$225,000,000	\$22,500,000	\$1,125,000,000.0	\$140,625,000	\$84,375,000	\$9,450,000	\$234,450,000
500	\$250,000,000	\$25,000,000	\$1,250,000,000.0	\$156,250,000	\$93,750,000	\$10,500,000	\$260,500,000

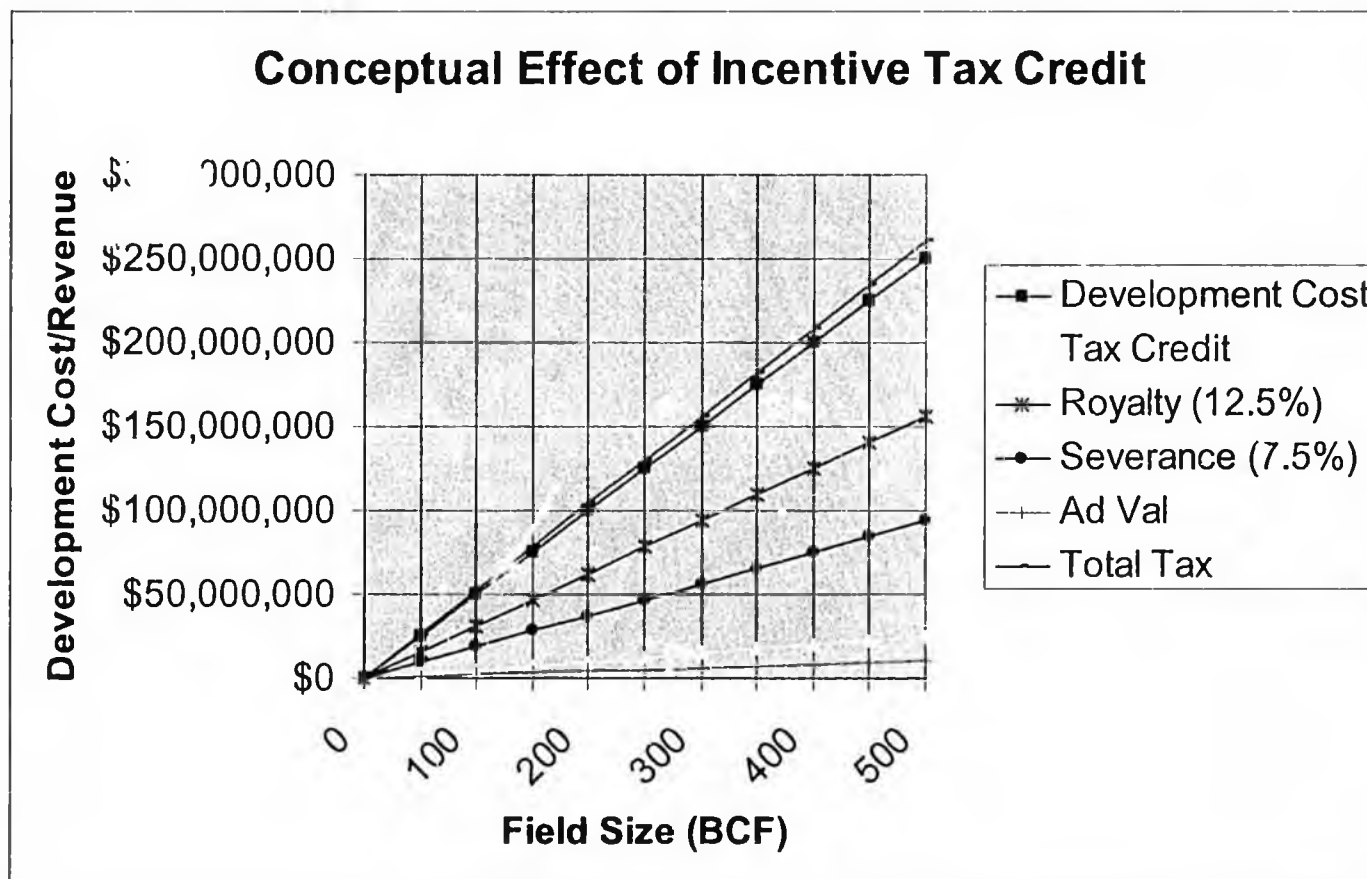
April 23, 2003

*Testimony of John A Barnes to House
Finance Committee*

13



Fiscal Impact to State of Alaska





HB 61 – Conclusions

- Based on conceptual model, State of Alaska receives from \$3 to \$10 additional revenue for each \$1 of tax credit.
- Credit is needed now!
 - Not enough exploration in Cook Inlet to meet demand.
 - Other areas of state need exploration and development.
 - New discoveries will take a minimum of 3 years to bring to first gas



HB 61 – Success Measures

- Increased Lease Activity
- Increased Drilling Rig Activity
- Increased Construction Activity
- Increased Production and Deliverability
- Credits Applied to Income Tax
 - For every dollar of credit approximately **TEN DOLLARS** were spent successfully developing new reserves, and ultimately paying new taxes!

John A. Barnes, P.E.
Alaska Business Unit Manager



Marathon Oil Company

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Email jabarnes@marathonoil.com