

HB

48

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: CSHB048(STA)-DOA-DRB-3-06-07
Bill Version: CSHB048(STA)
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Administration
Title An Act amending the powers of the ARMB to RDU Centralized Administrative Services
authorize purchase and sale of tax credit certificates. Component Retirement and Benefits
Sponsor Representatives Seaton
Requester House Finance Component No. 64

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
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CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0
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FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2007) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

POSITIONS

Full-time	0	0	0	0	0	0
Part-time	0	0	0	0	0	0
Temporary	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

This bill grants authority to the Alaska Retirement Management Board (ARMB) to purchase transferable tax credit certificates issued under AS 43.55.023 for 92% of the face value of the certificate and then sell the tax credit certificates to the Department of Revenue under AS 43.55.023(f) for the full face value of the certificate. Proceeds of the sale of tax credit certificates will be applied to the unfunded pension liability of the defined benefit retirement plans for which the board has responsibility. The bill will have no financial impact on the administration of the plans by the DividiRB and result in a zero fiscal note.

Prepared by: Melanie Millhorn, Director
Division: Division of Retirement and Benefits
Approved by: Rachael Petro, Deputy Commissioner
Agency: Department of Administration

Phone 465-4817
Date/Time 3/6/2007 10:30am
Date 3/6/07 11:15am

FISCAL NOTE

not adopted
2/14/07

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: CSHB048-DOR-TAX-2-14-07
 Bill Version: CSHB 48(STA)
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue 04
 Title Retirement Board Purchase PPT Credits RDU Taxation and Treasury
 Component Tax Division
 Sponsor Representatives Seaton, Kelly
 Requester (H) State Affairs Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

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

Estimate of any current year (FY2007) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

*This bill would authorize the Alaska Retirement Management Board (ARM) to purchase transferable tax credit certificates issued under AS 43.55.023 and AS 43.55.025 for 92 percent of the face value of the certificates. The ARM board would then sell the certificates to the Department of Revenue for the full face value of the certificates, unless the commissioner of the Department of Revenue determines that economic conditions are not acceptable for the state to purchase and pay for the certificates. The proceeds of these sales would be used by the ARM board to defray the unfunded pension liabilities for which the board is responsible.

Alaska Statutes 43.55 currently offers three clearly identifiable means of obtaining and selling tax credits for petroleum exploration activity and other capital costs relating to petroleum production.

Prepared by: Brian Andrews, Cherie Nienthuis and Roger Marks Phone 465-2300
 Division Treasury and Tax Date/Time 2/13/07 10:00 AM
 Approved by: Jerry Burnett Date 2/14/2007
 Agency Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

BILL NO. HB 48

ANALYSIS CONTINUATION

AS 43.55.025, known as the Exploration Incentive Credit, offers tax credits for either 20% or 40% of exploration expenditures incurred before July 1, 2016. The certificates issued under this program can be carried forward or transferred. Current statutes allow these credit certificates to be sold to other taxpayers; there is no provision for the state to buy credit certificates generated under AS 43.55.025 directly from the explorer to which the credit was originally issued.

Tax credits generated under AS 43.55.023, through excess capital expenditures or net losses, can also be carried forward or transferred. Current statutes allow these credit certificates to be sold to (1) other taxpayers (AS 43.55.023(e)), or (2) to the state Department of Revenue (AS 43.55.023(f)).

Although there are qualifying criteria for the state's purchase of credit certificates at AS 43.55.023(f), there are no restrictions on the amount to be paid for the certificates (other than the maximum refund per taxpayer of \$25 million per year), and it is assumed that the state would pay full face value for the certificates. There are also no restrictions on the amount other taxpayers can pay for the certificates, although it is assumed they would pay less than face value and current statutes limit the amount transferred certificates can reduce a taxpayer's liability to 20 percent per year.

Given the three options and their qualifying criteria, it is difficult to assess which program certificate holders will favor. Were the expenditures to qualify under the EIC 40% credit program, then it is likely that would be the first choice. As of December 31, 2006, the EIC program issued credits totaling \$34.7 million dollars over the 3.5 years since the program's inception; additional applications are pending approval by the department. If all the credits issued were sold to the ARM board for 92% of the face value and resold to the Department of Revenue, the total generated for the ARM board over the period would have been approximately \$2.8 million.

Alternatively, should the expenditures qualify only for the 20% credit, then it is likely that the certificates would be transferred to the highest bidder. The highest bidder could be another taxpayer, the state Department of Revenue, or, under this bill, the ARM board.

moved N/O
3/6/07

not taken up
on 2/14/07

25-LS0259A.E.1
Bullock
2/12/07

AMENDMENT 1

Meyer on
behalf of
Rep Seaton

OFFERED IN THE HOUSE
TO: CSHB 48(STA)

1 Page 1, line 3, following "gas;":

2 Insert "relating to transferable tax credit certificates issued under the oil and gas
3 production tax;"

5 Page 2, line 6:

6 Delete "AS 43.55.023(f) and 43.55.025"

7 Insert "AS 43.55.023(l) and 43.55.025(l)"

9 Page 2, following line 19:

10 Insert new bill sections to read:

11 "* Sec. 2. AS 43.55.023 is amended by adding a new subsection to read:

12 (l) Notwithstanding the limitation on the use of a transferable tax credit by a
13 transferee in (e) of this section and subject to appropriations made by law, the
14 department shall issue a cash refund to the Alaska Retirement Management Board for
15 a transferable tax credit originally issued to a person under (d) of this section and
16 purchased by the Alaska Retirement Management Board under AS 37.10.220(b).

17 * Sec. 3. AS 43.55.025 is amended by adding a new subsection to read:

18 (l) Subject to appropriations made by law, the department shall issue a cash
19 refund to the Alaska Retirement Management Board for a transferable tax credit
20 originally issued to an explorer under (f) of this section and purchased by the Alaska
21 Retirement Management Board under AS 37.10.220(b)."

23 Renumber the following bill section accordingly.

3-6-07

Alaska Retirement Management Board
P.O. Box 110405
Juneau, Alaska 99811-0405
(907) 465-3749

February 23, 2007

The Honorable Paul Seaton
Alaska House of Representatives
State Capitol, Room 102
Juneau, Alaska 99801-1182

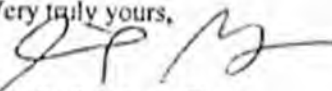
Dear Representative Seaton:

The trustees of the Alaska Retirement Management Board (ARMB) met today to consider the questions regarding HB 48 forwarded from you through Chief Investment Officer Gary Bader. At an earlier meeting this month the Board heard a legislative update with a brief synopsis of pending legislation that included this bill. The trustees also reviewed a memorandum from staff, a copy of which is attached.

The trustees agree that passage of HB 48, allowing the ARMB to purchase transferable tax credits established under the Petroleum Profits Tax (PPT) and obtain reimbursement of the credits through the Department of Revenue, is a valuable tool in addressing the retirement systems' unfunded liabilities and/or contribution rates. Trustees also concur with setting the discount rate at 92% for purchase of the investment tax credits.

We appreciate your continued support and efforts at finding solutions to fully fund our retirement system.

Very truly yours,


Gail R. Schubert, Chair

Attachment

ALASKA RETIREMENT MANAGEMENT BOARD

SUBJECT: Position on House Bill 48

ACTION: X

DATE: February 23, 2007

INFORMATION: _____

BACKGROUND:

House Bill 48 would allow the Alaska Retirement Management Board (ARMB) to purchase transferable tax credits established under the Petroleum Profits Tax (PPT) and obtain reimbursement of the credits through the Department of Revenue (DOR). The PPT created a direct refund of up to \$25,000,000 in transferable tax credits per company each year. These transferable credits only arise when a company generates investment credit, but has insufficient production tax against which to take the credit.

Under HB 48, the ARMB would not be required to purchase the credits. However, if the ARMB purchased credits, it would be required to do so at 92% of the face value of the credit certificate. The opportunity to purchase a credit for \$0.92 and sell it for \$1.00 would result in an 8.69% $((\$1.00 - \$0.92) / \$0.92)$ return on investment. However, the annualized rate of return on investment would be considerably higher since funds for the purchase would only be utilized for a short time. Therefore, it is likely that investment staff would nearly always opt to purchase a credit.

STATUS:

HB 48 is currently being considered by the House Finance Committee. During the course of deliberations about the Bill, some committee members expressed a desire to know: (1) if the ARMB supports legislation that would include this tool in the ARMB investment toolbox; and (2) if the ARMB would favor pegging the transfer rate to the ARMB at 92%, or empowering the investment staff to negotiate the rate with potential sellers.

Staff assumes the ARMB would only be approached to purchase the credits if a taxpayer could not use the credit directly and the universe of potential buyers of the credit is extremely thin or non-existent. If the legislature empowers ARMB staff to negotiate each tax credit purchase, staff would have a fiduciary responsibility to purchase the credits at the lowest possible price.

Investment staff engages in the buying and selling securities on a daily basis. However, in most instances, staff is investing in markets with substantially more transparency than anticipated in this instance. From an annualized rate of return perspective, investment staff may find a purchase price higher than 92% attractive. However, without market transparency, staff would be reluctant to bid up the price without knowing there was in fact a higher bidder. Staff believes the ARMB should favor a set purchase rate of 92% for the credits based upon the assumptions that the purchased credits can be rapidly converted to cash and that the originator of the credit will bear any penalty for denial of the credit by DOR pursuant to a subsequent audit.

RECOMMENDATION:

That the Chair of the ARMB notify Representative Seaton in writing that the ARMB endorses the passage of HB 48 with a set discount rate of 92% for purchase of investment tax credits as a valuable tool to address PERS and/or TRS unfunded liabilities and/or contribution rates.

Alaska State Legislature

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Representative Paul Seaton
House District 35

HB 48 Sponsor Statement

HB 48 addresses the massive unfunded liability in the state retirement system by allowing the Alaska Management Retirement (ARM) Board to purchase transferable credits established under the Petroleum Profits Tax, and the Exploration Incentive Credit statute, and obtain reimbursement of the credits through the Department of Revenue (DOR). The ARM Board shall then apply the return on their investment against the state's unfunded liability.

Under HB 48 the ARM Board is not required to purchase the credits. However, if the ARM Board does purchase the credit, it must do so at a rate of 92% of the face value of the credit certificate.

The Petroleum Production Tax (PPT) directs the DOR to reimburse companies for 100% of the face value of their transferable tax credit certificates (AS 43.55.023 (f)). When the ARM Board reimburses their credit (purchased at 92%) though the DOR for 100% face value, the Board will realize an 8% return on their investment. This is close to the ARM Board's annual target rate of 8.25%. However, because the return under HB 48 is on short term instead of a yearly basis, the overall rate of return on the ARM Board portfolio is significantly improved.

HB 48 provides an additional benefit to small oil and gas companies. The PPT created a direct refund of up to \$25,000,000 in transferable tax credit per company each year. These transferable credits only arise when a company generates investment credit but has insufficient production tax against which to take the credit. This generally would be an exploration company before any production begins. Beyond that amount the credits are tradable and may be purchased and utilized to offset another company's PPT liability up to an annual limit of 20% of their tax liability. The explorers and small producers are concerned about the discount rate that they may be forced to accept for the transfer since the credits can only be applied to the PPT liability and there are few companies large enough (with enough tax liability under the PPT) to utilize the credits. In the past, 90% has been paid for similar credits, although with a limited pool of users this rate could fall to 70% or 80%. HB 48 would effectively set a "floor" on the discount rate at 92%, ensuring an equitable return for the companies actually making the investment in exploration.

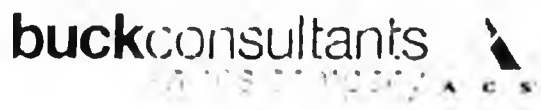
The language in HB 48 is permissive and does not require the DOR to incur a debt. Before the DOR reimburses the credit certificate the Commissioner must make the determination that the economic conditions are acceptable for the state to purchase the credit. Since the Commissioner of Revenue is a statutory member of the ARM Board the determination of the ability to get the face value reimbursement will be known by the Board before it takes action to purchase a transferable tax credit.

2/14/07



**State of Alaska
Public Employees'
Retirement System**

Actuarial Valuation Report as of June 30, 2005



Submitted By:
Buck Consultants
1200 Seventeenth Street, Suite 1200
Denver, CO 80202

Distributed by Rep. Paul Seaton
Back-up: HB 48

**1.5(e) Actuarial Projections – Effect of Economic Scenarios
Based on DB Only Payroll After July 1, 2006**

Key Assumptions

- All assumptions and methods are the same as Section 1.5(a) except
 - The actuarially calculated contribution rate with a two-year lag is adopted in each year beginning in FY08
 - Investment returns are assumed as follows:

Base Case:	8.25% for all future years
Optimistic:	9.00% for all future years
Pessimistic:	7.50% for all future years

Observations

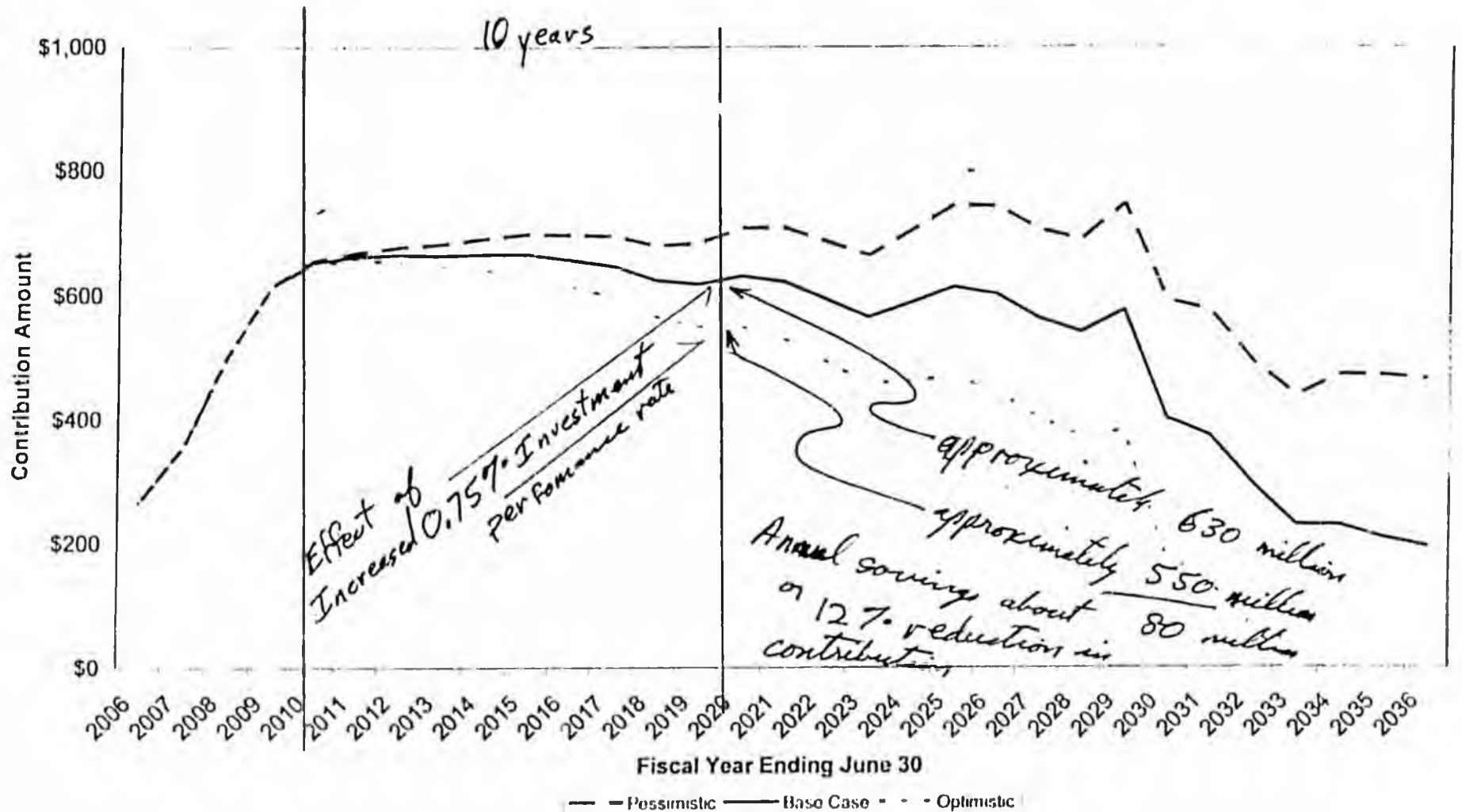
- In all cases, liabilities have been projected using 8.25% as the discount rate for future benefit payments. These scenarios are intended to illustrate the impact if investment rates are different than the 8.25% assumed investment return. They do not illustrate the effect of changing the assumed investment return for determining liabilities.

*Distributed by Rep. Paul Seaton
Back-Up: HB 48*

1.5(e) Actuarial Projections – Projections at Calculated Rate
Effect of Economic Scenarios
Based on DB Only Payroll After July 1, 2006 (continued)

Notations by Rep. Seaton to demonstrate the effect of increased return on ARM Board investment. The notations are not purporting to describe the size of the actual investment increase under HB 48.

Contribution Amounts

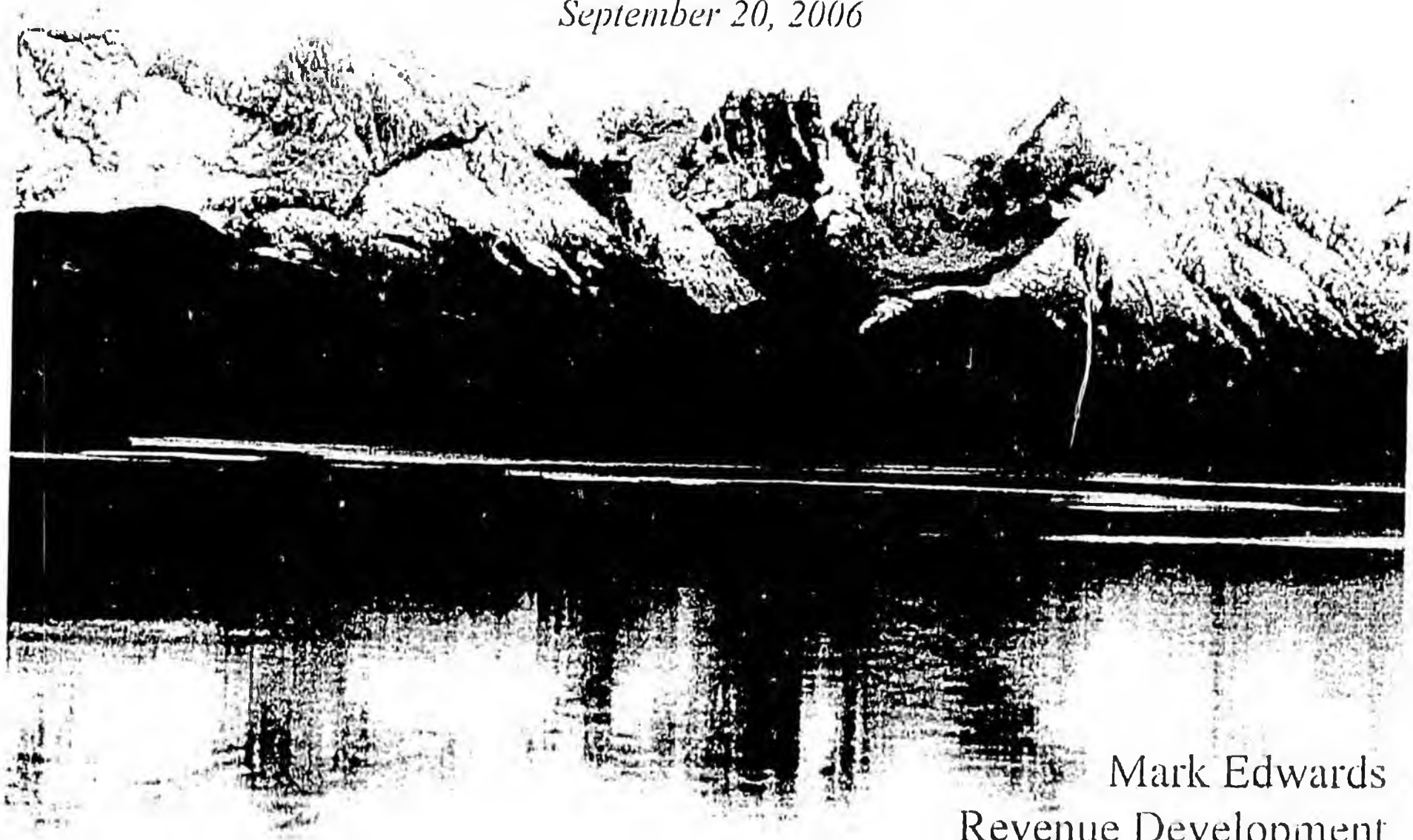


Distributed by Rep. Paul Seaton
Back-up: HB 48

South Central Alaska Energy Forum

Taxes and Incentives

September 20, 2006



Mark Edwards
Revenue Development
Department of Revenue

Tradable Capital Investment Tax Credits - 43.55.023 (a) – (h)

- 20% tax credit for qualified capital expenditures
- Unused credit can be applied in future years And 20% Net Operating Loss
- Transferable and re-transferable with a certificate
- Producers of less than 50,000 BTU equivalent barrels per day can get a cash refund if they meet certain qualifications
- Flexible for a wide variety of circumstances, can be cashed out, traded or saved

Exploration Tax Credits

43.55.025

- Extends exploration tax credits six years to 2016
- 20% credit for exploration wells more than 3 miles from an existing well (C.I. deemed separate target)
- 20% for wells more than 25 miles from existing unit (10 miles for Cook Inlet)
- 40% credit if both conditions are met
- 40% credit for seismic operations not associated with a well

TRANSFERABLE CREDIT LANGUAGE UNDER THE PPT

Sec. 43.55.023 Tax credits for certain losses and expenditures.

(a) A producer or explorer may take a tax credit for a qualified capital expenditure as follows:

(1) notwithstanding that a qualified capital expenditure may be a deductible lease expenditure for purposes of calculating the production tax value of oil and gas under AS 43.55.160 (a), unless a credit for that expenditure is taken under AS 38.05.180 (i), AS 41.09.010, AS 43.20.043, or AS 43.55.025, a producer or explorer that incurs a qualified capital expenditure may also elect to take a tax credit against a tax due under AS 43.55.011 (e) in the amount of 20 percent of that expenditure;

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

(A) to notify the Department of Natural Resources, before the later of 30 days after completion of the geological or geophysical data processing or completion of the well, or 30 days after the statement is filed, of the date of completion and to submit a report to that department describing the processing sequence and provide a list of data sets available;

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

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

(b) A producer or explorer may elect to take a tax credit in the amount of 20 percent of a carried-forward annual loss. A credit under this subsection may be applied against a tax due under AS 43.55.011 (e). For purposes of this subsection, a carried-forward annual loss is the amount of a producer's or explorer's adjusted lease expenditures under AS 43.55.165 and 43.55.170 for a previous calendar year that was not deductible for that calendar year under AS 43.55.160 (b) and (c).

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

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

(e) A person to which a transferable tax credit certificate is issued under (d) of this section may transfer the certificate to another person, and a transferee may further transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and notwithstanding any action the department may take with respect to the applicant under (g) of this section, the owner of a certificate may apply the credit or a portion of the credit shown on the certificate only against a tax due under AS 43.55.011 (e). However, a credit shown on a transferable tax credit certificate may not be applied to reduce a transferee's total tax due under AS 43.55.011 (e) on oil and gas produced during a calendar year to less than 80 percent of the tax that would otherwise be due without applying that credit. Any portion of a credit not used under this subsection may be applied in a later period.

(f) Under standards established in regulations adopted by the department and subject to appropriations made by law, the department, on the written application of the person to whom a transferable tax credit has been issued under (d) of this section and whose average amount of oil and gas produced a day taxable under AS 43.55.011 (e) is not more than 50,000 BTU equivalent barrels a day for the preceding calendar year, shall issue a cash refund, in whole or in part, for the certificate if the department finds

(1) within 24 months after having applied for the transferable tax credit certificate, that the applicant incurred a qualified capital expenditure or was the successful bidder on a bid submitted for a lease on state land under AS 38.05.180 (1);

(2) that the amount of the refund would not exceed the total of qualified capital expenditures and successful bids described in (1) of this subsection that have not been the subject of a finding made under this paragraph for purposes of a previous refund;

(3) that the applicant does not have an outstanding liability to the state for unpaid delinquent taxes under this title; and

(4) that the sum of the amount of the refund applied for and amounts previously refunded to the applicant during the calendar year under this subsection would not exceed \$25,000,000.

(g) The issuance of a transferable tax credit certificate under (d) of this section or the issuance of a cash refund under (f) of this section does not limit the department's ability to later audit a tax credit claim to which the certificate relates or to adjust the claim if the department determines, as a result of the audit, that the applicant was not entitled to the amount of the credit for which the certificate was issued. The tax liability of the applicant under AS 43.55.011 (e) and 43.55.017 - 43.55.180 is increased by the amount of the credit that exceeds that to which the applicant was entitled, or the applicant's available valid outstanding credits applicable against the tax levied by AS 43.55.011 (e) are reduced by that amount. If the applicant's tax liability is increased under this subsection, the increase bears interest under AS 43.05.225 from the date the transferable tax credit certificate was issued. For purposes of this subsection, an applicant that is an explorer is considered a producer subject to the tax levied by AS 43.55.011 (e).

(h) Regulations adopted to implement this section must include provisions prescribing reporting, record keeping, and certification procedures and requirements to verify the accuracy of credits claimed and to ensure that a credit is not used more than once.

(i) For the purposes of this section,

(1) a producer's or explorer's transitional investment expenditures are the sum of the expenditures the producer or explorer incurred after March 31, 2001, and before April 1, 2006, that would be qualified capital expenditures if they were incurred after March 31, 2006, less the sum of the payments or credits the producer or explorer received before April 1, 2006, for the sale or other transfer of assets, including geological, geophysical, or well data or interpretations, acquired by the producer or explorer as a result of expenditures the producer or explorer incurred before April 1, 2006 that would be qualified capital expenditures, if they were incurred after March 31, 2006;

(2) a producer or explorer may elect to take a tax credit against a tax due under AS 43.55.011 (e) in the amount of 20 percent of the producer's or explorer's transitional investment expenditures, but only to the extent that the amount does not exceed 1/10 of the producer's or explorer's qualified capital expenditures that are incurred during the calendar year for which the credit is taken;

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

(A) for any calendar year after the later of

(i) 2013; or

(ii) the sixth calendar year after the calendar year for which the producer first applies a credit under this subsection against a tax due under AS 43.55.011 (e), if the producer did not have commercial production of oil or gas from a lease or property in the state before April 1, 2006;

(B) more than once; or

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

(4) notwithstanding (d), (e), and (g) of this section, a producer or explorer may not transfer a tax credit or obtain a transferable tax credit certificate for a transitional investment expenditure.

(j) As a condition of receiving a tax credit under this section, a producer or explorer that obtains the tax credit for or directly related to a pipeline, facility, or other asset that is or becomes subject to regulation by the Federal Energy Regulatory Commission, the Regulatory Commission of Alaska, or a successor regulatory body shall at all times support and in all rate proceedings file to flow through 100 percent of the tax credits to ratepayers as a reduction in the costs of service for the pipeline, facility, or other asset.

(k) In this section, "qualified capital expenditure"

(1) means, except as otherwise provided in (2) of this subsection, an expenditure that is a lease expenditure under AS 43.55.165 and is

(A) incurred for geological or geophysical exploration; or

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

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

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

(2) does not include an expenditure incurred to acquire an asset (A) the cost of previously acquiring which was a lease expenditure under AS 43.55.165 or would have been a lease expenditure under AS 43.55.165 if it had been incurred after March 31, 2006; for purposes of this subparagraph, "asset" includes geological, geophysical, and well data and interpretations; or (B) that has previously been placed in service in the state; an expenditure to acquire an asset is not excluded under this paragraph if not more than an immaterial portion of the asset meets a description under this paragraph.

EXPLORATION INCENTIVE CREDIT

Sec. 43.55.025 Alternative tax credit for oil and gas exploration.

(a) Subject to the terms and conditions of this section, a credit against the production tax due under AS 43.55.011 (e) or (f) is allowed for exploration expenditures that qualify under (b) of this section in an amount equal to one of the following:

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

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

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

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

(b) To qualify for the production tax credit under (a) of this section, an exploration expenditure must be incurred for work performed on or after July 1, 2003, and before July 1, 2016, except that an exploration expenditure for a Cook Inlet prospect must be incurred for work performed on or after July 1, 2005, and

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

(2) if for an exploration well,

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

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

(C) must be for goods, services, or rentals of personal property reasonably required for the surface preparation, drilling, casing, cementing, and logging of an exploration well, and, in the case of a dry hole, for the expenses required for abandonment if the well is abandoned within 18 months after the date the well was spudded;

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

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

(c) To be eligible for the 20 percent production tax credit authorized by (a)(1) of this section or the 40 percent production tax credit authorized by (a)(3) of this section, exploration expenditures must

(1) qualify under (b) of this section; and

(2) be for an exploration well, subject to the following:

(A) for an exploration well other than a well that is described in (B) of this paragraph, the well must be located and drilled in such a manner that the bottom hole is located not less than three miles away from the bottom hole of a preexisting suspended, completed, or abandoned oil or gas well; in this subparagraph, "preexisting" means a well that was spudded more than 150 days but less than 35 years before the exploration well was spudded;

(B) for an exploration well that explores a Cook Inlet prospect, the well must be located at least three miles from any other well drilled for oil and gas with all distances measured as the horizontal distance between exploration targets, except that the exploration well that is located within three miles of a well drilled for oil and gas qualifies for the tax credit authorized by this subsection if the exploration well tests potential hydrocarbon traps that the commissioner of natural resources determines, after analyzing evidence submitted by the explorer and from other information that the commissioner of natural resources determines relevant, constitute a distinctly separate exploration target.

(d) To be eligible for the 20 percent production tax credit authorized by (a)(2) of this section or the 40 percent production tax credit authorized by (a)(3) of this section, an exploration expenditure must

(1) qualify under (b) of this section; and

(2) be for an exploration well that is located not less than 25 miles outside of the outer boundary, as delineated on July 1, 2003, of any unit that is under a plan of development, except that for an exploration well for a Cook Inlet prospect to qualify under this paragraph, the exploration well must be located not less than 10 miles outside the outer boundary, as delineated on July 1, 2003, of any unit that is under a plan of development.

(e) To be eligible for the 40 percent production tax credit authorized by (a)(4) of this section, the exploration expenditure must

(1) qualify under (b) of this section;

(2) be for seismic exploration; and

(3) have been conducted outside the boundaries of a production unit or an exploration unit; however, the amount of the expenditure that is otherwise eligible under this subsection is reduced proportionately by the portion of the seismic exploration activity that crossed into a production unit or an exploration unit.

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

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

(2) an explorer shall agree, in writing,

(A) to notify the Department of Natural Resources, within 30 days after completion of seismic or geophysical data processing, completion of a well, or filing of a claim for credit, whichever is the latest, for which exploration costs are claimed, of the date of completion and submit a report to that department describing the processing sequence and providing a list of data sets available; if, under (c)(2)(B) of this section, an explorer submits a claim for a credit for expenditures for an exploration well that is located within three miles of a well already drilled for oil and gas, in addition to the submissions required under (1) of this subsection, the explorer shall submit the information necessary for the commissioner of natural resources to evaluate the validity of the explorer's claim that the well is directed at a distinctly separate exploration target, and the commissioner of natural resources shall, upon receipt of all evidence sufficient for the commissioner to evaluate the explorer's claim, make that determination within 60 days;

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

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

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

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

(5) if the department is satisfied that the explorer's claimed expenditures are qualified under this section, the department shall issue to the explorer a production tax credit certificate for the amount of credit to be allowed against production taxes due under AS 43.55.011(e) or (f).

(g) An explorer may transfer, convey, or sell its production tax credit certificate to any person, and any person who receives a production tax credit certificate may also transfer, convey, or sell the certificate.

(h) A producer that purchases a production tax credit certificate may apply the credits against its production tax liability under AS 43.55.011(e) or (f). Regardless of the price the producer paid for the certificate, the producer may receive a credit against its production tax liability for the full amount of the credit, but for not more than the amount for which the certificate is issued. A production tax credit allowed under this section may not be applied more than once.

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

(1) the amount of the credit that may be applied against the production tax for each calendar year may not exceed the total production tax liability under AS 43.55.011 (e) or (f) of the taxpayer applying the credit for the same calendar year; and

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

(j) Notwithstanding any other provision of this title, of AS 31.05, or of AS 40.25.100, the department shall provide to the Department of Natural Resources information submitted with a claim under this section to support the eligibility of an exploration expenditure, including seismic exploration data and well data, and any information described in (f)(2) of this section received by the department.

(k) In this section,

(1) *[Repealed, Sec. 34 ch 2 TSSLA 2006]*.

(2) "Cook Inlet prospect" means a location within the Cook Inlet sedimentary basin, as that term is defined by regulation adopted to implement AS 38.05.180 (f)(4);

(3) *[Repealed, Sec. 34 ch 2 TSSLA 2006]*.

OIL AND GAS PRODUCTION TAXES

AS 43.56

Description

Alaska imposes the production tax on all oil and gas produced in Alaska. The Oil and Gas Production Tax and the Conservation Surcharge on Oil are severance taxes.

Rate

The rate of taxation for oil varies depending on the age of the field and the economic limit factor (ELF) which varies depending on field size and well productivity.

The severance tax rate on oil is 12.25% of production value as determined at the point of production, for the first five (5) years of production and 15% thereafter. There is a minimum tax of \$0.80/bbl.

Both the percent of value and the cents per barrel tax rates are subject to the ELF. The effective tax rate is the appropriate tax rate multiplied by the ELF.

The ELF formula results in lower tax rates for smaller, low productive fields and higher tax rates for larger highly productive fields. The formula is difficult to characterize in a simple way because it is based on a fraction that is calculated using fractional exponents and is unique for every combination of field size and well productivity. A field that produces 300 bbl/day per well or less has an ELF of zero i.e. no severance taxes are assessed.

On January 12, 2005 the Tax Division issued a decision to aggregate certain Prudhoe Bay area oil fields for purposes of calculating the economic limit factor (ELF). The Prudhoe Bay Initial participating area, the Aurora, the Borealis, the Midnight Sun, the Orion, the Polaris, and the Point McIntyre participating areas are the fields that were aggregated under this decision. That decision was effective for oil produced on or after February 12, 2005. The decision has been appealed by the taxpayers.

The table below reflects the aggregated Prudhoe Bay area ELF. In Fiscal Year 2005, four of Alaska's North Slope 24 producing fields had an ELF higher than 0.1:

Field	ELF	FY05 Tax Rate
Prudhoe	843033	12.6455%
North Star	834275	10.2199%
Alpine	829133	10.1569%
Kuparuk	050742	00.7611%
Tarn	009742	00.1461%

The 3 largest fields account for 94% of all production tax revenues

The severance tax rate on gas is 10% of production value. There is a minimum tax of \$0.064/mcf. The gas severance tax rate is also subject to an ELF based on daily gas production per well.

Returns

Returns are filed monthly and due with payment of taxes on or before the 20th day of the month following the month of production.

Exemptions

The tax on oil is levied on all production except for public (government) royalty production. The tax on gas is levied on all production except for public (government) royalty production and gas used in production operations including enhanced recovery, or flared for safety purposes.

Credits

Education - Taxpayers making contributions to accredited Alaska universities or colleges for educational purposes may take a tax credit for 50% of the first \$100,000, 100% of the next \$100,000 of contributions with a maximum credit of \$150,000 per tax year.

Oil and Gas Exploration Incentive - There are two exploration credits available to the producers. The first "Oil and Gas Exploration Incentive" is approved by the commissioner of Department of Natural Resources, and the second "Oil and Gas Exploration Tax Credit" is approved by the Department of Revenue. A producer may claim either one, but not both.

Taxpayers may take a credit for up to 50% on state land (or 25% on non state lands) of oil and gas exploration costs approved by the commissioner of Natural Resources. An approved oil and gas exploration incentive credit may not exceed \$5 million per project and is limited to \$30 million per taxpayer. Taxpayers may apply the credit against 100% of oil and gas production taxes.

Oil and Gas Exploration Tax Credit - Explorers may take a credit against their production taxes of (1) 20% of allowable expenses for exploration wells drilled more than 3 miles from a preexisting well, (2) 20% of allowable expenses for exploration wells drilled more than 25 miles from the boundary of a unit or (3) 40% of allowable expenses for certain seismic work and for exploration wells that meet both condition (1) and (2). Once approved, the credit or any remaining portion of it can be either carried forward month to month until fully applied, or sold to another taxpayer

OIL AND GAS PRODUCTION TAXES

AS 43.56

To qualify the work must have been performed between July 1, 2003 and July 1, 2007. However the credits could not be applied until after July 1, 2004 (i.e. in FY 2005).

The legislature extended the time until July 1, 2010 for qualifying work south of the Brooks Range and including the Alaska Peninsula and Bristol Bay, the Nenana Basin the Red Dog Mine Area, the Healy Basin and Cook Inlet. The new rules also changed the 3 mile and 25 mile rules for the Cook Inlet to reflect a more mature exploration area.

The table below reports the credits issued under the program through September 30, 2005:

Area	Project	Number of Projects	Credits Issued
<i>20 % Credits Issued</i>			
Cook Inlet	Wells	1	\$392,293
North Slope	Wells	3	\$3,588,666
<i>Total 20 % credits issued</i>		4	\$3,980,959
<i>40 % Credits Issued</i>			
Cook Inlet	Seismic	1	\$754,619
Cook Inlet	Wells	0	\$0
North Slope	Seismic	0	\$0
North Slope	Wells	1	\$719,482
<i>Total 40 % credits issued</i>		2	\$14,74,101
<i>Total credits issued (through 9/30/05)</i>		6	\$14,455,060

Disposition of Revenue

All revenue derived from the Oil and Gas Production Tax is deposited in the General Fund except that payments received as a consequence of an assessment are deposited in the Constitutional Budget Reserve Fund (CBRF).

History

1955 – The legislature enacts an oil and gas production tax of 1% of production value.

1967 – A 1% disaster production tax is enacted to provide relief after the Fairbanks flood.

1968 – The legislature increases oil and gas production tax from 1% to 3% of production value.

1970 – The legislature repeals the disaster oil and gas production tax. The legislature changes the oil production tax to a graduated tax with rates of 3% on the first 300 barrels per day per well, 5% on the next 700 barrels per day per well, 6% on the next 1500 barrels

per day and 8% on production exceeding 2500 barrels per day per well.

1972 – The legislature establishes a minimum oil production tax based on "cents per barrel" equivalent to percent of value tax on oil with wellhead value of \$2.65 per barrel.

1973 – The legislature revises the "stairstep" rate schedule to lower production levels. The legislature indexes the cents per barrel minimum to the wholesale price index for crude oil published by the US Bureau of Labor Statistics.

1977 – The legislature raises the nominal gas production tax rate to 10%. The legislature raises the nominal oil production tax rate to 12.25% and adopts the oil and gas economic limit factors.

1981 – As part of legislation that repealed the separate accounting oil and gas corporation income tax, the nominal tax rate on oil produced prior to 1981 was raised to 15% and fields coming into production after 1981 are taxed at 12.25% for five years after which the rate increases to 15%. The oil economic limit factor is now subject to a rounding rule so that if the calculated factor is greater than or equal to 0.7 during the first 10 years of production, the factor is set to 1.0.

1989 – The legislature changes the economic limit factor for oil production taxes to include a field size factor in the formula, fixes the production at the economic limit (not rebuttable) at 300 barrels per well per day, and drops the rounding rule. The legislature fixes production at the economic limit for gas production at 3000 mcf per well per day.

2002 - Alaska Veterans' Memorial Endowment, SB 267, provides credits of up to 50% for contributions of not more than \$100,000 and 75% of the next \$100,000 in contributions made to the Veterans' Memorial Endowment Fund. The tax credit expired July 1, 2003.

2003 – To encourage drilling for oil and gas within the state, AS 43.55.025 provided a new tax credit for exploration costs. The minimum credit is 20% and the maximum 40% for qualified expenditures.

2005 - Prudhoe Bay area oil fields are aggregated for purposes of calculating the economic limit factor, effective February 1, 2005.

2005 – To expand the exploration credit enacted the previous year, the deadline was extended until July 1, 2010 for qualifying work south of the Brooks Range (i.e. non-North Slope). New rules also changed the 3 mile and 25 mile rules for the Cook Inlet allowing closer