

SB

305

(FILE 3)

HFIN

FILE

FISCAL NOTES

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: CS for HB 488(RES)
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title An Act Relating to the Production Tax on RDU Tax and Treasury
Oil and Gas Component Tax
Sponsor Rules Committee
Requester Governor Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	359.2	366.4	373.7	381.2	388.8	396.6
Travel						
Contractual	400.0	370.0				
Supplies	24.0					
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous (OH office, etc)	18.0	18.0	18.0	18.0	18.0	18.0
TOTAL OPERATING	801.2	754.4	391.7	399.2	406.8	414.6

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()	<i>See analysis section</i>
-------------------------------	-----------------------------

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	801.2	754.4	391.7	399.2	406.8	414.6
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type-Do not abbreviate)						
TOTAL	801.2	754.4	391.7	399.2	406.8	414.6

Estimate of any current year (FY2006) cost: 275.0
Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time	4	4	4	4	4	4
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

Relative to Status Quo

This bill would amend the oil and gas production tax by basing the tax on the net value of the oil and gas. The net value is the wellhead value (net of royalty) less all qualified lease expenditures, including capital and operating costs, property taxes. The net income would be subject to a 20% tax, less a credit of 20% which applies to capital costs upstream of the point of production. There would also be a progressive surcharge based on .3% of the difference between actual West Texas Intermediate (WTI) oil price and \$50 applied to the gross value at the point of production. There would be no surcharge when the WTI price was under \$50. The surcharge would also be considered a deductible lease expenditure. There would be an additional annual credit per company of up to the lesser of actual net income or \$12 million per year. In addition, as a transition provision, there would be a deduction for capital costs incurred over the 3 month period January through March 2006, which can be realized over the 9 month period April

Prepared by: Robynn Wilson, Michael Williams, and Roger Marks
Division: Tax Division

Phone 269-1019
Date/Time 3/24/06 2:00 PM

Approved by: Jerry Burnett
Agency: Department of Revenue

Date 3/25/2006

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. CS for HB 488 (RES)

ANALYSIS CONTINUATION

through December 2006. It is estimated this would reduce revenues about \$50 million total over that 9 month period. Finally, the conservation surcharge on oil is decreased from 2 cents/bbl to 1 cent/bbl, while the additional conservation surcharge on oil is increased from 3 cents to 4 cents. The net impact of this, assuming that the oil and hazardous substance release prevention account is at capacity, would be a 1 cent/bbl increase in revenues.

The bill would be effective April 1, 2006.

Relative to Governor's Bill

The Governor's bill had no progressive surcharge. There was an deductible allowance of up to \$73 million of net income per company per year. There was a transition provision where all qualified capital expenditures incurred between July 1, 2001 through July 1, 2006 would be deductible over six years. The 3 cent additional conservation surcharge on oil would have been a credit against the oil tax.

The bill would have been effective July 1, 2006.

The figures in the table below reflect the revenues that would be received from the bill relative to the status quo under various prices. Columns 1-3 reflect the original fiscal note for the bill. Columns 4-5 reflect adjustments to the original fiscal note to reflect net adjustments in state corporate income tax from changes in the severance tax, the recognition of the credit for the additional conservation surcharge on oil, the re-assessment of the number of full allowances from 7 company equivalents to nine, and minor model changes. Columns 6-8 reflect changes from converting from the Fall 2005 Department of Revenue Source Book data to Spring 2006. The volumes for the last quarter have been adjusted to reflect short-term adjustments resulting from the North Slope oil spill in March. Finally, Columns 9-11 reflect the House Resources CS. The figures reflect North Slope activity; the impact on Cook Inlet is expected to be modest. The status quo assumes the January 2005 ELF aggregation decision by the Department of Revenue for Prudhoe Bay continues.

The cost assumptions are as follows:

- \$100 mm/yr exploration
- \$1/bbl on-going capital on all barrels
- \$3.50/bbl developmental capital on 2/3 of existing conventional oil
- \$8/bbl developmental capital on 2/3 of existing heavy oil
- \$3.50/bbl developmental capital on new conventional oil
- \$8/bbl developmental capital on new heavy oil
- \$3/bbl operating cost on conventional oil
- \$5/bbl operating cost on heavy oil

The table shows the 2006-2012 receipts from the bill, sensitive to different oil prices. These include the Department of Revenue forecast, a \$40 price, and a \$60 price. (Note that the status quo numbers are slightly different from what is reflected in the Spring 2006 Revenue Sources Book because of volume adjustments from the oil spill, and because of some differences between what some taxpayers actually remit and what is ultimately expected to be collected.)

Operating expenditures include costs for 3 additional positions for auditors: 1 O & G Specialist (Range 23), 1 O & G Revenue Auditor IV (Range 22), and 1 O & G Revenue Auditor III (Range 20). These positions would be used to fulfill additional audit responsibilities inherent in a net profits tax. In addition, we request 1 additional position for a Tax Tech III (Range 14) to process additional information and tax returns that will be required, and additional credit applications anticipated. Personal Services reflect a 2% yearly increase.

Contractual expenses include \$100,000 and \$70,000 for programming in FY 07 and FY 08, respectively, and \$300,000 in each of FY 07 and FY 08 for help in writing regulations. Supplies include computers and other supplies necessary for new positions.

See Page 3 for revenue estimates

ANALYSIS CONTINUATION (MILLIONS OF 2005 DOLLARS)

GOVERNOR'S BILL
ORIGINAL FISCAL NOTE

GOVERNOR'S BILL
WITH CORPORATE INCOME TAX,
CONSERVATION SURCHARGE
NINE COMPANY ALLOWANCES
MINOR MODEL CHANGES

Fiscal Year	DOR Forecast	Col. 1 Status Quo Tax	Col. 2 Tax from Bill	Col. 3 Gain from Bill	Col. 4 Tax from Bill	Col. 5 Gain from Bill
2006	na	na	na	na	na	na
2007	\$49.20	934	1,363	429	1,317	383
2008	\$40.95	697	915	217	876	179
2009	\$25.50	404	349	-55	320	-84
2010	\$25.50	387	339	-48	310	-77
2011	\$25.50	362	351	-11	319	-43
2012	\$25.50	343	332	-10	300	-42

Fiscal Year	Medium Price	Status Quo Tax	Tax from Bill	Gain from Bill	Tax from Bill	Gain from Bill
2006	na	na	na	na	na	na
2007	\$40.00	737	1,038	301	997	260
2008	\$40.00	679	1,031	353	988	309
2009	\$40.00	673	1,118	445	1,070	397
2010	\$40.00	646	1,106	460	1,058	411
2011	\$40.00	606	1,138	532	1,086	480
2012	\$40.00	576	1,112	536	1,059	483

Fiscal Year	High Price	Status Quo Tax	Tax from Bill	Gain from Bill	Tax from Bill	Gain from Bill
2005	na	na	na	na	na	na
2007	\$60.00	1,165	1,938	773	1,879	714
2008	\$60.00	1,069	1,917	848	1,855	786
2009	\$60.00	1,042	2,007	965	1,939	897
2010	\$60.00	1,003	1,992	989	1,923	921
2011	\$60.00	941	2,051	1,110	1,977	1,036
2012	\$60.00	896	2,014	1,117	1,939	1,043

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. CS for HB 488 (RES)

ANALYSIS CONTINUATION (MILLIONS OF 2005 DOLLARS)

GOVERNOR'S BILL
CHANGES FROM FALL 2005 FORECAST
TO SPRING 2006 FORECAST

Fiscal Year	DOR Forecast	Col. 6 Status Quo Tax	Col. 7 Tax from Bill	Col. 8 Gain from Bill	Col. 9 Status Quo Tax	Col. 10 Tax from Bill	Col. 11 Gain from Bill
2006	na	na	na	na	262	517	255
2007	\$53.60	989	1,514	526	989	1,825	836
2008	\$46.90	759	1,136	377	759	1,318	558
2009	\$25.50	355	302	-52	355	323	-32
2010	\$25.50	315	283	-32	315	304	-11
2011	\$25.50	281	291	10	281	312	31
2012	\$25.50	271	291	20	271	312	41

Fiscal Year	Medium Price	Status Quo Tax	Tax from Bill	Gain from Bill	Status Quo Tax	Tax from Bill	Gain from Bill
2006	na	na	na	na	174	227	53
2007	\$40.00	713	978	270	708	967	259
2008	\$40.00	655	953	298	655	974	319
2009	\$40.00	631	1,021	390	631	1,042	411
2010	\$40.00	582	990	408	582	1,011	429
2011	\$40.00	544	1,012	468	544	1,033	489
2012	\$40.00	536	1,021	485	536	1,042	506

Fiscal Year	High Price	Status Quo Tax	Tax from Bill	Gain from Bill	Status Quo Tax	Tax from Bill	Gain from Bill
2006	na	na	na	na	275	572	297
2007	\$60.00	1,120	1,840	720	1,120	2,380	1,260
2008	\$60.00	1,032	1,786	754	1,032	2,350	1,318
2009	\$60.00	978	1,848	871	978	2,421	1,443
2010	\$60.00	901	1,800	899	901	2,366	1,465
2011	\$60.00	842	1,841	999	842	2,414	1,572
2012	\$60.00	831	1,861	1,029	831	2,438	1,606

INCLUDES VOLUMES, PRICE, TAPS, MARINE, UPSTREAM, WELLS

SPRING 2006 VOLUMES FOR THE LAST QUARTER OF FY 2006 HAVE BEEN REDUCED TO REFLECT SHORT TERM ADJUSTMENTS FROM THE NORTH SLOPE OIL SPILL

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: HB 488
(H) Publish Date: 2/21/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
Title: Repealing the oil production tax and gas RDU: Resource Development
production tax etc. Component: Oil & Gas Development
Sponsor: Rules by Request of Governor
Requester: Governor Component No.: 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
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						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

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 (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

There is no anticipated fiscal impact for DNR associated with implementation of this legislation.

Prepared by: Bill VanDyke, Acting Director Phone: 907-269-8800
Division: Oil & Gas Date/Time: 2/15/2006
Approved by: Michael Menge, Commissioner Date: 2/15/2006
Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: HB 488
(H) Publish Date: 2/21/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title: An Act Relating to the Production Tax on RDU: Tax and Treasury
Oil and Gas Component: Tax
Sponsor: Rules Committee
Requester: Governor Component No.: 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	359.2	366.4	373.7	381.2	388.8	396.6
Travel						
Contractual	1,200.0	520.0				
Supplies	24.0					
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous [OH office, etc]	18.0	18.0	18.0	18.0	18.0	18.0
TOTAL OPERATING	1,601.2	904.4	391.7	399.2	406.8	414.6

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES () *See analysis section*

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	1,601.2	904.4	391.7	399.2	406.8	414.6
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	1,601.2	904.4	391.7	399.2	406.8	414.6

Estimate of any current year (FY2006) cost: 275.0

Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal.

POSITIONS

Full-time	4	4	4	4	4	4
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill would amend the oil and gas production tax by basing the tax on the net value of the oil and gas. The net value is the wellhead value (net of royalty) less all qualified lease expenditures, including capital and operating costs, property taxes, and an additional \$73 million per year allowance for each producer. (The allowance can be no greater than the net value before the allowance.) The net income would be subject to a 20% tax, less a credit of 20% which applies to capital costs upstream of the point of production. In addition, there would be a deduction for capital costs incurred over the previous five years, which can be realized over the next six years, but only in years where the ANS price is over \$40. It is estimated this would reduce revenues about \$170 million in years when it was realized. In years where the ANS price is under \$40 the deduction can be carried forward.

Prepared by: Robynn Wilson, Michael Williams, and Roger Marks Phone 269-1019
Division: Tax Division Date/Time 2/21/06 12:00 AM
Approved by: Jerry Burnett Date 2/21/2006
Agency: Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. HB 488

ANALYSIS CONTINUATION

The figures in the table below reflect the revenues that would be received from the bill relative to the status quo under various prices. They are predicated on the oil volumes in the Department of Revenue Fall 2005 Revenue Sources Book. The figures reflect North Slope activity; the impact on Cook Inlet is expected to be modest. They assume that seven producers utilize the full allowance. The status quo assumes the January 2005 ELF aggregation decision by the Department of Revenue for Prudhoe Bay continues.

The cost assumptions are as follows:

- \$100 mm/yr exploration
- \$1/bbl on-going capital on all barrels
- \$3.50/bbl developmental capital on 2/3 of existing conventional oil
- \$8/bbl developmental capital on 2/3 of existing heavy oil
- \$3.50/bbl developmental capital on new conventional oil
- \$8/bbl developmental capital on new heavy oil
- \$3/bbl operating cost on conventional oil
- \$5/bbl operating cost on heavy oil

The following table shows the 2007-2012 receipts from the bill, sensitive to different oil prices. These include the Department of Revenue forecast, a \$40 price, and a \$60 price. (Note that the status quo numbers are slightly different from what is reflected in the Fall 2005 Revenue Sources Book because of some minor changes in assumptions introduced since Fall 2005, and because of some differences between what some taxpayers actually remit and what is ultimately expected to be collected.)

Operating expenditures include costs for 3 additional positions for auditors: 1 O & G Specialist (Range 23), 1 O & G Revenue Auditor IV (Range 22), and 1 O & G Revenue Auditor III (Range 20). These positions would be used to fulfill additional audit responsibilities inherent in a net profits tax. In addition, we request 1 additional position for a Tax Tech III (Range 14) to process additional information and tax returns that will be required, and additional credit applications anticipated. Personal Services reflect a 2% yearly increase.

Contractual expenses include \$100,000 and \$70,000 for programming in FY 07 and FY 08, respectively, \$250,000 in each of FY 07 and FY 08 for help in writing regulations, and \$850,000 and \$200,000 in FY 07 and FY 08, respectively, for auditing costs related to the new transition rules. Supplies include computers and other supplies necessary for new positions.

FISCAL NOTE #2

STATE OF ALASKA
 2006 LEGISLATIVE SESSION
ANALYSIS CONTINUATION (MILLIONS OF 2005 DOLLARS)

BILL NO. HB 488

Fiscal Year	DOR Forecast	Status Quo Tax	Tax from Bill	Gain from Bill
2007	49.20	934	1,363	429
2008	40.95	697	915	217
2009	25.50	404	349	-55
2010	25.50	387	339	-48
2011	25.50	362	351	-11
2012	25.50	343	332	-10

.....

Fiscal Year	Medium Price	Status Quo Tax	Tax from Bill	Gain from Bill
2007	40.00	737	1,038	301
2008	40.00	679	1,031	353
2009	40.00	673	1,118	445
2010	40.00	646	1,106	460
2011	40.00	606	1,138	532
2012	40.00	576	1,112	536

.....

Fiscal Year	High Price	Status Quo Tax	Tax from Bill	Gain from Bill
2007	60.00	1,165	1,938	773
2008	60.00	1,069	1,917	848
2009	60.00	1,042	2,007	965
2010	60.00	1,003	1,992	989
2011	60.00	941	2,051	1,110
2012	60.00	896	2,014	1,117

BILLS

COMPARISON OF PPT BILL VERSIONS--HIGHLIGHTS

DRAFT 5/4/06 4:00pm.

5/4/2006

source: DOR

	governor's bill	House Resources CS Version L	SENATE (page refs = S. Fin. CS)	House Finance CS Version
tax rate	20% .011(a)-page 3	20% .011(a)-page 3	22.5% general 5% on Cook Inlet oil .011(e)-pages 3-4	20.0% .011(e)-page 3 3/4 rev. excl. for Cook Inlet oil .160(a) -page 20 tax ceiling on Cook Inlet gas .011(i) -page 5
credit rate	20% .024(a)-page 5	20% .024(a)-page 8	25% .024(a)-page 7	20% .024(a)-page 7
private royalty tax rate	no special rate	5% .011(e)-page 3-4	5% oil & 1.67% gas Report from Commish .011(f)-page 4 & .180 pg 26	5% oil & 1.67% gas Report from Commish .011(f)-page 3 & .180 pg 27
Gas (GRE)	n/a		Gas Revenue Exclusion in 160 equivalent to rate approximating 7%(also applies to private royalty rate creating equivalent rate below 1.5%) .160(a) page 19	Gas Revenue Exclusion in 160 equivalent to rate approximating 7%(also applies to private royalty rate creating equivalent rate below 1.5%) .160(a) page 20
progressivity surcharge	none	over \$50/bbl WTI. (.3% x (WTI - \$50) x gross; <\$110 rate is 37.5% .011(f)-page 4	over \$50/bbl, (ANSwc - \$50) x .002 x ANSwH x .775 x bbls (oil only) .011(g) and (h)-pages 4-5	over \$35/bbl (net value/boe) x 0025 x net value .011(g) and (h) page 4-5
special gas progressivity?	n/a	yes .011(i)-page 4-5	no	n/a
progressivity deductible?	n/a	yes .160(a)-page 18	no .160(d)(2)(O)-page 22	no .160(d)(2)(O)-page 23
transition	5 yr lookback of capex .160(g)-page 15	3 mo. of capex & opex. ? Sec. 42 uncodified-page 30	5 yrs.lookback capex 2 for 1 recoupment .024(i)-pages 10-11	5 yrs.lookback capex 2 for 1 recoupment .024(i)-page 10
transition treatment	deduction over 6 yr, if ANSwc >=\$40 .160(g)-page 15	deduction over 9 mo, no oil price test Sec. 42 uncodified-page 30	20% credit; no oil price test .024(i)-pages 10-11	20% credit; no oil price test .024(i)-page 11
unset of transition	no	n/a	3/31/2013 .024(i)-page 11	7 yr rolling .024(i)(3) page 11
base allowance	\$73M deduction .160(i)-page 16	\$12M credit (equates to \$60M ded.) .170(a)-page 23	Revised 5000 bbl equivalent credit capped at 14 million .170(a)-pages 25-26	\$12M credit (equates to \$60M ded.) .170(a)-page 26
gold-plating solution				avail. up to 1/2 curr invest .170(a)-page 26
sunset of base allowance	none	3/31/2016 (exp incurred) .170(e)-page 24	3/31/2016 w/commissioner report .170(a)-page 25. 180 pg 26-27	10 yr rolling .170(a)-page 27
safe harbor	90%, annual true-up, no interest .020(a)-page 3	90% with interest .020(g)-page 7	95%, annual true-up, no interest .020(a)-pages 5-6	95%, annual true-up, no interest .020(a)-page 6
pmt < safe harbor??	interest only .020(a)-page 3	5% penalty + interest .020(h)-page 7	interest only .020(a)-pages 5-6	interest only .020(a)-page 6
effective date	7/1/2006 page 20	4/1/2006 Section 45-page 30	4/1/2006 Sec. 40 -page 33	7/1/2006 Sec. 40 -page 35

COMPARISON OF PPT BILL VERSIONS--HIGHLIGHTS

DRAFT 5/4/06 4:00pm.

5/4/2006

source: DOR

	governor's bill	House Resources CS Version L	SENATE (page refs = S. Fin. CS)	House Finance CS Version
transition payment	none	6 mos. pymt on old system; true-up in 7th mo. <i>sec. 39--page 28</i>	6 mos. pymt on old system; true-up in 7th mo. <i>sec. 37(g)--pages 31-32</i>	6 mos. pymt on old system; true-up in 7th mo. <i>Sec. 36(h)--page 34</i>
spill surcharge total spill surcharge split (.201/.300) spill surcharge payable	no change (5 cents) 2/3 no change	no change (5 cents) 1/4 increase 1 cent <i>page 24--25</i>	increase 1 cent, to 6 cents 1/5 increase 2 cent <i>.201, .300 pages 27--28</i>	no change (5 cents) 1/4 increase 1 cent <i>pages 28-29</i>
surcharge treatment	creditable against PPT <i>page 17--18</i>	not creditable, not ded. <i>.160(d)(2)(L)--page 21</i>	not creditable, not ded. <i>.160(d)(2)(L)--page 22</i>	not creditable, not ded. <i>.160(d)(2)(L)--page 23</i>
SB 185 credit	no change	extends 10 years; only usable against PPT <i>.025(b), .025(f)--page 11-12</i>	extends 10 years; fixes \$20 m issue <i>.025(b), .025(f)--page 12-14</i>	extends 10 years; fixes \$20 m issue <i>.025(b), .025(f)--pages 13-14</i>
abandonment	no provision	no credit <i>.024(i)(2)--page 11</i>	no deduction or credit for abandonment on old production <i>.160(d)(2)(P) page 22</i>	no deduction or credit for abandonment on old production (Improved language) <i>.160(d)(2)(P)--page 22</i>
credits usable	against PPT only <i>.024(a)--page 3</i>	against PPT only <i>.024(a)--page 8</i>	against PPT only <i>.024(a)--page 7</i>	against PPT only <i>.024(a)--page 7</i>
credits transferable	yes--20% tax limit <i>.024(d)-(e)--page 6</i>	yes--20% tax limit <i>.024(d)-(e)--page 8-9</i>	yes--20% tax limit <i>.024(d)-(e)--page 8-9</i>	yes--20% tax limit <i>.024(d)-(e)--page 9-10</i>
credits refundable?	no	up to \$10M depends on investment <i>.024(f)(5)--page 9-10</i>	no	no
credits for annual loss	yes, at 20% <i>.024(b)--page 5</i>	yes, at 20% <i>.024(b)--page 8</i>	yes, at 22.5% <i>.024(b)--page 8</i>	yes, at 20% <i>.024(b)--page 8-9</i>
point of production	upstream of gas treatment upstream <i>.900(7)--page 19</i>	upstream of gas treatment upstream <i>.900(7)--page 25-26</i>	upstream of gas treatment upstream <i>.900(7)--pages 28-29</i>	upstream of gas treatment upstream (definition added) <i>.900(7)--page 29-30</i>
DNR royalty value	yes <i>.150(d)--page 11</i>	yes <i>.150(d)--page 17-18</i>	no	yes <i>.150(d)--page 19</i>
IRC sec 482 as a tool	no	no	yes (incl. §6662) <i>.160(i)--page 24</i>	yes (w/o §6662) <i>.160(i)--page 26</i>
catastrophic oil spill deductible?	yes, if on lease (not precluded)	no <i>.160(c)--page 19</i>	yes, if on lease (not precluded)	yes, if on lease (not precluded)
DNR gets exploration Data			yes <i>.024(a) page 8</i>	yes <i>.024(a)--page 7</i>
020 (f) Sales Language			yes <i>.020(f) page 7</i>	yes <i>.020(f)--page 7</i>
NPSL regs after industry practice			yes <i>.160(c)(1)(B) page 20</i>	yes <i>.160(c)(1)(B)--page 21</i>

24-GS2052N
Chenoweth
5/4/06

HOUSE CS FOR CS FOR SENATE BILL NO. 305(FIN)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY THE HOUSE FINANCE COMMITTEE

Offered:
Referred:

Sponsor(s): SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

A BILL
FOR AN ACT ENTITLED

1 "An Act repealing the oil production tax and the gas production tax and providing for a
2 production tax on oil and gas; relating to the calculation of the gross value at the point
3 of production of oil and gas and to the determination of the value of oil and gas for
4 purposes of the production tax on oil and gas; providing for tax credits against the
5 production tax on oil and gas; relating to the relationship of the production tax on oil
6 and gas to other taxes, to the dates those tax payments and surcharges are due, to
7 interest on overpayments of the tax, and to the treatment of the tax in a producer's
8 settlement with the royalty owners; relating to flared gas, and to oil and gas used in the
9 operation of a lease or property under the production tax; relating to the prevailing
10 value of oil and gas under the production tax; relating to surcharges on oil; relating to
11 statements or other information required to be filed with or furnished to the
12 Department of Revenue, to the penalty for failure to file certain reports for the tax, to

1 the powers of the Department of Revenue, and to the disclosure of certain information
2 required to be furnished to the Department of Revenue as applicable to the
3 administration of the tax; relating to criminal penalties for violating conditions
4 governing access to and use of confidential information relating to the tax, and to the
5 deposit of tax money collected by the Department of Revenue; amending the definitions
6 of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the
7 definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and
8 adding further definitions; making conforming amendments; and providing for an
9 effective date."

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

11 * Section 1. The uncodified law of the State of Alaska is amended by adding a new section
12 to read:

13 LEGISLATIVE INTENT. (a) It is the intent of the legislature through sec. 11 of this
14 Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by the
15 Department of Revenue.

16 (b) It is the intent of the legislature that the division or other unit of the Department of
17 Environmental Conservation assigned responsibility for administration of the programs under
18 AS 46.08 that are principally supported by the conservation surcharges on oil levied under
19 AS 43.55.201 - 43.55.299 and 43.55.300 - 43.55.310

20 (1) reduce program costs, including personnel costs, as necessary to operate
21 within the revenue anticipated to be generated by those surcharges, in the amounts of those
22 surcharges as amended by secs. 27 and 29 of this Act; and

23 (2) request appropriations for exceptional program needs and expansions
24 beyond what can be provided from the estimated amounts collected from those surcharges
25 from alternative funding sources.

26 * Sec. 2. AS 43.05.230(f) is amended to read:

27 (f) A wilful violation of the provisions of this section or of a condition
28 imposed under AS 43.55.040(1)(B) is punishable by a fine of not more than \$5,000.

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

1 or by imprisonment for not more than two years, or by both.

2 * Sec. 3. AS 43.20.031(c) is amended to read:

3 (c) In computing the tax under this chapter, the taxpayer is not entitled to
4 deduct any taxes based on or measured by net income. The taxpayer may deduct the
5 tax levied and paid under AS 43.55.

6 * Sec. 4. AS 43.20.072(b) is amended to read:

7 (b) A taxpayer's business income to be apportioned under this section to the
8 state shall be the federal taxable income of the taxpayer's consolidated business for the
9 tax period, except that

10 (1) taxes based on or measured by net income that are deducted in the
11 determination of the federal taxable income shall be added back; the tax levied and
12 paid under AS 43.55 may not be added back;

13 (2) intangible drilling and development costs that are deducted as
14 expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the
15 federal taxable income shall be capitalized and depreciated as if the option to treat
16 them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been
17 exercised;

18 (3) depletion deducted on the percentage depletion basis under 26
19 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income
20 shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612
21 (Internal Revenue Code); and

22 (4) depreciation shall be computed on the basis of 26 U.S.C. 167
23 (Internal Revenue Code) as that section read on June 30, 1981.

24 * Sec. 5. AS 43.55.011 is amended by adding new subsections to read:

25 (e) There is levied on the producer of oil or gas a tax for all oil and gas
26 produced each month from each lease or property in the state, less any oil and gas the
27 ownership or right to which is exempt from taxation or constitutes a landowner's
28 royalty interest. Except as otherwise provided under (i) of this section, the tax is equal
29 to 20 percent of the production tax value of the taxable oil and gas as calculated under
30 AS 43.55.160.

31 (f) There is levied on the producer of oil or gas a tax for all oil and gas

1 produced each month from each lease or property in the state the ownership or right to
 2 which constitutes a landowner's royalty interest, except for oil and gas the ownership
 3 or right to which is exempt from taxation. The provisions of this subsection apply to a
 4 landowner's royalty interest as follows:

5 (1) the rate of tax levied on oil is equal to five percent of the gross
 6 value at the point of production of the oil;

7 (2) the rate of tax levied on gas is equal to 1.667 percent of the gross
 8 value at the point of production of the gas;

9 (3) if the department determines that, for purposes of reducing the
 10 producer's tax liability under (1) or (2) of this subsection, the producer has received or
 11 will receive consideration from the royalty owner offsetting all or a part of the
 12 producer's royalty obligation, other than a deduction under AS 43.55.020(d) of the
 13 amount of a tax paid,

14 (A) notwithstanding (1) of this subsection, the tax is equal to

15 (i) for oil that is produced from a lease or property in
 16 the Cook Inlet sedimentary basin, five percent of the gross value at the
 17 point of production of the oil;

18 (ii) for oil, except oil described in (i) of this
 19 subparagraph, 20 percent of the gross value at the point of production
 20 of the oil; and

21 (B) notwithstanding (2) of this subsection, for gas the tax is
 22 equal to 6.67 percent of the gross value at the point of production of the gas.

23 (g) In addition to the taxes levied under (e) and (f) of this section, during each
 24 month for which the price index determined under (h) of this section is greater than
 25 zero, there is levied on the producer of oil or gas a tax for all oil and gas produced
 26 during that month from each lease or property in the state, less any oil and gas the
 27 ownership or right to which is exempt from taxation or constitutes a landowner's
 28 royalty interest. Except as otherwise provided under (i) of this section, the tax levied
 29 under this subsection is equal to .25 percent of the production tax value of the taxable
 30 oil and gas as calculated under AS 43.55.160, multiplied by the price index
 31 determined under (h) of this section.

1 (h) For purposes of (g) of this section, the price index for a month is calculated
 2 by subtracting 35 from the number that is equal to the quotient of the production tax
 3 value of the taxable oil and gas produced during that month, as calculated under
 4 AS 43.55.160, divided by the number of barrels of oil equivalent of that oil and gas.
 5 For purposes of this subsection, a barrel of oil equivalent is a barrel of oil, in the case
 6 of oil, or 6,000 cubic feet of gas, in the case of gas.

7 (i) If a producer produces gas during a month from a lease or property in the
 8 Cook Inlet sedimentary basin, and if the imputed gas tax rate for that month under (j)
 9 of this section exceeds \$.019 per Mcf, the producer's total tax for that month levied
 10 under (e) and (g) of this section is reduced by the amount equal to the number of Mcf
 11 produced by the producer from all leases or properties in the Cook Inlet sedimentary
 12 basin and taxable under (e) and (g) of this section, multiplied by the difference
 13 between that imputed gas rate and \$.019 per Mcf.

14 (j) For purposes of (i) of this section, a producer's imputed gas tax rate for a
 15 month is equal to

$$1/6 \times TT/BOE$$

16 where

17 (1) TT = the producer's total tax for the month levied under (e) and (g)
 18 of this section, calculated without regard to (i) of this section and net of any credits
 19 that are available to be applied under this chapter; and

20 (2) BOE = the amount of oil and gas produced by the producer during
 21 the month and taxable under (e) of this section, expressed as barrels of oil equivalent;
 22 for purposes of this paragraph, a barrel of oil equivalent is

23 (A) one barrel of oil, in the case of oil;

24 (B) six Mcf of gas, in the case of gas.

25 (k) In (i) and (j) of this section, "Mcf" means 1,000 cubic feet.

26 * Sec. 6. AS 43.55.017(a) is amended to read:

27 (a) Except as provided in this chapter, the taxes imposed by this chapter are in
 28 place of all taxes now imposed by the state or any of its municipalities, and neither the
 29 state nor a municipality may impose a tax on [UPON]
 30

31 (1) producing oil or gas leases;

1 (2) oil or gas produced or extracted in the state;

2 (3) the value of intangible drilling and development costs, as
3 described in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through
4 January 1, 1974 [EXPLORATION EXPENSES].

5 * Sec. 7. AS 43.55.020(a) is repealed and reenacted to read:

6 (a) Ninety-five percent of the total tax levied under AS 43.55.011(e) - (g), net
7 of any credits applied under this chapter, is due on the last day of each calendar month
8 on oil and gas produced from each lease or property during the preceding month. The
9 remaining portion of the tax levied under AS 43.55.011(e) - (g) net of any credits
10 applied under this chapter, is due on March 31 of the year following the calendar year
11 during which the oil and gas were produced. An unpaid amount of tax that is not paid
12 when due in accordance with this subsection becomes delinquent. An overpayment of
13 tax with respect to a month may be applied against the tax due for any later month.
14 Notwithstanding any contrary provision of AS 43.05.280, interest on an overpayment
15 is allowed only from a date that is 90 days after the later of (1) the March 31 described
16 in this subsection, or (2) the date that the statement required under AS 43.55.030(a)
17 and (e) to be filed on or before that March 31 is filed. Interest is not allowed if the
18 overpayment was refunded within the 90-day period.

19 * Sec. 8. AS 43.55.020(b) is amended to read:

20 (b) The production tax on oil and [OR] gas shall be paid by or on behalf of the
21 producer.

22 * Sec. 9. AS 43.55.020(d) is amended to read:

23 (d) In making settlement with the royalty owner for oil and gas that is
24 taxable under AS 43.55.011, the producer may deduct the amount of the tax paid on
25 taxable royalty oil and [OR] gas, or may deduct taxable royalty oil or gas equivalent
26 in value at the time the tax becomes due to the amount of the tax paid. Unless
27 otherwise agreed between the producer and the royalty owner, the amount of the
28 tax paid under AS 43.55.011(e) and (g) on taxable royalty oil and gas for a month,
29 other than oil and gas the ownership or right to which constitutes a landowner's
30 royalty interest, is considered to be the gross value at the point of production of
31 the taxable royalty oil and gas produced during the month multiplied by a figure

1 that is a quotient, in which

2 (1) the numerator is the producer's total tax liability under
3 AS 43.55.011(e) and (g) for the month of production; and

4 (2) the denominator is the total gross value at the point of
5 production of the oil and gas taxable under AS 43.55.011(e) and (g) produced by
6 the producer from all leases and properties in the state during the month.

7 * Sec. 10. AS 43.55.020(e) is repealed and reenacted to read:

8 (e) Gas flared, released, or allowed to escape in excess of the amount
9 authorized by the Alaska Oil and Gas Conservation Commission is considered, for the
10 purpose of AS 43.55.011 - 43.55.180, as gas produced from a lease or property. Oil or
11 gas used in the operation of a lease or property in the state in drilling for or producing
12 oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and
13 Gas Conservation Commission to be waste, is not considered, for the purpose of
14 AS 43.55.011 - 43.55.180, as oil or gas produced from a lease or property.

15 * Sec. 11. AS 43.55.020(f) is amended to read:

16 (f) If oil or gas is produced but not sold, or if oil or gas is produced and
17 sold under circumstances where the sale price does not represent the prevailing value
18 for oil or gas of like kind, character, or quality in the field or area from which the
19 product is produced, the department may require the tax to be paid upon the basis of
20 the value of oil or gas of the same kind, quality, and character prevailing for that field
21 or area during the calendar month of production or sale [FOR THAT FIELD OR
22 AREA].

23 * Sec. 12. AS 43.55 is amended by adding a new section to read:

24 **Sec. 43.55.024. Tax credits for certain losses and expenditures.** (a) A
25 producer or explorer may take a tax credit for a qualified capital expenditure as
26 follows:

27 (1) notwithstanding that a qualified capital expenditure may be a
28 deductible lease expenditure for purposes of calculating the production tax value of oil
29 and gas under AS 43.55.160(a), unless a credit for that expenditure is taken under
30 AS 38.05.180(d), AS 41.09.010, AS 43.20.043, or AS 43.55.025,

31 (A) a producer or explorer that incurs a qualified capital

1 expenditure may also elect to take a tax credit against a tax due under
2 AS 43.55.011(e) in the amount of 20 percent of that expenditure;

3 (B) for a calendar year for which the producer makes an
4 election under AS 43.55.160(f), instead of taking a tax credit at a rate
5 authorized by (A) of this paragraph as to each separate qualified capital
6 expenditure after it has been incurred, a producer that incurs a qualified capital
7 expenditure during that year and that wishes to apply a credit based on that
8 expenditure against a tax due under AS 43.55.011(e) shall calculate and apply
9 every month an annualized tax credit in an amount equal to 1 2/3 percent of the
10 total qualified capital expenditures incurred during that year and for which the
11 tax credit is taken for that year;

12 (2) a producer or explorer may take a credit for a qualified capital
13 expenditure incurred in connection with geological or geophysical exploration or in
14 connection with an exploration well only if the producer or explorer provides to the
15 department, as part of the statement required under AS 43.55.030(a) for the month for
16 which the credit is sought to be taken, the producer's or explorer's written agreement

17 (A) to notify the Department of Natural Resources, within 30
18 days after completion of the geological or geophysical data processing or
19 completion of the well, or within 30 days after the statement is filed, whichever
20 is the latest, of the date of completion and to submit a report to that department
21 describing the processing sequence and provide a list of data sets available;

22 (B) to provide to the Department of Natural Resources, within
23 30 days after the date of a request, specific data sets, ancillary data, and reports
24 identified in (A) of this paragraph;

25 (C) that, notwithstanding any provision of AS 38, the
26 Department of Natural Resources shall hold confidential the information
27 provided to that department under this paragraph for 10 years following the
28 completion date, after which the department shall publicly release the
29 information after 30 days' public notice.

30 (b) A producer or explorer may elect to take a tax credit in the amount of 20
31 percent of a carried-forward annual loss. A credit under this subsection may be applied

1 against a tax due under AS 43.55.011(e) and may be applied irrespective of whether
2 the producer or explorer also claims a credit for transitional investment expenditures
3 authorized by (i) of this section. For purposes of this subsection, a carried-forward
4 annual loss is the amount of a producer's or explorer's adjusted lease expenditures
5 under AS 43.55.160 for a previous calendar year that was not deductible in any month
6 under AS 43.55.160(a) and (b).

7 (c) A credit or portion of a credit under this section may not be used to reduce
8 a person's tax liability under AS 43.55.011(e) for any month below zero, and any
9 unused credit or portion of a credit not used under this subsection may be applied in a
10 later month.

11 (d) Except as limited by (i) of this section, a person entitled to take a tax credit
12 under this section that wishes to transfer the unused credit to another person may
13 apply to the department for a transferable tax credit certificate. An application under
14 this subsection must be on a form prescribed by the department and must include
15 supporting information and documentation that the department reasonably requires.
16 The department shall grant or deny an application, or grant an application as to a lesser
17 amount than that claimed and deny it as to the excess, not later than 60 days after the
18 latest of (1) March 31 of the year following the calendar year in which the qualified
19 capital expenditure or carried-forward annual loss for which the credit is claimed was
20 incurred; (2) if the applicant is required under AS 43.55.030(a) and (e) to file a
21 statement on or before March 31 of the year following the calendar year in which the
22 qualified capital expenditures or carried-forward annual loss for which the credit is
23 claimed was incurred, the date the statement was filed; or (3) the date the application
24 was received by the department. If, based on the information then available to it, the
25 department is reasonably satisfied that the applicant is entitled to a credit, the
26 department shall issue the applicant a transferable tax credit certificate for the amount
27 of the credit. A certificate issued under this subsection does not expire.

28 (e) A person to which a transferable tax credit certificate is issued under (d) of
29 this section may transfer the certificate to another person, and a transferee may further
30 transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and
31 notwithstanding any action the department may take with respect to the applicant

1 under (f) of this section, the owner of a certificate may apply the credit or a portion of
2 the credit shown on the certificate only against a tax due under AS 43.55.011(e).
3 However, a credit shown on a transferable tax credit certificate may not be applied to
4 reduce a transferee's total tax due under AS 43.55.011(e) on oil and gas produced
5 during a calendar year to less than 80 percent of the tax that would otherwise be due
6 without applying that credit. Any portion of a credit not used under this subsection
7 may be applied in a later period.

8 (f) The issuance of a transferable tax credit certificate under (d) of this section
9 does not limit the department's ability to later audit a tax credit claim to which the
10 certificate relates or to adjust or deny the claim if the department determines that the
11 applicant was not entitled to the amount of the credit for which the certificate was
12 issued. The tax liability of the applicant under AS 43.55.011(e) and 43.55.017 -
13 43.55.180 is increased by the amount of the credit that exceeds that to which the
14 applicant was entitled. That amount bears interest under AS 43.05.225 from the date
15 the transferable tax credit certificate was issued. For purposes of this subsection, an
16 applicant that is an explorer is considered a producer subject to the tax levied under
17 AS 43.55.011(e).

18 (g) The department may adopt regulations to carry out the purposes of this
19 section, including prescribing reporting, record keeping, and certification procedures
20 and requirements to verify the accuracy of credits claimed and to ensure that a credit is
21 not used more than once, and otherwise implementing this section.

22 (h) A person may not elect to take a tax credit under (a) or (i) of this section
23 for an expenditure incurred to acquire an asset (1) the cost of previously acquiring
24 which was a lease expenditure under AS 43.55.160(c) or would have been a lease
25 expenditure under AS 43.55.160(c) if it had been incurred on or after July 1, 2006; or
26 (2) that has previously been placed in service in the state. An expenditure to acquire an
27 asset is not excluded under this subsection if not more than an immaterial portion of
28 the asset meets a description under (1) or (2) of this subsection. For purposes of this
29 subsection, "asset" includes geological, geophysical, and well data and interpretations.

30 (i) For the purposes of this section,

31 (1) a producer's or explorer's transitional investment expenditures are

1 the sum of the expenditures the producer or explorer incurred on or after July 1, 2001,
2 and before July 1, 2006, that would be qualified capital expenditures if they were
3 incurred on or after July 1, 2006, less the sum of the payments or credits the producer
4 or explorer received before July 1, 2006, for the sale or other transfer of assets,
5 including geological, geophysical, or well data or interpretations, acquired by the
6 producer or explorer as a result of expenditures the producer or explorer incurred
7 before July 1, 2006, that would be qualified capital expenditures, if they were incurred
8 on or after July 1, 2006;

9 (2) a producer or explorer may elect to take a tax credit against a tax
10 due under AS 43.55.011(e) in the amount of 20 percent of the producer's or explorer's
11 transitional investment expenditures, but only to the extent that the amount does not
12 exceed

13 (A) one-half of the producer's or explorer's qualified capital
14 expenditures that are incurred during the month for which the credit is taken, if
15 the producer or explorer does not make an election under AS 43.55.160(f);

16 (B) 1/24 of the producer's or explorer's qualified capital
17 expenditures that are incurred during the calendar year that includes the month
18 for which the credit is taken, if the producer or explorer makes an election
19 under AS 43.55.160(f);

20 (3) a producer or explorer may not take a tax credit for a transitional
21 investment expenditure

22 (A) for any month that ends the later of

23 (i) July 31, 2013; or

24 (ii) the seventh anniversary of the last day of the month
25 for which the producer first applies a credit under this subsection
26 against a tax due under AS 43.55.011(e), if the producer did not have
27 commercial production of oil or gas from a lease or property in the state
28 before July 1, 2006;

29 (B) more than once; or

30 (C) if a credit for that expenditure was taken under
31 AS 38.05.180(i), AS 41.09.010, AS 43.20.043, or AS 43.55.025;

1 (4) notwithstanding (d) - (f) of this section, a producer or explorer may
2 not transfer a tax credit or obtain a transferable tax credit certificate for a transitional
3 investment expenditure.

4 (j) As a condition of receiving a tax credit under this section, a producer or
5 explorer that obtains the tax credit for or directly related to a pipeline, facility, or other
6 asset that

7 (1) is or becomes subject to regulation by the Federal Energy
8 Regulatory Commission or the Regulatory Commission of Alaska, or a successor
9 regulatory body shall at all times support and in all rate proceedings file to flow
10 through 100 percent of the tax credits to ratepayers as a reduction in the costs of
11 service for the pipeline, facility, or other asset;

12 (2) is not regulated by the Federal Energy Regulatory Commission or
13 the Regulatory Commission of Alaska, or a successor regulatory body, and that
14 charges third parties for use of a pipeline, facility, or other asset shall flow through
15 100 percent of the tax credits as a reduction in the costs of service on which the
16 charges set by the producer or explorer for the pipeline, facility, or other asset are
17 based.

18 (k) In this section, "qualified capital expenditure" means, except as otherwise
19 provided in (h) of this section, an expenditure that is a lease expenditure under
20 AS 43.55.160 and is

21 (1) incurred for geological or geophysical exploration; or

22 (2) treated as a capitalized expenditure under 26 U.S.C. (Internal
23 Revenue Code), as amended, regardless of elections made under 26 U.S.C. 263(c)
24 (Internal Revenue Code), as amended, and is

25 (A) treated as a capitalized expenditure for federal income tax
26 reporting purposes by the person incurring the expenditure; or

27 (B) eligible to be deducted as an expense under 26 U.S.C.
28 263(c) (Internal Revenue Code), as amended.

29 * Sec. 13. AS 43.55.025(a) is amended to read:

30 (a) Subject to the terms and conditions of this section. [ON OIL AND GAS
31 PRODUCED ON OR AFTER JULY 1, 2004, FROM AN OIL AND GAS LEASE,

1 OR ON GAS PRODUCED FROM A GAS ONLY LEASE.] a credit against the
2 production tax due under AS 43.55.011(e) [THIS CHAPTER] is allowed for
3 exploration expenditures that qualify under (b) of this section in an amount equal to
4 one of the following:

5 (1) 20 percent of the total exploration expenditures that qualify only
6 under (b) and (c) of this section;

7 (2) 20 percent of the total exploration expenditures for work performed
8 before July 1, 2007, and that qualify only under (b) and (d) of this section;

9 (3) 40 percent of the total exploration expenditures that qualify under
10 (b), (c), and (d) of this section; c:

11 (4) 40 percent of the total exploration expenditures that qualify only
12 under (b) and (e) of this section.

13 * Sec. 14. AS 43.55.025(b) is amended to read:

14 (b) To qualify for the production tax credit under (a) of this section, an
15 exploration expenditure must be incurred for work performed on or after July 1, 2003,
16 and before July 1, 2016 [2007], except that an exploration expenditure for a Cook Inlet
17 prospect must be incurred for work performed on or after July 1, 2005, [AND
18 BEFORE JULY 1, 2010, AND EXCEPT THAT AN EXPLORATION
19 EXPENDITURE, IN WHOLE OR IN PART, SOUTH OF 68 DEGREES, 15
20 MINUTES, NORTH LATITUDE, AND NOT PART OF A COOK INLET
21 PROSPECT MUST BE INCURRED FOR WORK PERFORMED ON OR AFTER
22 JULY 1, 2003, AND BEFORE JULY 1, 2010.] and

23 (1) may be for seismic or geophysical exploration costs not connected
24 with a specific well;

25 (2) if for an exploration well,

26 (A) must be incurred by an explorer that holds an interest in the
27 exploration well for which the production tax credit is claimed;

28 (B) may be for either an oil or gas discovery well or a dry hole;

29 and

30 (C) must be for goods, services, or rentals of personal property
31 reasonably required for the surface preparation, drilling, casing, cementing

1 and logging of an exploration well, and, in the case of a dry hole, for the
2 expenses required for abandonment if the well is abandoned within 18 months
3 after the date the well was spudded;

4 (3) may not be for testing, stimulation, or completion costs;
5 administration, supervision, engineering, or lease operating costs; geological or
6 management costs; community relations or environmental costs; bonuses, taxes, or
7 other payments to governments related to the well; or other costs that are generally
8 recognized as indirect costs or financing costs; and

9 (4) may not be incurred for an exploration well or seismic exploration
10 that is included in a plan of exploration or a plan of development for any unit on
11 May 13, 2003.

12 * Sec. 15. AS 43.55.025(f) is amended to read:

13 (f) For a production tax credit under this section,

14 (1) an explorer shall, in a form prescribed by the department and
15 within six months of the completion of the exploration activity, claim the credit and
16 submit information sufficient to demonstrate to the department's satisfaction that the
17 claimed exploration expenditures qualify under this section;

18 (2) an explorer shall agree, in writing,

19 (A) to notify the Department of Natural Resources, within 30
20 days after completion of seismic or geophysical data processing, completion of
21 a well, or filing of a claim for credit, whichever is the latest, for which
22 exploration costs are claimed, of the date of completion and submit a report to
23 that department describing the processing sequence and providing a list of data
24 sets available; if, under (c)(2)(B) of this section, an explorer submits a claim
25 for a credit for expenditures for an exploration well that is located within three
26 miles of a well already drilled for oil and gas, in addition to the submissions
27 required under (1) of this subsection, the explorer shall submit the information
28 necessary for the commissioner of natural resources to evaluate the validity of
29 the explorer's claim that the well is directed at a distinctly separate exploration
30 target, and the commissioner of natural resources shall, upon receipt of all
31 evidence sufficient for the commissioner to evaluate the explorer's claim, make

1 that determination within 60 days;

2 (B) to provide to the Department of Natural Resources, within
3 30 days after the date of a request, specific data sets, ancillary data, and reports
4 identified in (A) of this paragraph;

5 (C) that, notwithstanding any provision of AS 38, information
6 provided under this paragraph will be held confidential by the Department of
7 Natural Resources for 10 years following the completion date, at which time
8 that department will release the information after 30 days' public notice;

9 (3) if more than one explorer holds an interest in a well or seismic
10 exploration, each explorer may claim an amount of credit that is proportional to the
11 explorer's cost incurred;

12 (4) the department may exercise the full extent of its powers as though
13 the explorer were a taxpayer under this title, in order to verify that the claimed
14 expenditures are qualified exploration expenditures under this section; and

15 (5) if the department is satisfied that the explorer's claimed
16 expenditures are qualified under this section, the department shall issue to the explorer
17 a production tax credit certificate for the amount of credit to be allowed against
18 production taxes due under AS 43.55.011(e) [THIS CHAPTER]; however,
19 notwithstanding any other provision of this section, after the end of the calendar
20 year following the calendar year in which the total of production tax credit
21 certificates issued by the department under this section based on exploration
22 expenditures for Cook Inlet prospects reaches \$20,000,000, the department may
23 not issue to an explorer a production tax credit certificate [IF THE TOTAL OF
24 PRODUCTION TAX CREDITS SUBMITTED FOR COOK INLET
25 PRODUCTION,] based on an exploration expenditure for a Cook Inlet prospect
26 [EXPENDITURES FOR WORK PERFORMED DURING THE PERIOD
27 DESCRIBED IN (b) OF THIS SECTION FOR THAT PRODUCTION, THAT HAVE
28 BEEN APPROVED BY THE DEPARTMENT EXCEEDS \$20,000,000].

29 * Sec. 16. AS 43.55.025(h) is amended to read:

30 (h) A producer that purchases a production tax credit certificate may apply the
31 credits against its production tax liability under AS 43.55.011(e) [THIS CHAPTER].

1 Regardless of the price the producer paid for the certificate, the producer may receive
2 a credit against its production tax liability for the full amount of the credit, but for not
3 more than the amount for which the certificate is issued. A production tax credit
4 allowed under this section may not be applied more than once.

5 * **Sec. 17.** AS 43.55.025(i) is amended to read:

6 (i) For a production tax credit under this section,

7 (1) the amount of the credit that may be applied against the production
8 tax for each tax month may not exceed the total production tax liability under
9 AS 43.55.011(e) of the taxpayer applying the credit for the same month; and

10 (2) an amount of the production tax credit that is greater than the total
11 tax liability under AS 43.55.011(e) of the taxpayer applying the credit for a tax month
12 may be carried forward and applied against the taxpayer's production tax liability
13 under AS 43.55.011(e) in one or more immediately following months.

14 * **Sec. 18.** AS 43.55.030(a) is amended to read:

15 (a) The tax shall be paid to the department, and the person paying the tax shall
16 file with the department at the time the tax or a portion of the tax is required to be
17 paid a statement, under oath, on forms prescribed by or acceptable to the department,
18 giving, with other information required, the following:

19 (1) a description of each [THE] lease or property from which the oil
20 and [OR] gas were [WAS] produced, by name, legal description, lease number, or
21 [BY] accounting codes [CODE NUMBERS] assigned by the department;

22 (2) the names of the producer and the person paying the tax;

23 (3) the gross amount of oil and the gross amount of [OR] gas
24 produced from each [THE] lease or property, and the percentage of the gross amount
25 of oil and gas owned by each producer for whom the tax is paid;

26 (4) the gross [TOTAL] value at the point of production of the oil
27 and of the [OR] gas produced from each [THE] lease or property owned by each
28 producer for whom the tax is paid; [AND]

29 (5) the name of the first purchaser and the price received for the oil
30 and for the [OR] gas, unless relieved from this requirement in whole or in part by
31 the department; and

1 (6) the producer's lease expenditures and adjustments as
2 calculated under AS 43.55.160 [IF SOLD IN THE STATE].

3 * Sec. 19. AS 43.55.030(d) is amended to read:

4 (d) Reports by or on behalf of the producer are delinquent the first day
5 following the day the tax is due. [EACH PRODUCER IS SUBJECT TO A PENALTY
6 OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH THE
7 REPORT IS NOT FILED. THE PENALTY FOR FAILURE TO FILE A REPORT IS
8 IN ADDITION TO THE PENALTY FOR DELINQUENT TAXES, AND IS A LIEN
9 AGAINST THE ASSETS OF THE PRODUCER.]

10 * Sec. 20. AS 43.55.030 is amended by adding a new subsection to read:

11 (e) In addition to other required information, the statement required to be filed
12 on or before March 31 of a year must show any adjustments or corrections to the
13 statements that were required under (a) of this section to be filed for the months of the
14 preceding calendar year during which the oil or gas was produced.

15 * Sec. 21. AS 43.55.040 is amended to read:

16 Sec. 43.55.040. Powers of Department of Revenue. Except as provided in
17 AS 43.05.405 - 43.05.499, the department may

18 (1) require a person engaged in production and the agent or employee
19 of the person, and the purchaser of oil or gas, or the owner of a royalty interest in oil
20 or gas to furnish, whether by the filing of regular statements or reports or
21 otherwise, additional information that is considered by the department as necessary to
22 compute the amount of the tax; notwithstanding any contrary provision of law, the
23 disclosure of additional information under this paragraph to the producer
24 obligated to pay the tax does not violate AS 40.25.100(a) or AS 43.05.230(a);
25 before disclosing information under this paragraph that is otherwise required to
26 be held confidential under AS 40.25.100(a) or AS 43.05.230(a), the department
27 shall

28 (A) provide the person that furnished the information a
29 reasonable opportunity to be heard regarding the proposed disclosure and
30 the conditions to be imposed under (B) of this paragraph; and

31 (B) impose appropriate conditions limiting

1 arm's length transaction or is not representative of the market value of that
2 transportation; and

3 (3) [WHEN THE] method of transportation of oil or gas is not
4 reasonable in view of existing alternative methods of transportation.

5 * Sec. 25. AS 43.55.150 is amended by adding a new subsection to read:

6 (d) Under regulations adopted by the department, the department may allow a
7 producer, subject to limitations prescribed by the department as to the frequency of
8 making elections, to elect prospectively to calculate the gross value at the point of
9 production of oil or gas based in whole or part on

10 (1) a royalty value determined under a royalty settlement agreement
11 between the producer and the state, with adjustments if appropriate;

12 (2) a formula prescribed by the department that uses, with adjustments
13 if appropriate, a royalty value or valuation methodology accepted by the

14 (A) Department of Natural Resources under AS 38.05, in the
15 case of oil and gas produced from a lease issued by the Department of Natural
16 Resources or produced from a lease or property that is part of a unit approved
17 by the Department of Natural Resources;

18 (B) United States Department of the Interior under applicable
19 federal oil and gas leasing statutes, in the case of oil and gas produced from a
20 lease issued by the United States Department of the Interior that is not part of a
21 unit approved by the Department of Natural Resources, or produced from a
22 lease or property that is part of a unit approved by the United States
23 Department of the Interior but not approved by the Department of Natural
24 Resources; or

25 (3) another formula prescribed by the Department of Revenue that
26 reasonably estimates a value for the oil or gas at a specific geographical location, such
27 as the point of tender or delivery into a common carrier pipeline; the formula may use
28 factors such as published price indices for oil or gas in or outside the state, quality
29 differentials for oil or gas, transportation costs between markets, and inflation
30 adjustments.

31 * Sec. 26. AS 43.55 is amended by adding new sections to article 1 to read:

1 **Sec. 43.55.160. Determination of production tax value of oil and gas. (a)**

2 Except as provided in (f) of this section, for purposes of AS 43.55.011(e) and (g), the
3 production tax value of the taxable oil and gas produced during a month is (1) the total
4 of (A) the gross value at the point of production of the oil taxable under
5 AS 43.55.011(e) and (g) and produced by the producer from all leases or properties in
6 the state, less three-quarters of the gross value at the point of production of the oil
7 taxable under AS 43.55.011(e) and (g) and produced by the producer from leases or
8 properties in the Cook Inlet sedimentary basin, and (B) one-third of the gross value at
9 the point of production of the gas taxable under AS 43.55.011(e) and (g) and produced
10 by the producer from all leases or properties in the state, (2) less the producer's lease
11 expenditures for the month as adjusted under (e) of this section. However, the
12 production tax value calculated under this subsection may not be less than zero. If a
13 producer does not produce taxable oil or gas during a month, the producer is
14 considered to have generated a positive production tax value if the calculation
15 described in this section yields a positive number because the producer's adjusted
16 lease expenditures for a month are less than zero as a result of the producer's receiving
17 a payment or credit under (e) of this section or otherwise.

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

19 (1) any adjusted lease expenditures that would otherwise be deductible
20 in a month but whose deduction would cause the production tax value calculated under
21 (a) of this section of the taxable oil and gas produced during the month to be less than
22 zero may be added to the producer's adjusted lease expenditures for one or more other
23 months in the same calendar year; the total of any adjusted lease expenditures that are
24 not deductible in any month during a calendar year because their deduction would
25 cause the production tax value calculated under (a) of this section of the taxable oil
26 and gas produced during one or more months to be less than zero may be used to
27 establish a carried-forward annual loss under AS 43.55.024(b);

28 (2) an explorer that has taken a tax credit under AS 43.55.024(b) or
29 that has obtained a transferable tax credit certificate under AS 43.55.024(d) for the
30 amount of a tax credit under AS 43.55.024(b) is considered a producer, subject to the
31 tax levied under AS 43.55.011(e), to the extent that the explorer generates a positive

1 production tax value as the result of the explorer's receiving a payment or credit
2 described in (e) of this section.

3 (c) For purposes of this section,

4 (1) a producer's lease expenditures for a period are the total costs
5 upstream of the point of production of oil and gas that are incurred on or after July 1,
6 2006, by the producer during the period and that are direct, ordinary, and necessary
7 costs of exploring for, developing, or producing oil or gas deposits located within the
8 producer's leases or properties in the state or, in the case of land in which the producer
9 does not own a working interest, direct, ordinary, and necessary costs of exploring for
10 oil or gas deposits located within other land in the state; however, lease expenditures
11 do not include the costs incurred to satisfy a work commitment under an exploration
12 license under AS 38.05.132; in determining whether costs are direct, ordinary, and
13 necessary costs of exploring for, developing, or producing oil or gas deposits located
14 within a lease or property or other land in the state,

15 (A) the department shall give substantial weight to the typical
16 industry practices and standards in the state and in the United States in
17 determining costs that an operator is allowed to bill a working interest owner
18 that is not the operator, under unit operating agreements or similar operating
19 agreements that were in effect on or before December 1, 2005, and were
20 subject to negotiation with at least one working interest owner with substantial
21 bargaining power, other than the operator; and

22 (B) as to matters that are not addressed by the industry
23 practices and standards described in (A) of this paragraph or as to which those
24 practices and standards are not clear or are not uniform, the department shall
25 give substantial weight to the standards adopted by the Department of Natural
26 Resources that determine the costs, other than interest, that a lessee is allowed
27 to deduct from revenue in calculating net profits under a lease issued under
28 AS 38.05.180(f)(3)(B), (D), or (E);

29 (2) the Department of Revenue may authorize a producer, including a
30 producer that is an operator, to treat as its lease expenditures under this section the
31 costs paid by the producer that are billed to the producer by an operator in accordance

1 with the terms of a unit operating agreement or similar operating agreement if the
2 Department of Revenue finds that

3 (A) the pertinent provisions of the operating agreement are
4 substantially consistent with the Department of Revenue's determinations and
5 standards otherwise applicable under this subsection; and

6 (B) at least one working interest owner party to the agreement,
7 other than the operator, has substantial incentive and ability to effectively audit
8 billings under the agreement;

9 (3) an activity does not need to be physically located on or near the
10 premises of the lease or property from which oil or gas is recovered in order for the
11 cost of the activity to be a cost upstream of the point of production of the oil or gas.

12 (d) For purposes of (c) of this section, "direct costs"

13 (1) includes

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

18 (B) payments of property taxes, sales and use taxes, motor fuel
19 taxes, and excise taxes;

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

24 (2) does not include

25 (A) depreciation, depletion, or amortization;

26 (B) oil or gas royalty payments, production payments, lease
27 profit shares, or other payments or distributions of a share of oil or gas
28 production, profit, or revenue;

29 (C) taxes based on or measured by net income;

30 (D) interest or other financing charges or costs of raising equity
31 or debt capital;

1 (E) acquisition costs for a lease or property or exploration
2 license;

3 (F) costs arising from fraud, wilful misconduct, or negligence;

4 (G) fines or penalties imposed by law;

5 (H) costs of arbitration, litigation, or other dispute resolution
6 activities that involve the state or concern the rights or obligations among
7 owners of interests in, or rights to production from, one or more leases or
8 properties or a unit;

9 (I) donations;

10 (J) costs incurred in organizing a partnership, joint venture, or
11 other business entity or arrangement;

12 (K) amounts paid to indemnify the state; the exclusion
13 provided by this paragraph does not apply to the costs of obtaining insurance
14 or a surety bond from a third-party insurer or surety;

15 (L) surcharges levied under AS 43.55.201 or 43.55.300;

16 (M) for a transaction that is an internal transfer or is otherwise
17 not an arm's length transaction, expenditures incurred that are in excess of fair
18 market value;

19 (N) an expenditure incurred to purchase an interest in any
20 corporation, partnership, limited liability company, business trust, or any other
21 business entity, whether or not the transaction is treated as an asset sale for
22 federal income tax purposes;

23 (O) a tax levied under AS 43.55.011;

24 (P) the portion of costs incurred for dismantlement, removal,
25 surrender, or abandonment of a well, facility, pipeline, platform, or other
26 structure, or for the restoration of a lease, field, unit, area, body of water, or
27 right-of-way in conjunction with dismantlement, removal, surrender, or
28 abandonment, that is attributable to production of oil or gas occurring before
29 July 1, 2006; the portion is calculated as a ratio of the amount of oil and gas
30 production associated with the well, facility, pipeline, platform, or other
31 structure, lease, field, unit, area, body of water, or right-of-way occurring

1 before July 1, 2006 to the total amount of oil and gas production associated
2 with that well, facility, pipeline, platform, or other structure, lease, field, unit,
3 area, body of water, or right-of-way through the end of the calendar month
4 before commencement of the dismantlement, removal, surrender, or
5 abandonment; for purposes of the ratio calculated under this subparagraph,
6 6,000 cubic feet of gas is considered to be equivalent to one barrel of oil.

7 (e) A producer's lease expenditures must be adjusted by subtracting certain
8 payments or credits received by the producer, as provided in this subsection. If one or
9 more payments or credits subject to this subsection are received by a producer during
10 a month or, under (f) of this section, during a calendar year, and if either the total
11 amount of the payments or credits exceeds the amount of the producer's lease
12 expenditures or the producer has no lease expenditures, the producer shall nevertheless
13 subtract those payments or credits from the lease expenditures or from zero,
14 respectively, and the producer's adjusted lease expenditures for that month or calendar
15 year are a negative number and shall be applied to the calculation under (a) of this
16 section as a negative number. The payments or credits that a producer shall subtract
17 from the producer's lease expenditures, or from zero, under this subsection are
18 payments or credits, other than tax credits, received by the producer for

19 (1) the use by another person of a production facility in which the
20 producer has an ownership interest or the management by the producer of a production
21 facility under a management agreement providing for the producer to receive a
22 management fee;

23 (2) a reimbursement or similar payment that offsets the producer's
24 lease expenditures, including a payment from the state or federal government for
25 reimbursement of the producer's upstream costs, including costs for gathering,
26 separating, cleaning, dehydration, compressing, or other field handling associated with
27 the production of oil or gas upstream of the point of production;

28 (3) the sale or other transfer of

29 (A) an asset, including geological, geophysical, or well data or
30 interpretations, acquired by the producer as a result of a lease expenditure or an
31 expenditure that would be a lease expenditure if it were incurred on or after

1 July 1, 2006; for purposes of this subparagraph,

2 (i) if a producer removes from the state, for use outside
3 the state, an asset described in this subparagraph, the value of the asset
4 at the time it is removed is considered a payment received by the
5 producer for sale or transfer of the asset;

6 (ii) for a transaction that is an internal transfer or is
7 otherwise not an arm's length transaction, if the sale or transfer of the
8 asset is made for less than fair market value, the amount subtracted
9 must be the fair market value; and

10 (B) oil or gas

11 (i) that is not considered produced from a lease or
12 property under AS 43.55.020(e); and

13 (ii) the cost of acquiring which is a lease expenditure
14 incurred by the person that acquires the oil or gas.

15 (f) In place of the adjusted lease expenditures for a month under (a) of this
16 section, a producer may, at any time, elect to substitute, for every month of a calendar
17 year, 1/12 of the producer's adjusted lease expenditures for the calendar year. An
18 election made under this subsection applies to calculation of the tax under
19 AS 43.55.011(e) and (g).

20 (g) The department shall specify or approve a reasonable allocation method
21 for determining the portion of a cost that is appropriately treated as a lease expenditure
22 under (c) of this section if a cost that would otherwise constitute a lease expenditure
23 under (c) of this section is incurred to explore for, develop, or produce

24 (1) both an oil or gas deposit located within land outside the state and
25 an oil or gas deposit located within a lease or property, or other land, in the state; or

26 (2) an oil or gas deposit located partly within land outside the state and
27 partly within a lease or property, or other land, in the state.

28 (h) For purposes of AS 43.55.024(a) and (b) and only as to expenditures
29 incurred to explore for an oil or gas deposit located within land in which an explorer
30 does not own a working interest, the term "producer" in (b), (c), and (e) of this section
31 includes "explorer."

1 (i) The department may adopt regulations that establish additional standards
2 necessary to carrying out the purposes of this section, including the incorporation of
3 the concepts of 26 U.S.C. 482 (Internal Revenue Code), as amended, the related or
4 accompanying regulations of each of that section, and any ruling or guidance issued
5 by the United States Internal Revenue Service that relates to that section.

6 (j) For purposes of this section,

7 (1) "explore" includes conducting geological or geophysical
8 exploration, including drilling a stratigraphic test well;

9 (2) "ordinary and necessary" has the meaning given to "ordinary and
10 necessary" in 26 U.S.C. 162 (Internal Revenue Code), as amended, and regulations
11 adopted under that section;

12 (3) "stratigraphic test well" means a well drilled for the sole purpose of
13 obtaining geological information to aid in exploring for an oil or gas deposit and the
14 target zones of which are located in the state.

15 **Sec. 43.55.170. Additional nontransferable tax credit.** (a) For a month for
16 which a producer's tax liability under AS 43.55.011(e) exceeds zero before application
17 of any credits under this chapter, a producer that is qualified under (c) of this section
18 and, during the calendar year, has incurred a qualified capital expenditure, as that term
19 is defined in AS 43.55.024, may apply a tax credit under this section, in an amount
20 that does not exceed one-half of the amount of that expenditure, against that liability.
21 An unused portion of a tax credit may be applied to the extent otherwise allowed
22 under this section for one or more months during the same calendar year. A tax credit
23 authorized by this subsection may not be applied

24 (1) to reduce a producer's tax liability under AS 43.55.011(e) for any
25 month below zero;

26 (2) if application of the credit would cause the total of the tax credits
27 applied by the producer under this subsection during a calendar year to exceed
28 \$12,000,000; or

29 (3) by a producer that

30 (A) had commercial production of oil or gas from at least one
31 lease or property in the state before July 1, 2006, if, during 2016, application of

1 the credit would cause the total of the tax credits applied by the producer under
2 this section to exceed \$6,000,000; or

3 (B) did not have commercial production from a lease or
4 property in the state before July 1, 2006, if application of the credit would
5 cause the total of all tax credits applied by the producer under this section to
6 exceed \$120,000,000.

7 (b) The producer may take the tax credit under this section for a period of not
8 more than 120 consecutive months. The 120-month period commences in the first
9 month that begins on or after July 1, 2006, and during which the producer has
10 commercial production of oil or gas from a lease or property in the state.

11 (c) On written application by a producer, including any information the
12 department may require, the department shall determine whether the producer
13 qualifies under this section for a calendar year. To qualify under this section, a
14 producer must demonstrate that its operation in the state or its ownership of an interest
15 in a lease or property in the state as a distinct producer entity would not result in the
16 division among multiple producer entities of any production tax liability under
17 AS 43.55.011(e) that would be reasonably expected to be attributed to a single
18 producer entity if the tax credit provided in (a) of this section did not exist.

19 (d) An unused tax credit or portion of a tax credit under this section is not
20 transferable under AS 43.55.024(d), and may not be carried forward to or used in a
21 later calendar year.

22 (e) The use of a tax credit under this section does not prevent a producer from
23 taking a tax credit under AS 43.55.024(a) or 43.55.025 for the same qualified capital
24 expenditure.

25 **Sec. 43.55.180. Required reports.** (a) The Department of Revenue shall

26 (1) study

27 (A) the effects of the tax rates under AS 43.55.011(f) and of
28 potential changes in those tax rates on state revenue and on oil and gas
29 exploration, development, and production on private land; and

30 (B) the fairness of the tax rates under AS 43.55.011(f) and of
31 potential changes in those tax rates for private landowners; and

1 (2) prepare a report on or before the first day of the 2013 regular
2 session of the legislature on the results of the study made under (1) of this subsection,
3 including a recommendation as to whether those tax rates should be changed; the
4 department shall notify the legislature that the report prepared under this paragraph is
5 available.

6 (b) The Department of Revenue shall

7 (1) study the effects of the credits authorized by AS 43.55.025 and
8 43.55.170 on state revenue, on the encouragement of exploration, development, and
9 production of oil and gas deposits located in the state, and on the encouragement of
10 new entrants into the oil and gas industry in the state; and

11 (2) prepare a report on or before the first day of the 2015 regular
12 session of the legislature on the results of the study made under (1) of this subsection,
13 and shall include with the report a recommendation as to whether the legislature
14 should extend the availability of the credit under AS 43.55.025 beyond June 30, 2016;
15 the department shall notify the legislature that the report prepared under this paragraph
16 is available.

17 * Sec. 27. AS 43.55.201 is amended to read:

18 Sec. 43.55.201. Surcharge levied. (a) Every producer of oil shall pay a
19 surcharge of \$.01 [\$.02] per barrel of oil produced from each lease or property in the
20 state, less any oil the ownership or right to which is exempt from taxation.

21 (b) The surcharge imposed by (a) of this section is in addition to the tax
22 imposed by AS 43.55.011 and is due on the last day of the month on oil produced
23 from each lease or property during the preceding month. The surcharge [SHALL
24 BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 -
25 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -
26 43.55.310.

27 (c) A producer of oil shall make reports of production in the same manner and
28 under the same penalties as required under AS 43.55.011 - 43.55.180 [AS 43.55.011 -
29 43.55.150].

30 * Sec. 28. AS 43.55.201 is amended by adding a new subsection to read:

31 (d) Oil not considered under AS 43.55.020(c) to be produced from a lease or

1 property is not considered to be produced from a lease or property for purposes of this
2 section.

3 * Sec. 29. AS 43.55.300 is amended to read:

4 Sec. 43.55.300. Surcharge levied. (a) Every producer of oil shall pay a
5 surcharge of \$.04 [\$.03] per barrel of oil produced from each lease or property in the
6 state, less any oil the ownership or right to which is exempt from taxation.

7 (b) The surcharge imposed by (a) of this section is in addition to the tax
8 imposed by AS 43.55.011 and is due on the last day of the month on oil produced
9 from each lease or property during the preceding month. The surcharge [SHALL
10 BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 -
11 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 -
12 43.55.231.

13 (c) A producer of oil shall make reports of production in the same manner and
14 under the same penalties as required under AS 43.55.011 - 43.55.180 [AS 43.55.011 -
15 43.55.150].

16 * Sec. 30. AS 43.55.300 is amended by adding a new subsection to read:

17 (d) Oil not considered under AS 43.55.020(e) to be produced from a lease or
18 property is not considered to be produced from a lease or property for purposes of this
19 section.

20 * Sec. 31. AS 43.55.900(6) is repealed and reenacted to read:

21 (6) "gas" means

22 (A) all natural, associated, or casinghead gas;

23 (B) all hydrocarbons that

24 (i) are recovered by mechanical separation of well
25 fluids or by gas processing in a gas processing plant; and

26 (ii) exist in a gaseous phase at the completion of
27 mechanical separation and any gas processing in a gas processing plant;
28 and

29 (C) all other hydrocarbons produced from a well not defined as
30 oil;

31 * Sec. 32. AS 43.55.900(7) is repealed and reenacted to read:

1 (7) "gross value at the point of production" means

2 (A) for oil, the value of the oil at its point of production
3 without deduction of any costs upstream of that point of production;

4 (B) for gas, the value of the gas at its point of production
5 without deduction of any costs upstream of that point of production;

6 * Sec. 33. AS 43.55.900(10) is repealed and reenacted to read:

7 (10) "oil" means

8 (A) crude petroleum oil; and

9 (B) all liquid hydrocarbons that are recovered by mechanical
10 separation of well fluids or by gas processing in a gas processing plant;

11 * Sec. 34. AS 43.55.900 is amended by adding new paragraphs to read:

12 (17) "Cook Inlet sedimentary basin" has the meaning given in
13 regulations adopted to implement AS 38.05.180(f)(4);

14 (18) "explorer" means a person who, in exploring for new oil or gas
15 reserves, incurs expenditures;

16 (19) "gas processing"

17 (A) means processing a gaseous mixture of hydrocarbons

18 (i) by means of absorption, adsorption, externally
19 applied refrigeration, artificial compression followed by adiabatic
20 expansion using the Joule-Thomson effect, or another physical process
21 that is not mechanical separation; and

22 (ii) for the purpose of extracting and recovering liquid
23 hydrocarbons;

24 (B) does not include gas treatment;

25 (20) "gas processing plant" means a facility that

26 (A) extracts and recovers liquid hydrocarbons from a gaseous
27 mixture of hydrocarbons by gas processing; and

28 (B) is located upstream of any gas treatment and upstream of
29 the inlet of any gas pipeline system transporting gas to a market;

30 (21) "gas treatment"

31 (A) means conditioning gas and removing from gas

1 nonhydrocarbon substances for the purpose of rendering the gas acceptable for
2 tender and acceptance into a gas pipeline system;

3 (B) includes incidentally removing liquid hydrocarbons from
4 the gas;

5 (C) does not include

6 (i) dehydration required to facilitate the movement of
7 gas from the well to the point where gas processing takes place;

8 (ii) the scrubbing of liquids from gas to facilitate gas
9 processing;

10 (22) "landowner's royalty interest" means

11 (A) a lessor's royalty interest under an oil and gas lease; or

12 (B) a royalty interest that is

13 (i) held by a surface owner of land from which oil or
14 gas is produced; and

15 (ii) granted in exchange for the right to use the surface
16 of that land or as compensation for damage to the surface of that land;

17 (23) "oil and gas lease" includes an oil and gas lease, a gas only lease,
18 and an oil only lease;

19 (24) "point of production" means

20 (A) for oil, the automatic custody transfer meter or device
21 through which the oil enters into the facilities of a carrier pipeline or other
22 transportation carrier in a condition of pipeline quality; in the absence of an
23 automatic custody transfer meter or device, "point of production" means the
24 mechanism or device to measure the quantity of oil that has been approved by
25 the department for that purpose, through which the oil is tendered and accepted
26 in a condition of pipeline quality into the facilities of a carrier pipeline or other
27 transportation carrier or into a field topping plant;

28 (B) for gas, other than gas described in (C) of this paragraph,
29 that is

30 (i) not subjected to or recovered by mechanical
31 separation or run through a gas processing plant, the first point where

1 the gas is accurately metered;

2 (ii) subjected to or recovered by mechanical separation
3 but not run through a gas processing plant, the first point where the gas
4 is accurately metered after completion of mechanical separation;

5 (iii) run through a gas processing plant, the first point
6 where the gas is accurately metered downstream of the plant;

7 (C) for gas run through an integrated gas processing plant and
8 gas treatment facility that does not accurately meter the gas after the gas
9 processing and before the gas treatment, the first point where gas processing is
10 completed or where gas treatment begins, whichever is further upstream.

11 * Sec. 35. AS 43.55.011(a), 43.55.011(b), 43.55.011(c), 43.55.012, 43.55.013, 43.55.016,
12 43.55.025(k)(1), 43.55.025(k)(3), 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12),
13 and 43.55.900(16) are repealed.

14 * Sec. 36. The uncodified law of the State of Alaska is amended by adding a new section to
15 read:

16 APPLICABILITY. (a) Sections 5, 7 - 10, 12, 13, 15 - 18, 20, 24, 25, and 27 - 35 of
17 this Act and AS 43.55.160 and 43.55.170, enacted by sec. 26 of this Act, apply to oil and gas
18 produced on or after July 1, 2006.

19 (b) Section 11 of this Act applies to oil and gas produced before, on, or after the
20 effective date of sec. 11 of this Act.

21 * Sec. 37. The uncodified law of the State of Alaska is amended by adding a new section to
22 read:

23 TRANSITIONAL PROVISIONS. (a) Notwithstanding any contrary provision of
24 AS 43.55.024(a), enacted by sec. 12 of this Act, for oil and gas produced on or after July 1,
25 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an
26 amount equal to 1 2/3 percent" in AS 43.55.024(a)(1)(B), enacted by sec. 12 of this Act, shall
27 be replaced by the phrase "every month during the period July 1, 2006, through December 31,
28 2006, an annualized tax credit in an amount equal to 3 1/3 percent."

29 (b) Notwithstanding any contrary provision of AS 43.55.024(e), enacted by sec. 12 of
30 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
31 phrase "a calendar year" in AS 43.55.024(e), enacted by sec. 12 of this Act, shall be replaced

1 by the phrase "the last six months of the calendar year."

2 (c) Notwithstanding any contrary provision of AS 43.55.024(i)(2), enacted by sec. 12
3 of this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007,

4 (1) the number "1/24" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of this
5 Act, shall be replaced by the number "1/12";

6 (2) the phrase "calendar year" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of
7 this Act, shall be replaced by the phrase "last six months of the calendar year."

8 (d) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 26 of
9 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
10 phrase "for every month of a calendar year, 1/12 of the producer's adjusted lease expenditures
11 for the calendar year" in AS 43.55.160(f), enacted by sec. 26 of this Act, shall be replaced by
12 the phrase "for each of the last six months of 2006, one-sixth of the producer's adjusted lease
13 expenditures for that six-month period."

14 (e) Notwithstanding any contrary provision of AS 43.55.170(a), enacted by sec. 26 of
15 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the
16 amount of "\$12,000,000" in AS 43.55.170(a)(2), enacted by sec. 26 of this Act, shall be
17 replaced by "\$6,000,000."

18 (f) For oil and gas produced before July 1, 2006, the provisions of AS 43.55, and
19 regulations adopted under AS 43.55, that were in effect before July 1, 2006, and that were
20 applicable to the oil and gas continue to apply to that oil and gas.

21 (g) Notwithstanding any contrary provision of AS 43.55.020(a), as repealed and
22 reenacted by sec. 7 of this Act, for oil and gas produced on or after July 1, 2006, and before
23 the first day of the first month that begins at least 180 days after the effective date of sec. 7 of
24 this Act,

25 (1) the amount of the taxes that would have been levied on the producer under
26 AS 43.55, as the provisions of that chapter read on June 30, 2006, is due on the last day of
27 each calendar month on the oil and gas that was produced from each lease or property during
28 the preceding month;

29 (2) the portion, if any, of the taxes levied under AS 43.55.011(e) - (g), enacted
30 by sec. 5 of this Act, that is due under AS 43.55.020(a), as repealed and reenacted by sec. 7 of
31 this Act, and that remains unpaid, net of any credits applied as allowed by law, is due on the

1 last day of the first month that begins at least 180 days after the effective date of sec. 5 of this
2 Act.

3 (h) Notwithstanding any contrary provision of AS 43.55.030(a), as amended by sec.
4 18 of this Act, for oil and gas produced on or after July 1, 2006, and before the first day of the
5 first month that begins at least 180 days after the effective date of sec. 18 of this Act, the
6 person paying the tax shall file with the Department of Revenue, at the time an amount of tax
7 is due

8 (1) under (g)(1) of this section, the statement required under former
9 AS 43.55.030(a), as that subsection read on June 30, 2006; and

10 (2) under (g)(2) of this section, the statements required under
11 AS 43.55.030(a), as amended by sec. 18 of this Act.

12 (i) Notwithstanding any contrary provision of AS 43.55.201(a) or (b), as amended by
13 sec. 27 of this Act, or AS 43.55.300(a) or (b), as amended by sec. 29 of this Act, for oil
14 produced on or after July 1, 2006, and before the first day of the first month that begins at
15 least 180 days after the effective date of secs. 27 and 29 of this Act,

16 (1) the amount of the surcharges that would have been imposed on the
17 producer under AS 43.55, as the provisions of that chapter read on June 30, 2006, is due on
18 the last day of each calendar month on oil produced from each lease or property during the
19 preceding month;

20 (2) the portion, if any, of the surcharges imposed under AS 43.55.201(a), as
21 amended by sec. 27 of this Act, and AS 43.55.300(a), as amended by sec. 29 of this Act, and
22 that remains unpaid is due on the last day of the first month that begins at least 180 days after
23 the effective date of secs. 27 and 29 of this Act.

24 (j) Notwithstanding any contrary provision of AS 43.55.201(c), as amended by sec.
25 27 of this Act, or AS 43.55.300(c), as amended by sec. 29 of this Act, for oil produced on or
26 after July 1, 2006, and before the first day of the first month that begins at least 180 days after
27 the effective date of secs. 27 and 29 of this Act, at the time an amount of surcharge is due,

28 (1) under (i)(1) of this section, the producer shall file the report of production
29 required under former AS 43.55.201(c) and 43.55.300(c), as those provisions read on June 30,
30 2006; and

31 (2) under (i)(2) of this section, the producer shall file the report of production

1 required under former AS 43.55.201(c), as amended by sec. 27 of this Act, and
2 AS 43.55.300(c), as amended by sec. 29 of this Act.

3 (k) For purposes of taxes to be calculated and due under (g)(1) of this section and
4 statements to be filed under (h)(1) of this section, regulations that were adopted by the
5 Department of Revenue under AS 43.55, as the provisions of that chapter read on June 30,
6 2006, and that were in effect on that date apply to those taxes and statements.

7 * Sec. 38. The uncodified law of the State of Alaska is amended by adding a new section to
8 read:

9 TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS. (a)
10 The Department of Revenue may proceed to adopt regulations to implement the changes
11 made by this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act),
12 but not before the effective date of the law implemented by the regulation.

13 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by
14 the Department of Revenue to implement, interpret make specific, or otherwise carry out the
15 provisions of secs. 5, 7 - 10, 12, 13, 15 - 18, 20, 24 - 35, and 37 of this Act may apply
16 retroactively as of July 1, 2006, if the Department of Revenue expressly designates in the
17 regulation that the regulation applies retroactively to that date.

18 * Sec. 39. The uncodified law of the State of Alaska is amended by adding a new section to
19 read:

20 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the
21 heading of

22 (1) AS 43.55 from "Oil and Gas Production Taxes and Oil Surcharge" to "Oil
23 and Gas Production Tax and Oil Surcharge";

24 (2) article 1 of AS 43.55 from "Oil and Gas Properties Production Taxes" to
25 "Oil and Gas Production Tax";

26 (3) AS 43.55.011 from "Oil production tax" to "Oil and gas production tax";

27 (4) AS 43.55.025 from "Tax credit for oil and gas exploration or gas only
28 exploration" to "Alternative tax credit for oil and gas exploration";

29 (5) AS 43.55.150 from "Determination of gross value" to "Determination of
30 gross value at the point of production."

31 * Sec. 40. The uncodified law of the State of Alaska is amended by adding a new section to

1 read:

2 CONTINGENT RETROACTIVITY OF PROVISIONS OF ACT. If, under sec. 40 of
3 this Act, this Act takes effect on or after July 1, 2006, sections 5, 7 - 10, 12, 13, 15 - 18, 20,
4 24 - 37 of this Act are retroactive to July 1, 2006.

5 * Sec. 41. This Act takes effect July 1, 2006.

SPONSOR
STATEMENT

ALASKA STATE LEGISLATURE HOUSE RESOURCES COMMITTEE

Representative Jay Ramras
Co-Chairman

(907) 465-3004

Fax: (907) 465-2833

Representative_Jay_Ramras@legis.state.ak.us

119 N. Cushman St., Suite 213
Fairbanks, AK 99701



Representative Ralph Samuels
Co-Chairman

(907) 465-2095

Fax: (907) 465-3810

Representative_Ralph_Samuels@legis.state.ak.us

716 W. 4th Avenue
Anchorage, AK 99501

State Capitol, Juneau, Alaska 99801-1182

SPONSOR STATEMENT CSHB 488 (RES)

Wednesday, March 22, 2006 / Tim Benintendi, Staff, 465-3715

(version 24-GH2052/L)

COMMITTEE REPORT: 6 "Do Pass" / 1 "Do Not Pass" / 1 "Amend"

CSHB 488 (RES) would convert Alaska's oil severance tax structure from the Economic Limit Factor (ELF) method, to a petroleum profits tax (PPT) method. The governor's version would increase revenue by about \$705 million per year, on average, over the next five years. The House Resources Committee (HRC) version would increase revenue by about \$816 million per year, on average, over the same five years.

The severance tax is one of four levies paid by the oil industry in Alaska, the others being royalties, property taxes, and income taxes. Tax deductions and tax credits continue to be used to motivate industry for exploration, production, and development activities. The objectives of the bill remain as follows: Increase the state's share or "government take," under conditions of high oil market prices; provide industry with new or expanded incentives to explore and produce from marginal and frontier fields; and to ensure motivation for continued activity in the Cook Inlet fields.

The HRC proposed several changes to the governor's bill, most notably, installing a two-pronged progressivity feature on the PPT tax rate. In the governor's version, the PPT rate is a flat 20% regardless of the market price of oil. The HRC version also uses the 20% rate, but only at market prices up to \$50 per barrel (WTI benchmark). At market prices between \$50 and \$110 per barrel, the progressivity feature adds 3/10% of the wellhead value for every dollar the market price is over \$50. A single year of additional revenue in times of high market prices can offset many years of lower revenues when prices are close to their historical average.

If there is a dramatic price shock or the value of oil continues to rise at market prices over \$110 per barrel, the tax generates an additional 37.5% of wellhead value for the state. We would get a greater share at very high market prices. As prices climb, the combined effect of the 20% PPT base rate and the 37.5% progressivity factor (which is deductible in calculating the amount payable under the PPT rate) approaches 50% of the oil's value in Alaska. The committee felt this two-pronged progressivity feature would keep investment opportunity in Alaska strong, while allowing the state to share in windfalls at high spikes of market prices.

Another policy change from the governor's bill to the HRC version was the elimination of transition costs as deductions from the production tax. The governor provided a deduction for investment costs incurred in the past five-years, feeling that investments made in that period and directly tied to the production of oil which would be taxed at the new rate, should be allowed. After hearing considerable testimony on this component, the HRC deleted it completely.

Exploration tax credits of 40% under SB 185 (Ch. 59, SLA 03) will be extended ten years under the HRC version, and the governor's credit rate of 20% remains intact. This is intended to motivate explorers and independent firms. As is currently done, a company will be able to choose from the two options as they assess which is most beneficial to them.

The House Resources Committee allowed no credit for abandonment costs, but such expenses remain tax-deductible. And, in terms of a private royalty severance tax rate, the HRC version set it at 5%.

As introduced, the governor's version of HB 488 proposes to make the current oil spill contingency surcharge (which is currently 5-cents per barrel) creditable against the PPT. The HRC left the current statute in place, but modified the program. The current 2-cents per barrel which goes into the Response Mitigation Account (RMA), is reduced to 1-cent. This surcharge will continue in suspension as long as the RMA balance holds at \$50 million. The remaining 3-cent per barrel surcharge, which is deposited into the Prevention Mitigation Account (PMA), increases to 4-cents per barrel under the HRC substitute bill.

The governor provided a \$73 million annual allowance for all producers, against which a 20% credit would be applied, resulting in a \$14.6 million tax credit per company, annually. The merits of this allowance and credit incentive eluded committee members, so this provision was changed to a direct tax credit, dollar for dollar, on the first \$12 million worth of capital investment for exploration, production, or development work. This annual credit is non-transferable, non-salable, not eligible for carry-forward, and can only be applied to a current year's severance tax. Should a company spend less than \$12 million, the credit would be applied to whatever amount they did spend.

As protection for explorers and new entrants to Alaska, the HRC devised a tax credit repurchasing program for those credits a company earns on expenditures of up to \$10 million per year for investments in exploration and/or lease purchases in Alaska.

The effective date for HB 488 as introduced by the governor, was July 1, 2006. The HRC version changed that to April 1st, also the beginning of a fiscal quarter, but a change which would bring the state another \$200 million this year.

SECTIONAL ANALYSIS

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

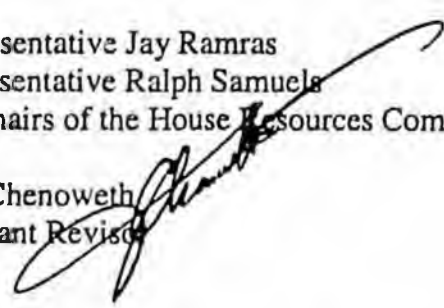
State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

March 24, 2006

SUBJECT: CSHB 488(RES) -- sectional analysis
(Work Order No. 24-GH2052\L)

TO: Representative Jay Ramras
Representative Ralph Samuels
Co-Chairs of the House Resources Committee

FROM: Jack Chenoweth
Assistant Revisioner 

The House Resources Committee Substitute proposes to repeal the state's current oil and gas properties production tax and replace it with a production tax on oil and gas. The replacement tax is to be based on a percentage of the production tax value of oil and gas, the determination of which is prescribed by the bill. The measure makes a number of related and conforming additions and changes.

The measure is an administration-sponsored bill, so in the preparation of this memo, for provisions not substantively altered by the Resources Committee, I have drawn on the explanatory language of the administration's February 21 sectional analysis of the bill as introduced.

PROVISIONS IMPOSING A PRODUCTION TAX ON THE NET VALUE OF OIL AND GAS:

Provisions imposing the tax and setting the basic tax rate(s) --

Bill section 5: The bill section enacts (as a repeal and reenactment of AS 43.55.011(a) levying a tax on a percentage of the gross value at the point of production) the tax levy as a production tax on both oil and gas, with exceptions and limitations noted in the provision's text, and sets the rate of levy at 20 percent of the production tax value of the taxable oil and gas.

Bill section 6: As part of this bill section, a new subsection, AS 43.55.011(e), is added to authorize a levy and set a rate of levy on oil and gas produced that constitutes a lessor's royalty interest under an oil and gas lease. The rate specifies a rate of five percent of the gross value at the point of production. It also sets out an alternative rate of 20 percent of the gross value that applies under circumstances in which there is evidence the producer's receipt of consideration from the lessor offsets the producer's royalty obligation.

Representative Jay Ramras
Representative Ralph Samuels
March 24, 2006
Page 2

Provisions authorizing a progressively higher tax rate for oil when the price exceeds \$50 per barrel --

As part of **bill section 6**, proposed AS 43.55.011(f) sets out an oil price index by which the tax levy on oil is adjusted by an addition .3 percent of gross value per dollar in excess of \$50, based on Gulf Coast prices for West Texas Intermediate crude. Subsection (g) caps the index increase when the average price reaches \$110 per barrel. Subsection (h) sets out the manner in which the index may be calculated and authorizes use of a substitute formula under circumstances specified in the subsection.

Provisions authorizing a progressively higher tax rate for gas when the price of gas exceeds \$8 per million BTUs --

Again, as part of **bill section 6**, proposed AS 43.55.011(i) sets out a natural gas price index by which the tax levy on gas is adjusted by 2 percent of gross value when the average Henry Hub price exceeds \$8 per million BTUs. Subsection (j) caps the index increase at 18.75 and subsection (k) spells out the manner in which the index may be calculated and authorizes use of a substitute formula under circumstances specified in the subsection.

Provisions relating to the determination of the production tax value of oil and gas --

The oil and gas production tax levy is imposed as a percentage of the production tax value of the taxable oil and gas. Calculation of the production tax value is set out in AS 43.55.160, added by **bill section 28**:

-- Under AS 43.55.160(a), the calculation begins with the determination of the gross value at the point of production of all of a producer's taxable oil and gas statewide. The producer may deduct taxes paid that are attributable to application of the indexed production tax rate increases as well as the deductible costs of oil and gas exploration, development, and production (adjusted deductible lease expenses). Subsection (a) contains language that precludes net value calculation from falling below zero.

-- Subsection (b) sets out rules for the producer's claim and use of unused deductions.

-- Subsection (c) spells out the exploration, development, and production costs that qualify as deductible lease expenses ("total costs upstream of the point of production . . . incurred on or after January 1, 2006, . . . and that are direct, ordinary, and necessary costs for exploring for, developing, or producing oil or gas deposit"), and provides guidance to the department as to evidence of those costs, especially in situations involving activities occurring under operating agreements.

Representative Jay Ramras
Representative Ralph Samuels
March 24, 2006
Page 3

-- Subsection (d) spells out allowable direct costs and costs that may not be deductible because they are not direct costs.

-- The mechanics of making adjustments to a producer's lease expenditures are addressed in subsection (e). Adjustments are required to account for reimbursements, assets sales, and other producer receipts.

-- Subsection (f) authorizes substitution of determination of adjusted lease expenditures on a monthly basis, at the election of the producer.

--The provisions of subsections (g) - (i) spell out additional authority of the department with respect to tax administration, while subsection (j) supplies definitions of terms used.

Tax credit provisions --

The measure contains two separate sections authorizing tax credits.

Bill section 14 adds a new section, AS 43.55.024, that sets out tax credits for certain expenditures and losses. In the section,

-- Subsection (a) authorizes a tax credit of 20 percent of "qualified capital expenditures"--the term is defined in subsection (j)--against the production tax on the net value of taxable oil, bars claim of the tax if the same expenditures are used to claim a credit under AS 43.55.025 (existing tax credit for oil and gas exploration or gas only exploration), and authorizes claim and application of the credit on a monthly basis if, under AS 43.55.160(f), the producer has elected to substitute determination of adjusted lease expenditures on a monthly basis.

-- Subsection (b) authorizes election of a 20 percent tax credit on the basis of carried forward annual losses, defined in the subsection as "the producer's . . . adjusted lease expenditures under AS 43.55.160 for a previous calendar year that was not deductible in any month under AS 43.55.160(a) and (b)."

-- Subsection (c) precludes a tax credit from reducing the producer's tax liability below zero but authorizes application of the unused portion of the credit in a later month.

-- Subsections (d) and (e) establish a system by which tax credits for expenditures and losses as authorized by the section may be transferred through transferable tax credit certificates. Subsection (f) authorizes the department to repurchase credit certificates and, subject to appropriation, make cash refunds, but repurchase and refunds must comply with the requirements spelled out in paragraphs (1) - (5).

-- Subsections (g) and (h) spell out the authority of the department with respect to the administration of transferable tax credit certificates.

-- Subsection (i) bars a producer from making a claim of a tax credit for expenditures to acquire and use certain assets or for costs associated with abandonment.

AS 43.55.170, enacted as part of **bill section 28**, sets out a second or additional tax credit. The section allows the producer to claim a credit for qualified capital expenditures (as that term is defined in AS 43.55.024). The credit may not be applied to reduce the producer's tax liability to less than zero. Unused portions of the credit may be carried forward from month-to-month within a calendar year, may not exceed a total of \$12,000,000 for a calendar year, and may not be carried forward into a following calendar year. These credits are not transferable and not refundable. The authorization for these additional credits expires March 31, 2016.

Provisions relating to tax payment and the administration of the tax --

Bill section 8: The bill section enacts (as a repeal and reenactment of AS 43.55.020(a)) a requirement of monthly payment of the net value production tax on oil, with payment due at the end of the calendar month for production during the preceding month. The provision spells out conditions when a tax due is delinquent, the handling of overpayments, and limitations on interest that may be payable on tax overpayments.

Bill section 10, amending AS 43.55.020(d), deals with a producer's right to charge a private royalty owner for the share of production taxes attributable to royalty oil and gas. The amending language adds a method of determining the royalty share of taxes in the absence of an agreement between the producer and royalty owner to use a different method.

Bill section 11 expands the current production tax exemption for gas that is used in lease operations by including oil that is used in those lease operations. The section also clarifies the manner of tax treatment of flared gas, based on authorization to do so from the Alaska Oil and Gas Conservation Commission.

Bill sections 1 and 12: The latter provision amends AS 43.55.020(f) allowing the Department of Revenue to require production tax to be paid on the basis of prevailing value. It clarifies that the provision applies not only when the sale price differs from the prevailing value but also when the oil or gas on which tax is due is not sold at all. The former sets out a statement of intent for the amendment made to the permanent law provision.

Bill section 13: As is done earlier in the bill with respect to oil, proposed AS 43.55.020(g) enacts a requirement of monthly payment of the net value production tax on amounts due under the lessor's royalty share provisions, on the indexed production tax rate increases as applied to oil and the indexed production tax rate increases as applied to gas. Payment is due at the end of the calendar month for production during the preceding month and, if not paid, the tax due is delinquent. Proposed AS 43.55.020(h)

Representative Jay Ramras
Representative Ralph Samuels
March 24, 2006
Page 5

authorizes imposition and collection of a five percent civil penalty on the difference between the amount not paid and a 90 percent threshold if payment, when due, falls below that threshold.

Bill section 20: This section, proposing amendments to AS 43.55.030(a), clarifies what the Department of Revenue may obtain as information relevant to determining taxes due under AS 43.55.

Bill section 21 amends AS 43.55.030(d) to delete a per day penalty for failure to file a tax return under AS 43.55. Other provisions in this measure and in AS 43 are applicable to late filing of tax return documents.

Bill section 22, adding AS 43.55.030(e), sets out a requirement of an annual "true-up" of the prior year monthly returns and directs submission of adjustments or corrections of the previously-filed statements.

Bill section 23, amending AS 43.55.040, clarifies the department's power to obtain information relevant to determining taxes imposed under AS 43.55 by adding the authority to require filing of regular statements or reports. In addition, the bill section modifies the statutory confidentiality restrictions related to use of information in returns and reports when necessary to determine a taxpayer's liability, particularly as those provisions may be applicable to persons -- state officers and employees and privately-retained contractors -- who may have access to the information.

Bill section 27: AS 43.55.150 deals with determining the gross value at the point of production of oil and gas. The addition of new subsection (d) authorizes the Department of Revenue to allow producers to calculate that gross value with a formula that uses a producer's royalty agreement with the state, a royalty value or valuation method accepted by the Department of Natural Resources or the United States Department of the Interior, or another formula using factors such as published price indices.

OTHER SUBSTANTIVE PROVISIONS AFFECTING OIL PRODUCTION AND GAS PRODUCTION TAXES:

Bill section 16: The amendment to AS 43.55.025(b) extends the current production tax credit for exploration expenditures, authorized by AS 43.55.025, from the current deadline of July 2007 (July 2010 for the North Slope and Cook Inlet activities) to July 1, 2016, on a statewide basis.

Bill section 29: The amendments to AS 43.55.201 modify the component of the so-called nickel-per-barrel surcharge that directs a portion of the money to the response account in the oil and hazardous substance release prevention and response fund, reducing by one cent the amount directed to that account, and making necessary conforming changes to cross-references.

Representative Jay Ramra;
Representative Ralph Sanuels
March 24, 2006
Page 6

Bill section 30: The addition of AS 43.55.201(d) relieves from payment of this component of the tax surcharge oil that is exempt from the production tax because it is used in lease operations.

Bill section 31: The amendments to AS 43.55.300 modify the component of the so-called nickel-per-barrel surcharge that directs a portion of the money to the release prevention account in the oil and hazardous substance release prevention and response fund, increasing by one cent the amount directed to that account, and making necessary conforming changes to cross-references.

Bill section 32: The addition of AS 43.55.300(d) relieves from payment of this component of the tax surcharge oil that is exempt from the production tax because it is used in lease operations.

Bill sections 33 - 35 amend definitions of terms used in the chapter: "gas", "gross value at the point of production," and "oil."¹

Bill section 36 adds definitions for "explorer" (for use in the chapter), "gas processing", and "gas treatment".²

PROVISIONS PROPOSING REPEAL OF THE CURRENT OIL AND GAS PROPERTIES PRODUCTION TAX:

In addition to repeals and reenactments made in bill sections 1 and 8, **bill section 37** collects and sets out repeals of provisions relating to the current oil and gas properties production tax that are obsolete or unnecessary due to other changes proposed in the measure:

-- repeal of AS 43.55.011(b) and (c) delete the provisions spelling out the percentage-of-value and cents-per-barrel tax methodologies applicable to taxation of oil;

-- repeal of AS 43.55.012(b) repeals the special cents-per-barrel provisions for heavy oil;

¹ By cross-reference, the change in the definition of "gas" has the effect of changing the definition of "gas" as used in AS 43.82, the Alaska Stranded Gas Development Act. See AS 43.82.900.

² As to the definitions, the administration's initial sectional analysis noted that

Under these definitions, gas processing is considered an operation upstream of the point of production for gas, and generally the line between what is oil and what is gas corresponds to what substances are in liquid form and what substances are in gaseous form, respectively, at the point of production.

-- repeal of AS 43.55.013 eliminates the economic limit factor, or ELF;

-- repeal of AS 43.55.016 deletes the current gas production tax;

-- repeal of AS 43.55.025(k)(3) eliminates the definition of "explorer" as applicable to the current tax credit for oil and gas exploration; the term is defined for the chapter by an addition made in bill section 36;

-- repeal of paragraphs (1), (8), (11), (12) and (16) of AS 43.55.900 eliminate definitions appearing in other repealed sections --"API gravity", "intangible drilling expense", "oil production operation", "old crude oil", and "well days".

CONFORMING ADDITIONS AND AMENDMENTS:

Bill section 2 amends criminal provisions for unauthorized disclosure of confidential records. The section imposes criminal penalties on current or former officers and employees for unauthorized disclosure; the amendment extends the penalties to others, private persons such as legal counsel and consultants, who make an unauthorized disclosure of otherwise confidential information to which they have had access.

Bill sections 3 and 4 authorize a producer who is a taxpayer under the Alaska Net Income Tax Act, AS 43.20, to deduct the production tax payments and disallows the adding back of the production taxes levied and paid in the determination of the producer's corporate income tax.

Bill section 7 conforms certain statutory language to that used in the Internal Revenue Code and incorporates by reference a definition for a term used elsewhere in the chapter.

Bill section 9 makes a corrective amendment to AS 43.55.020(b).

Bill sections 15, 17, 18, and 19: The provisions are in the nature of conforming amendments made to various subsections of AS 43.55.025, authorizing the current tax credit for oil and gas exploration or gas only exploration. The amendments insert or substitute reference to the specific subsection levying the production tax on oil and gas. The changes are necessary because, as proposed in the original bill and the committee substitute, the chapter (AS 43.55) would have multiple tax credits rather than the one existing tax credit for oil and gas, or gas only, exploration.

Bill section 24 proposes amendments to AS 43.55.080, directing that production taxes be deposited into the general fund, to incorporate exceptions imposed under the constitutional budget reserve fund amendment, and making a conforming amendment due to addition of new sections to article 1 of AS 43.55.

Representative Jay Ramras
Representative Ralph Samuels
March 24, 2006
Page 8

Bill section 25, amending AS 43.55.135, sets out a conforming amendment due to addition of new sections to article 1 of AS 43.55.

Bill section 26, amending AS 43.55.150(a), makes conforming amendments relating to the determination of gross value to be calculated and in the reference due to addition of new sections to article 1.

APPLICABILITY, TRANSITIONAL, AND RELATED PROVISIONS:

Bill section 38 specifies that provisions relating to the new tax on the production tax value of oil and gas apply to oil and gas produced on or after April 1, 2006, and that the provision under which the Department of Revenue collects the tax on the basis of prevailing value and that clarifies how that value is to be measured, confirming long-standing agency policy, applies to all production without reference to date.

Bill section 39 sets out a series of transitional provisions that clarify how certain calendar year rules added by the new tax will apply during the first nine-month period that the tax is in effect, that authorize the claim of tax credit for expenditures and losses based on expenditures made on or after January 1, 2006, that set out a transitional schedule for tax payments, and that former regulations in effect under the previous severance tax statute continue to govern oil and gas produced before the April 1, 2006, effective date of the new production tax.

Bill section 40 authorizes adoption of new regulations and provides that the new regulations adopted may apply retroactively as of the April 1, 2006, effective date of the new production tax.

Bill section 41 prescribes editorial instructions for the revisor of statutes.

Bill section 42 adds a provision authorizing retroactive application of expenditures incurred on or after January 1, 2006, for expenditures that support the tax credit claims under the new production tax.

In the event the bill becomes law after April 1, 2006, **bill section 43** makes the provisions of the measure that are identified as taking effect on that date retrospectively effective to that date.

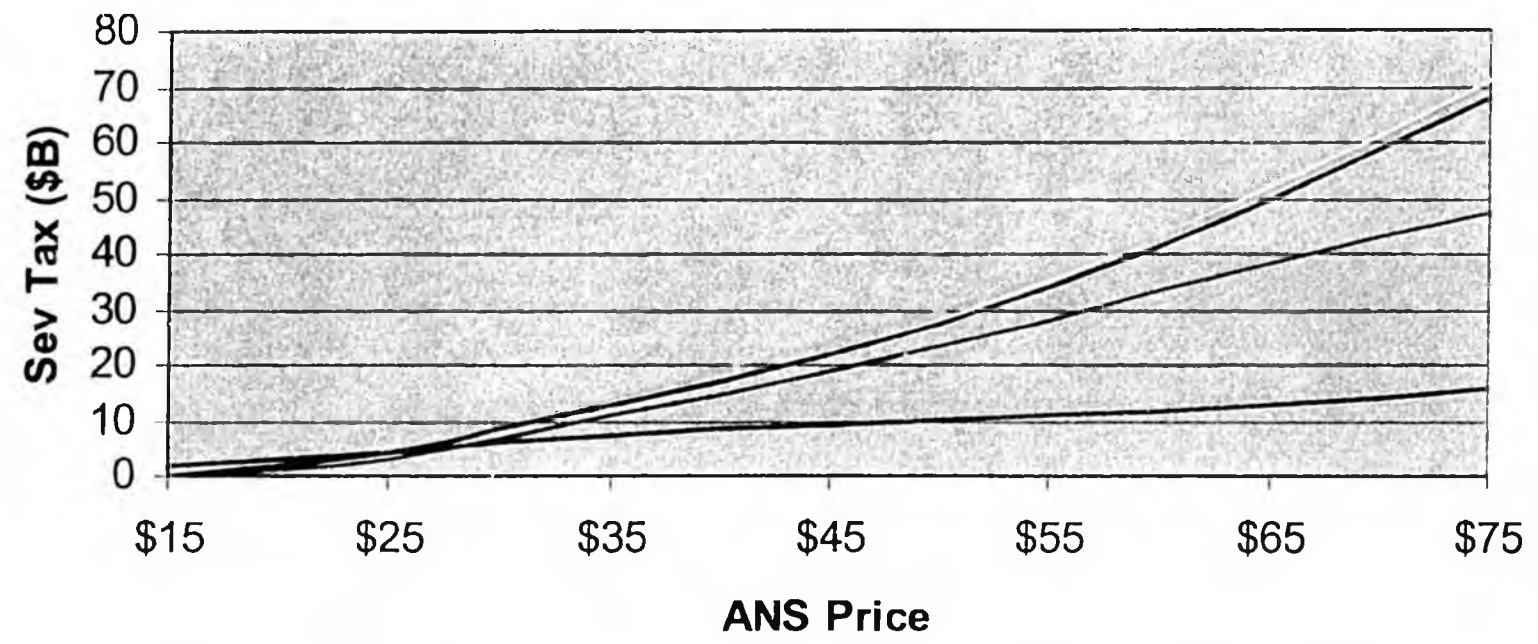
Bill sections 44 and 45 are the measure's effective dates. The production tax provisions have an April 1 effective date; the remainder of the bill is given immediate effect.

JBC:lmb
06-118.lmb

ADMINISTRATION

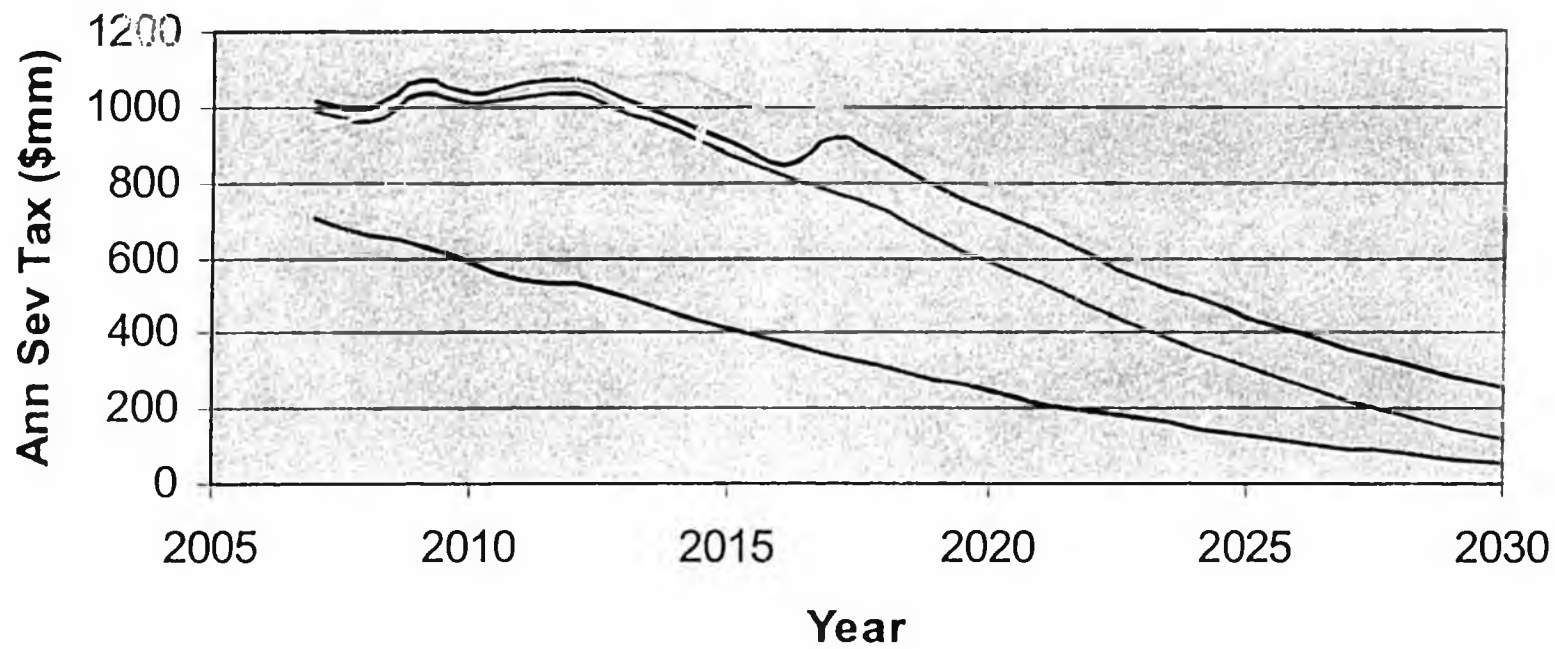
DRAFT
HB 488 House Finance CS
Comparative Revenues
Alaska Department of Revenue
May 5, 2006

Cumulative Severance Tax 2007-2030 (\$Billions)



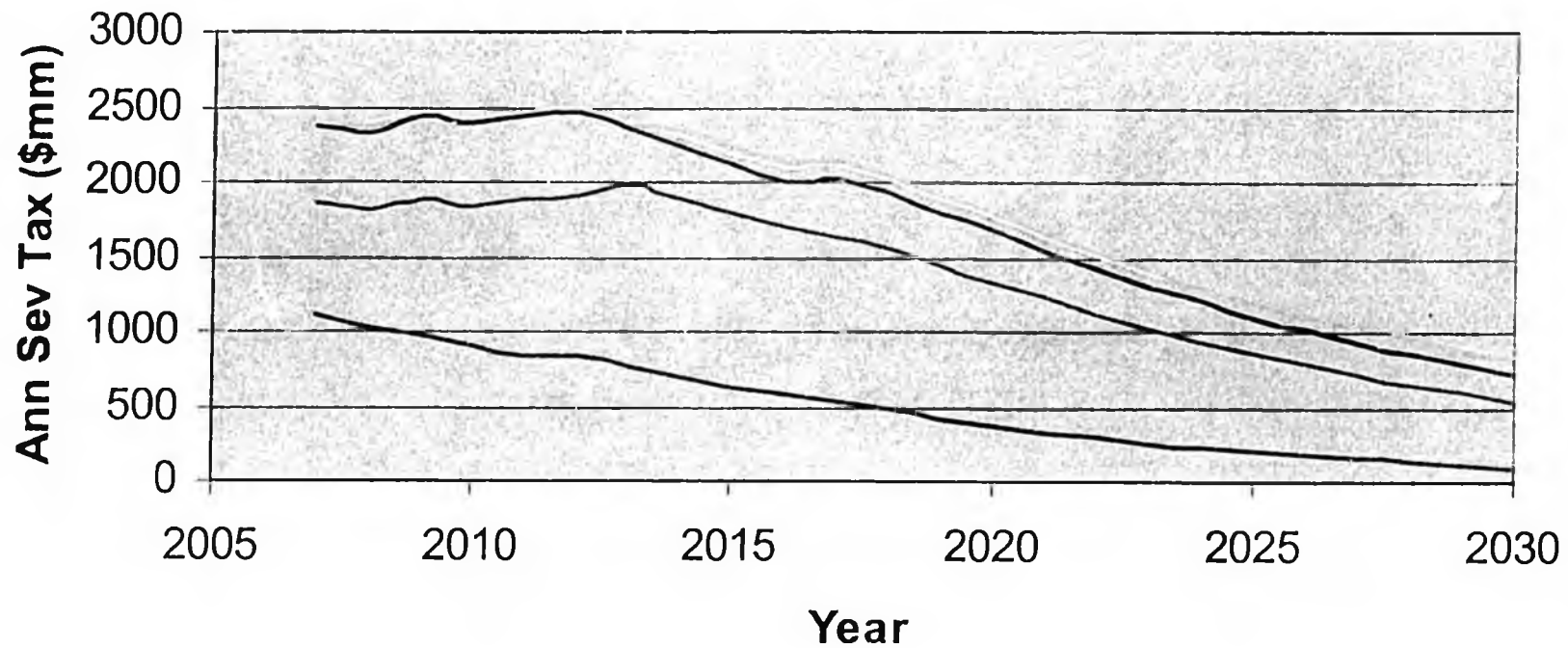
— sq
— gov
house res cs
— sb 305
— house fin cs

Annual Severance Tax @ \$40 2007-2030 (\$Millions)



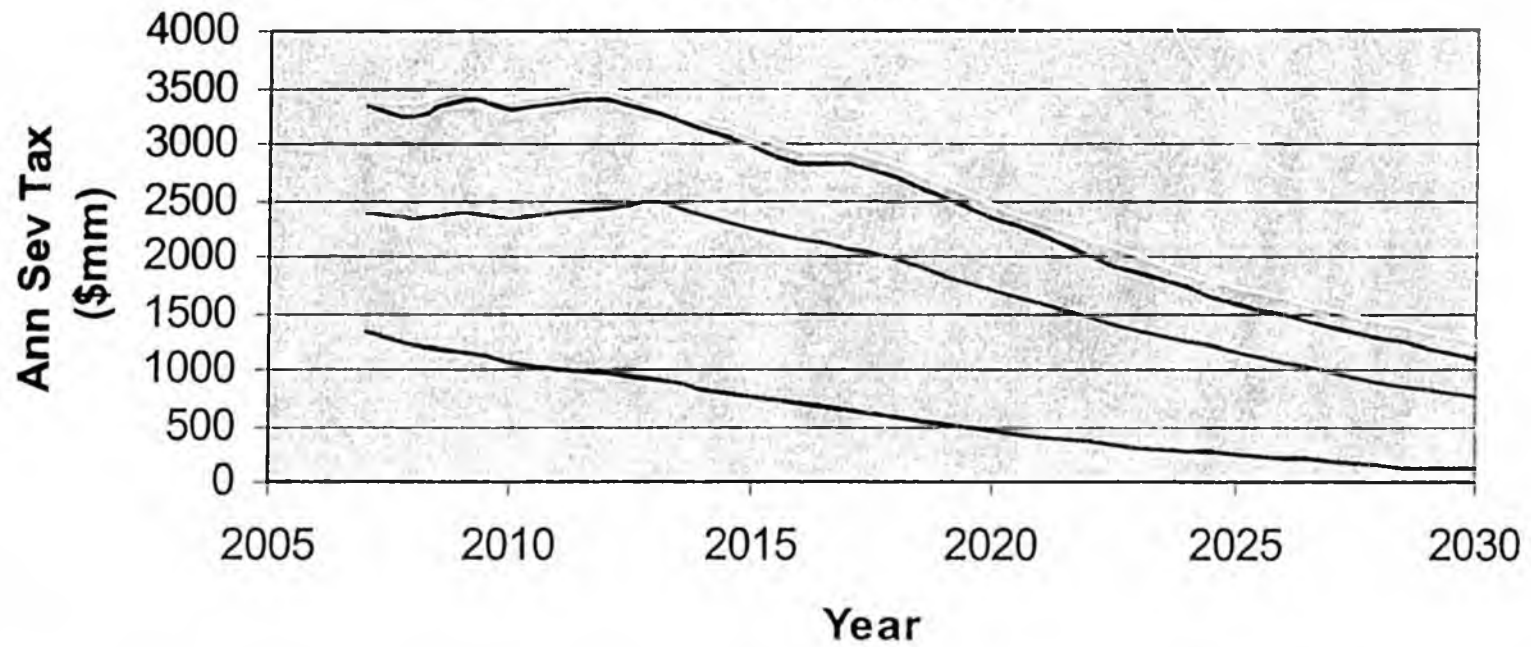
— sq — gov house res cs sb 305 — house fin cs

Annual Severance Tax @ \$60 2007-2030 (\$Millions)



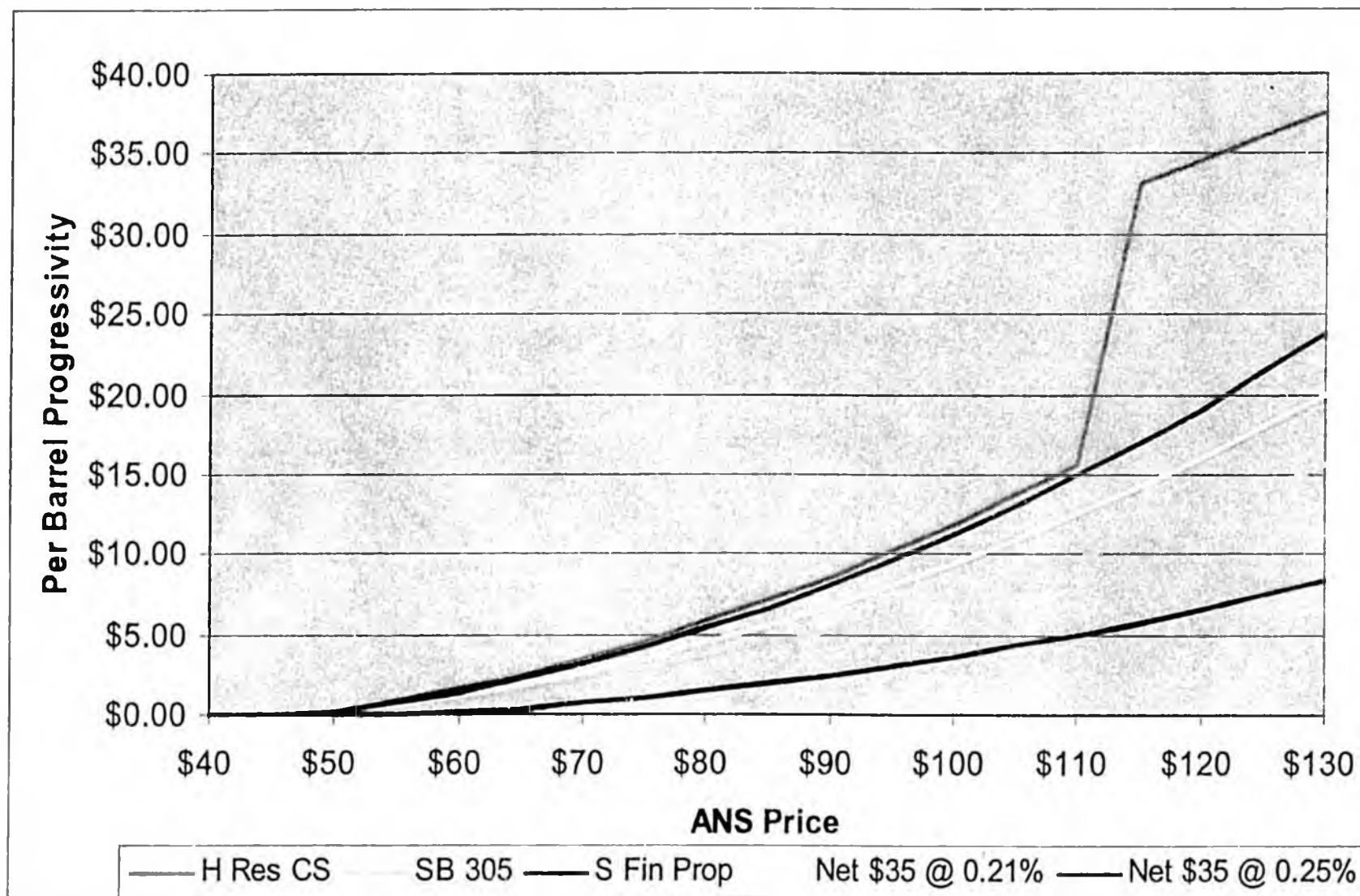
— sq — gov — house res cs — sb 305 — house fin cs

Annual Severance Tax @ \$70 2007-2030 (\$Millions)



— sq — gov house res cs sb 305 — house fin cs

Per Barrel Progressivity Surcharge on Net \$35 at 0.21% and 0.25%



Alaska Oil and Gas Association



121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907)272-1481 Fax: (907)279-8114
Email: brady@aoga.org
Judith Brady, Executive Director

April 13, 2006

The Honorable Mike Chenault
Co-Chair, Committee on Finance
The Alaska House of Representatives
Alaska State Capitol, Room 505
Juneau, AK 99801-1182

The Honorable Lyda Green
Co-Chair, Committee on Finance
The Alaska Senate
Alaska State Capitol, Room 516
Juneau, AK 99801-1182

The Honorable Kevin Meyer
Co-Chair, Committee on Finance
The Alaska House of Representatives
Alaska State Capitol, Room 515
Juneau, AK 99801-1182

The Honorable Gary Wilken
Co-Chair, Committee on Finance
The Alaska Senate
Alaska State Capitol, Room 518
Juneau, AK 99801-1182

The Honorable Bill Stoltze
Vice Chair, Committee on Finance
The Alaska House of Representatives
Alaska State Capitol, Room 501
Juneau, AK 99801-1182

The Honorable Con Bunde
Vice Chair, Committee on Finance
The Alaska Senate
Alaska State Capitol, Room 506
Juneau, AK 99801-1182

Re: Senate Bill No. 305 / House Bill No. 488 ("PPT")
Proposed Amendments

Dear Finance Committee Co-Chairs and Vice Chairs:

The Alaska Oil and Gas Association (AOGA) wishes to thank you and your respective committees for the hearings you have been holding on this legislation to replace the existing ELF-based production tax with a new "Petroleum Production Tax" (PPT) based on the value of oil and gas after costs of producing it have been deducted. AOGA is a non-profit trade association whose 17 member companies represent the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska. Our present comments and recommended technical amendments to the legislation have been approved by the Tax Committee without dissent.

With something as complex as the PPT, producers will need to have as much certainty and clarity as possible about how to calculate their PPT correctly. The Legislature too — as the Branch of government that sets state tax policy — deserves to know that any PPT law which it enacts will be administered and applied as the Legislature intends. We believe the PPT could be improved to better achieve these objectives. To this end we offer a number of technical amendments for your consideration. The actual text of our proposed amendments is attached. What follows below are explanations of what each amendment would do and why it should be adopted.

Amendment No. 1

This amendment relates to the so called 90% or 95% "safe harbor" provisions in the House and Senate Resources Committee CS's respectively. As structured in the original bill and both Resources CS's, these provisions are unworkable and inappropriate.

Two key elements of PPT are based on federal income-tax concepts. One is the use of the federal definition of "ordinary and necessary" in determining the scope of field expenditures that will be deductible under the PPT. The other is the use of the federal definition of "capital expenditure" to determine whether an expenditure gives rise to a tax credit against PPT.

Using these federal concepts offers three major advantages. One, everybody among the producers and in DOR understands what these concepts mean. There is a large and detailed body of federal statutes, regulations, rulings, and administrative and judicial precedents that establish these meanings. Two, using the federal concepts greatly simplifies DOR's task in writing regulations to implement the PPT, which will save time in getting the regulations in place to start implementing and complying with this new tax. Three, using the federal definitions lets the IRS do the heavy lifting in terms of auditing these expenditures and determining that they have been classified properly. When the IRS is done auditing, this allows DOR auditors to say "me too" to those audit adjustments just as they do now for federal items incorporated into the state income tax.

The present 90% and 95% safe-harbor provisions are structured on the assumption that the bookkeeping and accounting for deductible expenditures and credit-generating investments is on a monthly basis, thus allowing this level of precision in estimating the PPT payment each month. However, the records, accounting and IRS audits of the federal concepts being used for PPT are all maintained and performed on a full-year basis rather than a monthly one. There is nothing in this federally based approach that divides a year's cost items into individual monthly packets cleanly.

This does not mean that PPT cannot be paid on a monthly basis. The IRS, and Alaska and many other states in the context of their state income taxes, require businesses to make estimated payments during the tax year, with a final true-up the following March to the actual numbers for that year. In the income tax area these estimated payments are most commonly done on a quarterly basis, but there is nothing to prevent monthly estimated payments for PPT. We believe monthly estimated payments are possible and can be done on a reasonable and fair basis.

The IRS, Alaska in its income tax, and other states with their income taxes recognize that taxpayers making the early estimated payments for a tax year cannot accurately predict how the year will turn out for them. But as the year goes by, there are fewer months left to estimate and more months of actual data to use in calculating the estimated payments. By the last estimated payment for the year, that estimate should be pretty accurate even though the books for the year may not yet have closed and the figures become final. The IRS, and Alaska and the other states, figure that by the time the last estimated payment is made, taxpayers should be able to get it right so that at least 90% of the actual tax for the year is paid up with that last estimated payment. This is the source of the safe harbor concept and the original 90%, and we believe this federal and state rule in the income tax context is appropriate for PPT as well.

We all know that in the business world, it is better to come in under budget than over. But in the PPT world, being under budget means that, if you relied on your budget in the early months of the year to estimate your total deductions and credits for the remaining months, you will have overstated those deductions and credits if the actual expenditures for the year end up being under budget. But by the time you first start becoming aware of this toward the middle or end of the year, you are likely to have already filed and paid your monthly PPT for a fair number of prior months.

Under the original version of the PPT and both Resources CS's, a producer in this situation would be subject to an underpayment penalty, perhaps with interest, if it fails to estimate the correct amount of monthly PPT for the early

months of each year. This penalizes the producer, essentially, for not having the ability to see into the future how the year will turn out. Such a penalty is neither fair nor appropriate.

Our proposed amendment adapts the income-tax system of estimated payments so they are made monthly instead of quarterly. It also prevents the possibility that taxpayers might exploit the time-value of money by reporting very low estimated payments for the early months and then getting caught up to the 90% level with their last one or two estimated payments for the year.

Amendment No. 2

The provisions on the capex credit in the original legislation and both Resources CS's do not allow a credit for acquiring a capital asset that has already been used in this state by someone else, unless no more than an "immaterial portion" of that asset is used. See proposed AS 43.55.024(e). We do not disagree with this basic concept. However, we do believe that the term "immaterial" is too vague and subjective, and that using it as the test will lead to numerous disputes and squabbles over relatively minor items.

Our proposed amendment would replace this vague standard of immateriality by saying the credit for acquiring a used asset is not allowed unless no more than 15% of that asset is used (e.g., a replaced fender or windshield on an otherwise unused motor vehicle).

Amendment No. 3

Currently both Resources CS's and the original version all provide in AS 43.55.160(c) that deductions are allowed for "total costs upstream of the point of production of oil and gas that are incurred[.]"

We believe this description of the costs is potentially ambiguous. For instance, there can be no plausible dispute that the costs of the operations centers and dormitories for the workers in the fields on the North Slope should be deductible costs for those fields, nor is there any question that the cost of helicoptering workers out to the platforms in Cook Inlet should be deductible. But if you follow the course of the production fluids as they flow from the Christmas tree through the surface facilities and gathering lines to the point of production, neither of these costs shows up anywhere along that route. Are these costs "upstream of the point of production"? Clearly, this is the wrong test.

We also believe this description is potentially too narrow. It may be that simulations of well work or other processes in the field may be conducted on computers physically removed from the site of the field itself. If these costs are so directly related to the field work that the operator can bill them out to the working-interest owners as field operating costs, why should it matter whether they are "upstream of the point of production" or not? For that matter, the same ambiguity about whether they physically are "upstream" or not, also applies to them as it does to the operations centers and dormitories.

We believe it would be unambiguous, fairer and more appropriate to allow deductions for the "total costs in support of activities upstream of the point of production[.]" This is especially true whenever DOR utilizes the authority elsewhere in AS 43.55.160(c) to authorize the use of a producer's billings from the operator as that producer's deductible expenditures for that field.

Amendment No. 4

Proposed AS 43.55.160(c) in the original legislation and both Resources CS's provides that DOR, in determining the scope of the categories and kinds of expenditures that will be deductible for PPT, "shall give substantial weight" to industry practices and standards as reflected in existing unit operating agreements. We believe DOR should be required to "apply" the practices and standards reflected in those operating agreements, instead of merely giving

them "substantial weight."

In recommending this for your consideration, we would emphasize that there are two similar-appearing, but very different issues surrounding AS 43.55.160. One is the identification of the kinds and categories of expenditures that are deductible at all. The other is verification that the expenditures reported as falling into these deductible categories are properly included in those categories. The former is fundamentally a question of tax policy. The latter is primarily an audit issue.

Our concern is that the tax policy in the first question not be allowed to become just an audit issue as well.

We believe the cash expenditures that an operator under a unit operating agreement or similar agreement is allowed to bill to the other working-interest owners, partners or other participants reflect appropriate and reliable boundaries for what kinds of costs should be deductible. No one gives authority to an operator to spend their money without making certain that those expenditures are going to be spent on the right things. The operating agreements set tight limits on what an operator may or may not spend money for.

Those other participants have drawn a tight circle, and a clear one, about what is or is not an appropriate expenditure by the operator on their behalf. We believe DOR should "adopt" the wisdom and experience that are reflected in the operating agreements that arise from a true adversity of interest between the operator and those whom the operator bills and are patterned closely after other agreements where there was such an adversity of interest.

Amendment No. 5

Proposed AS 43.55.160(e) requires that a producer's deductible lease expenditures for a field be offset for "any payment or credit" that it receives from someone else as payment for the use of facilities in the field, was a reimbursement of chargeable field costs against a royalty interest of the state or federal government, or as proceeds from the sale of a capital asset.

We do not disagree with the purpose of these provisions. Rather, we want to avoid uncertainty in their administration and application to producers. This amendment clarifies that to the extent a reimbursement is for a producer's deductible expenditures under AS 43.55.160, the reimbursement will offset the deduction. This will ensure that every barrel is taxed once and no expenditure is deducted twice under 43.55.160.

Amendment No. 6

Alaska and many other states do not allow a deduction under their income taxes for taxes paid to another jurisdiction that are based on or measured by net income. Washington, for example, has an excise tax that allows a credit for other excise taxes paid to another jurisdiction. Currently there is no question that the ELF-based severance tax is an excise tax and is not an income tax, and there is similarly no question that it is creditable against the State of Washington's Business and Occupation ("B&O") excise tax and that it is deductible against the income taxes of many states.

The PPT is based on the gross value of oil or gas, minus the expenditures incurred to produce that oil or gas. The PPT legislation explicitly provides that PPT is deductible for Alaska's corporate income tax because it is not an income tax. However, Alaska cannot pass legislation that binds other states so that the PPT is creditable against Washington's B&O tax and deductible under the income taxes of other states.

What Alaska can do to keep PPT deductible and creditable is to clarify that it is not a tax on income or profits, but rather is an excise tax imposed on the act of severing and producing the oil or gas. Our proposed changes in terminology would make it clear that the PPT is an excise tax, not an income tax, and maintain the status quo of how the present production tax is treated in Alaska and elsewhere.

Senators Green, Wilken and Bunde
Representatives Chenault, Meyer and Stoltze
Senate Bill No. 305/House Bill No. 488 ("PPT")
April 13, 2006
Page 5

Thank you for this opportunity to share our recommendations with you and for your consideration of the amendments we offer. Please do not hesitate to contact us if you have any questions or comments about our present suggestions, or if we may be of further assistance to you.

Very truly yours,

ALASKA OIL AND GAS ASSOCIATION

/s/

Judith M. Brady
Executive Director

Attachment

cc: All Legislators (w/attachment)

AOGA'S PROPOSED PPT AMENDMENTS
to CSHB 488(RES) and CSSB 305(RES)

April 13, 2006

AMENDMENT NO. 1. 90% / 95% "SAFE HARBOR"

For CSHB 488(RES): On p. 6 line 9, between "becomes delinquent" and the period at the end of that sentence, insert "unless the producer has reasonable cause under (h) of this section for the underpayment"

On p. 7 line 23, between "becomes delinquent" and the period at the end of that sentence, insert "unless the producer has reasonable cause under (h) of this section for the underpayment"

For CSSB 305(RES): On p. 5 line 17, delete "as set out in this subsection" and replace with "monthly"

On p. 5, delete all material on lines 18-22 and "which the oil and gas were produced." on line 23, and replace with the following:

The tax, net of any credits applied under this chapter, is due on the last day of each calendar month on oil and gas produced from each lease or property during the preceding month.

On p. 7 line 24, between "becomes delinquent" and the period at the end of that sentence, insert "unless the producer has reasonable cause under (h) of this section for the underpayment"

On p. 7 line 10, delete "subsection" and replace with "subsections"

On p. 7 line 9, between "becomes delinquent" and the period at the end of that sentence, insert "unless the producer has reasonable cause under (h) of this section for the underpayment"

For CSHB 488(RES): On p. 7 lines 24-31, delete all material and replace with the following:

For CSSB 305(RES): On p. 7, between lines 9 and 10 insert the following:

(h) A producer has reasonable cause for an underpayment of tax under this section for any month if the total tax paid under this section for its taxable production during that month and the prior months of that calendar year is at least 90 percent of the total amount of tax due under this section for that month and those prior months as determined on the basis of the producer's

cumulative actual lease expenditures for the year as of the last day of that month and the lease expenditures budgeted for the remainder of the year as of that same day. A producer may also establish reasonable cause under this subsection for an underpayment on the basis of "reasonable cause" as defined for purposes of AS 43.05.220(a) or 26 U.S.C. 6651 (Internal Revenue Code) and Treasury Regulation § 301.6651-1(c).

AMENDMENT NO. 2. DEFINING AN "IMMATERIAL" USED PORTION OF AN OTHERWISE UNUSED ASSET

For CSHB 488(RES): On p. 10 line 30, delete "an immaterial portion" and replace with "15 percent"

For CSSB 305(RES): On p. 9 line 25, delete "an immaterial portion" and replace with "15 percent"

AMENDMENT NO. 3. DEDUCTIBLE "UPSTREAM" COSTS

For CSHB 488(RES): On p. 19 line 13, at the beginning of the line insert "in support of activities" before "upstream"

For CSSB 305(RES): On p. 15 line 29, at the beginning of the line insert "in support of activities" before "upstream"

AMENDMENT NO. 4. DEFINING SCOPE OF DEDUCTIBLE COSTS BY APPLYING INDUSTRY PRACTICE

For CSHB 488(RES): On p. 19 line 27, delete "give substantial weight to" and replace with "apply"

On p. 19 line 29, delete "as to costs" and replace with "in determining the amount"

On p. 20 line 1, delete ", not" and replace with "other than"

On p. 20 line 3, between "(B)" and "the standards" insert the following:

in the absence of unit operating agreements or similar operating agreements that were in effect on or before December 1, 2005, and were subject to negotiation with working interest owners, other than the operator, with substantial bargaining power.

For CSSB 305 (RES): On p. 16 line 8, delete "give substantial weight to" and replace with "apply"

On p. 16 line 10, delete "as to costs" and replace with "in determining the amount"

On p. 16 line 13, delete “, not” and replace with “other than”

On p. 16 line 15, between “(B)” and “the standards” insert the following:

in the absence of unit operating agreements or similar operating agreements that were in effect on or before December 1, 2005, and were subject to negotiation with working interest owners, other than the operator, with substantial bargaining power,

On p. 18, delete all material in lines 13-16, and in line 17 delete “(O)” and replace with “(N)”

On p. 19 line 18, delete “; the provisions of (k) and (l) of this”

On p. 19 line 19, delete “section apply to an asset that is subject to this subparagraph”

Beginning on p. 21 line 5 through p. 22 line 8 inclusive, delete all material

On p. 22 line 9, delete “(n)” and replace with “(k)”

AMENDMENT NO. 5. CLARIFYING OFFSETS AGAINST LEASE EXPENDITURES

For CSHB 488(RES): On p. 21 line 31, insert after “are” “the net working interest share of”

On p. 22 line 2, insert after “ownership interest” the phrase “to the extent that payment or credit is a deductible lease expenditure for that payor under 43.55.160.”

On p. 22 line 4, insert after “lease expenditures” “to the extent that payment or credit is for a deductible lease expenditure under 43.55.160”

For CSSB 305(RES): On p. 19 line 1, insert “the net working interest share of” before “payments or credits” at the beginning of the line

On p. 19 line 5, insert after “management fee” the phrase “to the extent that payment or credit is a deductible lease expenditure for that payor under 43.55.160.”

On p. 19 line 7, insert after “lease expenditures” “to the extent that payment or credit is for a deductible lease expenditure under 43.55.160”

AMENDMENT NO. 6. TO ENSURE DEDUCTIBILITY OF PPT UNDER OTHER STATES' INCOME TAXES

For CSHB 488(RES): On p. 1 line 1, delete “oil production tax and gas production tax” and replace with “oil and gas properties production tax”

On p. 1 lines 2, 6, 7 and 9, delete "production tax" and replace with "severance tax"

On p. 2, line 7, delete "production tax value" and replace with "gross severance value"

On p. 2, lines 7-8, delete "a tax on the production tax value of oil and gas" that carries over between the two lines and replace with "a severance tax on oil and gas"

On p. 2 lines 9 and 12, delete "production tax" and replace with "severance tax"

On p. 2 line 16, delete "a new section" and replace with "new sections"

On p. 2, between lines 20 and 21, insert the following:

INTENT OF AS 43.55.011(a) AS AMENDED BY THIS ACT AND OF AS 43.55.011(i) ENACTED BY THIS ACT. It is the intent of the legislature to tax the activity of severing oil and gas from the ground and the tax is to be measured on the value of oil and gas production as it is severed. The legislature recognizes that the costs permitted to be deducted under AS 43.55.160 are not properly included in the measure of the gross value of the oil and gas as they are severed, but rather are a measure of the cost and effort needed to complete the production of the oil and gas after severance; and therefore such costs are excluded from the measure of the tax.

On p. 3 lines 25-26: delete "production tax value" that carries over between the two lines and replace with "gross severance value"

On p. 5 lines 4-5, delete "gross value at the point of production" and replace with "gross severance value"

On p. 6, between lines 3 and 4 insert the following new Bill Section and renumber the remaining Bill Sections and the respective cross-references to them accordingly:

* Sec. 8. AS 43.55.017(c) is amended to read:

(c) The taxes imposed by the chapter are excise taxes on severing or extracting oil and gas from the ground. The taxes are not income or franchise taxes or taxes upon the sale of oil or gas products and are not imposed in lieu of such taxes.

On p. 8 line 4, delete "production tax value" and replace with "gross severance value"

On p. 11 lines 19 and 31; on p. 12 lines 29 and 30; and on p. 14 lines 3, 4, 6 (twice), 11, 12, 14, 15, 18, 19, 22 and 24, delete "production" and replace with "[PRODUCTION]"

On p. 18 line 13, delete "production tax value" and replace with "gross severance value"

On p. 18 lines 15, 20, 22 and 28 and on p. 19 lines 2 and 19, delete "production tax value" and replace with "gross severance value"

On p. 30 line 11, delete "PRODUCTION" at the beginning of the line

On p. 30 lines 11-12, delete "PRODUCTION TAX VALUE" that carries over between the two lines and replace with "GROSS SEVERANCE VALUE"

For CSSB 305(RES): On p. 1 line 1, delete "production tax" and replace with "severance tax"

On p. 1 line 2, insert "properties" before "production" at the beginning of the line and delete "(severance)"

On p. 1 line 3, insert "gross severance" between "determination of the" and "value"

On p. 1 lines 4, 5, 9 and 10 and on p. 2 line 6, delete "production tax" and replace with "severance tax"

On p. 2 line 10, delete "a new section" and replace with "new sections"

On p. 2, between lines 14 and 15, insert the following:

INTENT OF AS 43.55.011(e) ENACTED BY THIS ACT. It is the intent of the legislature to tax the activity of severing oil and gas from the ground and the tax is to be measured on the value of oil and gas production as it is severed. The legislature recognizes that the costs permitted to be deducted under AS 43.55.160 are not properly included in the measure of the gross value of the oil and gas as they are severed, but rather are a measure of the cost and effort needed to complete the production of the oil and gas after severance; and therefore such costs are excluded from the measure of the tax.

On p. 3 lines 17-18, delete "production tax value" that carries over between the two lines and replace with "gross severance value"

On p. 5 line 17, delete "production" and insert "under AS 43.55.011" between "oil and gas" and "shall be paid"

On p. 6 line 3, delete "production" and insert "under AS 43.55.011" between "gas" and "shall be paid"

On p. 6, between lines 3 and 4 insert the following new Bill Section and renumber the remaining Bill Sections and the respective cross-references to them accordingly:

* Sec. 7. AS 43.55.017(c) is amended to read:

(c) The taxes imposed by the chapter are excise taxes on severing or extracting oil and gas from the ground. The taxes are not income or franchise taxes or taxes upon the sale of oil or gas products and are not imposed in lieu of such taxes.

On p. 14 line 29, delete "production tax value" and replace with "gross severance value"

On p. 15 lines 1, 5, 7, 13, 18 and 25; on p. 19 line 28; on p. 20 lines 2, 4 and 19, delete "production tax value" and replace with "gross severance value"

On p. 28 lines 7 and 9, delete "Production" and replace with "Severance"

On p. 28 line 10, delete "production" and replace with "severance"

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

3-31-06

FRANK H. MURKOWSKI, GOVERNOR

P.O. BOX 110400
JUNEAU, ALASKA 99811-0400
TELEPHONE: (907) 465-2300
FACSIMILE: (907) 465-2389

March 31, 2006

Representative Mike Chenault, Co-Chair
House Finance Committee
State Capitol, Room 505
Juneau, AK 99801

Representative Kevin Meyer, Co-Chair
House Finance Committee
State Capitol, Room 515
Juneau, AK 99801

Re: Questions on PPT Legislation (CS for HB 488(RES))

Dear Representatives Chenault and Meyer,

Thank you for the opportunity to respond to questions posed during recent committee hearings. To date, we have received the following questions:

1. Why did the Governor offer five year transition (clawback) when capital has already been depreciated in the tax rate over a five to seven year period?

The Governor believes that this is a fairness issue. Once enacted, the PPT will measure tax based on net profit. These will be profits generated by investments made prior to the effective date of the legislation. The cost of all new investments will be reflected in the calculation of net profits; the costs will be deducted. However, the costs incurred for recent investments would not otherwise be reflected in the calculation. Without the transition deduction, the producer would be taxed on the profits generated by assets which would not be properly represented in the profit calculation.

Much of the oil and gas equipment is depreciated over seven years for federal tax purposes. In addition, certain oil and gas equipment is depreciated over 15 years. To our knowledge, the only oil and gas equipment with a 5-year life is offshore drilling equipment. It is notable, also, that these lives are those articulated for federal tax purposes. For accounting purposes, the depreciable lives are often longer than the lives under federal tax law. This means that very few of the assets are fully depreciated, even for those assets purchased five years ago.

The Governor believes that it is fair to give a five-year lookback for, in effect, depreciation expense on recent investments that are generating future profits which will be subject to tax.

2. Requested a written explanation of progressivity clause versus Governor's Bill.

As presented by the Governor, HB 488 included a fair tax rate of 20% of net profit. The Governor believes this strikes a good balance for long term state fiscal health. That bill did not include a progressive tax rate. Over the long run, increased revenues should be driven by increased investment and production rather than swings in commodity prices.

The CS for HB 388(RES) includes a two-pronged progressive tax rate. At prices between \$50 and \$100 per barrel, the progressive rate adds 3/10% of the wellhead value for every dollar the market price is over \$50. If the price of oil exceeds \$110 per barrel, the tax jumps up to 37.5% of gross wellhead value. The Governor believes that this is excessive, and will hinder future investment in the state.

3. Provide information on the decline of oil field production over next 50 years by field

See Attachment Section, indexed by question number.

4. I've been told that the incentives for the Major Producers are not the same as it would be for the new explorers. If that is so, what other incentives could we offer to make "wildcatters" interested in Alaska?

The Governor's bill was specifically designed to entice new entrants, particularly "wildcatters" to Alaska. The Governor's bill provides a 20% tax credit for exploration and capital investments, which could be immediately monetized by the explorer. In addition, current statute AS 43.55.025 provides a 40% credit for certain exploration expenditures. The Governor believes that these incentives are very adequate to promote new exploration.

5. Transition provisions should be allowed because no oil has been produced from those capital investments. But were those investments made at prices less than \$25/bbl and so would be recovered much more quickly at \$60/bbl? How is this accounted for in the clawback provision?

The transitional deduction (or "clawback") accounts for recent investments by, in effect, allowing depreciation expense to be recognized in the calculation of the net profits generated by those assets. From an accounting standpoint, depreciation expense is recognized on a systematic basis over the life of the asset. The asset is considered to generate net income evenly over the life of the asset. A windfall in one year does not change the asset's ability to generate income later in its useful life.

6. How much severance tax (dollars) did Alaska lose because the Kuparuk Tax went below the legacy field tax rate in 1998-99?

See Attachment Section, indexed by question number.

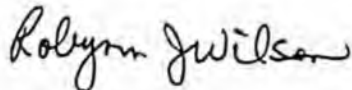
Letter to Reps. Chenault and Meyer
March 31, 2006
Page 3

7. How might we smooth the progressivity curve to eliminate or moderate the steep increase at \$110?

The elimination of the steep increase can be accomplished by changing the values at page 4 line 18, AS 43.55.011(g)(2) to reflect the desired price/index ceiling. If the index of 125 at \$110 is removed, and the progressivity tops out at \$110, then the top surcharge rate would be 18% applied to gross value.

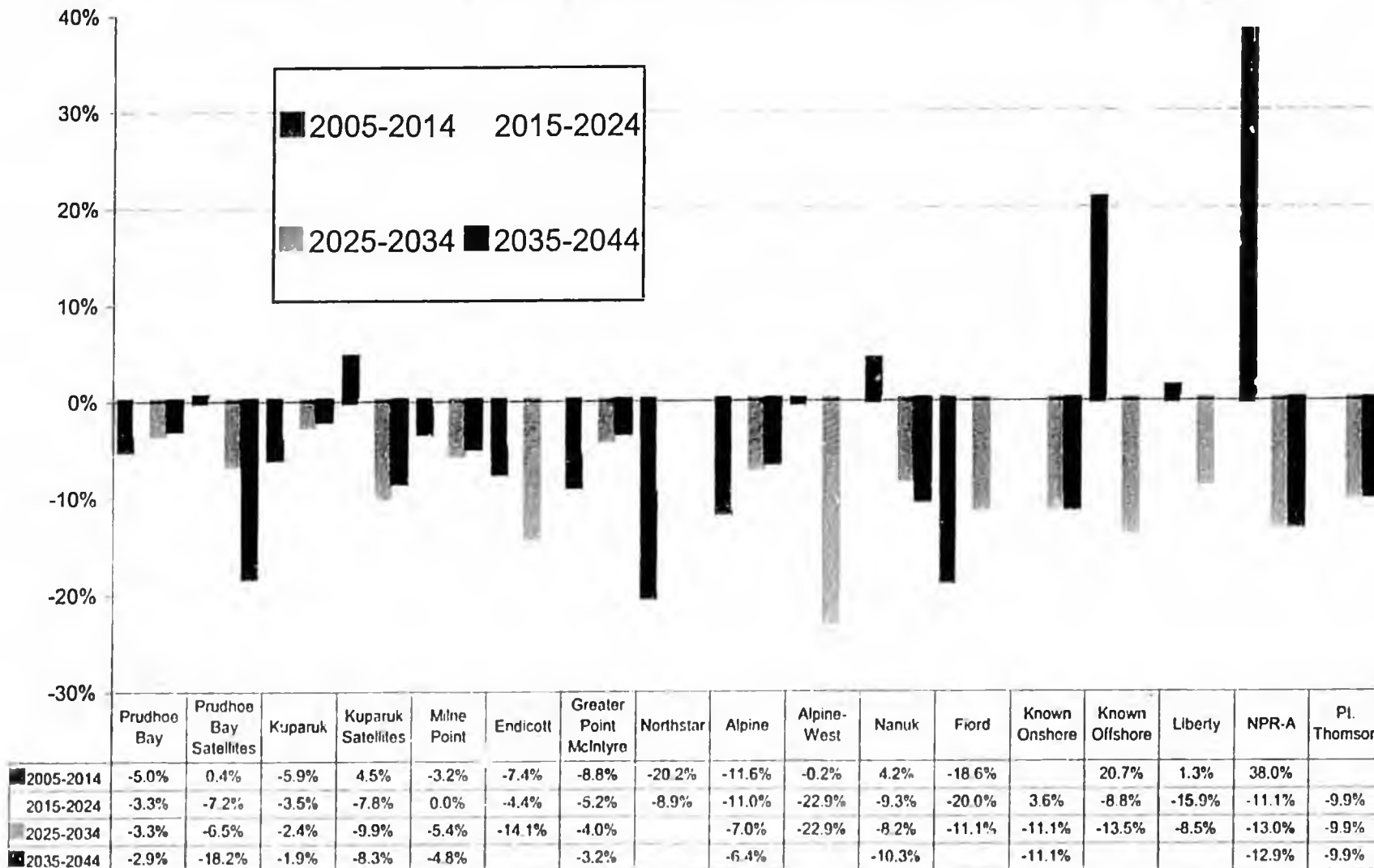
I hope that this information is helpful. Please let us know if you would like any additional information. Thank you for the opportunity to be of assistance.

Sincerely,



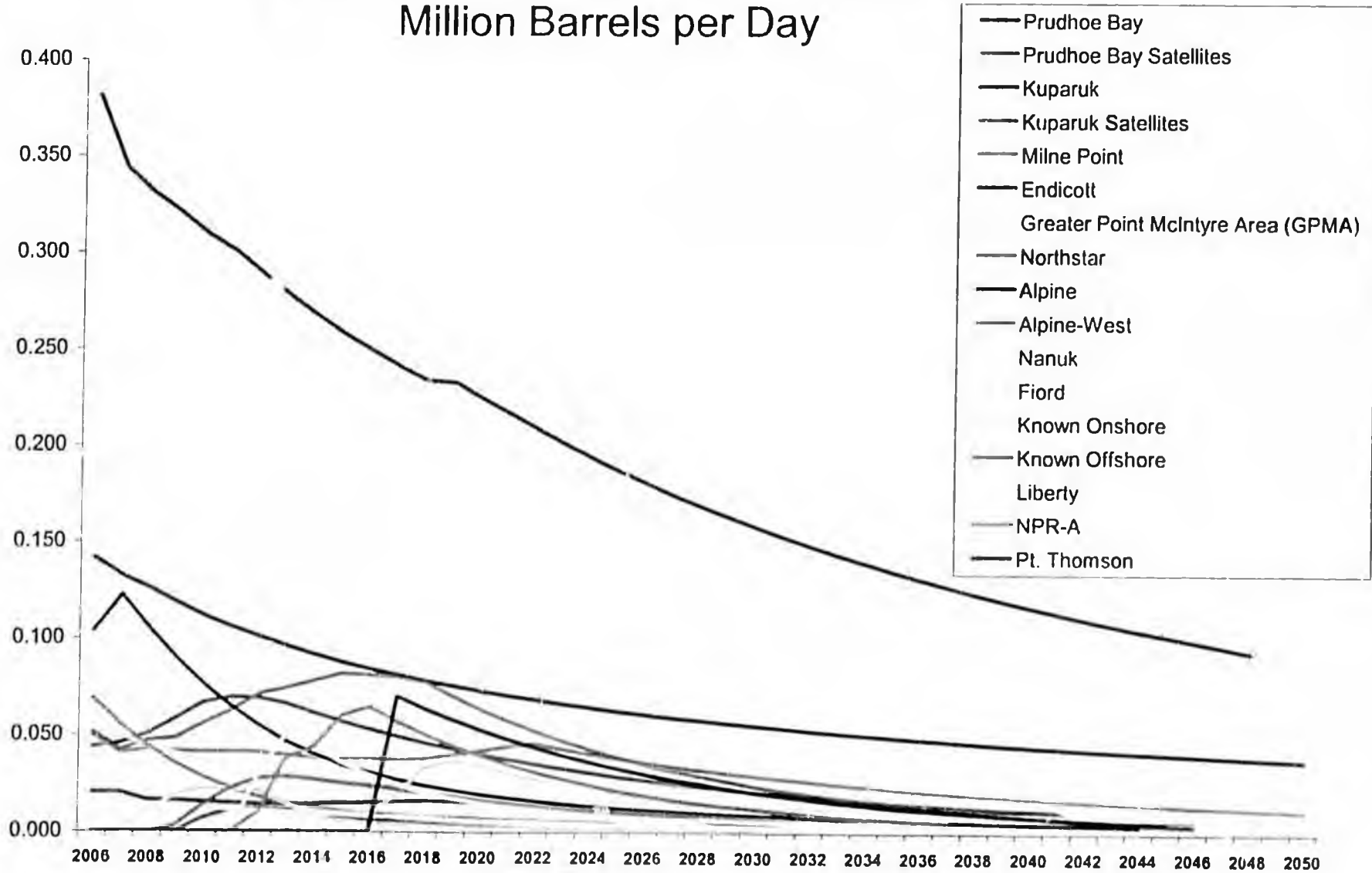
Robynn J. Wilson
Director, Tax Division
Department of Revenue

10-Year ANS Decline Rates by Field Based on DOR Spring 2006 Revenue Sources Book



ANS Production FY 2006-2050

Million Barrels per Day



Alaska Department of Revenue-Tax Division

Production Volume By Field: Million Barrels per Day
 - based on Spring 2006 Revenue Sources Book -

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)									Spring 2006	
	Prudhoe		Kuparuk		Milne	Greater Point McIntyre Area		Alpine-			Known	Known	Liberty	NPR-A	Thomson	PL	TOTAL			
FY	Prudhoe Bay	Bay Satellites	Kuparuk	Satellites	Point	Endicott	(GPMA)	Northstar	Alpine West	Nanut	Flord	Onshore	Offshore						ANS	
2006	0.381	0.044	0.142	0.052	0.050	0.021	0.056	0.069	0.104	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.917	
2007	0.344	0.046	0.133	0.042	0.041	0.020	0.050	0.055	0.122	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.854	
2008	0.331	0.051	0.126	0.047	0.043	0.017	0.045	0.044	0.105	0.000	0.006	0.011	0.000	0.000	0.000	0.000	0.000	0.000	0.825	
2009	0.321	0.059	0.119	0.048	0.042	0.016	0.041	0.035	0.090	0.000	0.011	0.019	0.000	0.003	0.000	0.000	0.000	0.000	0.803	
2010	0.309	0.067	0.112	0.056	0.041	0.016	0.037	0.028	0.076	0.007	0.012	0.023	0.000	0.014	0.000	0.000	0.000	0.000	0.799	
2011	0.301	0.069	0.106	0.063	0.042	0.015	0.034	0.023	0.065	0.012	0.012	0.023	0.000	0.023	0.000	0.000	0.000	0.000	0.786	
2012	0.289	0.069	0.101	0.071	0.041	0.014	0.032	0.018	0.055	0.012	0.011	0.021	0.000	0.028	0.030	0.010	0.000	0.000	0.802	
2013	0.277	0.066	0.096	0.074	0.040	0.015	0.030	0.015	0.047	0.011	0.010	0.015	0.000	0.028	0.050	0.038	0.000	0.000	0.813	
2014	0.267	0.061	0.092	0.078	0.038	0.015	0.028	0.012	0.040	0.010	0.010	0.008	0.010	0.027	0.045	0.044	0.000	0.000	0.785	
2015	0.257	0.057	0.088	0.082	0.038	0.015	0.026	0.011	0.035	0.008	0.009	0.005	0.010	0.025	0.036	0.060	0.000	0.000	0.762	
2016	0.249	0.053	0.084	0.081	0.038	0.015	0.025	0.009	0.031	0.007	0.008	0.004	0.010	0.024	0.030	0.064	0.000	0.000	0.732	
2017	0.241	0.049	0.081	0.080	0.037	0.016	0.023	0.009	0.027	0.005	0.008	0.003	0.019	0.022	0.025	0.057	0.070	0.000	0.772	
2018	0.233	0.046	0.078	0.078	0.038	0.016	0.022	0.008	0.024	0.004	0.007	0.003	0.033	0.020	0.021	0.050	0.064	0.000	0.746	
2019	0.233	0.043	0.075	0.070	0.040	0.016	0.021	0.007	0.022	0.004	0.006	0.003	0.037	0.019	0.017	0.044	0.058	0.000	0.714	
2020	0.224	0.040	0.073	0.064	0.042	0.015	0.020	0.007	0.019	0.003	0.006	0.002	0.034	0.017	0.015	0.039	0.053	0.000	0.673	
2021	0.217	0.038	0.070	0.058	0.044	0.015	0.019	0.006	0.018	0.002	0.005	0.002	0.030	0.015	0.013	0.035	0.048	0.000	0.635	
2022	0.208	0.035	0.068	0.052	0.046	0.014	0.018	0.006	0.016	0.002	0.005	0.002	0.027	0.014	0.012	0.031	0.044	0.000	0.599	
2023	0.201	0.033	0.068	0.047	0.043	0.012	0.017	0.005	0.015	0.002	0.004	0.001	0.025	0.013	0.010	0.027	0.040	0.000	0.561	
2024	0.194	0.031	0.064	0.043	0.040	0.011	0.017	0.005	0.013	0.001	0.004	0.001	0.022	0.012	0.009	0.024	0.036	0.000	0.527	
2025	0.187	0.029	0.063	0.039	0.038	0.010	0.016	0.005	0.012	0.001	0.004	0.001	0.020	0.011	0.008	0.021	0.033	0.000	0.488	
2026	0.180	0.027	0.061	0.035	0.036	0.009	0.015		0.011	0.001	0.003	0.001	0.018	0.010	0.007	0.019	0.030	0.000	0.463	
2027	0.174	0.025	0.059	0.032	0.034	0.007	0.015		0.011	0.001	0.003	0.001	0.016	0.010	0.007	0.017	0.027	0.000	0.438	
2028	0.168	0.023	0.058	0.029	0.032	0.006	0.014		0.010	0.001	0.003	0.001	0.015	0.009	0.006	0.015	0.025	0.000	0.414	
2029	0.163	0.022	0.056	0.027	0.030	0.005	0.013		0.009		0.003	0.001	0.013	0.008	0.006	0.013	0.023	0.000	0.392	
2030	0.157	0.021	0.055	0.024	0.029	0.005	0.013		0.009		0.003	0.001	0.012	0.007	0.005	0.012	0.021	0.000	0.372	
2031	0.152	0.019	0.054	0.022	0.027	0.005	0.012		0.008		0.003		0.011	0.003	0.005	0.010	0.019	0.000	0.353	
2032	0.148	0.018	0.052	0.020	0.026		0.012		0.008		0.002		0.010	0.005	0.005	0.009	0.017	0.000	0.331	
2033	0.143	0.017	0.051	0.018	0.025		0.012		0.007		0.002		0.009			0.008	0.015	0.000	0.307	
2034	0.139	0.016	0.050	0.017	0.024		0.011		0.007		0.002		0.008			0.007	0.014	0.000	0.294	
2035	0.135	0.015	0.049	0.015	0.022		0.011		0.006		0.002		0.007			0.006	0.013	0.000	0.281	
2036	0.131	0.014	0.048	0.014	0.021		0.010		0.006		0.002		0.006			0.006	0.012	0.000	0.270	
2037	0.127	0.014	0.047	0.013	0.020		0.010		0.006		0.001		0.006			0.005	0.011	0.000	0.259	
2038	0.123	0.013	0.046	0.012	0.019		0.010		0.005		0.001						0.010	0.000	0.239	
2039	0.120	0.012	0.045	0.011	0.018		0.009		0.005		0.001						0.009	0.000	0.231	
2040	0.116	0.011	0.045	0.010	0.018		0.009		0.005		0.001						0.008	0.000	0.223	
2041	0.113	0.011	0.044	0.009	0.017		0.009		0.004		0.001						0.007	0.000	0.215	
2042	0.110	0.005	0.043	0.009	0.016		0.009		0.004		0.001						0.007	0.000	0.202	
2043	0.107	0.004	0.042	0.008	0.015		0.008		0.004		0.001						0.006	0.000	0.196	
2044	0.104	0.004	0.041	0.007	0.015		0.008		0.004		0.001						0.005	0.000	0.190	
2045	0.102	0.004	0.041	0.007	0.014		0.008										0.005	0.000	0.180	
2046	0.099	0.004	0.040	0.007	0.013		0.008											0.000	0.000	0.171
2047	0.096		0.039		0.013		0.008											0.000	0.000	0.149
2048	0.094		0.039		0.012		0.008											0.000	0.000	0.145
2049			0.038		0.012		0.008											0.000	0.000	0.050
2050			0.037		0.011		0.008											0.000	0.000	0.049

Kuparuk

Question 6

CY	Wellhead	Barrels	ELF	Oil Severance Tax Calculated		Difference ELF=1 - Actual	Difference % of ELF=1
				Actual ELF	ELF = 1		
1995	\$11.37	106,679,819	0.8389	\$133,668,008	\$159,262,528	\$25,594,520	16.1%
1996	\$15.58	99,222,333	0.7964	\$161,366,850	\$202,961,961	\$41,595,111	20.5%
1997	\$14.52	95,738,430	0.7679	\$141,878,259	\$184,520,652	\$42,642,394	23.1%
1998	\$8.35	91,399,336	0.7318	\$74,586,433	\$101,643,668	\$27,057,235	26.6%
1999	\$13.22	82,079,519	0.6479	\$91,946,796	\$144,418,941	\$52,472,145	36.3%
2000	\$23.31	74,132,053	0.5368	\$123,025,832	\$230,006,226	\$106,980,394	46.5%
2001	\$17.68	68,264,000	0.4280	\$69,478,741	\$160,661,455	\$91,182,714	56.8%
2002	\$19.31	59,039,500	0.2485	\$36,593,749	\$151,749,704	\$115,155,955	75.9%
2003	\$24.37	58,533,619	0.2360	\$44,654,940	\$189,874,800	\$145,219,859	76.5%
2004	\$33.01	53,163,557	0.0872	\$19,451,298	\$233,617,710	\$214,166,412	91.7%
2005	\$46.42	50,415,356	0.0198	\$5,537,772	\$311,519,492	\$305,981,721	98.2%
Sum over period				\$902,188,677	\$2,070,237,137	\$1,168,048,460	56.4%

Comparing CSHB 488(RES)
to Senate Bill 305
(CSSB 305(FIN) am)

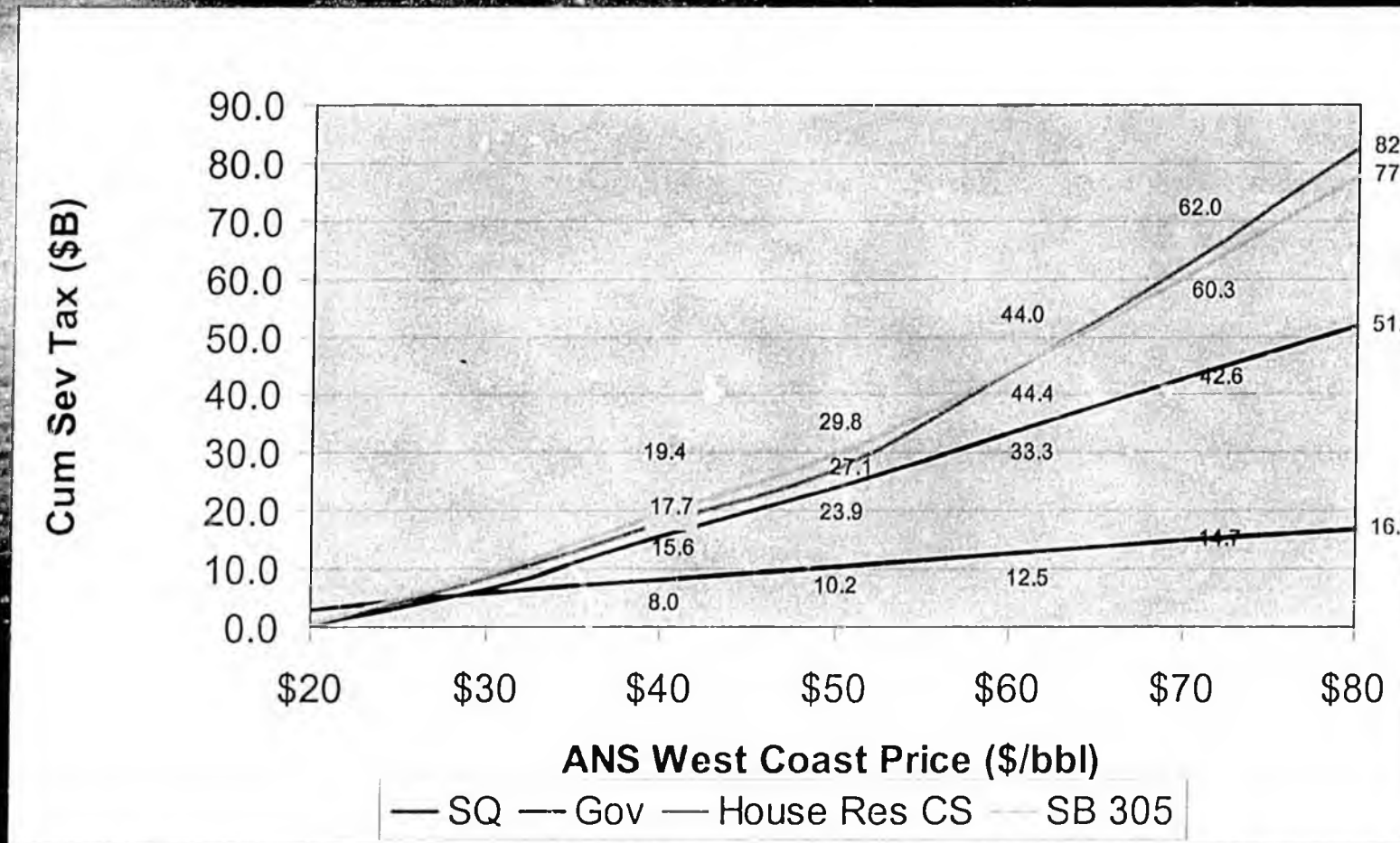
Before the House Finance
Committee

April 26, 2006

Robynn J. Wilson, CPA

Dan E. Dickinson, CPA

The Bottom Line: Cumulative Severance Tax (\$B) 2006-2030 Low Volume Scenario



2

Tax Rate:

CSHB 488(RES)

General rate: **20%**

Private royalty rate:
5% oil and gas

Cook Inlet oil: no
special provision

Gas: no special
treatment

SB 305

General rate: **22.5%**

Private royalty rate:
5% oil, 1.67% gas

Cook Inlet oil: 5% (net)

Gas: Special Revenue
(Value) exclusion

Gas Revenue (Value) Exclusion SB 305 (AS 43.55.160(a))

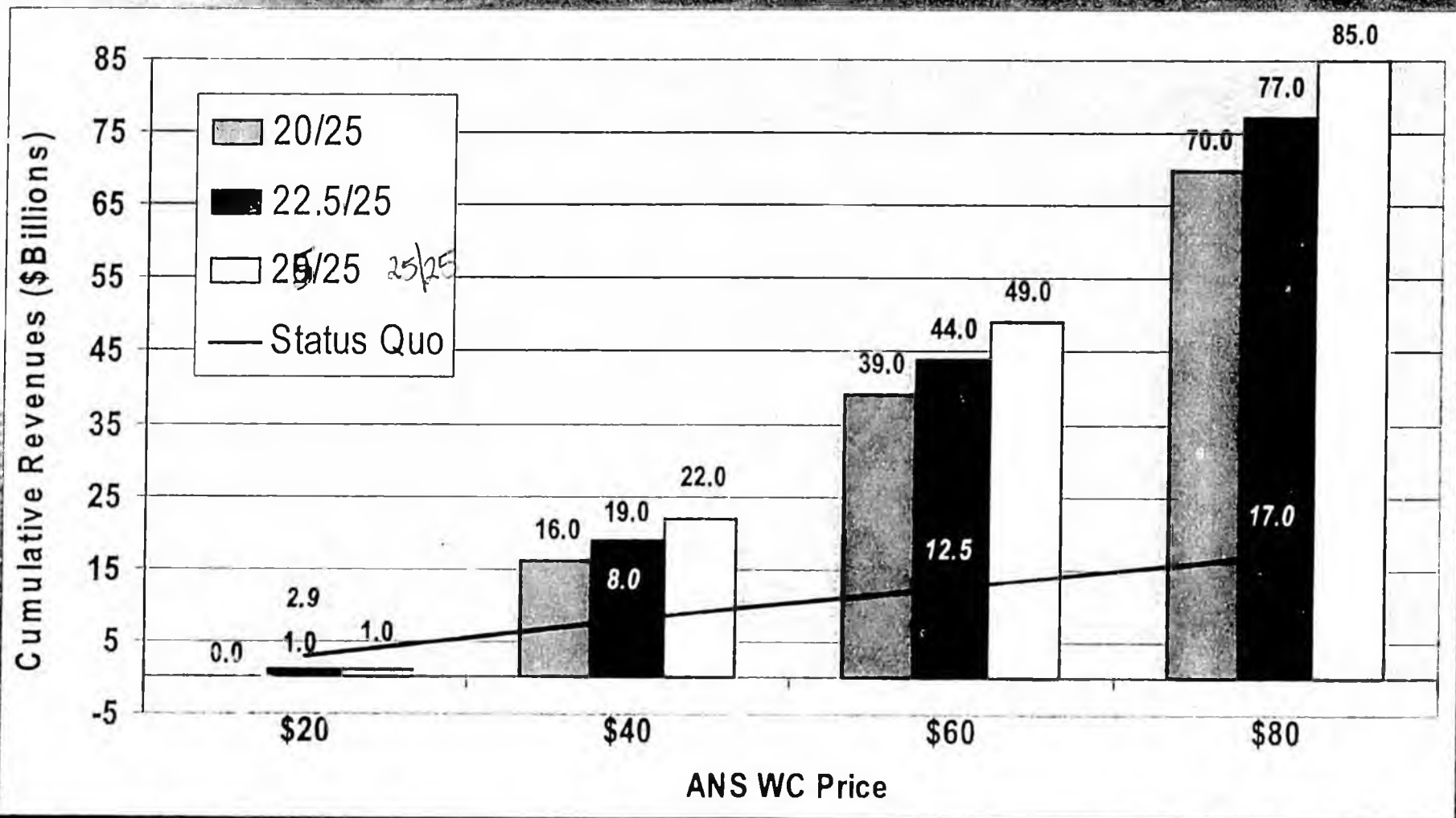
Gross value excludes 2/3 of the value of gas

- Yields an effective rate (before deductions) of 7.5%
- On a net value basis yields an effective tax rate of near 5%
- Obviates the need to allocate expenses

Applies statewide on all gas

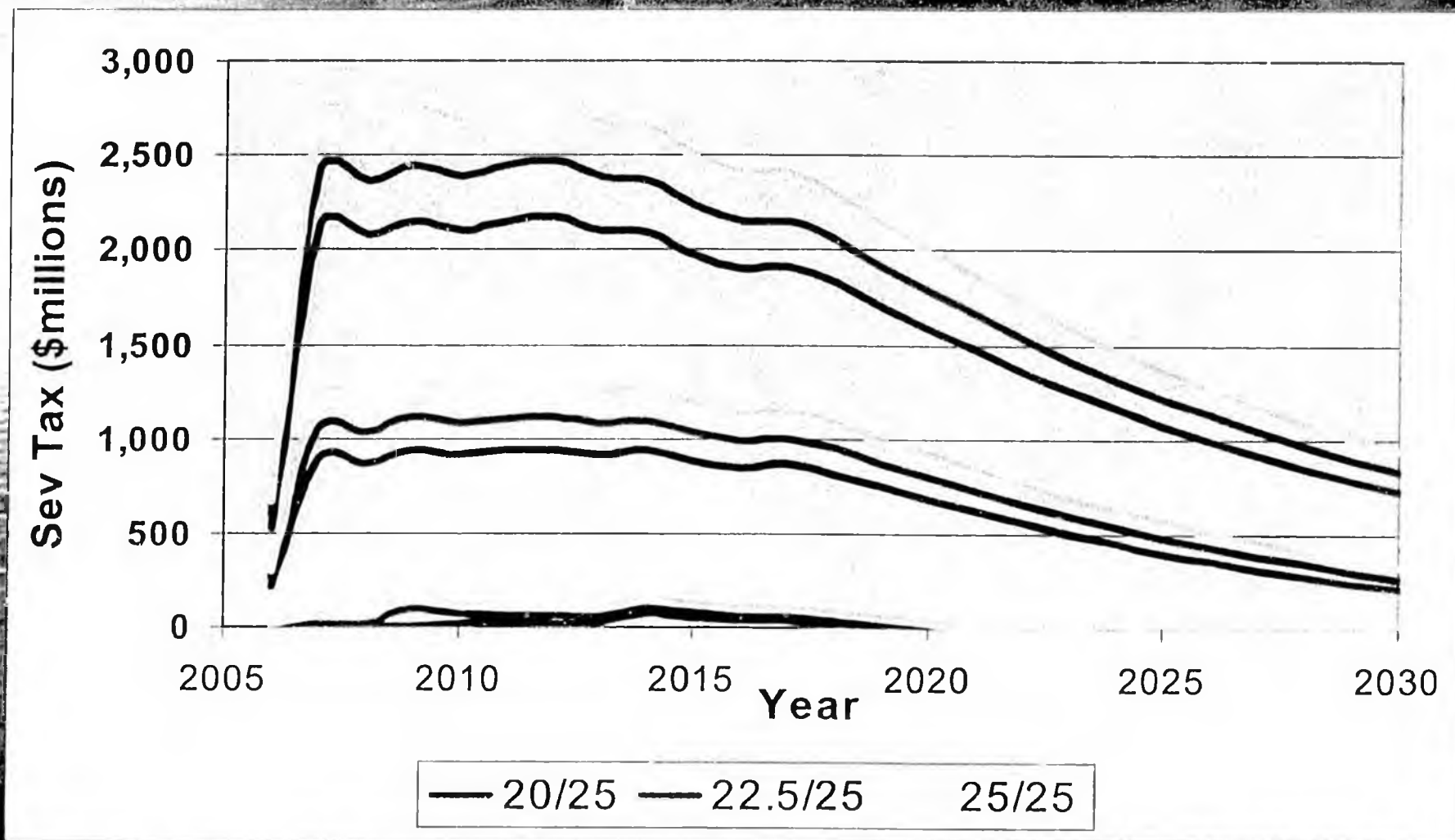
Effect of Tax Rate

Cumulative Severance Tax Revenues under SB 305 with 20%, 22.5%, and 25% Tax Rate, 2006-2030



Effect of Tax Rate

Annual Severance Tax under SB 305 with 20%, 22.5%, and 25% Tax Rate, 2006-2030 (\$millions)



Progressivity: CSHB 488(RES)

Progressivity on oil
Sec. 43.55.011(f), (g)

Triggered at \$50 WTI
slope factor .3%

$0.3\% \times (\text{WTI} - \$50)$
Jumps to 37.5% at
\$110

Progressivity on gas
Sec. 43.55.011(i), (j)

Triggered at \$8 HH
slope factor 2%

$2\% \times (\text{HH} - \$8)$
Jumps to 37.5% at \$18

Progressivity: SB 305

AS 43.55.011(g) & (h)

Applies to oil only

Triggered at \$50 ANSwc

Slope factor .00155

SB 305 progressivity formula

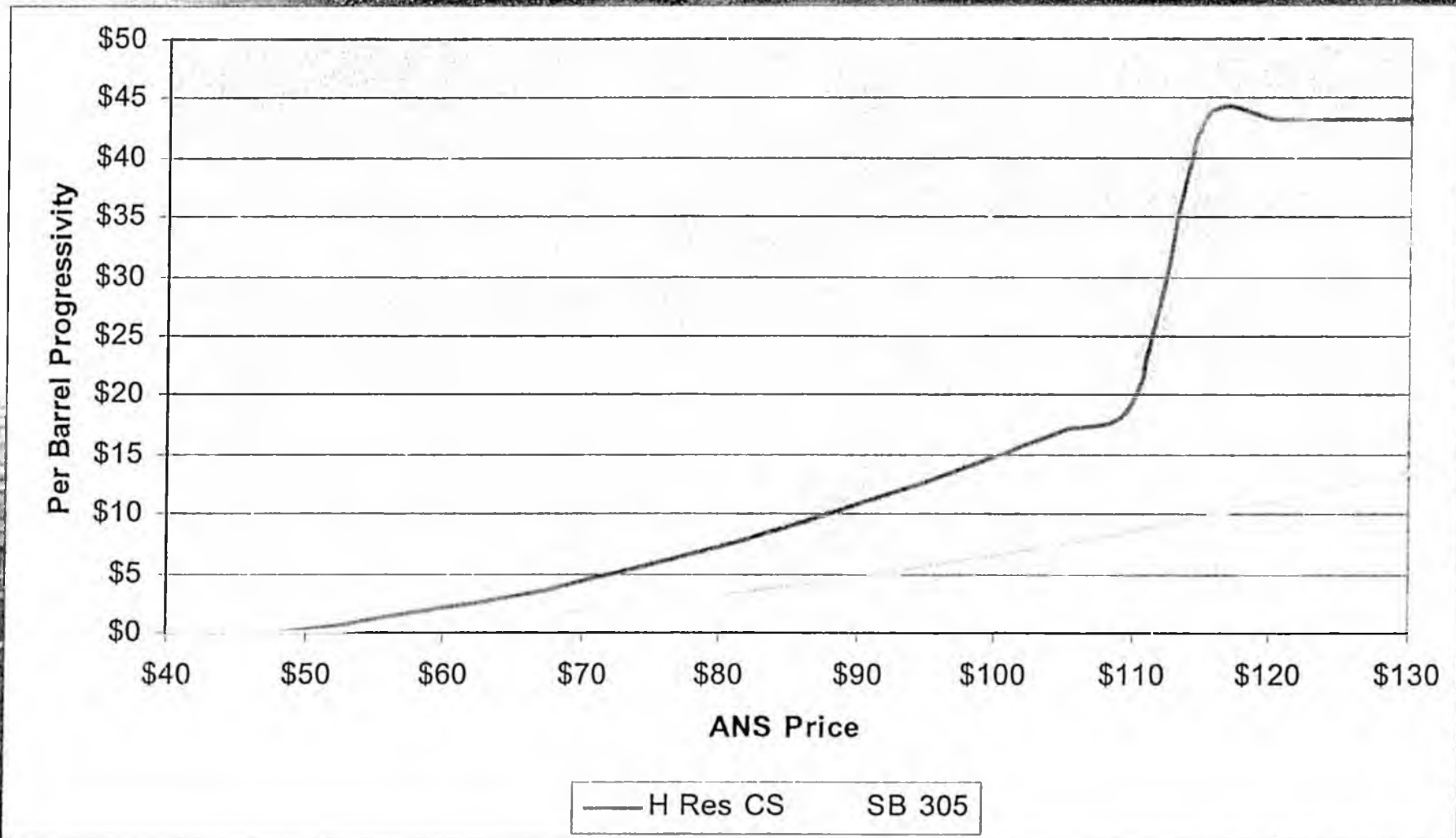
$(ANS_{wc} - \$50) \times .002) \times [ANS_{wh} \times (1 - PPT \text{ rate})]$ x (total taxable barrels of oil)
is the same as—

$(ANS_{wc} - \$50) \times .00155 \times ANS_{wh} \times$ (total taxable barrels of oil)

“ANS_{wh} price” means the **prevailing value** for oil produced in the Alaska ANS area

Effects of Progressivity

Progressive Surcharge per Barrel, 2010



Capital Investment Credit

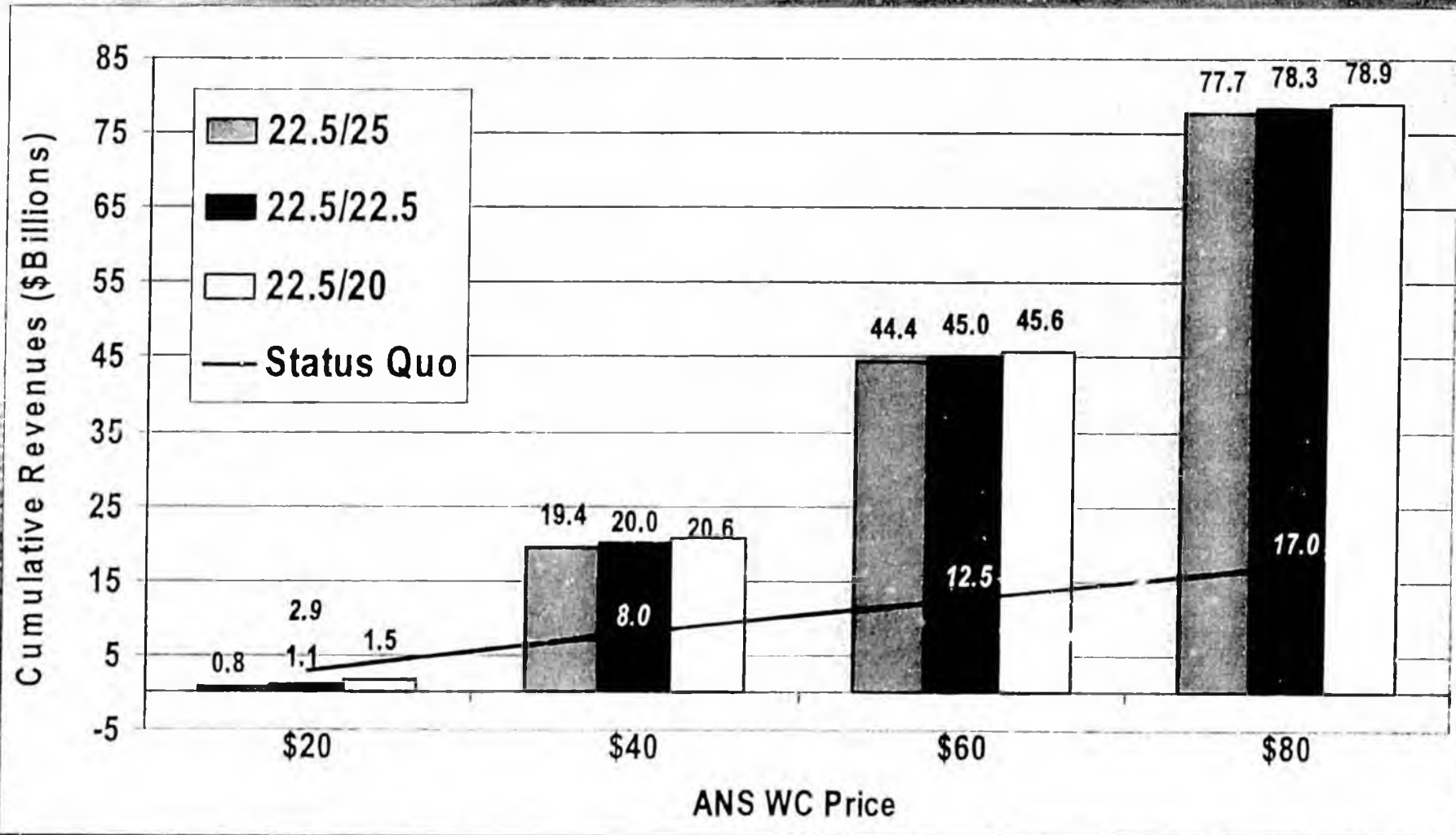
AS 43.55.024

CSHB 488(RES): **20%**

SB 305: **25%**

Effect of Credit Rate

Cumulative Severance Tax Revenues under SB 305 with
25%, 22.5%, and 20% Credit Rate, (2006—2030)



Capital Investment Credit (continued)

Both CSHB 488(RES) and SB 305:

Credit applies to PPT general tax only
(not against progressivity tax or spill
surcharges)

Credits are transferable—purchaser limited
to 20% tax shelter

Credits Refundable

CSHB 488(RES): up to \$10M depending
on current investment

SB 305: no provision

Carryforward of Loss

Both CSHB 488(RES) and SB 305:

Loss is carried forward to next month

At end of year, loss is converted to credit at
tax rate:

CSHB 488(RES)—20%

SB 305—22.5%

Treatment of Progressivity Tax

CSHB 488(RES)

AS 43.55.160(a)

Progressivity tax is
deductible like a lease
expenditure

SB 305

AS 43.55.160(d)(2)(O)

Progressivity tax is not
deductible

Transition: CSHB 488(RES)
AS 43.55.160(c)(1) & Sec. 42 uncodified

Deduction

Lookback: 3 months
Applies to: capex and opex
Deductible: over 9 months
Sunsets: No

Transition: SB 305
2 for 1 (AS 43.55.024(i))

Credit: 20%

Lookback: 5 years

Applies to: capex

Benefits: 7 years

Sunsets: 3/31/2013

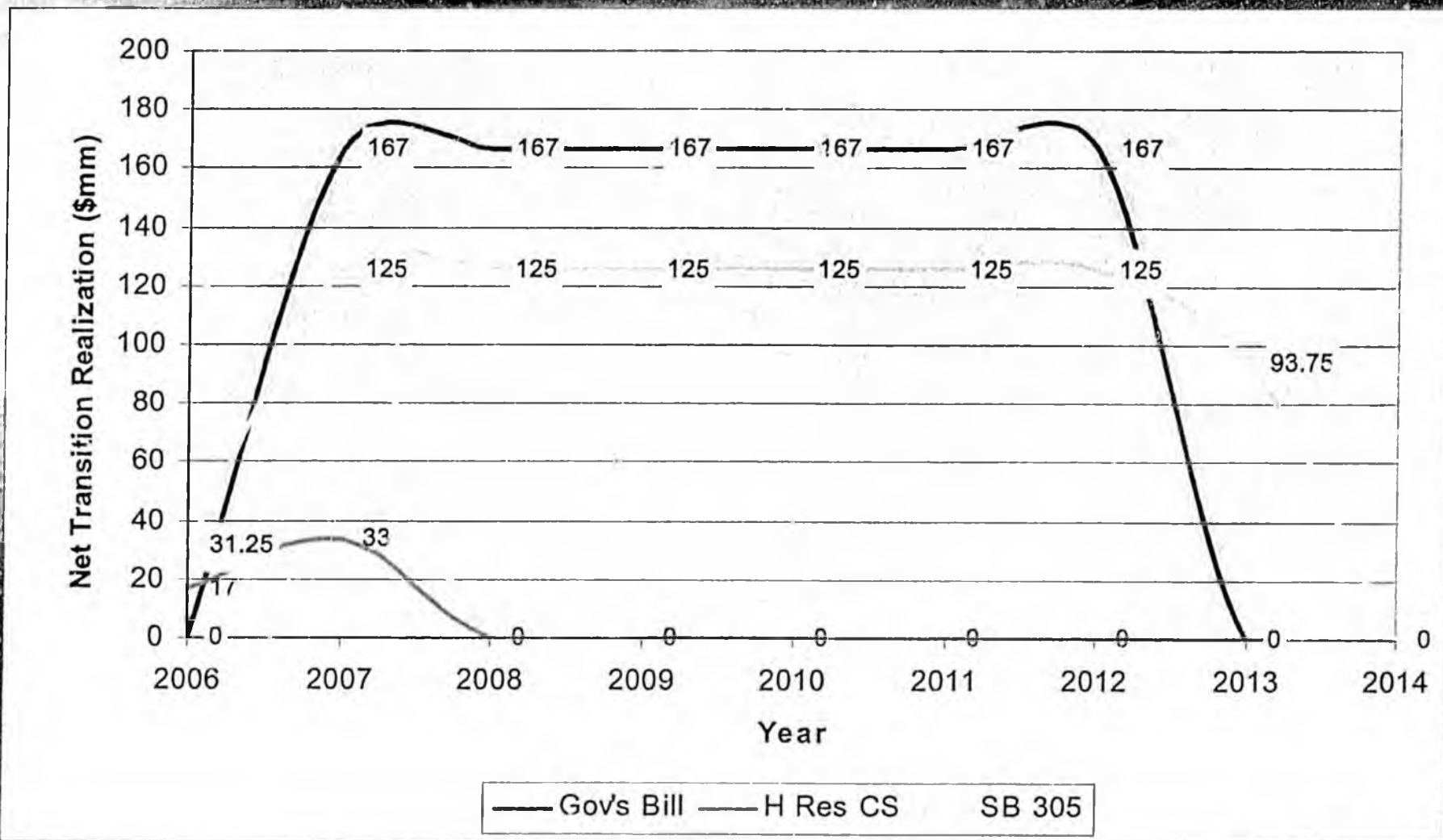
SB 305: 2 for 1

recoupment
5 yr **7 yr.**

C	historic investment per year		35		35
D	years of lookback ¹		5		5
	total lookback	\$	175	\$	175
D	total credit available (20%)		35		35
E	recoupment time		5		7
F	claim available per year	\$	35	\$	25
G	current investment required	\$	70	\$	50
H	increase over historic		100%		43%

Effect of Transition

Net Transition Realizations, 2006-2014



Base Allowance: CSHB 488(RES)
Sec. 43.55.170(a)

Credit: \$12M per year per company

Sunsets: 3/31/2016

Base Allowance: SB 305
5000 barrel plan
AS 43.55.170(a)

Credit: based on production

Maximum: \$14M

Sunsets: 3/31/2016

Base Allowance: SB 305 (continued)

Under 5000 bpd

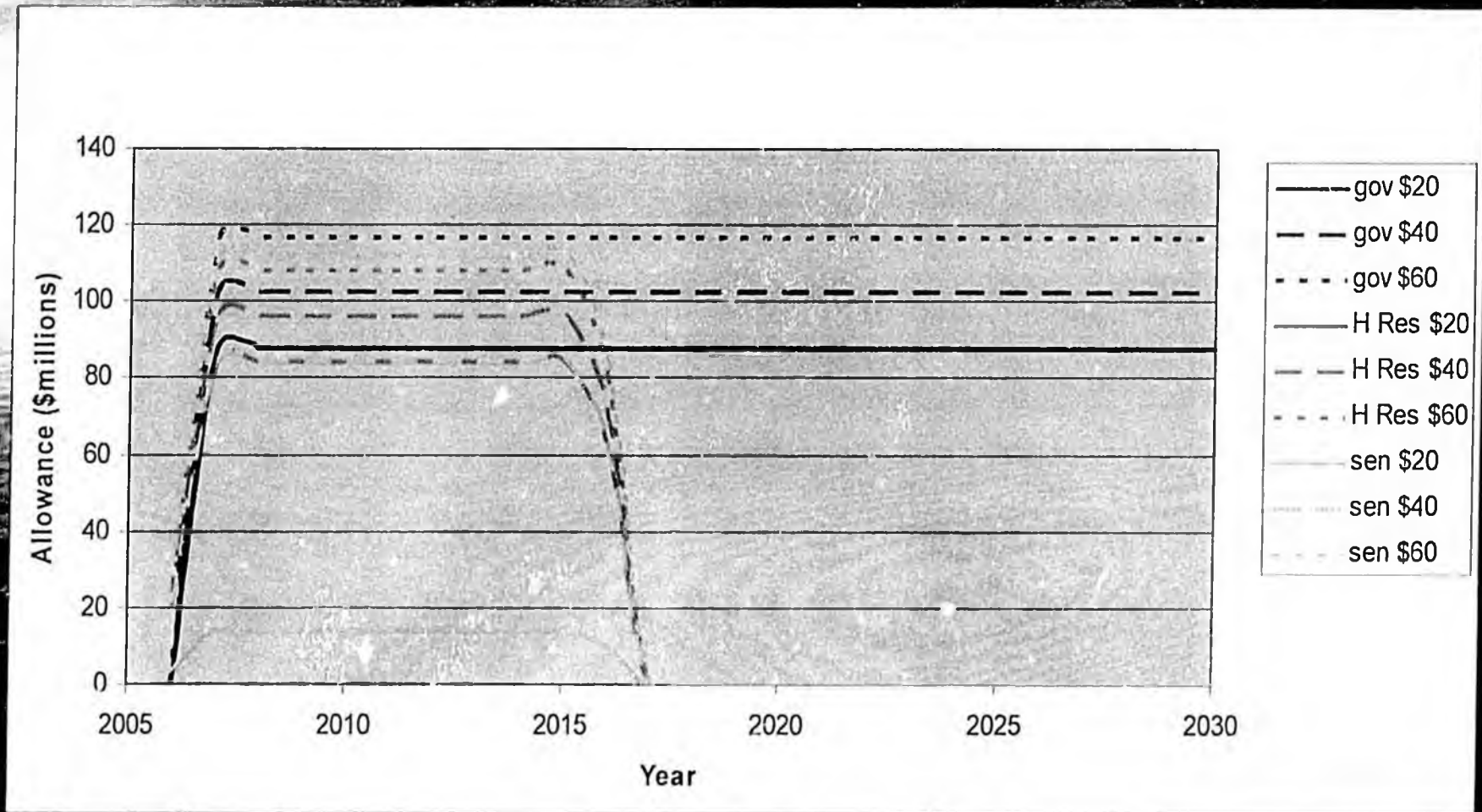
credit equal to 100% tax sheltered

Over 5000 bpd

percentage of tax sheltered

formula: $5000 / \text{total bpd} = \% \text{ shelter}$

Allowances 2006-2030 (\$millions)



Safe Harbor

CSHB 488(RES)

AS 43.55.020(h)

Safe harbor: 90%

If not met:

interest

penalty 5%

SB 305

AS 43.55.020(a)

Safe harbor: 95%

If not met:

interest on amount up

to 95%

Safe Harbor

CSHB 488(RES)

SB 305

Due: 100%

Due: 95%

True-up: not needed
because interest
accrues on 100%

True-up: 3/31 annual

Effective Date

CSHB 488(RES): **4/1/06** (Sec. 45)

SB 305: **4/1/06** (Sec. 40)

Both bills provide for transition rule that payments are made under old (ELF) system for 6 mo., with pay-up in 7th month

Spill Surcharge (split nickel)

CSHB 488(RES)

1/4

Total: no change (5¢)

Collected: increases 1¢
to 4¢

Treatment: no credit
no deduction

SB 305

1/5

Total: increases 1¢ to

6¢

Collected: increases 2¢
to 5¢

Treatment: no credit
no deduction

Use of DNR Royalty Values

CSHB 488(RES): DOR may allow the use of
DNR royalty values

SB 305: no provision for DOR to allow the
use of DNR royalty values

Use of DNR Values (SB 305 language)

AS 43.55.150(d)

Under regulations adopted by the
department, if the department determines
that an election under this subsection
would
of tax administration and would

and are

, the department may allow

Other differences

Abandonment:

CSHB 488(RES): no credit for any abandonment

SB 305: no credit or deduction for abandonment
of old production
allocation of expense based on
production before and after effective date

Other provisions included in SB 305

- For exploration credits, requires data to DNR
- DOR permitted to utilize principles of IRC Sec. 482 (transfer-pricing)
- Clarifying language in AS 43.55.160(c)(1)(B)
- Producer must support FERC's consideration of credits granted to producer on FERC-regulated facilities

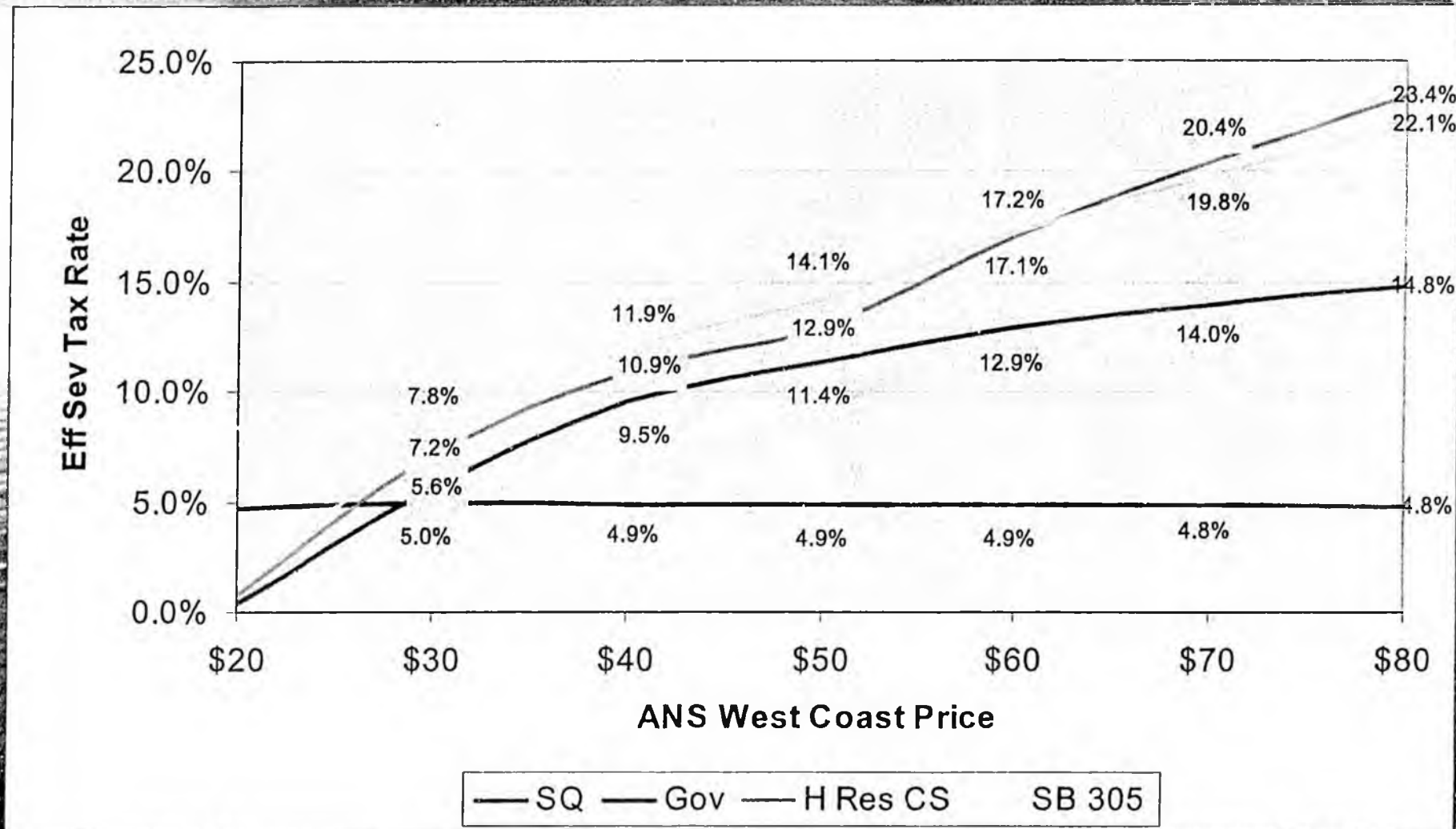
Catastrophic Oil Spill expenditures to clean up

CSHB 488(RES): not deductible

SB 305: may be deductible if on lease

AS 46.04.900: "catastrophic oil discharge" means
an oil discharge in excess of 100,000 barrels, or
any other discharge which the governor
determines presents a grave and substantial
threat to the economy or environment of the
state"

Effective Severance Tax Rate Sev Tax / Wellhead (less royalty) Low Volume Scenario



**Navigating CSHB 488 (RES)
(With the Differences from
HB 488 Highlighted)**

**Before the House Finance
Committee**

March 28, 2006

**Robert E. Mintz, Department of Law
Dan E. Dickinson, C.P.A.**

handout 3-28-06

HB 488, Section 35
CSHB 488, Section 38

New production tax provisions apply to oil
and gas produced on or after:

(HB 488)

April 1, 2006 (CSHB 488)

HB 488, Section 5

AS 43.55.011(a)

There is levied upon the producer . . . a tax
for all produced

The tax is equal to of the
. . . under AS 43.55.160.

CSHB 488, Section 5

AS 43.55.011(a)

There is levied upon the producer . . . a tax
for all produced . . .
[except for] a lessor's royalty interest. . . .
The tax is equal to of the
production tax . . . under AS ~~43~~.55.160.

CSHB 488, Section 6

AS 43.55.011(e)

There is levied upon the producer . . . a tax for all oil and gas produced each month . . . the ownership or right to which constitutes a lessor's royalty interest The tax is equal to five percent of the gross value at the point of production

CSHB 488, Section 6

AS 43.55.011(f) – (k)

[Above specified price thresholds] There is levied upon the producer

. . . a tax for all oil . . . equal to .30 percent of the gross value at the point of production . . . multiplied by the oil price index

. . . a tax for all gas . . . equal to two percent of the gross value at the point of production . . . multiplied by the gas price index

So . . .

The has a production tax: 20 %
of net value.

The CS has four production tax components:

- (1) 20% of net value (now called "production tax value") *except* for lessor royalty share
- (2) 5% of gross value for lessor royalty share
- (3) A progressive-rate oil tax on gross value, including lessor royalty share
- (4) A progressive-rate gas tax on gross value, including lessor royalty share

HB 488, Section 21

AS 43.55.160(a)

... is the total of the
of ... oil and gas ...
from in the state, less
... as ... and
... 1/72 of ...

CSHB 488, Section 28

AS 43.55.160(a)

production tax . . . is the total of the
of . . .

oil and gas . . . from
in the state,

less [progressivity taxes on gross value] . . .

and . . . less as

HB 488, Section 31
CSHB 488, Section 34

AS 43.55.900(7)

“gross value at the point of production”
means

for , the value . . . at the . . . meter . . . in .

..
for . . . the value . . . where . . . metered

[]

HB 488, Section 19
CSHB 488, Section 26

AS 43.55.150(a)

... gross value at the point of production is
calculated using the reasonable

HB 488, Section 20
CSHB 488, Section 28

AS 43.55.150(d)

... the department ... gross value
[to be calculated based upon] ... a
... [or]
a formula ... that uses ... [
] royalty ... valuation [or]
another
a value

HB 488, Section 21

AS 43.55.160(c)

... lease expenditures ... are the ... costs
of the point of production ... on
or after ... that are the
costs of
oil or gas
deposits located ... in the state.

CSHB 488, Section 28

AS 43.55.160(c)

... lease expenditures ... are the costs
of the point of production ... on
or after January 1, 2006 ... that are the
costs of
oil
or gas deposits located ... in the state.

Section 21/28

AS 43.55.160(c) (continued)

In determining . . . [. . .] costs . . . the department shall give substantial weight . . . to typical . . . as to [billable] costs . . . under . . . and [. . .].

CSHB 488, Section 28

AS 43.55.160(j)(2)

CS adds a definition of “ordinary and necessary” to make clear that Internal Revenue Code meaning is adopted.

CSHB 488, Section 28

AS 43.55.160(c) (continued)

lease expenditures . . . do not include . . .
catastrophic oil discharge . . . expenses . . .
or damages

HB 488, Section 21

CSHB 488, Section 28

AS 43.55.160(d) provides specific examples of, and exclusions from, “direct costs”

CSHB 488 has several improvements recommended by the Administration: e.g.,

- (d)(1)(A) and (d)(2)(A), clarifying treatment of capitalized expenditures
- (d)(2)(L), ensuring that conservation surcharges are not deductible

HB 488, Section 21
CSHB 488, Section 28

AS 43.55.160(e)

[Lease expenditures must be by the producer for (1) another's use of a production facility; (2) reimbursement, e.g. field costs paid by state, that offset lease expenditures; and (3) sale of assets acquired through lease expenditures or of non-taxable oil or gas used in lease operations.]

CSHB 488, Section 28

AS 43.55.160(a), (b)(2), and (e)

At the Administration's recommendation, the CS addresses potential timing mismatches between lease expenditures and adjustments, ensuring that the tax effect of an adjustment will be recognized even if a producer or explorer has no production, or has low lease expenditures, when an adjustment payment is received.

HB 488, Section 21

AS 43.55.160(g)

... transitional investment expenditures are ...
[incurred
] ... less ... [proceeds from] the
... acquired ... as a result of [those] capital
expenditures

[This provision is *not* in the CS; instead CS defines
“lease expenditures” to include expenditures back
to January 1, 2006]

HB 488, Section 21

AS 43.55.160(i)

... a producer that is ... may reduce the
net value by ... [T]he
total of the allowances ... during the calendar year
does . An unused
allowance ... may

[This provision is *not* in the CS; instead CS
provides for additional credit of up to \$12 million
per year]

HB 488, Section 7
CSHB 488, Section 8

AS 43.55.020(a)

... the tax levied under AS 43.55.011,
applied under this chapter, is due

... The tax levied under AS 43.55.011(a)
applied under this chapter, is
due :

HB 488, Section 12
CSHB 488, Section 14

AS 43.55.024(a)

... a producer ... that incurs a ...
... may ... elect ... to
take a ... in the amount of 25 percent
of that expenditure.

CSHB 488, Section 14

AS 43.55.024(i)(2)

“qualified capital expenditure” does not include

an expenditure incurred . . . for . . . an extended period of disuse, dismantlement, removal . . . or abandonment . . . or for the restoration of a lease, field, [etc.]

Section 12/14 (cont.)

AS 43.55.024(b)

A producer may elect to take a
... of ... of a carried-forward
[which is the amount of a previous year's
that were
because they would have reduced the net value
of the oil and gas below zero].

Section 12/14 (cont.)

AS 43.55.024(d) – (e), (g)

[AS 43.55.024(d) – (f) in original bill]

A producer entitled to a tax credit may apply to the Dep't of Revenue for a

. Once issued, a certificate may be used for its face value, but a transferee may not apply a certificate to reduce its tax liability by more than during a calendar year.

CSHB 488, Section 14 (cont.)

AS 43.55.024(f)

[D]epartment [of Revenue] . . . shall issue a cash refund . . . for a [transferable tax credit] certificate* if . . .

- [producer's total refunds in calendar year do not exceed \$10 million]
- [producer invests or buys an oil and gas lease for at least the amount of the refund]
- [producer owes no delinquent taxes]

CSHB 488, Section 28

AS 43.55.170 – Additional nontransferable credit

Up to \$12 million in a calendar year may be taken as a tax credit for qualified capital expenditures – even if a credit is taken under AS 43.55.024 or 43.55.025 for the same expenditure

-- unused credit may not be carried forward or transferred

-- the provision expires April 1, 2016

CSHB 488, Section 28

AS 43.55.170(b) – producer's qualification for the additional nontransferable credit

This is an anti-splitting provision to prevent abuse of the \$12 million *per producer* credit.

It is essentially the same anti-splitting provision that is in sec. 21 of the original bill, for the \$73 million *per producer* allowance.

HB 488, Sections 22-29
CSHB 488, Sections 29-32

Original bill allowed a to be taken for conservation surcharge payments; CS does not.

CS reduces sec. 201 surcharge from \$.02 to \$.01 per barrel and increases sec. 300 surcharge from \$.03 to \$.04 per barrel.

CSHB 488, Sections 15-19

Extends existing exploration credits under AS 43.55.025 through 2016 and conforms sec. 025 to new production tax provisions by specifying that the credits may be taken only against tax under AS 43.55.011(a) – i.e., against the 20 percent tax on production tax value, *not* against lessor royalty tax or additional progressive taxes on gross value

HB 488, Section 7

of production tax, net of
credits, is due

The remainder is due of the next
calendar year.

CSHB 488, Sections 8, 13

100 percent of total production tax (total of all four components), net of credits, is due each month.

Payment of less than 90 percent of total tax due triggers an automatic five percent penalty on the deficiency.

HB 488, Section 9

CSHB 488, Section 10

[P]roducer may deduct [from royalty] the amount of the tax paid on taxable royalty oil and gas . . .

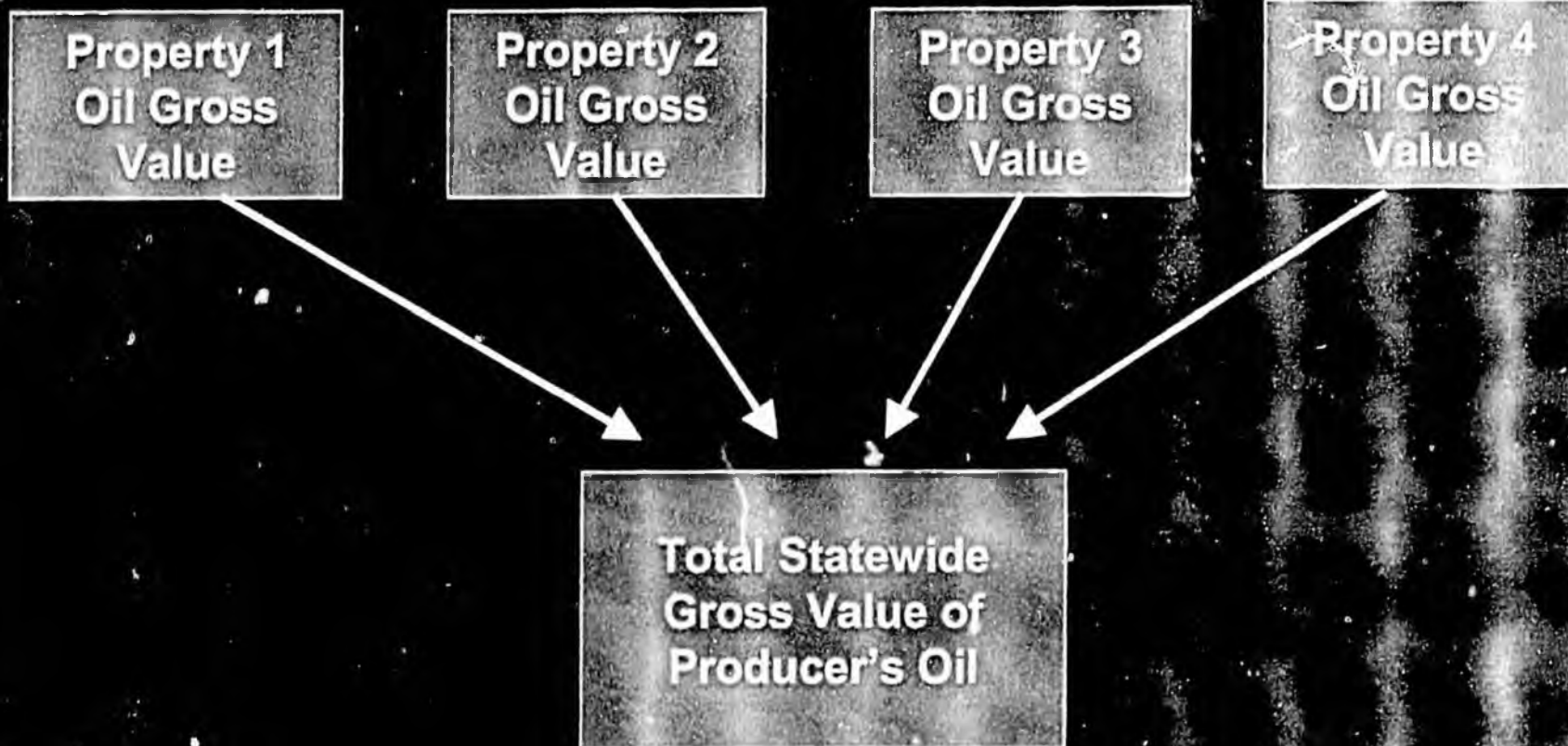
- Original bill provides a default formula for allocating the 20% tax on net value to royalty share.
- CS provides a slightly different formula for allocating the 20% tax on net value (“production tax value”) to *non-lessor* royalty share.

STEPS IN TAX CALCULATION

Under CSHB 488 (RES)

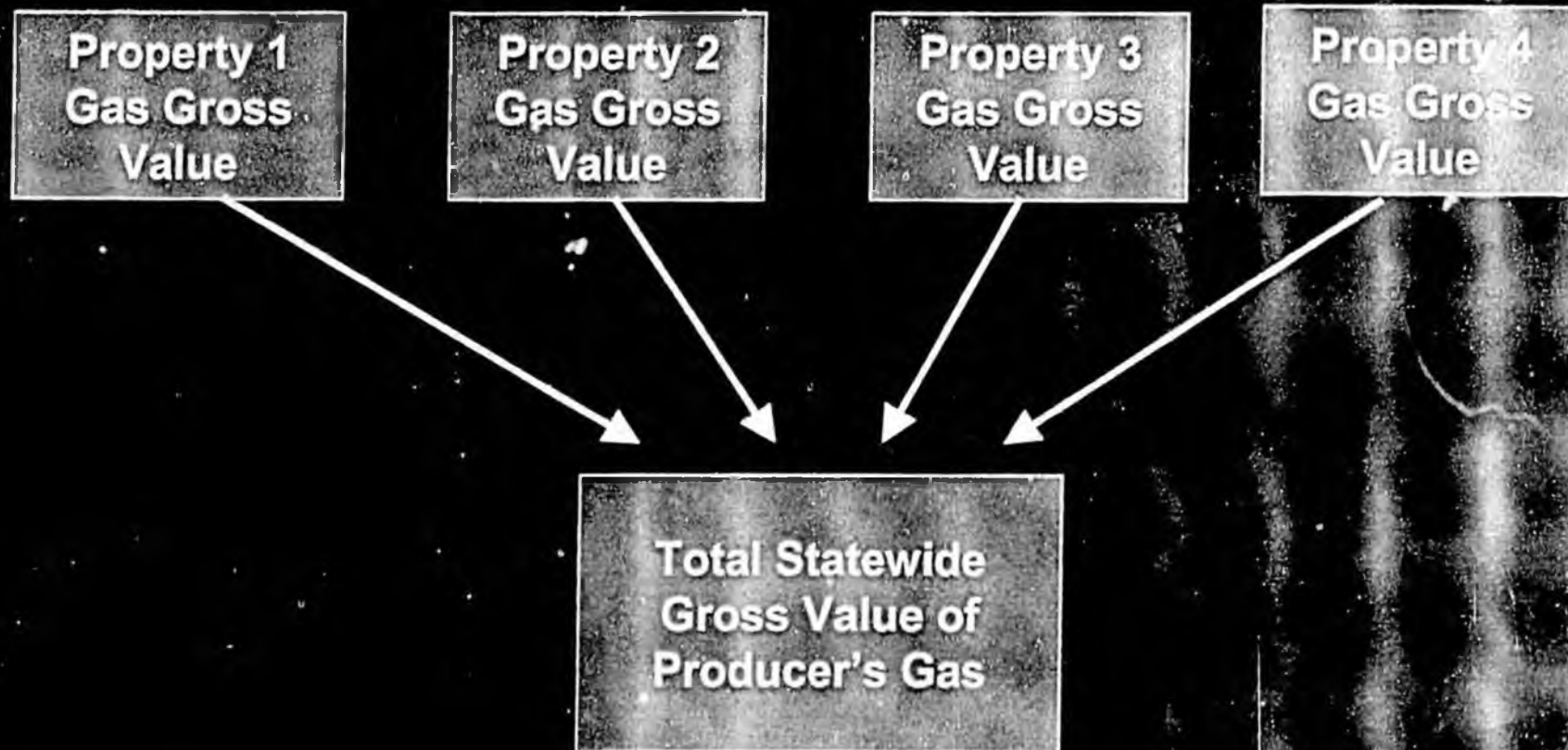
GROSS VALUE OF OIL

AS 43.55.150, AS 43.55.900



GROSS VALUE OF GAS

AS 43.55.150, AS 43.55.900



GROSS VALUE OF OIL AND GAS

AS 43.55.150, AS 43.55.900

**Total Statewide
Gross Value of
Producer's Oil**

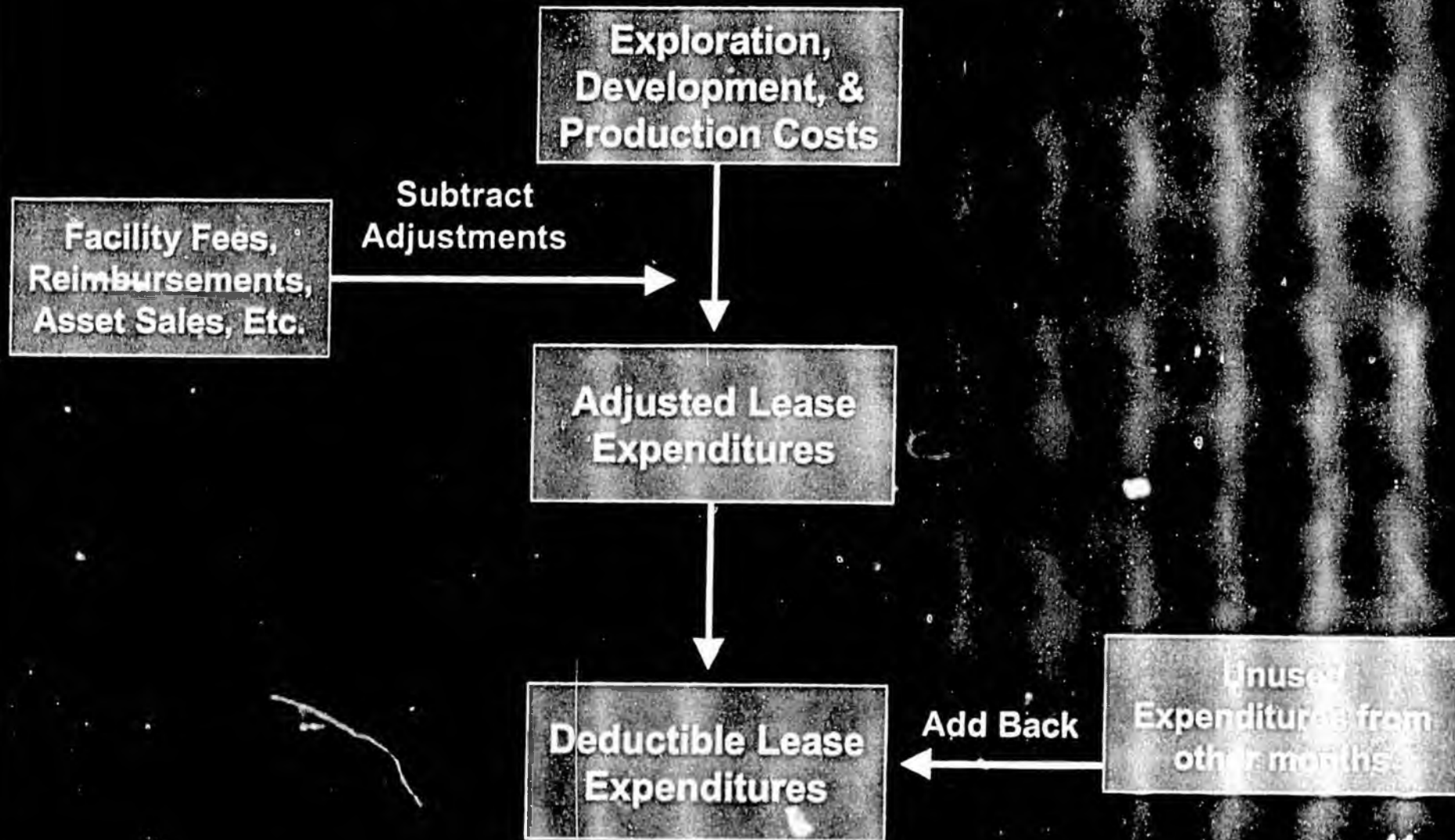
**Total Statewide
Gross Value of
Producer's Gas**



**Total Statewide
Gross Value of
Producer's Oil and
Gas**

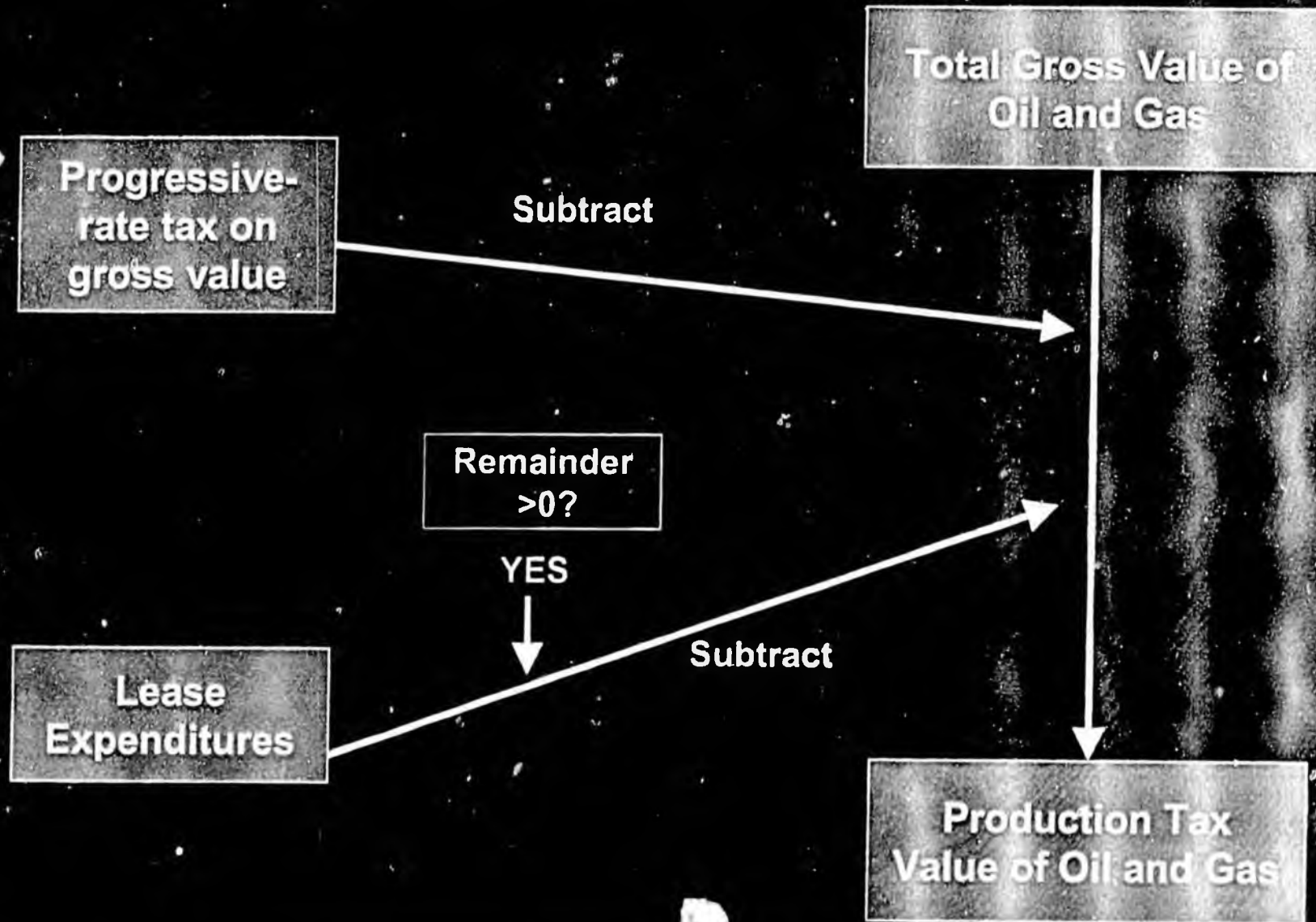
LEASE EXPENDITURES

AS 43.55.160(b) – (f)



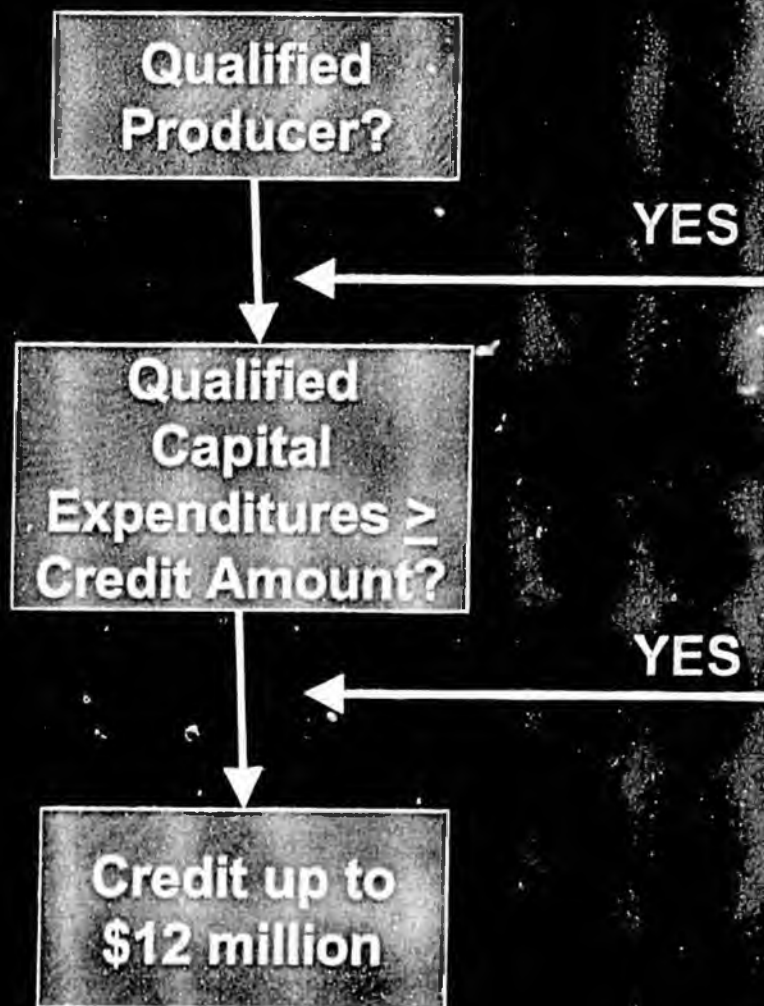
PRODUCTION TAX VALUE

AS 43.55.160 (a)



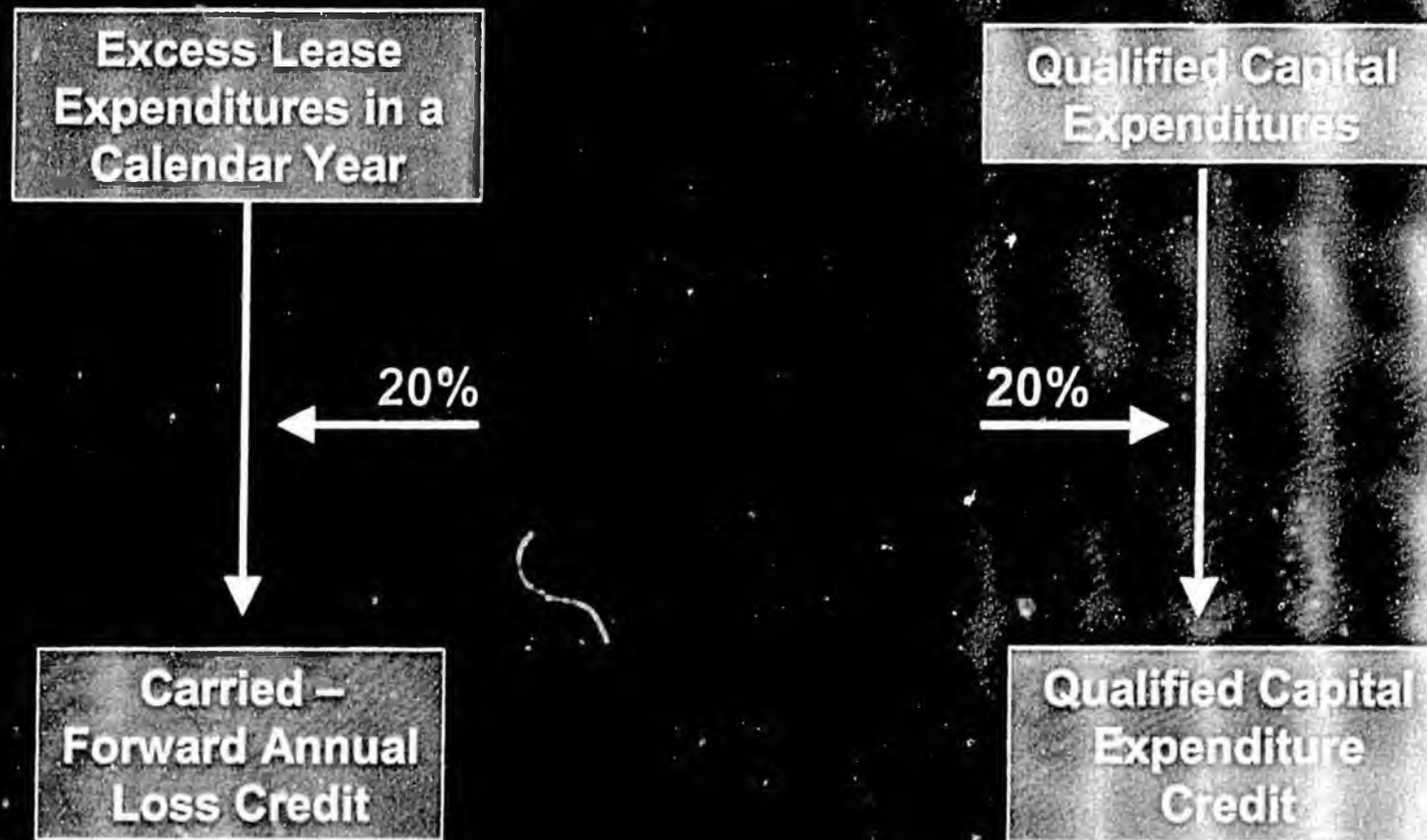
NONTRANSFERABLE CREDIT

43.55.170

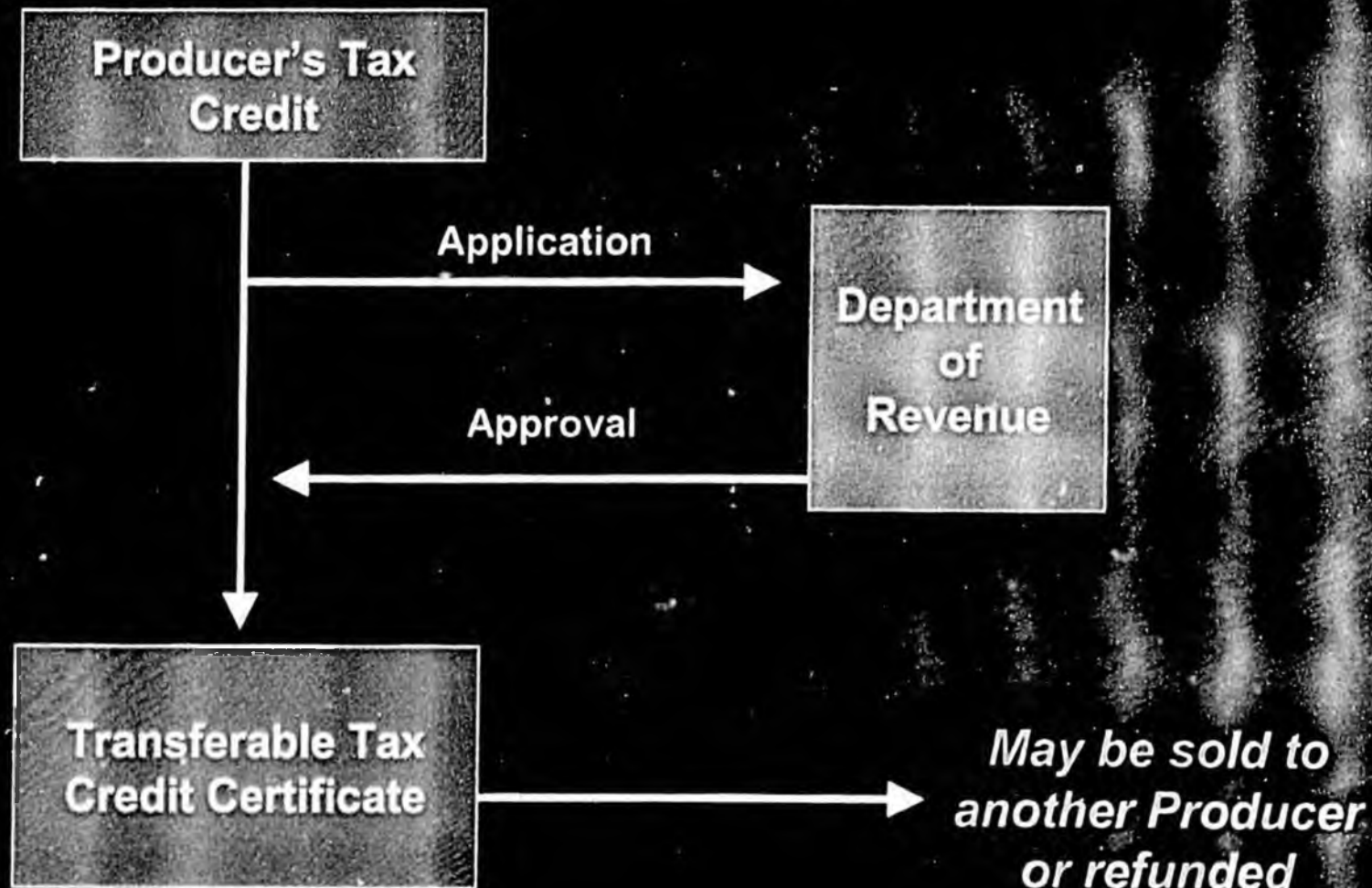


SEC. 024 TAX CREDITS

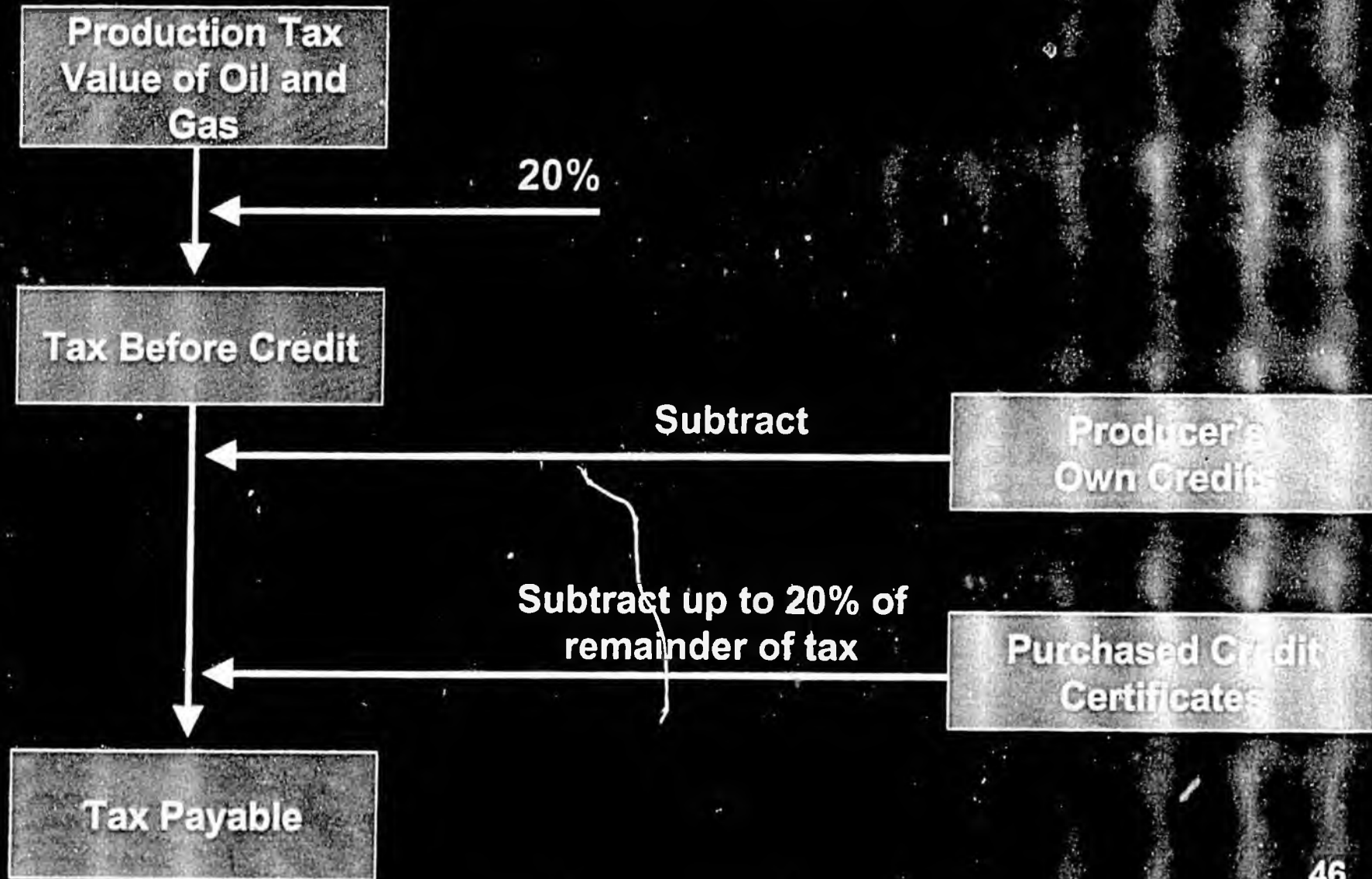
AS 43.55.024 (a) and (b)



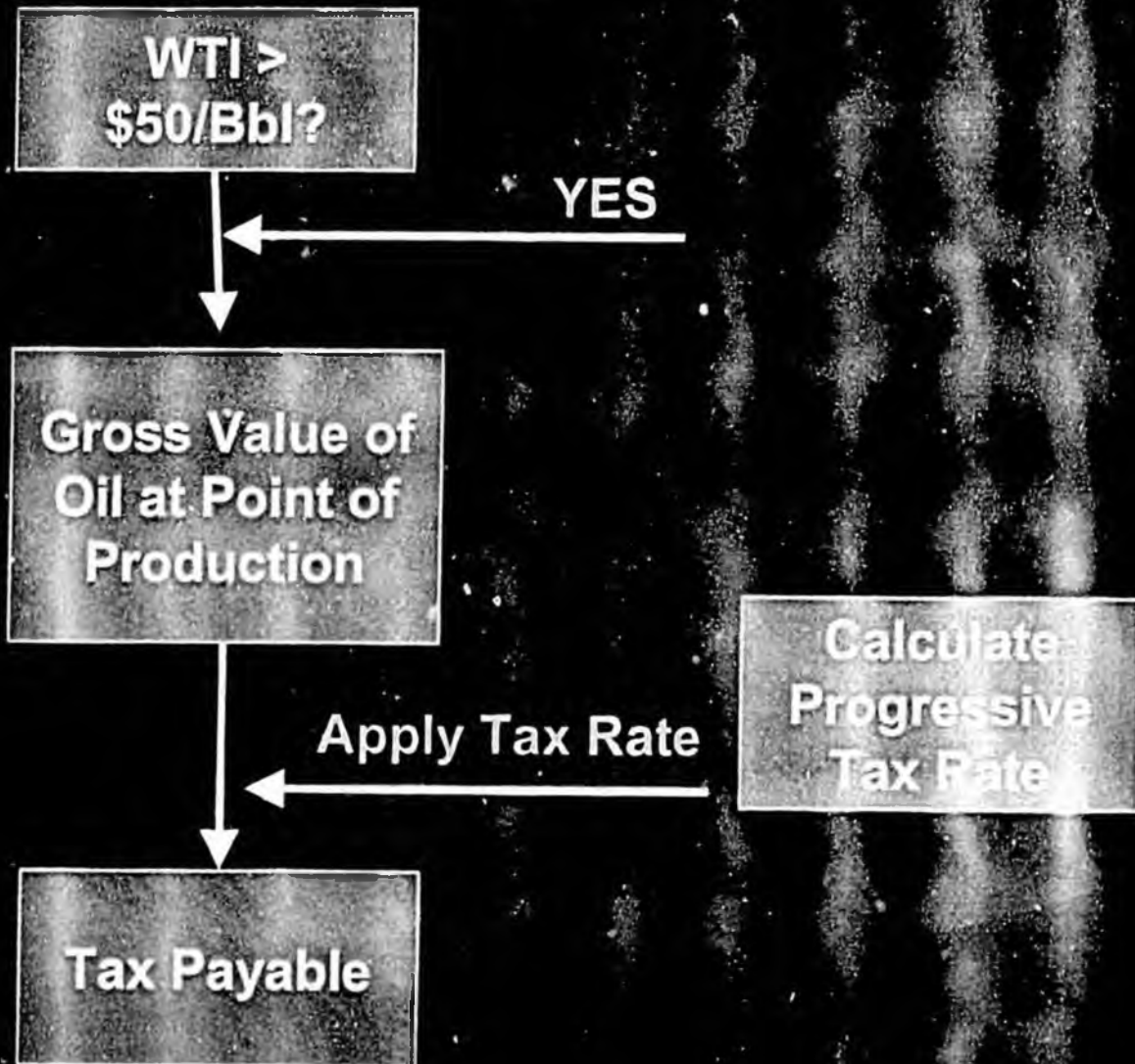
TRANSFERABLE TAX CREDIT CERTIFICATES - AS 43.55.024 (d)-(g)



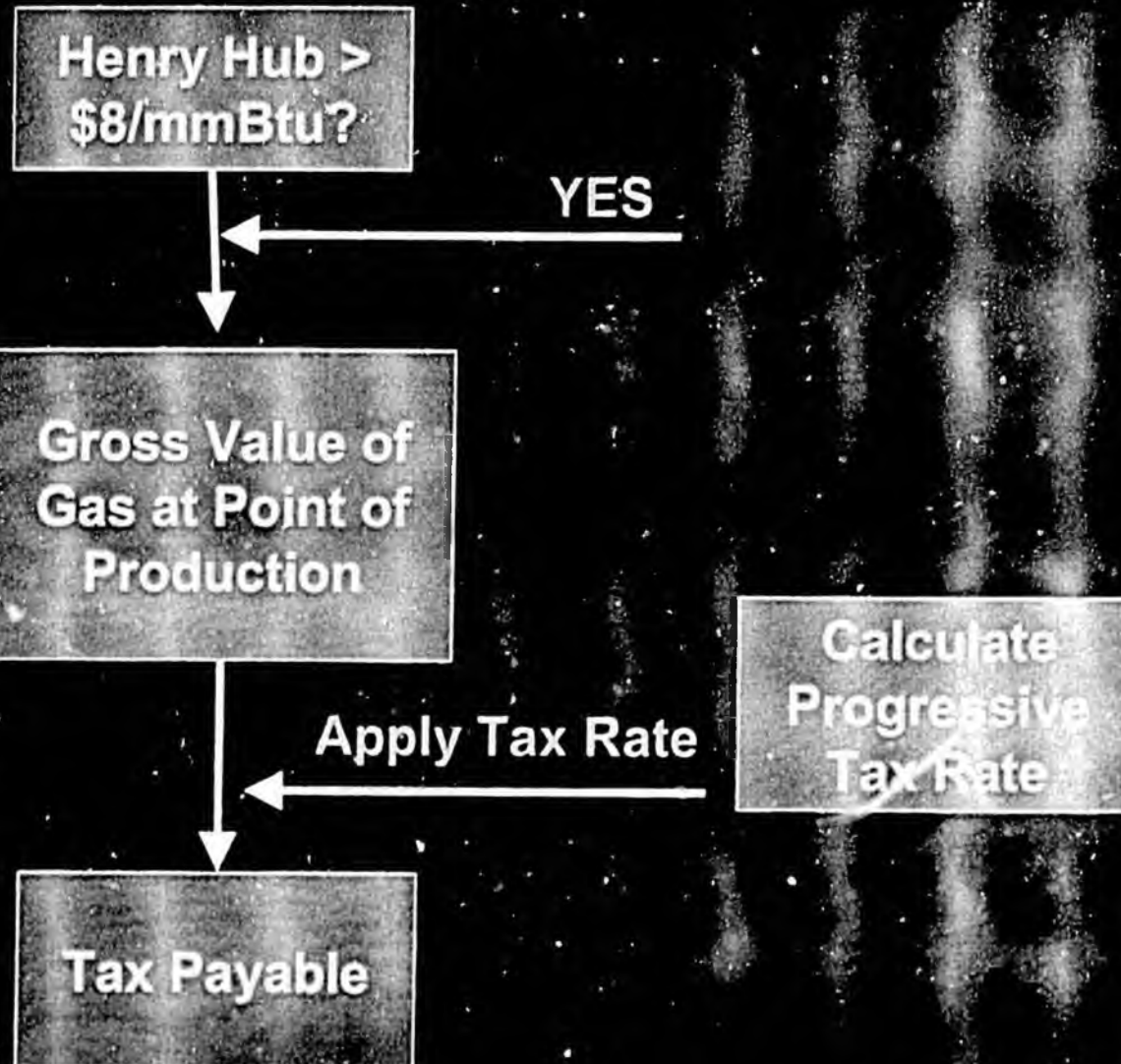
TAX CALCULATION: AS 43.55.011(a), 43.55.024, 43.55.025, 43.55.170



TAX CALCULATION: AS 43.55.011(f) – (h)



TAX CALCULATION: AS 43.55.011(i) –(k)



TAX CALCULATION: AS 43.55.011(e)

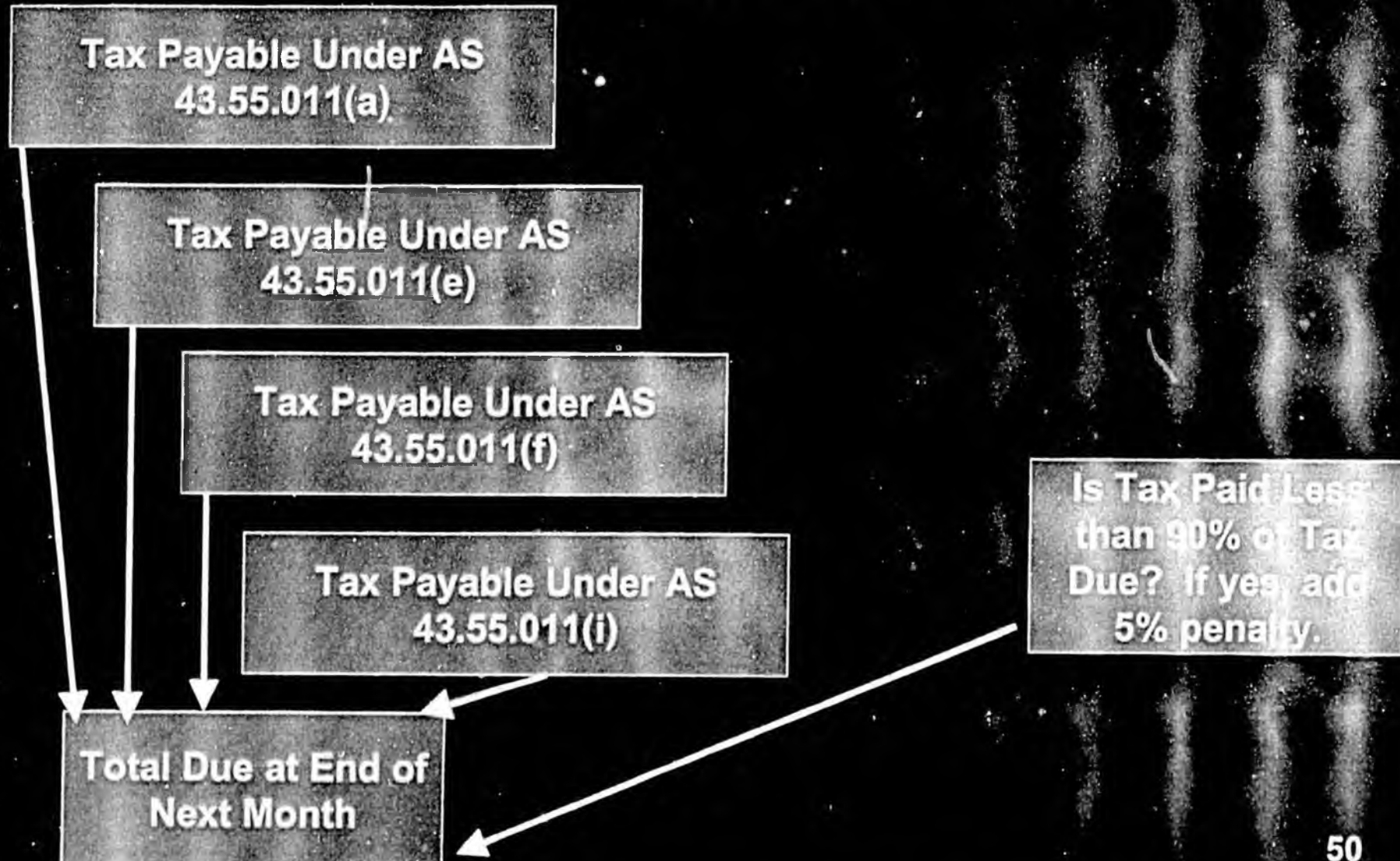
Gross Value at Point of
Production of Lessor's
Royalty Share of Oil and
Gas

Multiply by 5%

Tax Payable

TAX PAYMENT

AS 43.55.020(a), (g), and (h)



Petroleum Profits Tax (PPT)

CS for HB 488 (RES) Overview

Alaska Department of Revenue
Before the House Finance Committee

March 27, 2006

Robynn J. Wilson, Director, TAX Division, DOR

Dan E. Dickinson, CPA

3-27-06

The Governor's 3 Big Ideas

- The current Production Tax system is broken.
- We need to use the tax system to encourage investment
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low

The Governor's 3 Big Ideas

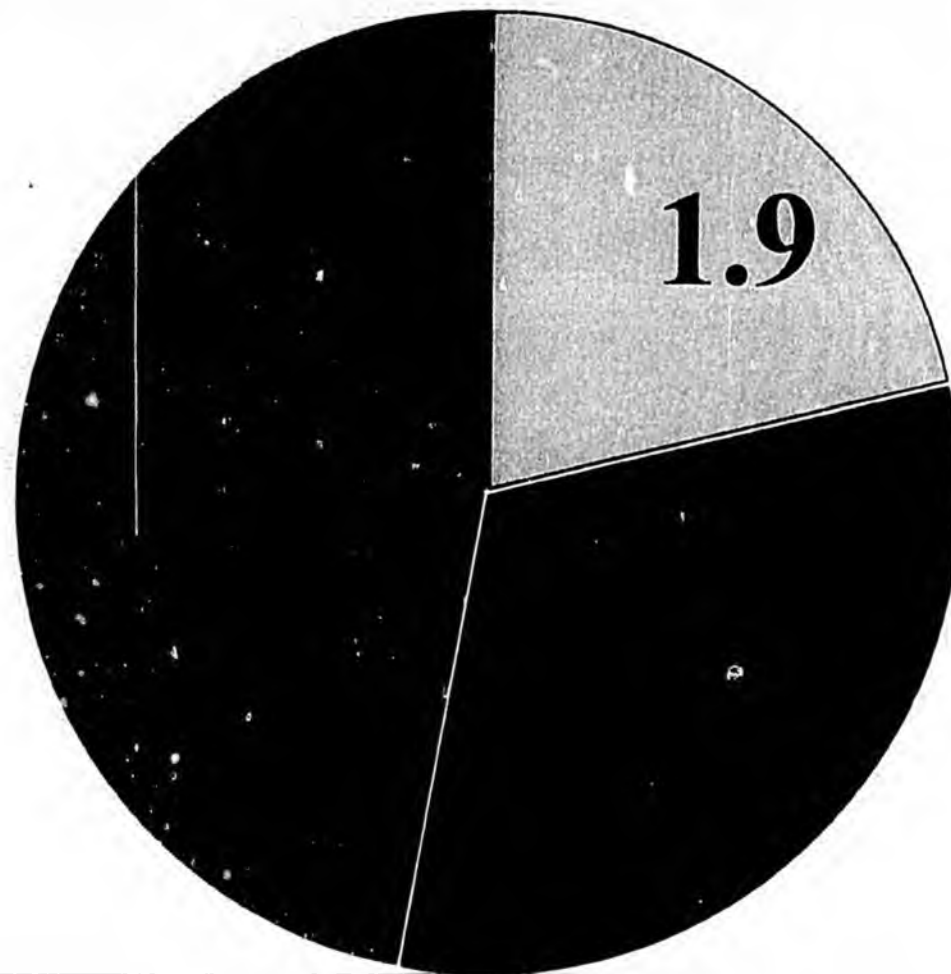
- The current Production Tax system is broken. *The CS also replaces it.*
- We need to use the tax system to encourage investment. *The CS has incentives for investment*
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low. The CS preserves the Governor's 20/20 structure

The Governor's 3 Big Ideas

- Idea one: The Production Current Tax System is broken
 - We are not getting the investment we need – could the structure of the Production Tax be to blame
 - We are not getting a fair share of revenues when Prices are high and investment is low

Unrestricted & Restricted Revenue

\$ Billion

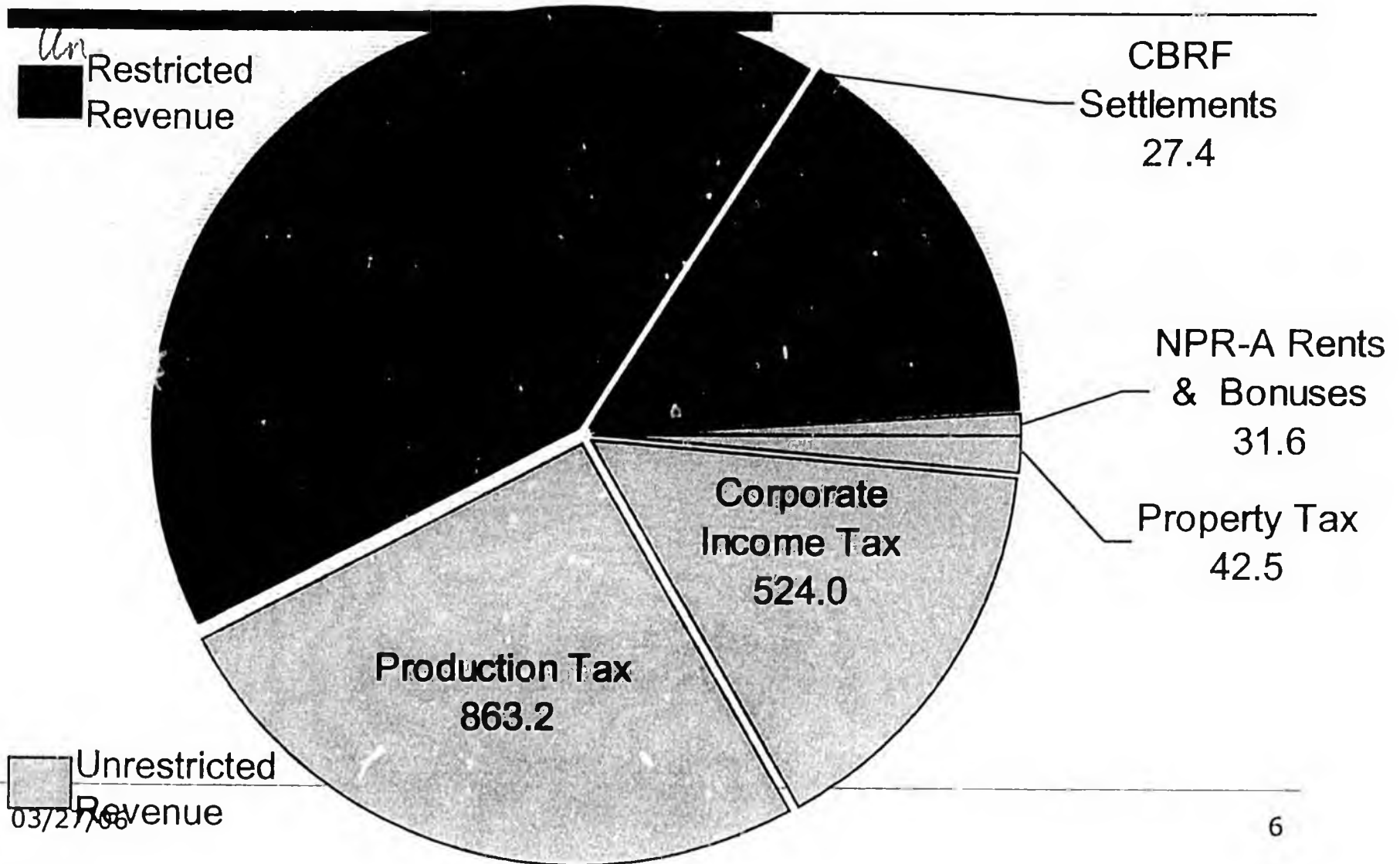


FY 2005

- Federal
- Investment
- Oil
- Other

FY 2005 Petroleum Revenue

\$ Million



1. Destination Value at Market (2005)

	Volume Millions barrels	\$ per barrel	\$ Million
Destination Value at Market	330	\$43.43	\$14,332
Less Tankering & Pipelines	330	\$ 4.51	(\$1,488)
Gross Value at Point of Production	330	\$38.92	\$12,844
Less Upstream Costs			
Operating:		\$ 3.33	
Capital:		\$ 3.18	
Total	330	\$ 9 6.52	(\$2,150)
Net Value at Point of Production	330	\$32.40	\$ 10,694

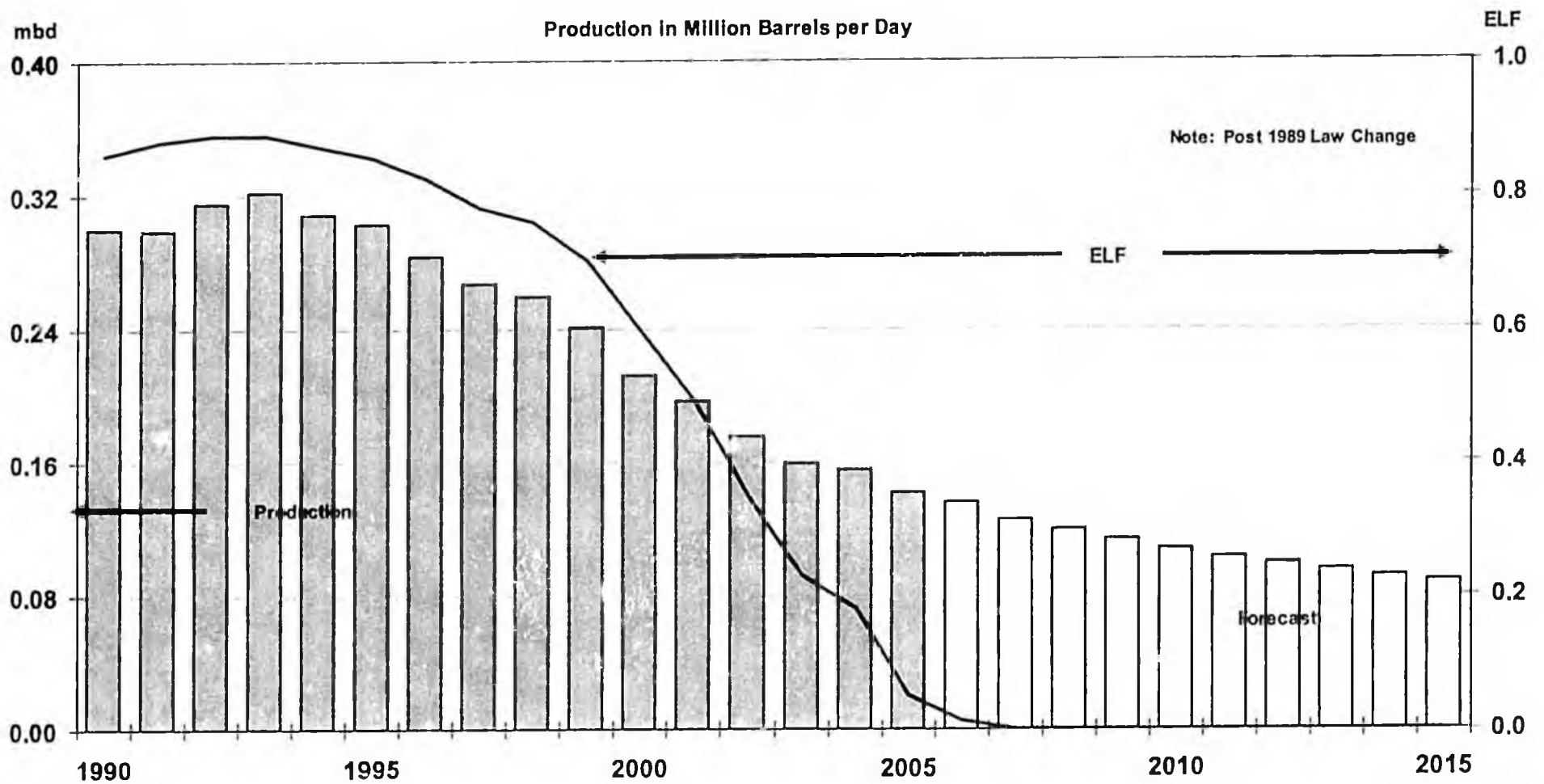
2. Current Production Tax

	\$ in Billion
Gross Value at Point of Production	\$12,844
1- Royalty Rate	0.875
Value Net of Royalty	<u>\$11,238</u>
Tax Rate	0.15
ELF Rate	0.55
Tax	\$ 927

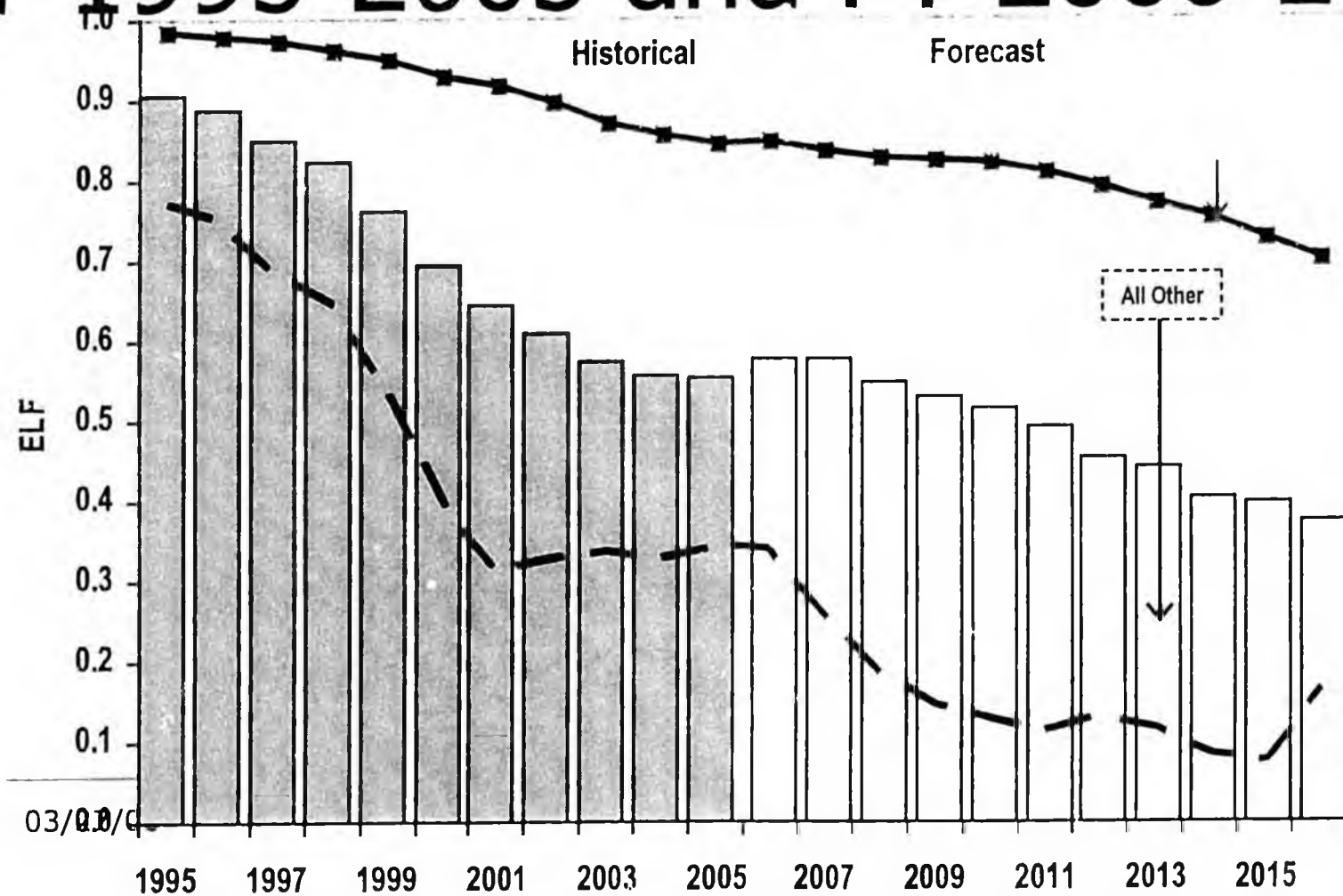
Implicit Cost

	\$ in Billion
Production Tax Net of Royalty	\$11,238
Less Implicit Cost from Proxy	<u>(\$ 5,057)</u>
	\$ 6,181
Tax Rate	0.15
Proposed Production Tax	\$ 927

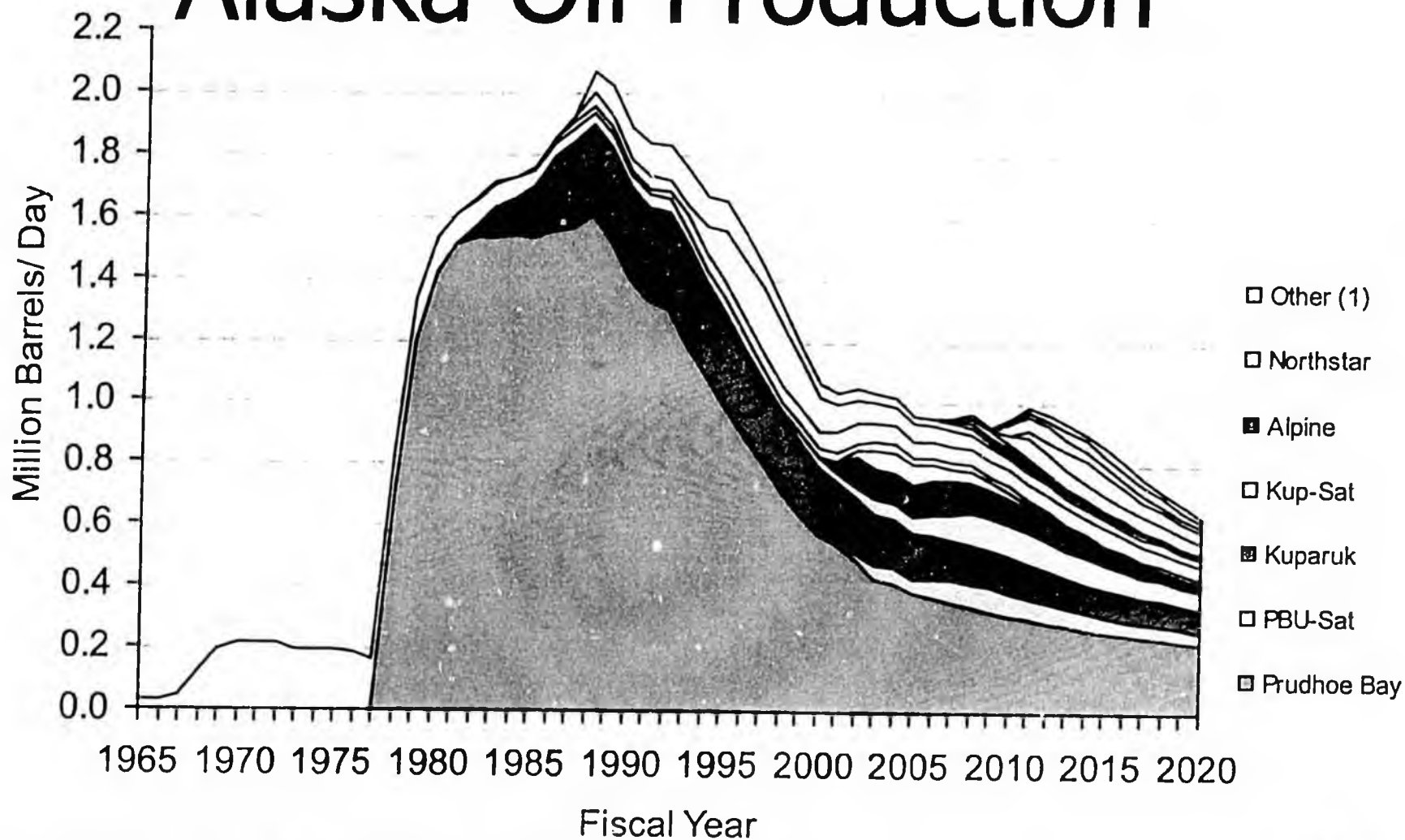
Kuparuk Crude Oil Production & ELF



Economic Limit Factor, FY 1995-2005 and FY 2006-2016



Alaska Oil Production



Source: Fall 2005 Revenue Sources Book; Alaska Department of Revenue, Tax Division
 (f) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and N-PRA.

03/27/06

The Governor's 3 Big Ideas

- Idea Two: We need to use the Tax system to encourage investment
- Investment leads to more production
- More production leads to more revenue
- Four ways the bill recognizes investment

4 ways of encouraging investment

- Net vs gross – all investment is a deduction
- 20% credits for capital investments
- Up to a \$73 million Annual Allowance
- Recognition of Transition Investment Expenditures

4 ways of encouraging investment

- Net vs gross – all investment is a deduction
CS preserves
- 20% credits for capital investments
CS preserves
- Up to a \$73 million annual allowance
CS has a similar feature with up to 12 million dollar annual credit
- Recognition of Transition Investment Expenditures
CS has reduced from 5 years to 3 months of investment

Tax Based on Net Profits

- Governor's bill provided a tax based on Net Profits
- CS maintains this approach

Gross vs. Net

Current Tax on Gross

Value at wellhead	\$50.00
Times: tax rate	15%
Tax before ELF	\$7.50

PPT on Net

Value at wellhead	\$50.00
Less:	
Lease op exps	<u>(12.50)</u>
Net taxable	\$37.50
Times: tax rate	20%
Tax before credits	\$7.50

Tax Base

Gross value at point of production

Determining value under current system

West coast value

\$



Gross Value under PPT

Dept. of Revenue can allow a producer to elect the use of:

- Royalty value
- DOR formula that estimates a value at a specific location such as point of delivery into a common carrier pipeline

Tax Based on Net Profits

Gross value at point of production

Less: Lease expenditures

- ♦ operating costs
- ♦ capital expenditures
- ♦ allowance for overhead

Equals: Net Profits

Non-deductible expenses

- Depreciation
- Royalty payments
- Taxes based on net income
- Interest & financing charges
- Lease acquisition costs
- Other costs

Governor's Bill: Credits to Encourage Investment

- **20%** of qualified capital expenditures

- May be taken on:
 - ◆ Exploration costs
 - ◆ Capital costs **incurred on lease**

- Credits are transferable

CS: Credits to Encourage Investment

- CS maintains credits
 - CS also allows the State to purchase up to \$10M worth of credits
- Credits may not be taken on:
 - Abandonment costs

Friendly to New Investors

- Ability to monetize credits and losses
- Base allowance
 - Governor's bill: \$73M deduction
 - CS: converts this to a credit of up to \$12M
(equivalent to \$60M deduction)

Effect of Standard Credit

	none	\$5M	\$12
net income	\$100.0	\$100.0	\$100.0
times:	20%	20%	20%
tax before credits	\$20.0	\$20.0	\$20.0
capex credit	0.0	(1.0)	(2.4)
standard credit	0.0	(5.0)	(12.0)
net due	\$20.0	\$14.0	\$5.6

How are losses handled?

Gross value	\$50.00
less:	
Lease op exps	(12.50)
Capital exp's	<u>(60.00)</u>
Net loss (NOL)	(\$22.50)

Net Operating Losses (NOL's)

- Can be converted to Credits
- 20% of loss

Transition Provision

- Governor's bill allowed deductions for recent capital expenditures
 - Last five years' capital expenditures
 - Allowed over 5 years
 - Allowable on when price of oil exceeded \$40

Transition Provisions in CS

- Allows cost recovery of assets placed in service 1/1/06—3/31/06
- Deduction of $1/9$ of cost in each of 9 months after effective date

The Governor's 3 Big Ideas

- Idea Three: We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low
- With high prices we are not getting a fair share
- We should be treated as fairly as other jurisdictions while remaining competitive with them for investment

Fair Tax Rate

Governor's bill: 20%

Fair Tax Rate

Governor's bill: 20%

*CS maintains general tax rate of 20% and adds
progressive feature*

Progressivity Surcharge

- Oil surcharge applies when oil price (WTI) exceeds \$50/bbl

- Gas surcharge applies when gas price (HH) exceeds \$8

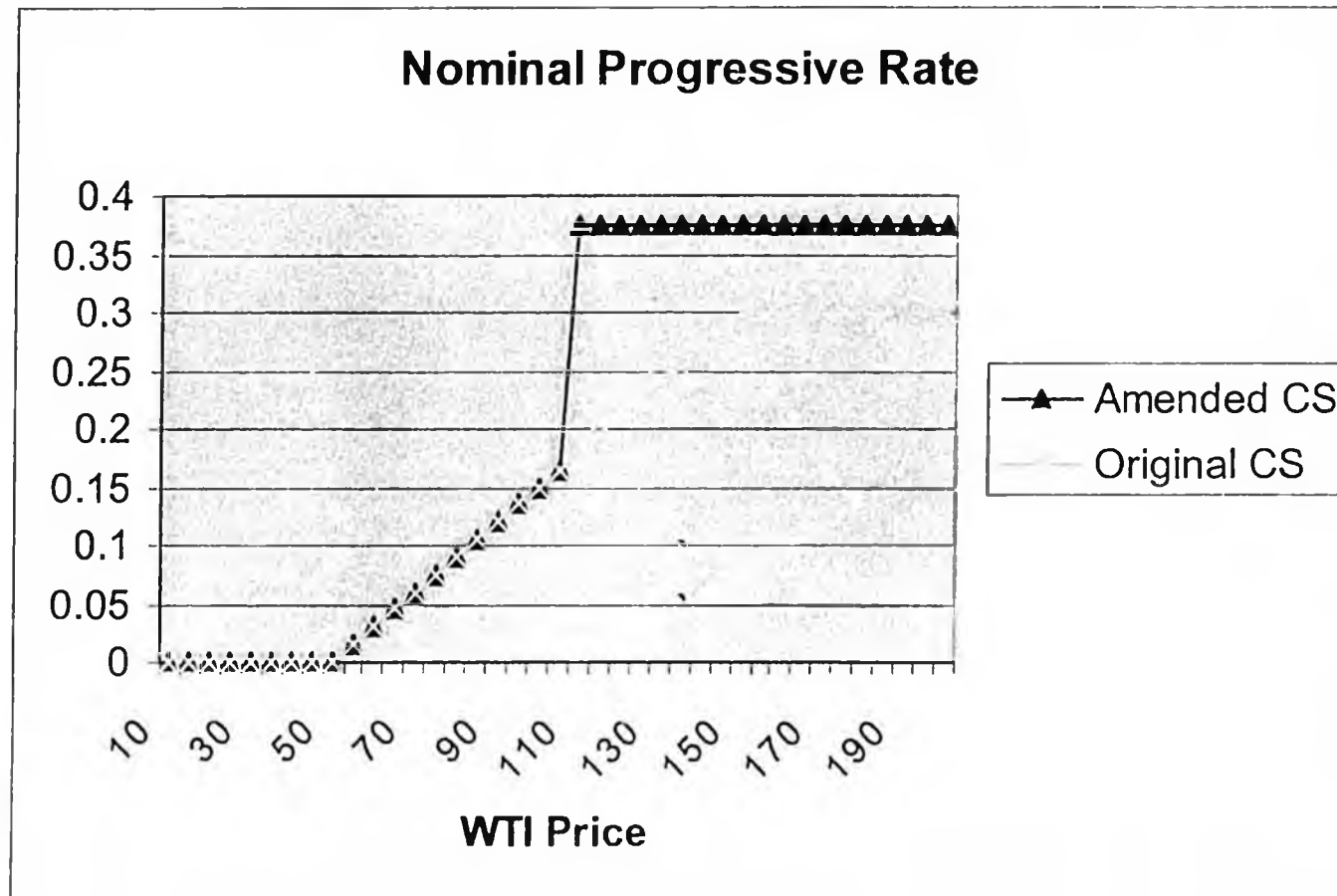
- Deductible from PPT

Progressivity Surcharge

- Oil surcharge adds 3% tax based on gross value of oil, for each \$10 increase in oil price

- Gas surcharge adds 2% tax based on gross value of gas, for each \$1 increase in HH gas price

Progressivity Feature as Amended



How does progressivity Feature Work?

	Governor's Bill
WTI Price:	\$ 70.00
ANS (Assume \$2 less)	68.00
Downstream Transportation	(7.00)
<i>Wellhead Value (gross)</i>	<u>61.00</u>
Upstream Production Costs	(7.00)
<i>Production Tax Value (net)</i>	<u>54.00</u>
	20%
	10.80
Percentage Gross	17.7%
Percentage Net	20.0%

How Does Progressivity Feature Work?

	House Resources CS		
	PPT	Progressivity	Total
WTI Price:	\$ 70.00	\$ 70.00	
ANS (Assume \$2 less)	68.00	68.00	
Downstream Transportation	(7.00)	(7.00)	
<i>Wellhead Value (gross)</i>	<u>61.00</u>	<u>61.00</u>	61.00
Progressivity		<u>6%</u>	
Progressivity Amount	(3.66)	3.66	
Upstream Production Costs	<u>(7.00)</u>		
<i>Production Tax Value (net)</i>	50.34		54.00

How Does Progressivity Feature Work? (Cont.)

House Resources CS

~~PPT~~ Progressivity Total

<i>Production Tax Value (net)</i>	50.34		54.00
PPT Rate	20%		
Total Tax	10.07	3.66	13.73
Percentage Gross	16.5%		22.5%
Percentage Net	20.0%		25.4%

Governor's Bill: Other Provisions

- Monthly return filing
- 90% payment safe harbor
- Yearly true-up on 3/31

Other Provisions in CS

spill fee remains the same in total

--suspended fee (AS 43.55.201)

--2 cents changed to 1 cent

--non-suspended fee (AS 43.55.300)

3 cents changed to 4 cents

No Longer Creditable as in Governor's Bill

Other Provisions in CS

- SB 185 40% credits extended for 10 years
- Private royalty oil tax rate set at 5%
- Penalty applies if 90% safe-harbor not met
- Effective date changed from 7/1/06 to 4/1/06

PPT: A Tax for Alaska's Future



PPT REVENUE STUDIES

Presentation to
House Finance

Alaska Department of Revenue
Tax Division
March 27, 2006

OVERVIEW

- Description of tax
- Description of model
- Long-term cumulative revenues
- Annual revenues
- Effective tax rate
- State take
- Cook Inlet

PPT

- Start with **WELLHEAD VALUE** (market value less transportation) (net of royalty)
- Compute **PROGRESSIVE SURCHARGE**
- Subtract **UPSTREAM COSTS** (capital, operating, property tax, progressive surcharge)
- This is **TAXABLE PROFIT**
- Multiply taxable income by **TAX RATE**
- This is the **TAX BEFORE CREDITS**
- Credits are capital costs multiplied by **CREDIT RATE**
- Subtract additional **STANDARD CREDIT** of \$12 million (first 10 years)
- This is subtracted from the tax before credits and progressive surcharge is added to yield the **PPT PAID**

Progressive Surcharge

- 0.3% of difference between WTI and \$50
- Applies to wellhead value
- Deductible for PPT calculation
- Over \$110 jumps up to 37.5% and stays constant

FIGURE 1

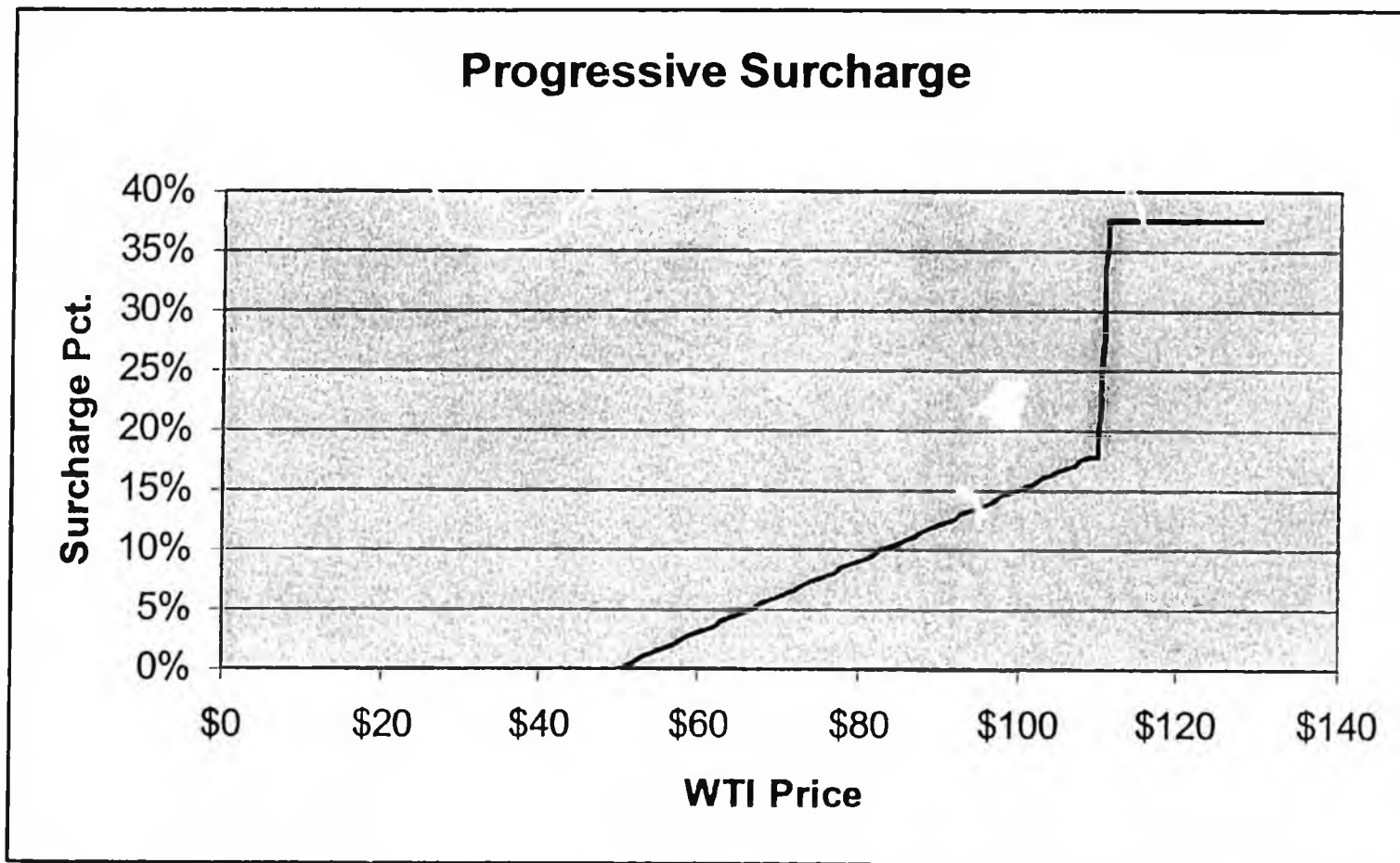


FIGURE 2A

WTI & ANS Crude Prices: Jan 1988-Feb 2006

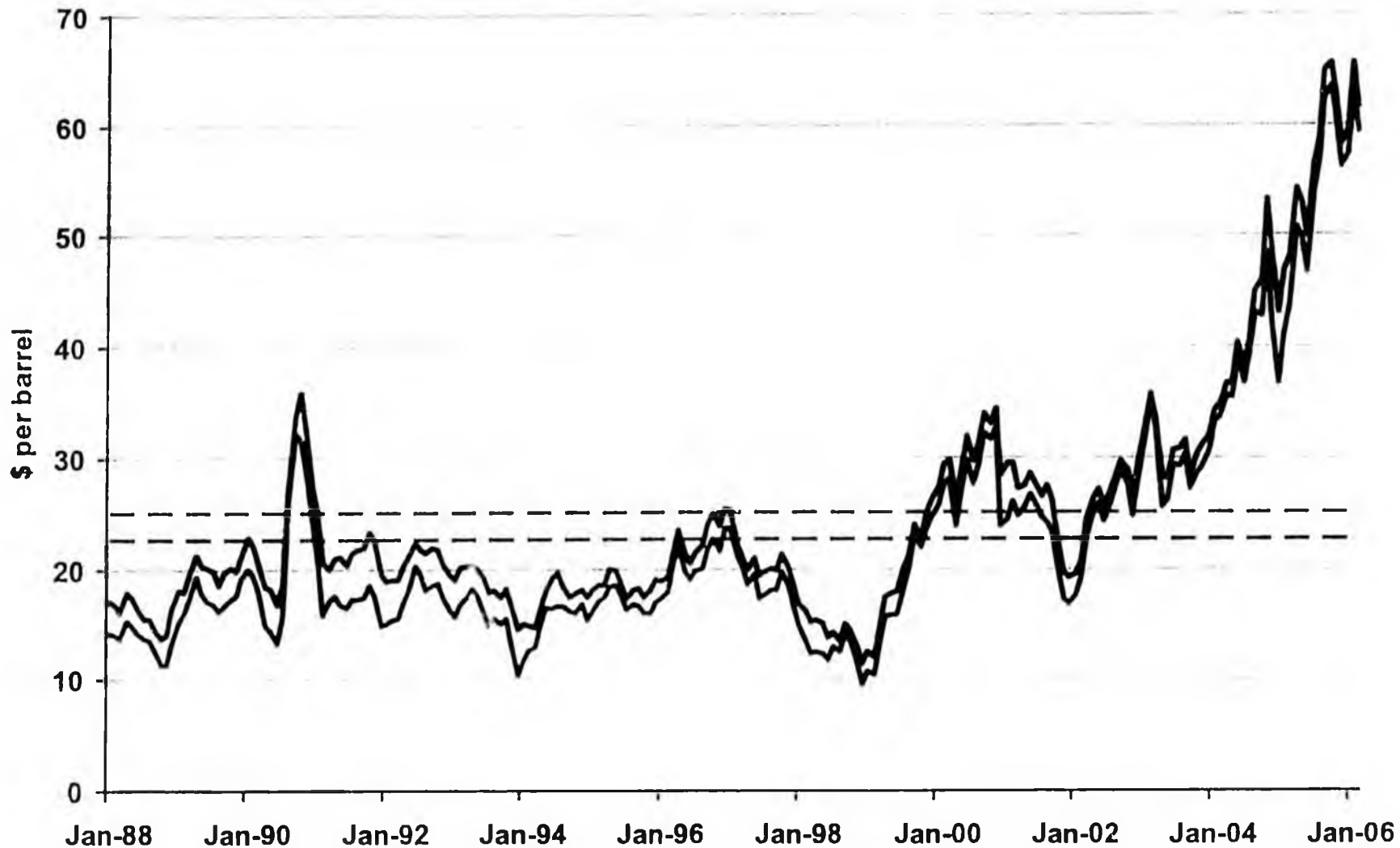
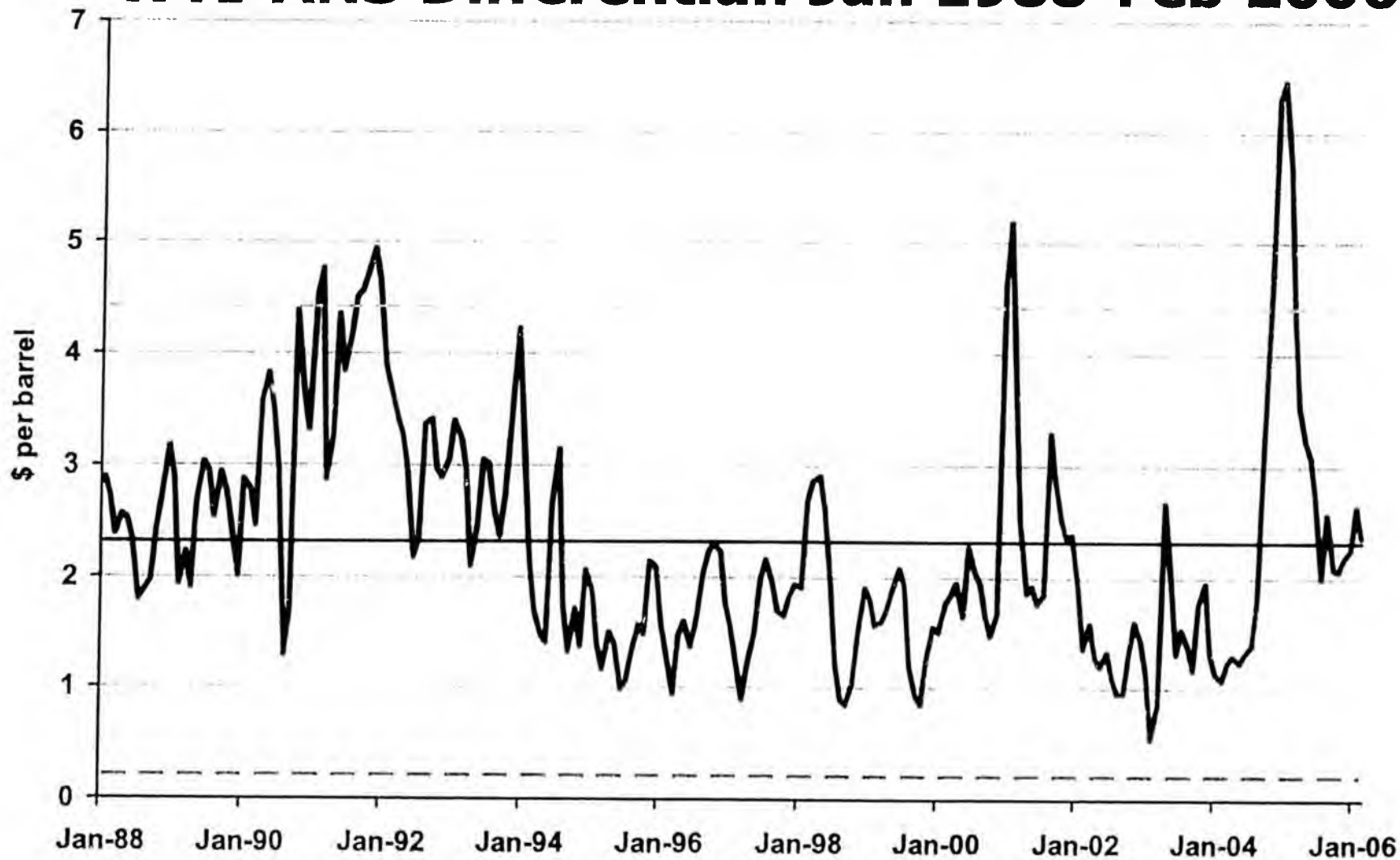


FIGURE 2B

WTI-ANS Differential: Jan 1988-Feb 2006



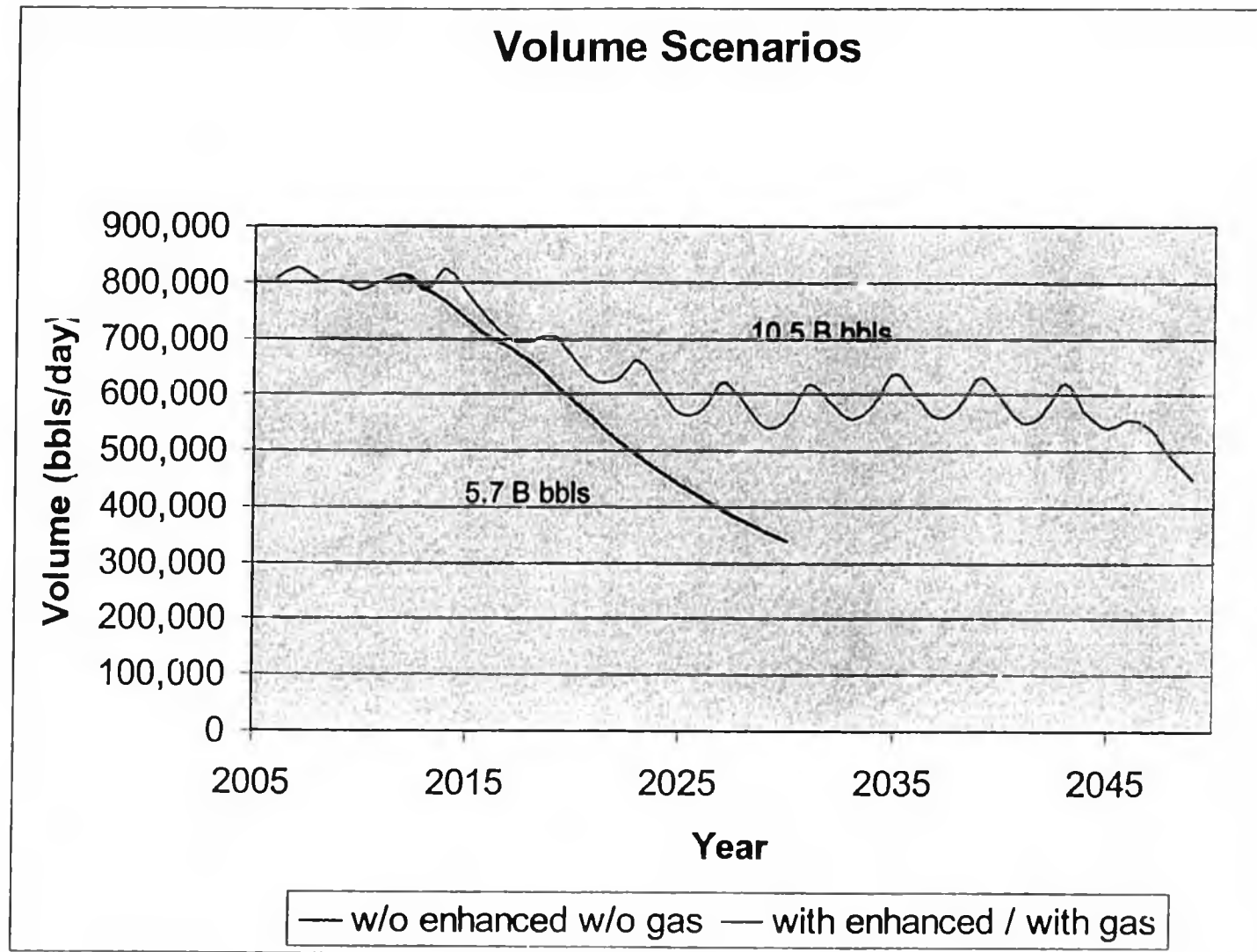
PPT Example

- 20 million taxable barrels @ \$60/bbl ANS West Coast = MARKET VALUE of \$1,200 million (excludes royalty)
- \$2/bbl shipping + \$3/bbl TAPS = \$5/bbl = \$100 million
- WELLHEAD VALUE = \$1,100 million
- PROGRESSIVE SURCHARGE = 3% X \$1,100 = \$33 million
- UPSTREAM COST = Capital + Operating + Property Tax + Progressive Surcharge = \$300 million
- TAXABLE PROFIT = \$1,100 - \$300 - \$33 = \$767
- If TAX RATE = 20%, TAX BEFORE CREDITS = 20% X \$767 = \$153 million
- If capital = \$200 million and the CREDIT RATE = 20%, credit = \$40 million
- Additional STANDARD CREDIT of \$12 million (first 10 years)
- PPT PAID = \$153 + \$33 - \$12 - \$40 = \$134 million

Volume Scenarios

- No enhanced volumes / No gasline
 - Totals 5.7 billion barrels through 2030
 - Including 0.6 billion barrels of heavy oil
 - No additional heavy oil at prices under \$30
- Gasline and enhanced volumes
 - Totals 10.5 billion barrels through 2050
 - Includes additional 3.1 billion barrels conventional
 - 700 million barrels net stemming from gasline
 - Including additional 1.7 billion barrels heavy oil
 - No additional heavy oil at prices under \$30

FIGURE 3



Costs and Prices

- Costs
 - \$100 mm/yr exploration through 2040
 - \$1/bbl on-going capital on all barrels
 - \$3.50/bbl developmental capital on 2/3 of existing conventional oil
 - \$8/bbl developmental capital on 2/3 of existing heavy oil
 - \$3.50/bbl developmental capital on new conventional oil
 - \$8/bbl developmental capital on new heavy oil
 - \$3/bbl operating costs on conventional oil
 - \$5/bbl operating costs on heavy oil
- Costs, prices, and revenues are all real \$2005 dollars
- Heavy oil discounted 8% for quality
- 10 full equivalent standard \$12 million credits

Feedback Effects Not Modeled

- Production depends on investment
 - More investment with incentives
 - Credits are incentive
- More investment with higher prices
- Less investment with higher taxes
- Investment driven by competitive international opportunities ... which are always evolving

Cumulative Revenues

- Without enhanced volumes / without gasline (through 2030)
- With enhanced volumes / with gasline (through 2050)
 - Does not include gasline severance taxes
 - Includes gasline costs

FIGURE 4

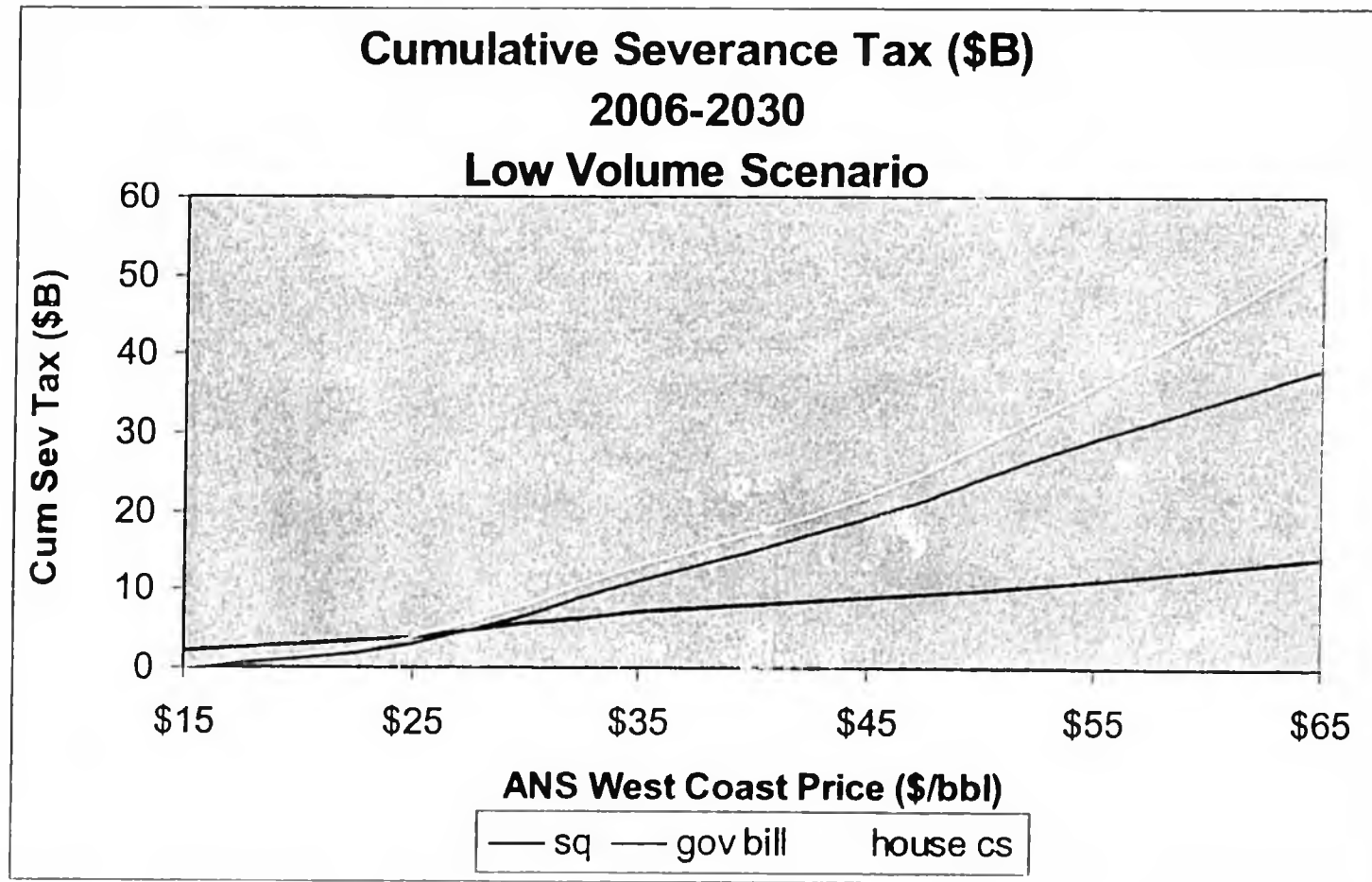


Figure 5
Crossover Point and Slope

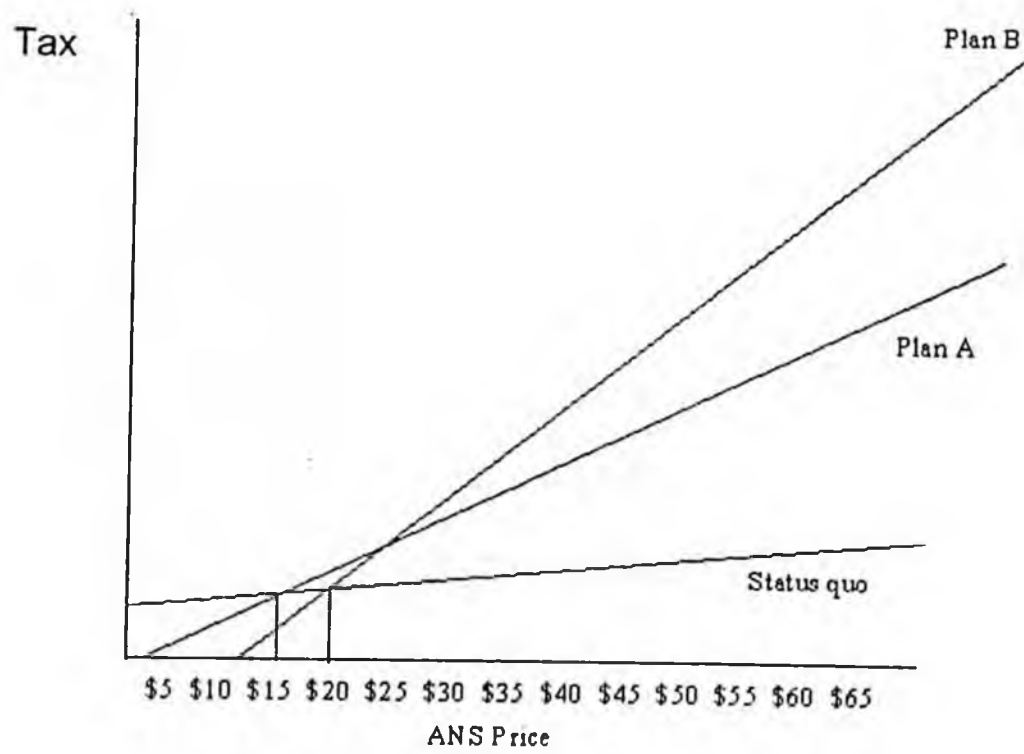
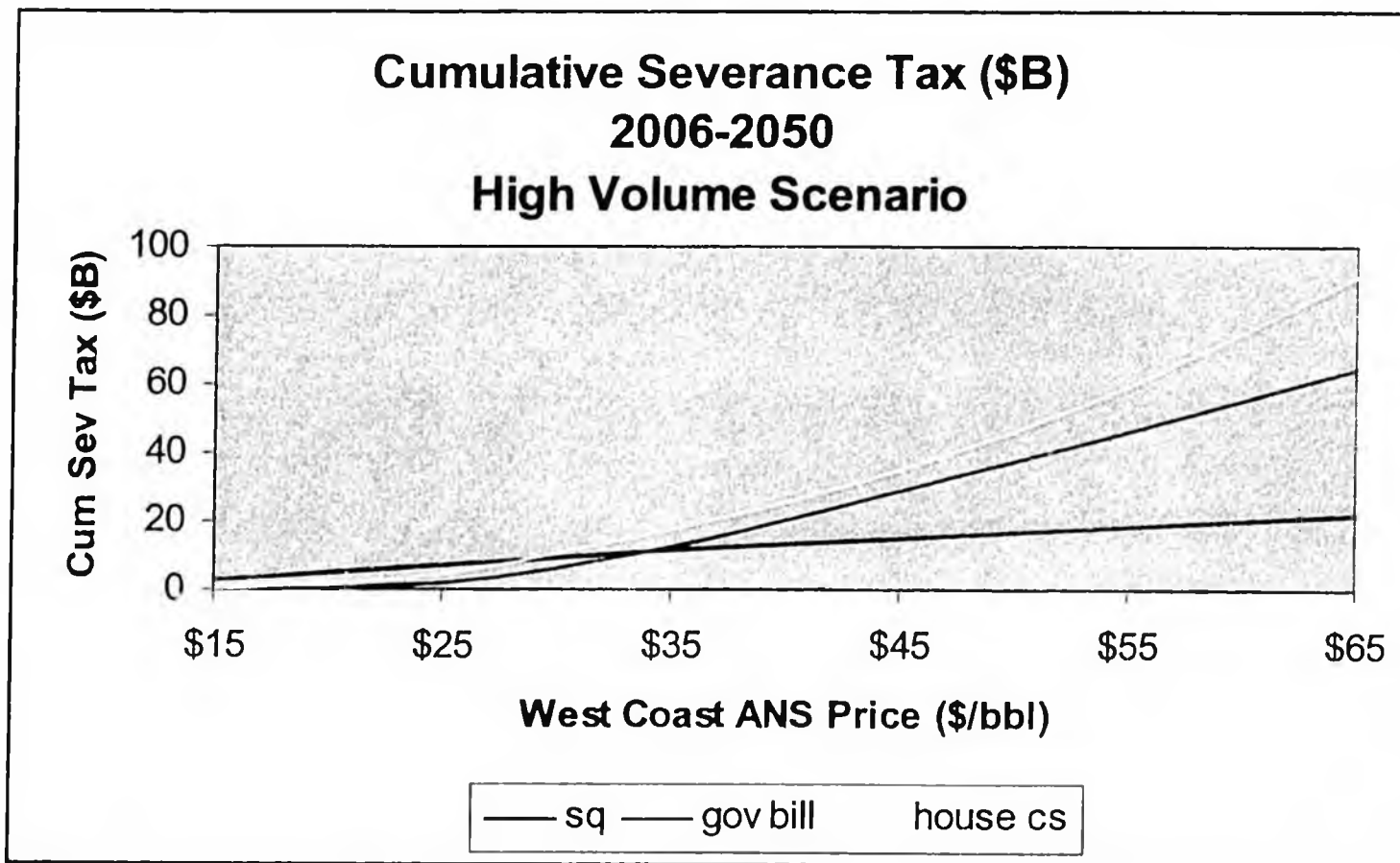


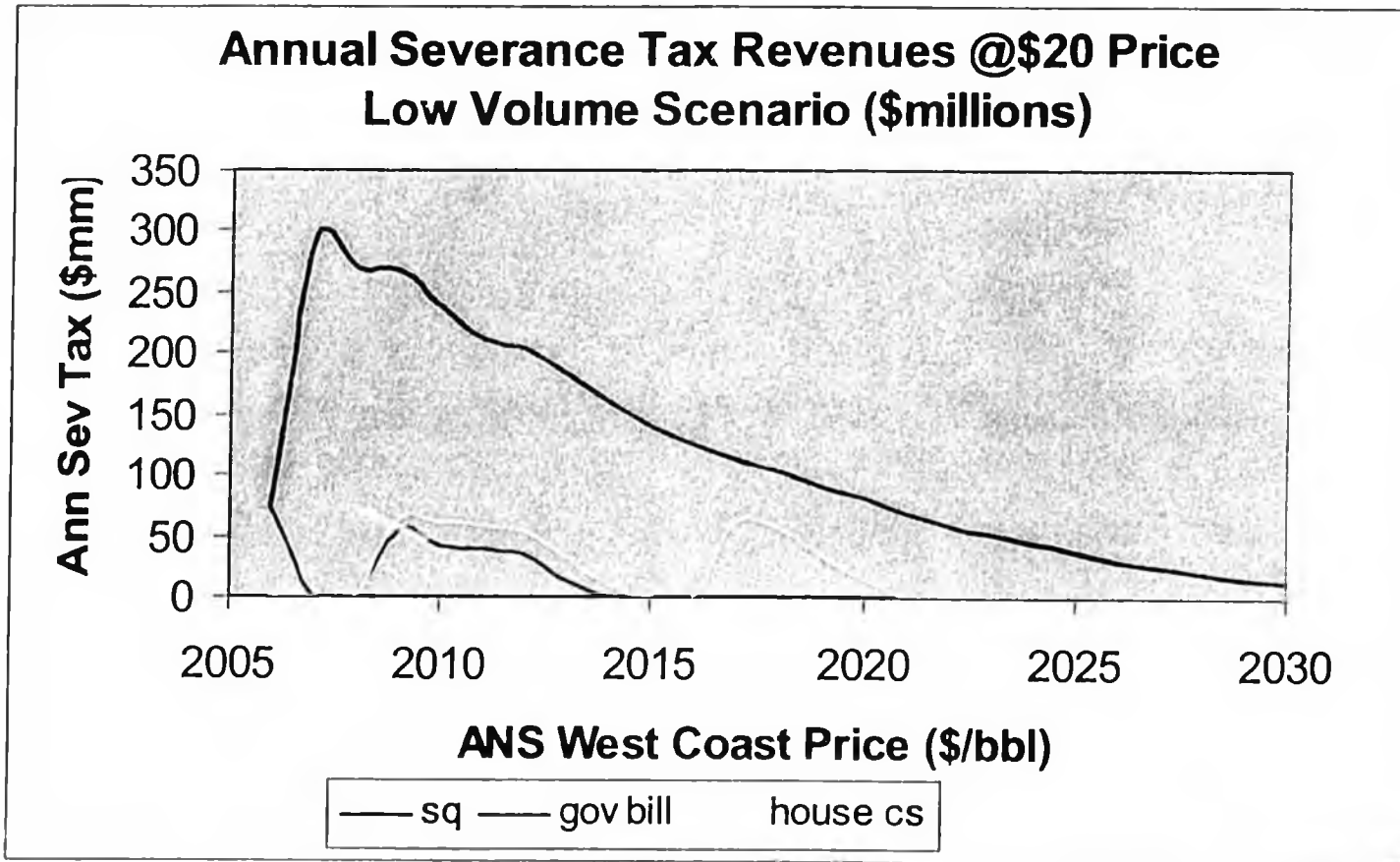
Figure 6



Annual Revenues

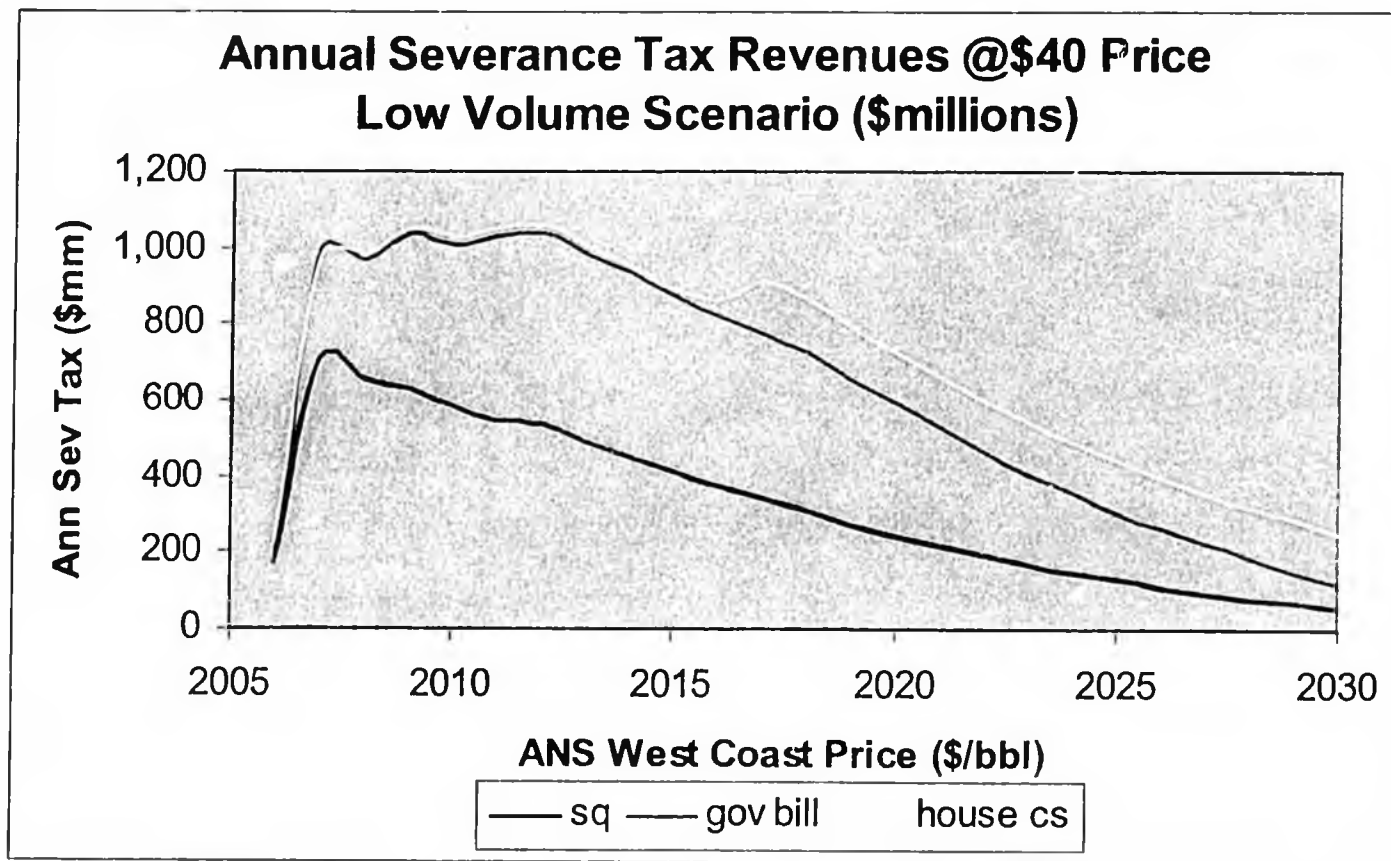
- Without enhanced volumes / without gasline (through 2030)
 - \$20
 - \$40
 - \$60
- With gasline / with enhanced volumes (through 2050) (does not include gasline severance taxes; includes gasline costs)
 - \$20
 - \$40
 - \$60

Figure 7



Average annual revenues \$100 million less than status quo (both proposals)
Note: Status quo averages \$116 million annually

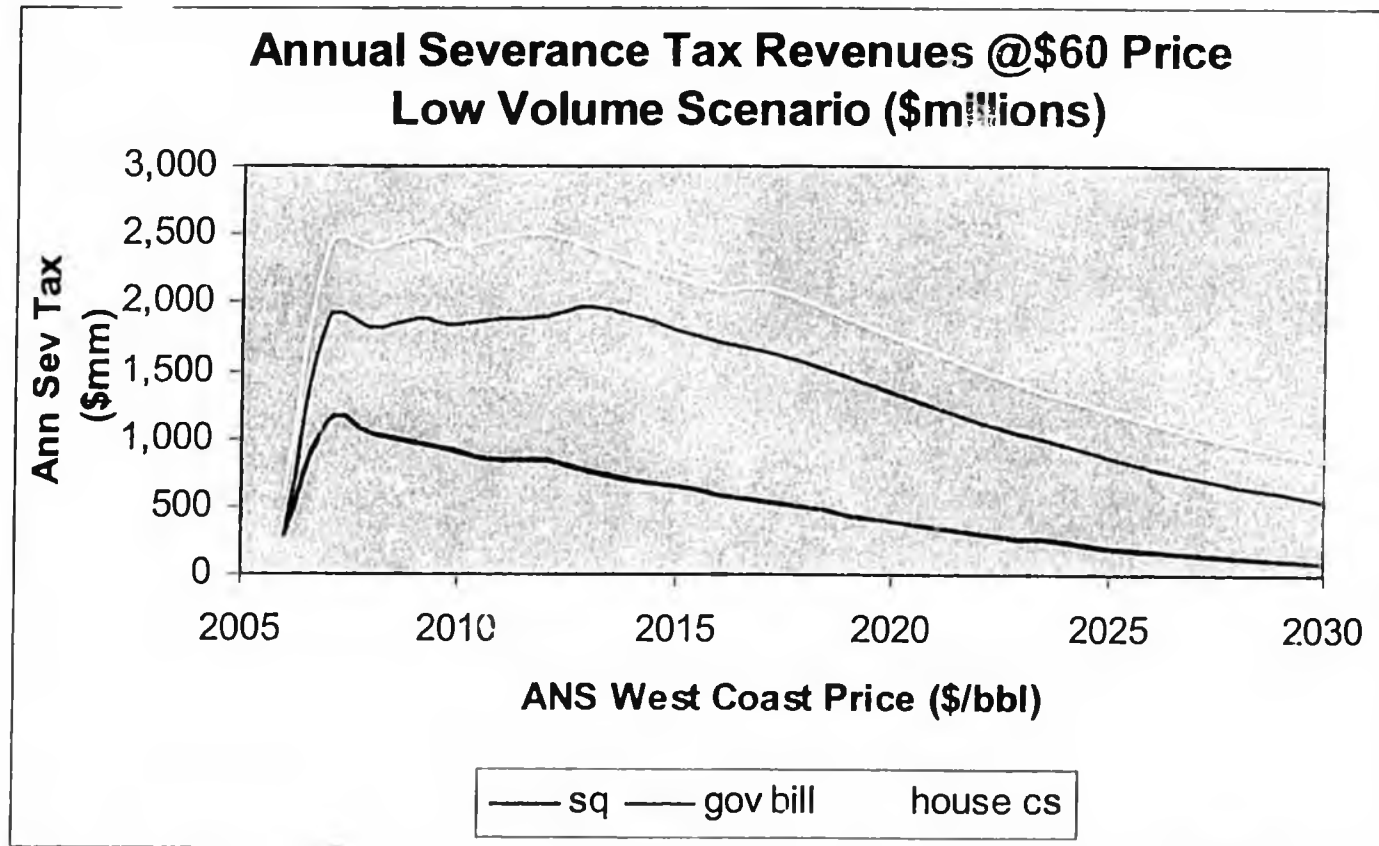
Figure 8



House CS has average annual revenues \$400 million more than status quo
and \$100 more than Governor's bill

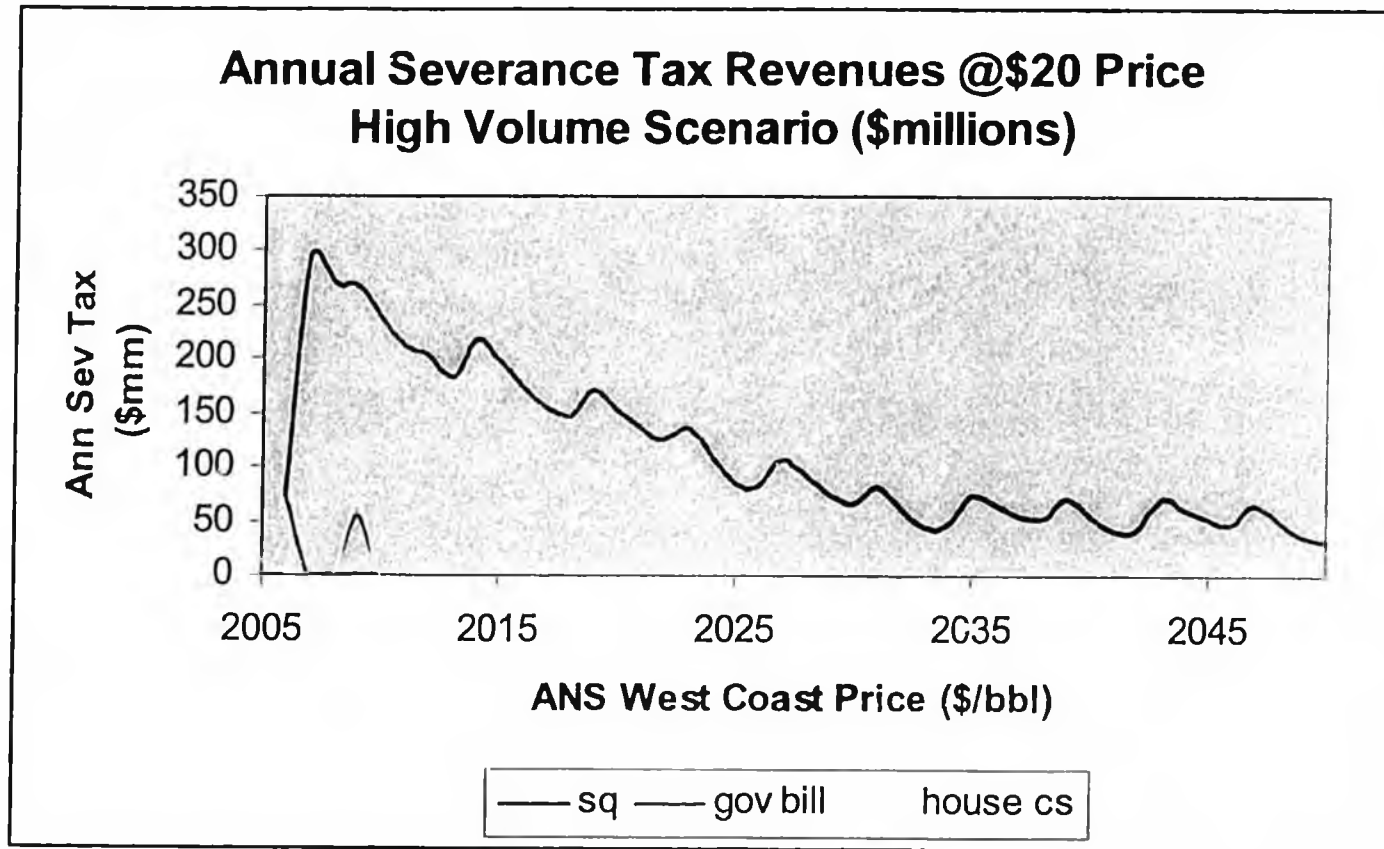
Note: 2017 is when \$12 million allowance expires under House CS

Figure 9



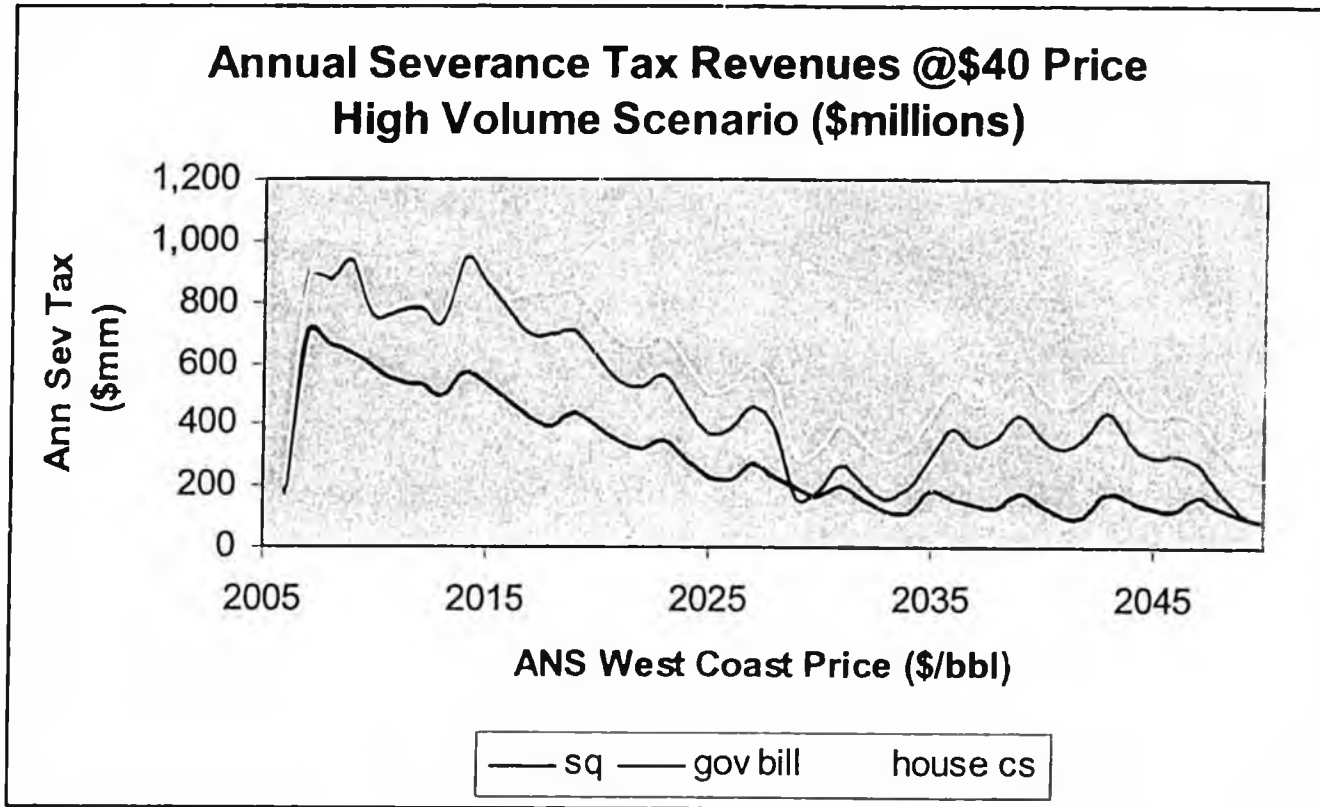
House CS has average annual revenues \$1.3 billion more than status quo and \$400 million more than Governor's bill. Net annual progressive surcharge \$200-\$400
Note this is equivalent to State gasoline revenues at \$5.00/mmbtu Chicago price without the gasoline.

Figure 10



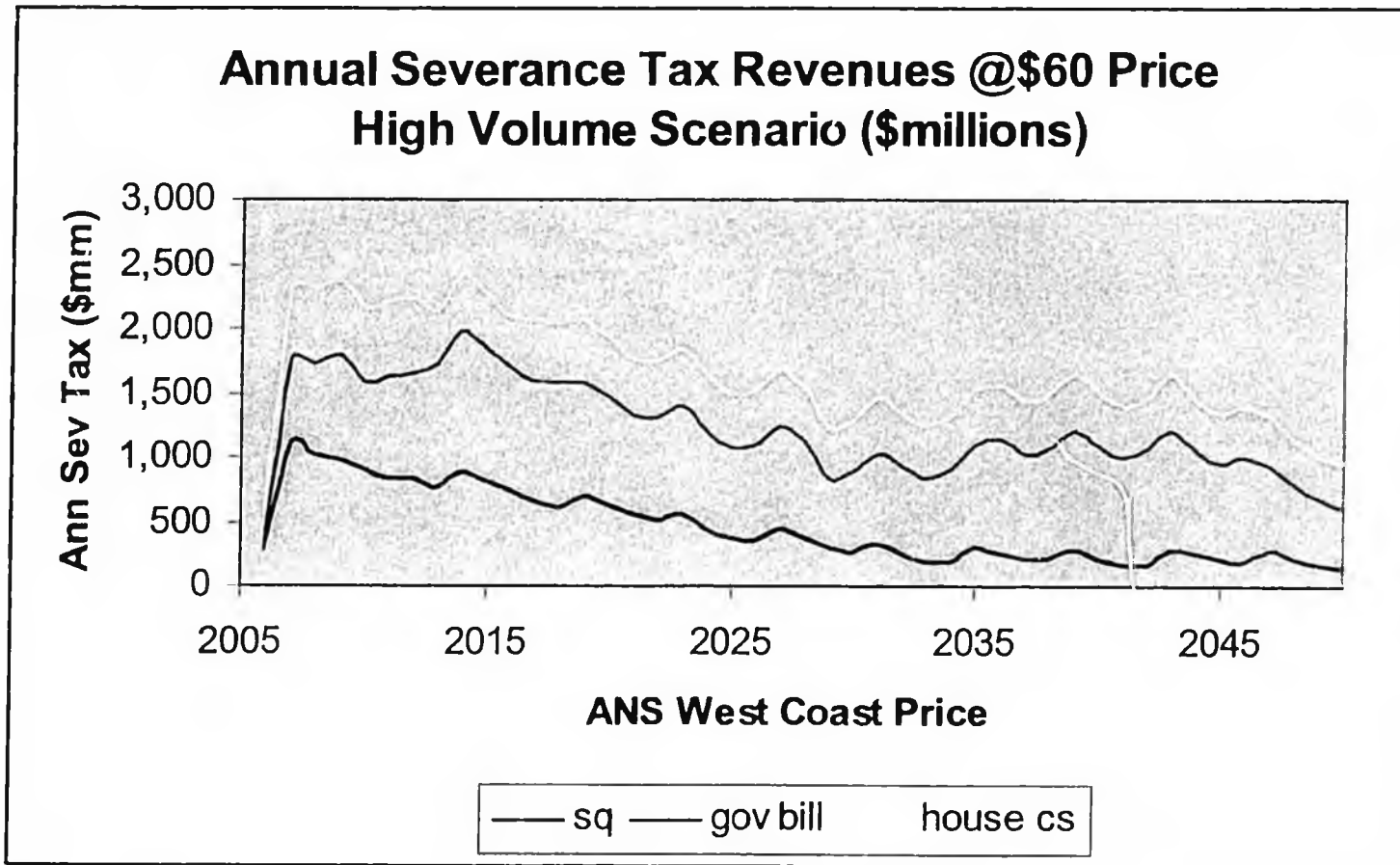
Average annual revenues \$100 million less than status quo (both proposals)
Note: Status quo averages \$112 million annually

Figure 11



House CS has average annual revenues \$300 million more than status quo and \$100 more than Governor's bill
Note: 2017 is when \$12 million allowance expires under House CS

Figure 12



House CS has average annual revenues \$1.2 billion more than status quo and \$400 million more than Governor's bill. Net annual progressive surcharge \$200-\$400 mm.

Effective Tax Rate

- Severance Tax / (Wellhead less Royalty)
 - Without enhanced volumes / without gasline
 - With enhanced volumes / with gasline

FIGURE 13

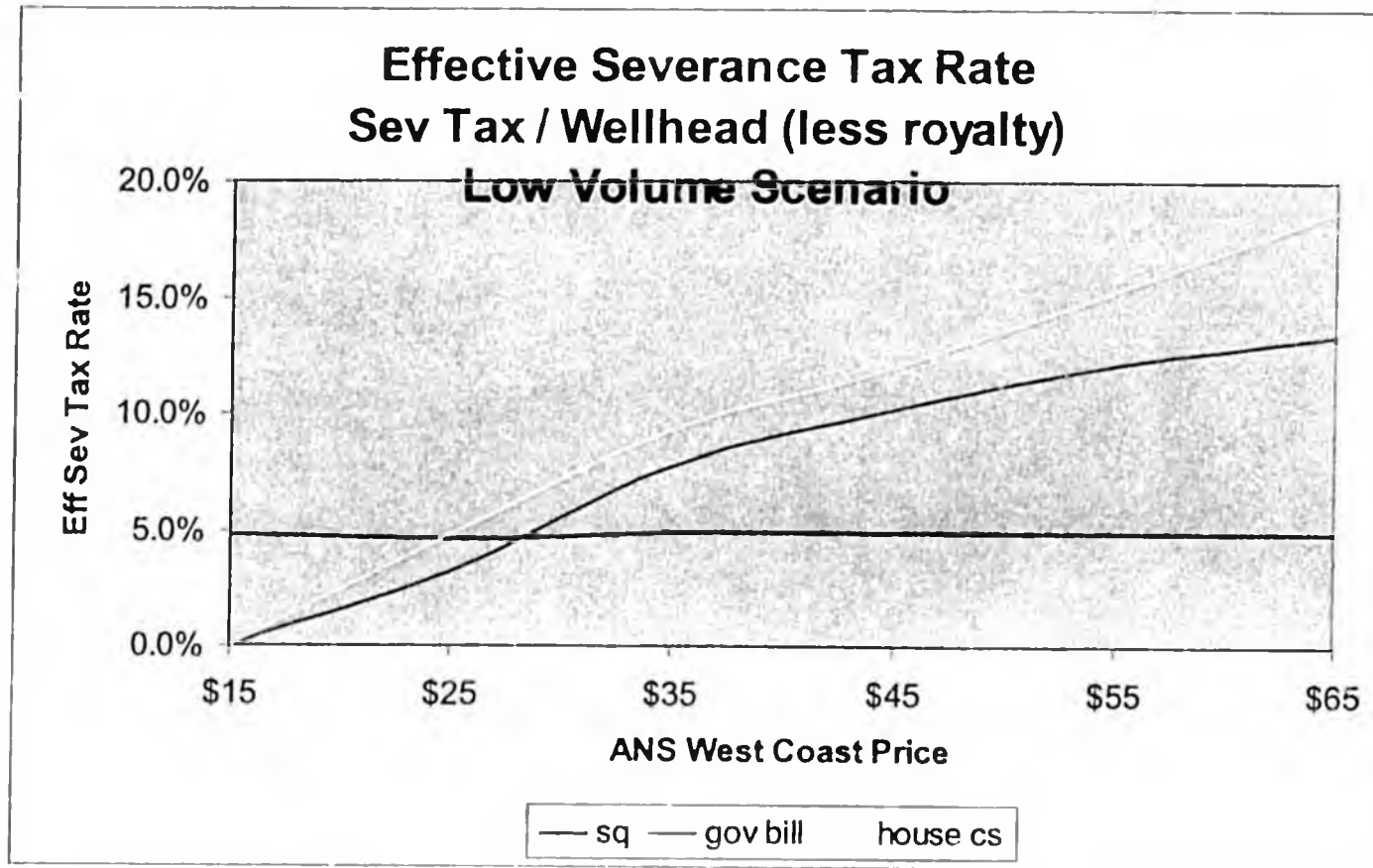
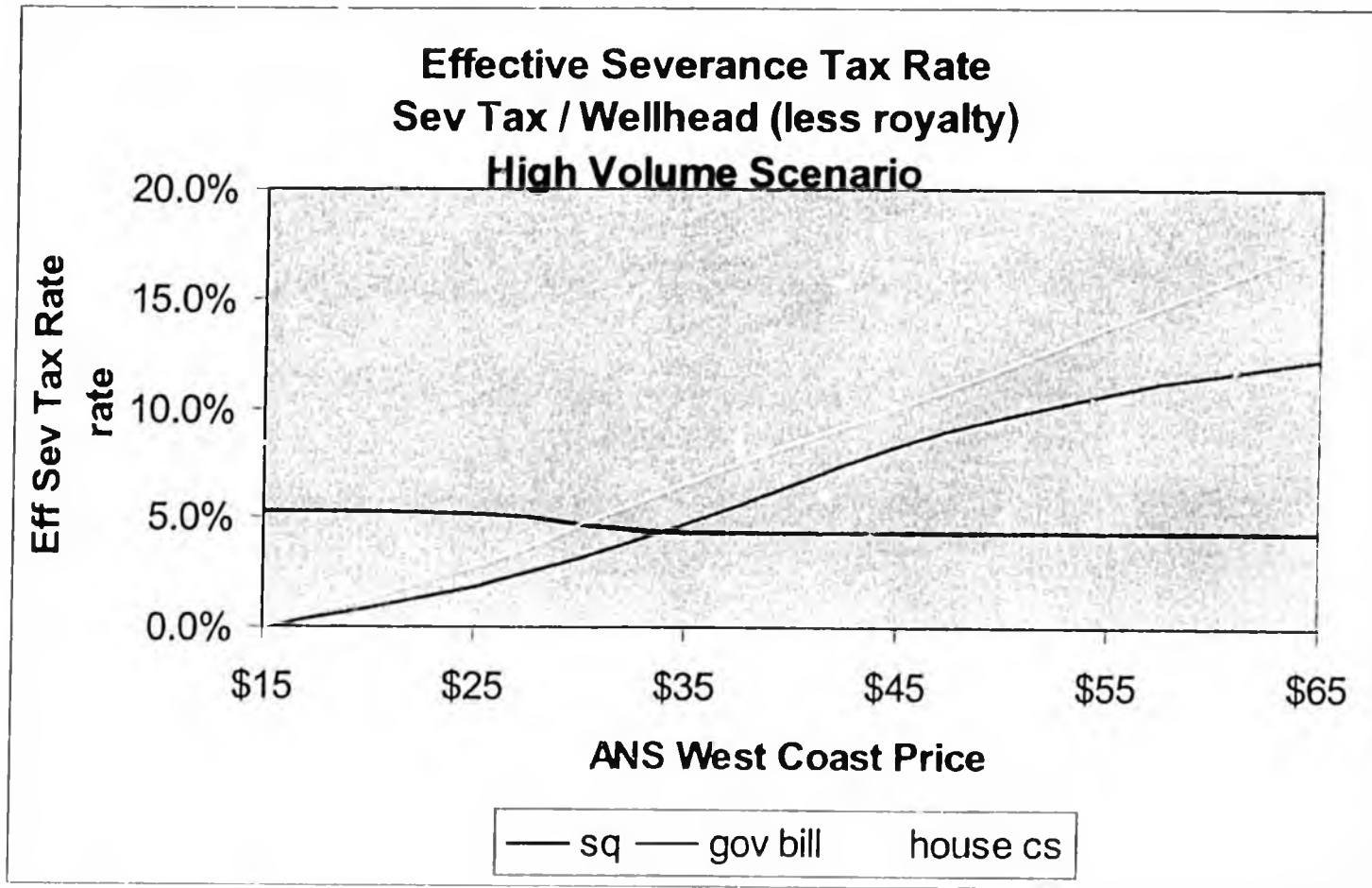


FIGURE 14



State Take

Sev Tax / Economic Rent

FIGURE 15

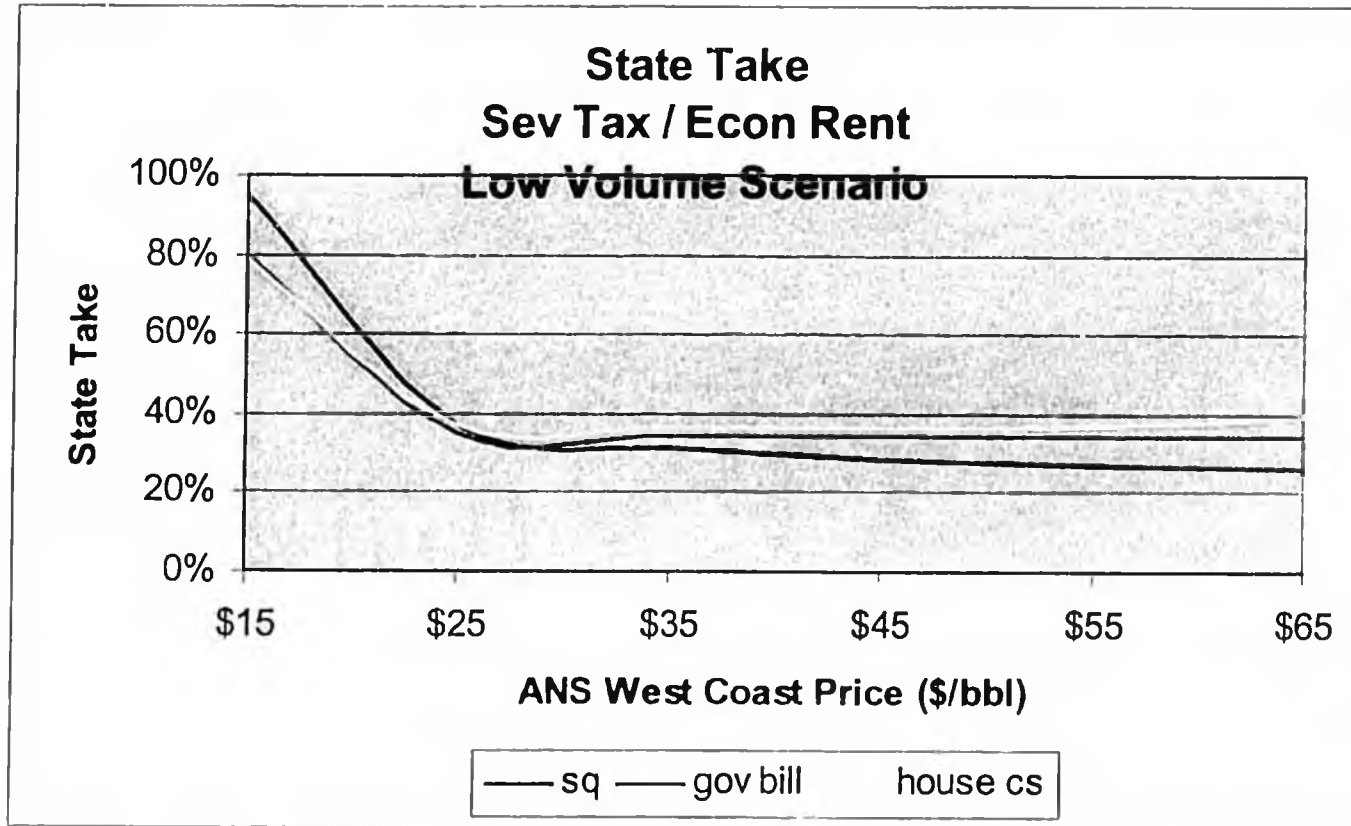
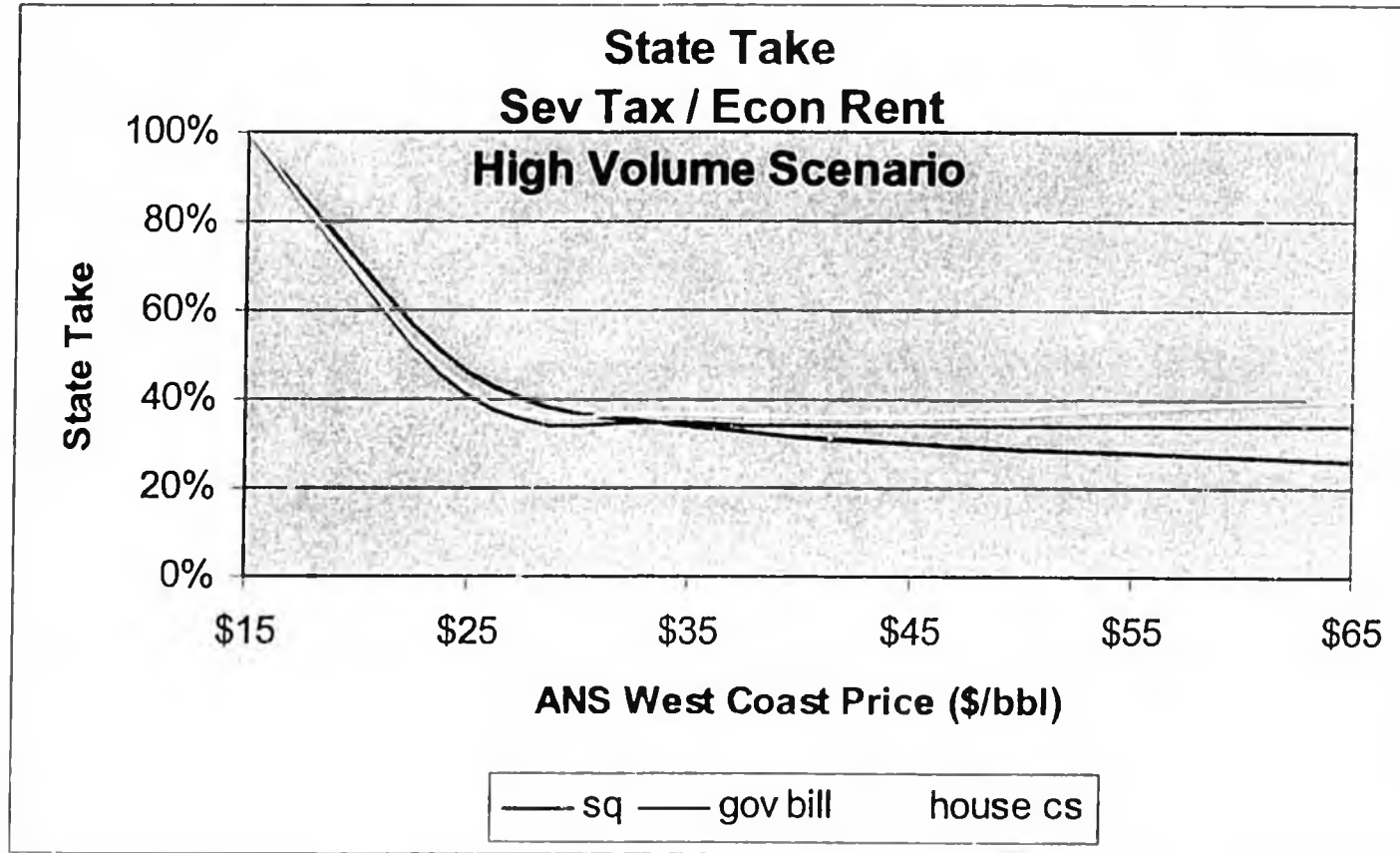


FIGURE 16



Cook Inlet

COOK INLET			
	Oil	Gas	Barrels of oil
	barrels/day	mcf/day	Equivalent
Aurora	0	9,260	1,543
Chevron/Unocal	7,885	116,755	27,344
ExxonMobil	1,111	0	1,111
Forest	6,891	108	6,909
Marathon	157	165,288	27,705
ML&P	0	15,431	2,572
ConocoPhillips	0	167,650	27,942
XTOE Energy	3,283	92	3,298
TOTAL	19,327	474,584	98,424

Cook Inlet Gas

- Cook Inlet is 80% gas on a BOE basis
- Industry is evolving
 - Decreased production?
 - Higher prices?
 - Increased investment?
- PPT impact on oil taxes not significant
- Gas taxes on existing fields may increase at higher prices
- New fields may see lower taxes/higher npv

GAS ELF

$$1 - (3000 / \text{Average Well Productivity})$$

Example: 10,000 mcf/well/day

$$\text{ELF} = 0.70$$

6,000 mcf/well/day

$$\text{ELF} = 0.50$$

COOK INLET GAS FIELDS

Field	MCF/day	Avg Elf
BELUGA RIVER	155,740	0.751
BEAVER CREEK	17,554	0.088
CANNERY LOOP	40,636	0.601
GRANITE POINT	208	0.000
HAPPY VALLEY	5,083	0.170
IVAN RIVER	4,348	0.000
KALOA FIELD	3,269	0.424
KENAI UNIT	60,907	0.001
LEWIS RIVER	1,042	0.000
LONE CREEK	4,240	0.358
MIDDLE GROUND SHOAL	61	0.000
MOQUAWKIE	5,188	0.354
NORTH COOK INLET	108,421	0.648
NICOLAI CREEK	1,593	0.000
NINILCHIK	30,783	0.373
NORTH TRADING BAY UNIT	587	0.000
PRETTY CREEK	1,967	0.000
REDOUBT SHOALS	2	0.559
STERLING GAS FIELD	2,094	0.278
TRADING BAY UNIT	146,343	0.474
SWANSON RIVER	10,539	0.000
WOLF LAKE	163	0.000
	600,768	0.500

Gas ELF

- A 0.50 ELF implies 6,000 mcf/well/day
- Therefore, 3,000 mcf/well/day is tax-free
- The revenue from tax-free gas is supposed to recover operating costs
- Operating costs for Cook Inlet gas is estimated to be 50 cents
- Therefore operating costs are \$3,000/well/day
- Henry Hub prices are over \$7/mcf
- The revenue from the 3,000 tax-free mcf/well/day is worth \$21,000
- This is 7X more than it should be recovering

Cook Inlet Gas Tax

- We estimate crossover point at about \$5/mcf on existing fields
- At \$6/mcf increase of \$25 million annually on existing fields
- Out of \$1 billion gross revenues annually
- Decrease as production goes down
- New production may see reduced taxes