

HB

2001

(1 1/2/07)

ALASKA STATE LEGISLATURE
House Resources Committee

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Friday, November 2nd
House Finance Committee Room 519
9:00 a.m.

HB 2001 Oil and Gas Tax Amendments

**Steve Porter, Contract Consultant to LB&A and Dan Dickinson,
Consultant to LB&A
Revenue Commissioner Pat Galvin**

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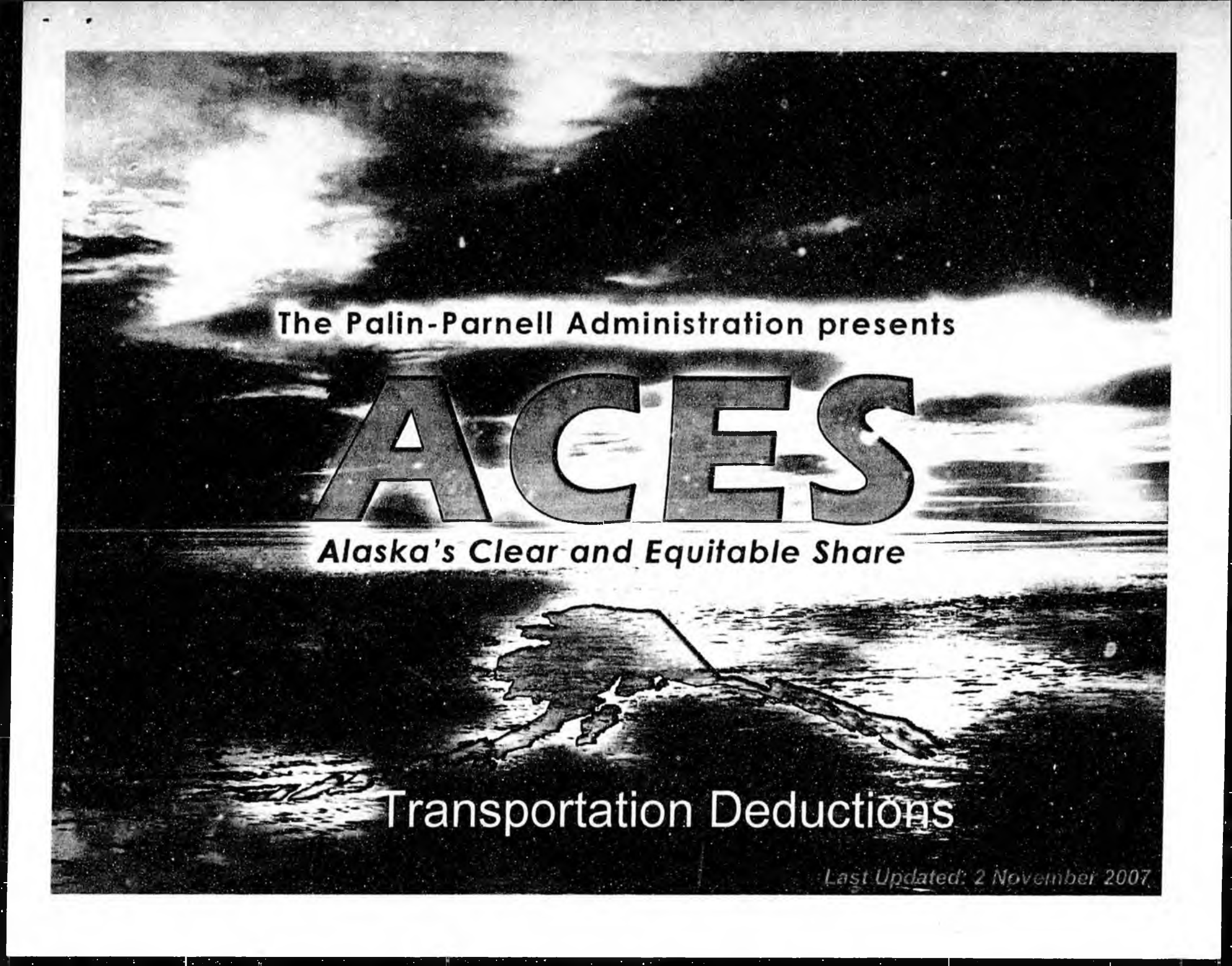
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The Palin-Parnell Administration presents

ACES

Alaska's Clear and Equitable Share

Transportation Deductions

Last Updated: 2 November 2007

Overview



- Current law
- The commercial reality
- Some problems
- Potential remedies

AS 43.55.150



- Gross value at point of production determined by subtracting “reasonable costs of transportation” from market prices
- “Reasonable costs” = “actual costs”
- “Actual costs” have historically been understood as FERC/RCA tariffs
- Exception for affiliate transactions, but only if “there are other reasonable modes of transportation” → exception is never met!

Transportation Deductions (Oil Pipelines)



- Deductions have historically relied on rates sanctioned by regulatory bodies
- Typically, this “sanction” does not reflect a regulatory determination
- Rather, the regulatory bodies have “blessed” settlement agreements between the state and the pipeline owner

Why does state base its tax policy for pipeline transportation deductions on pipeline rate litigation?

- MMS doesn't when pipeline is owned by producing affiliates.
 - They adopt a method promulgated through regulation

Pipeline Transportation Deductions



- Key reasons for state to avoid relying on regulatory process in setting tax value
 - Creates uncertainty: While litigation drags on tax value not fully known
 - Inefficient: Regulatory process unlikely to work well absent arms-length commercially sophisticated parties

TAPS Tariffs Example



Background:

- TAPS rates are currently ~\$5/bbl, set under a 1985-era settlement agreement between the State and the TAPS owners
- Rates don't appear to reflect "actual costs"
 - RCA determined that actual costs ~\$2/bbl
 - FERC Administrative Law Judge determined that actual costs ~\$2/bbl
- While litigation continues, State continues to allow a ~\$5/bbl transportation deduction

TAPS Tariffs Example



Indicative Value of “Tariffs by DOR”

- Assume:
 - TAPS tariffs are \$3/Bbl too high
 - Production tax rate of 22.5%
 - All barrels are shipped on affiliated transportation
- Then production tax value to state of setting tariffs for affiliate transactions is **~\$160 - \$200 million/year**

Transportation Deductions (Gas Pipelines)



- Gas pipelines typically built on basis of “negotiated rates” between shippers and pipelines
- FERC typically gives no scrutiny as to whether the negotiated rates are a “fair” bargain between shipper and pipeline
- If Producers end up owning the gas pipeline, then they can negotiate rates with themselves

Why would the state want to set its tax policy for transportation deductions on the basis of a non-arms length deal that state can't even litigate?

- Experience on TAPS suggests it would be unwise
- No compelling need to do so

The Key to a Remedy



- At present, state is arguably forced to live with non-arms length transactions because it is never the case that “there are other reasonable modes of transportation”
- DOR could follow MMS’ lead and establish regulations that determine appropriate cost deductions for non arms-length transactions on pipelines
- Cleanup language needed to ensure that the arms-length shippers – who really do have “actual costs” of the posted tariffs – are not forced to use the DOR-established tax deduction

DIST BY REP. Edgman.
11/2/07
10/31/2007

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (U&G)	CSSB 2001 (RES)
Administration Intent		Sec. 1. Confirmation of DOR's interpretation of statute of limitations for retroactive tax changes.	Deleted.	Deleted.
Information		Sec. 2. Amends AS 38.05.035(a). Adds authority for DMR to share oil & gas info with DOR.	CS Sec. 1. ACES language	CS Sec. 1. ACES language
Technical Amendments		Secs. 3-9. Conforming technical amendments.	CS Secs. 2-8. ACES language	CS Secs. 2-8. ACES language
Administration Auditors		Sec. 10. Amends AS 39.25.110. Adds exempt service for auditors.	CS Sec. 9. ACES language	CS Sec. 9. ACES language
Technical Amendments		Sec. 11. Amends AS 11.09.010(d). Conforming technical amendments.	CS Sec. 10. ACES language	CS Sec. 10. ACES language
Information		Sec. 12. Amends AS 43.05.230(a). Adds AS 43.55.890 (disclosure of tax info) as possible exception under AS 43.05.230(a) (unlawful disclosure).	CS Sec. 11. ACES language	CS Sec. 11. ACES language
Information		Sec. 13. Amends AS 43.05.230(h). Adds authority for DOR to share production tax info with DNR.	CS Sec. 12. ACES language	CS Sec. 12. ACES language
Administration Assessments		Sec. 14. Amends AS 43.05.260(a). Creates an exemption to allow DOR six years to conduct production tax assessments rather than three years.	CS Sec. 13. ACES language	Deleted.
Production Tax	AS 43.55.011(e). Sets the production tax rate at 22.5%	Sec. 15. Repeals & reenacts AS 43.55.011(e). Sets the production tax rate generally at 25%.	PPT	PPT
Production Tax Floor	AS 43.55.011(f). Sets a tax floor of not less than 4% of gross value when the average West Coast price is \$25 per barrel with step down factors.	Sec. 16. Repeals & reenacts AS 43.55.011(f). Sets a tax floor on legacy fields of 10% of the total gross value at the point of production; tax credits cannot reduce liability below floor.	PPT	PPT

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Progressivity Slope	AS 43.55.011(g). Progressivity is triggered at \$40 net value with a .25% increase per dollar; 25% tax cap on progressivity rate. (50% cap)	Sec. 17. Repeals & reenacts AS 43.55.011(g). Progressivity is triggered at \$30 net value on an annual basis with 0.2% increase per dollar; 50% maximum tax rate (including progressivity).	Repeals AS 43.55.011(g) (PPT progressivity); adds new gross progressivity provision in sec. 17 AS 43.55.011(o).	PPT
Progressivity Trigger	AS 43.55.011(h). Establishes the price index for calculating progressivity on a monthly basis.	Sec. 18. Amends AS 43.55.011(h). Establishes price index for calculating progressivity on an annual basis.	Repeals AS 43.55.011(h) (PPT progressivity calculation).	PPT
Progressivity Method	AS 43.55.011(h). Establishes the price index for calculating progressivity on a monthly basis.	Sec. 18. Amends AS 43.55.011(h). Establishes price index for calculating progressivity on an annual basis.	Repeals AS 43.55.011(h) (PPT progressivity calculation).	
Production Tax Cook Inlet	AS 43.55.011(j). Cook Inlet tax ceiling.	Sec. 19. Amends AS 43.55.011(j). Conforming technical amendment; deletes reference to AS 43.55.011(g) (progressivity) because reference is no longer applicable.	CS Sec. 14. ACES language Amends 43.55.011(j). Conforming technical amendment; deletes reference to AS 43.55.011(g) (PPT progressivity), inserts reference to 43.55.011(o) (O&G progressivity).	PPT
Production Tax Cook Inlet	AS 43.55.011(k). Cook Inlet tax ceiling.	Sec. 20. Amends AS 43.55.011(k) (Cook Inlet tax ceiling). Conforming technical amendment; deletes reference to AS 43.55.011(g) (progressivity) because reference is no longer applicable.	CS Sec. 15. ACES language Amends AS 43.55.011(k) (Cook Inlet tax ceiling). Conforming technical amendment; deletes reference to AS 43.55.011(g) (PPT progressivity), inserts reference to 43.55.011(o) (O&G progressivity).	PPT
Production Tax Cook Inlet	AS 43.55.011(l). Cook Inlet tax ceiling.	Repeals AS 43.55.011(l); conforming technical amendment.	CS Sec. 16. ACES language Amends AS 43.55.011(l). Conforming technical amendments; deletes reference to AS 43.55.011(g) (PPT progressivity), inserts reference to 43.55.011(o) (O&G progressivity).	ACES

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Production Tax Cook Inlet	AS 43.55.011(m). Cook Inlet tax administration.	Sec. 21. Amends AS 43.44.011(m). Adds language to be consistent with sec. 55 (lease expenditures); deletes reference to AS 43.55.011(g) (progressivity) because reference is no longer applicable.	CS Sec. 17. ACES language Amends AS 43.55.011(m). Deletes language added in ACES; deletes reference to AS 43.55.011(g) (PPT progressivity), inserts reference to 43.55.011(o) (O&G progressivity).	PPT
Production Tax Progressivity			Sec. 18. Adds AS 43.55.011(o). Replaces ACES and PPT progressivity provisions with a new a new progressivity provision.	
Production Tax Mid-Alaska Tax Ceiling			Sec. 18. Adds AS 43.55.011(p). Extends Cook Inlet tax ceilings in .011(j) to gas outside Cook Inlet and outside the North Slope.	
Tax Payment	AS 43.55.020(a). Installment payments.	Sec. 22. Repeals & reenacts AS 43.55.020(a). Makes installment payment calculations consistent with changes to the production tax.	CS Sec. 19. ACES language with conforming ammendments.	PPT
Tax Payment	AS 43.55.020(d). Royalty owner settlement deductions and installment payments.	Sec. 23. Amends AS 43.55.020(d). Conforming technical ammendments; deletes reference to AS 43.55.011(g) (progressivity) because reference is no longer applicable.	CS Sec. 20. ACES language Conforming technical ammendment; deletes r-ference to AS 43.55.011(g) (PPT progressivity), inserts reference to 43.55.011(o) (O&G progressivity).	PPT
Tax Payment	AS 43.55.020(g). Interest on unpaid installment payments.	Sec. 24. Amends AS 43.55.020(g). Conforming technical ammendment.	CS Sec. 21. ACES language Amends AS 43.55.020(g). Conforming technical ammendment.	PPT
Tax Payment	AS 43.55.020(h). Interest on overpayment of installment payments.	Sec. 25. Amends AS 43.55.020(h). Conforming technical ammendment.	CS Sec. 22. ACES language Amends AS 43.55.020(h). Conforming technical ammendment.	PPT
Tax Credits Capital Expenditures	AS 43.55.023(a). 20% tax credit for qualified capital expenditures and information requirements.	Sec. 26. Amends AS 43.55.023(a). Spreads use of tax credits over two years; moves and adds to info requirements; adds that legacy field tax credits may be applied only against legacy field taxes.	PPT	PPT

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Tax Credits Capital Expenditures	AS 43.55.023(b). 20% of carried-forward annual loss credit allowed against deductible lease expenditures when use of the deduction would cause the production tax in a month to be less than zero.	Sec. 27. Amends AS 43.55.023(b). Matches carried-forward annual loss to production tax rate of 25%; adds that carried-forward annual losses may not be based on lease expenditures accrued in legacy fields.	PPT	PPT
Tax Credits Capital Expenditures	AS 43.55.023(d). Transferable tax credit certificates.	Sec. 28. Amends AS 43.55.023(d). Adds no transfer of tax credits earned on legacy fields, option to obtain cash payment, and more time for agency approval; requires annual reporting requirements; spreads use of tax credits over two years.	CS Sec. 23. ACES language Amends AS 43.55.023(d). Technical amendment to PPT provision.	PPT
Tax Credits Capital Expenditures	AS 43.55.023(e). Transfer of tax credits.	Sec. 29. Amends AS 43.55.023(e). Conforming technical amendment.	PPT	PPT
Tax Credits Capital Expenditures	AS 43.55.023(f). Cash refund of up to \$25,000,000 for small producer tax credits.	Repeals AS 43.55.023(f) (replaced with oil and gas tax credit fund).	PPT	PPT
Tax Credits Capital Expenditures	AS 43.55.023(g). Tax credit audits.	Sec. 30. Amends AS 43.55.023(g). Adds language to reflect DOR authority to purchase tax credits granted in AS 45.55.028.	PPT	PPT
Tax Credits Capital Expenditures	AS 43.55.023(i). Transitional investment expenditure (TIE) tax credits for qualified capital expenditures incurred after March 31, 2001 and before April 1, 2006.	Repeals AS 43.55.023(i).	CS Sec. 24. ACES language Amends AS 43.55.023(i). Changes application of TIE credits to qualified capital expenditures incurred after March 31, 2003 and before April 1, 2006.	CS Sec. 13. ACES language Amends AS 43.55.023(i). Limits TIE credits to taxpayers that did not have commercial production before January 1, 2008, and to 1/10 of qualified capital expenditures incurred after March 31, 2006 and before January 1, 2008.

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Tax Credits Capital Expenditures		Sec. 31. Amends AS 43.55.023. Adds subsection (I) to make clear a tax exempt entity may not obtain a transferable tax credit.	CS Sec. 25. ACES language	Deleted.
Tax Credits Mid-Alaska	AS 43.55.024. Additional tax credit of \$6,000,000 for production from leases outside Cook Inlet and the North Slope for small producers.	Secs. 32 - 35. Amends AS 43.55.024. Subsection(a): technical correction; (b), (c), (e), (g): conforming technical amendments	PPT	PPT
Tax Credits Exploration	AS. 43.55.025. Alternative tax credits for up to 40% for oil and gas exploration.	Secs. 36 - 44. Amends AS 43.55.025 to clarify credit eligibility; extends eligibility for deliniation wells from 150 days to 540 days; requires additional information to be submitted to DOR; allows additional 5% credit for seismic exploration conducted before July 1, 2003 in exchange for seismic data.	PPT	PPT
Tax Credits Oil & Gas Tax Credit Fund		Sec. 45. Adds AS 43.55.028. Replaces PPT tax credit refund with an oil and tax credit fund funded by an appropriation of a percentage of production tax revenues.	PPT	PPT
Reporting Requirements		Sec. 46. Amends AS 43.55.030(a). Makes clear every taxpayer must file an annual return; expands info requirements.	CS Sec. 26. ACES language	CS Sec. 14. ACES language
Reporting Requirements Penalties		Sec. 47. Amends AS 43.55.030(d). Adds late filing penalty of \$1000/day for information required by the DOR.	Deleted.	CS Sec. 15. ACES language

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Reporting Requirements		Sec. 48. Amends AS 43.55.030. Adds new subsections (e) - requires annual expenditure statement; and (f) - authorizes DOR to require monthly filing of info.	CS Sec. 27. ACES language	CS Sec. 16. ACES language
Reporting Requirements and Penalties		Sec. 49. Amends AS 43.55.040. Clarifies DOR has authority to require filing of reports necessary to forecast state revenue; adds additional penalties.	CS Sec. 28. ACES language Amends AS 43.55.040. Retains ACES authority clarification; deletes additional penalty.	CS Sec. 17. ACES language
Administration Statute of Limitations		Sec. 50. Amends AS 43.55. Adds a new section, AS 43.55.075, that expands statute of limitations for conducting tax assessments from three years to six years.	CS Sec. 29. ACES language	Deleted.
Administration Electronic Filing & Advisory Bulletins		Sec. 51. Amends AS 43.55.110. Adds new subsections (e) & (f) that authorize DOR to require electronic filings and payments; and (g) that gives DOR authority to issue advisory bulletins.	CS Sec. 30. ACES language	CS Sec. 18. ACES language
Tax Determination	AS 43.55.160(a). Determination of production tax value of oil and gas.	Sec. 52. Repeals and reenacts AS 43.55.160(a). Retains PPT principle that the taxable value is the gross value at the point of production minus lease expenditures; the changes are necessary to implement different tax treatments.	CS Sec. 31. ACES language Amends AS 43.55.160(a). Retains PPT language with conforming amendments.	PPT
Tax Determination	AS 43.55.160(b). Production tax value may not be less than zero.	Sec. 53. Amends AS 43.55.160(b). Conforming technical amendment.	PPT	PPT
Tax Determination	AS 43.55.160(e). Carried forward annual losses established when production tax value is less than zero.	Sec. 54. Repeals & reenacts AS 43.55.160(e). Provides explicit rules for calculating production tax values for oil and gas subject to different statutory provisions.	PPT	PPT

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Tax Determination		Sec. 55. Amends AS 43.55.160. Adds four new subsections related to allocations and calculations of adjusted lease expenditures.	Deleted.	Deleted.
Lease Expenditures	AS 43.55.165(a). Describes deductible lease expenditures for purposes of determining the net taxable amount; provides standards DOR shall consider for determining lease expenditures.	Sec. 56. Repeals & reenacts AS 43.55.165(a). Retains but rewords deductible lease expenditures description; adds requirement that deductible lease expenditures be affirmatively allowed through regulation; allows overhead expenses (moved from 165(b)); deletes standards (moved to 165(b)).	CS Sec. 32. ACES language PPT with conforming ammendments.	Sec. 19. ACES
Lease Expenditures	AS 43.55.165(b). Lists direct costs that may be considered deductible lease expenditures; allows overhead expenses; and specifies allowed costs need not be physically located on lease.	Sec. 57. Amends AS 43.55.165(b). Retains PPT language; adds the standards DOR shall consider for determining lease expenditures (moved from 165(a) and (c)); deletes overhead expenses (moved to 165(a)).	PPT	CS Sec. 20. ACES language
Lease Expenditures	AS 43.55.165(c) and (d). Allows DOR to substitute costs that are billable or actually billed through unit operating agreements in place of the general lease expenditures standards.	Repeals AS 43.55.165(c) and (d).	ACES	ACES
Lease Expenditures		Sec. 58. Amends AS 43.55.165(e). Adds to the list of non-deductible lease expenditures, including costs incurred for violations of law and for repair, replacement or deferred maintenance in specified circumstances.	CS Sec. 33. ACES language	CS Sec. 21. ACES language

ACES Bill Version Comparisons

10/31/2007

Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Lease Expenditures	AS 43.55.165(h). Allocation of costs between oil and gas.	Sec. 59. Amends AS 43.55.165(h). Conforming amendment to be consistent with new AS 43.55.160 (production tax determination).	PPT	PPT
Lease Expenditure Adjustments		Sec. 60. Amends AS 43.55.170(a). Conforming amendment necessitated by repeal of AS 43.55.165(c) and (d) (determination of lease expenditures).	CS Sec. 34. ACES language	CS Sec. 22. ACES language
Information		Sec. 61. Amends AS 43.55. Adds new section AS 43.55.890; makes clear DOR may publish production tax info that is aggregated among at least three taxpayers.	CS Sec. 35. ACES language	CS Sec. 23. ACES language
Definitions		Sec. 62. Amends AS 43.55.900. Adds new definitions for "nonunitized reservoir;" "pool;" "producer;" and "unit."	CS Sec. 36. ACES language Amends AS 43.55.900. Retains ACES definitions for "producer" and "unit;" deletes "nonunitized reservoir" and "pool."	CS Sec. 24. ACES language Amends AS 43.55.900. Retains ACES definitions for "producer" and "unit;" deletes "nonunitized reservoir" and "pool."
Repeals	AS 43.55.023(f) Provides cash refund for small producer credits.	Sec. 63. Repeals	PPT	PPT
Repeals		Sec. 64. Repeals AS 43.55.165(c) and (d): determination of deductible lease expenditures using unit operating agreements.	CS Sec. 37. ACES language	CS Sec. 25. ACES language
Repeals		Sec. 65. Repeals AS 43.55.011(f); (order for applying Cook Inlet tax ceiling); AS 43.55.023(i) (transitional investment expenditures); and AS 43.55.160(c) (determining tax value under AS 43.55.011(g) (progressivity)).	CS Sec. 38. ACES language Adds repeals of AS 43.55.011(g) and (h) (progressivity); retains ACES repeal of AS 43.55.160(c) (determining tax value); deletes repeal of AS 43.55.011(f) and AS 43.55.023(i).	CS Sec. 26. ACES language Retains ACES repeal of AS 43.55.011(f); deletes other repeals.

ACES Bill Version Comparisons

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Subject	PPT	ACES	CSHB 2001 (O&G)	CSSB 2001 (RES)
Applicability		Sec. 66. Applicability of specified sections.	CS Sec. 39. ACES language No change to applicability of retained ACES sections.	CS Sec. 27. ACES language No change to applicability of retained ACES sections.
Transition Auditors		Sec. 67. Allows current oil and gas auditors to opt to remain in classified service.	CS Sec. 40. ACES language	CS Sec. 28. ACES language
Transition Regulations		Sec. 68. Allows regulations adopted by DOR and DNR to be applied retroactively to the applicability date of the statutory provisions being implemented.	CS Sec. 41. ACES language (with changed section numbers)	CS Sec. 29. ACES language (with changed section numbers)
Transition Pending Applications		Sec. 69. Provides for the treatment of pending applications for transferable credits and the refund of credits under AS 43.55.023.	Deleted.	Deleted.
Transition Regulations		Sec. 70. Authorizes DNR and DOR to proceed with adopting regulations.	CS Sec. 42. ACES language	CS Sec. 30. ACES language
Retroactivity		Sec. 71. Provides for the retroactivity of certain provisions.	CS Sec. 43. ACES language No change to retroactivity of retained ACES sections.	CS Sec. 31. ACES language No change to retroactivity of retained ACES sections.
Effective Dates		Secs. 72 and 73.	CS Sec. 44 & 45. ACES language No change to effective dates of retained ACES sections.	CS Secs. 32 & 33. ACES language No change to effective dates of retained ACES sections.

State of Alaska

Department of Revenue
Commissioner's Office



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To: Carl Gatto, *Chairman*
House Resources Committee
Capitol Building, Room 108

October 30, 2007

cc: All Members
House Resources Committee

Dear Representative Gatto:

A number of questions were posed during the October 19th hearing of the House Resources Committee. The answers are provided below. If your own records indicate requests which we have not addressed, please notify my office and we will respond as soon as possible.

1. Representative Johnson requested organizational charts for the respective audit divisions of the Department of Revenue and Department of Natural Resources. The requested organization charts, with position vacancies noted are attached.
2. Representative Seaton inquired about the retroactivity of the penalty assessed under ACES for failure to submit required information, in response to testimony given by the Alaska Oil and Gas Association (AOGA).

Under Sections 47 and 49 of the HB 2001, the penalty for failing to file a report by the time required by the department is a fine of not more than \$1,000 per day the failure continues. These two sections were not included in Section 71 of the bill and thus are not effective retroactively. Nor are they included in Section 72 which provides an effective date of January 1, 2008. Therefore, under Section 73, these two sections would take effect immediately in accordance with AS 01.10.070(c).

3. Representative Seaton asked whether in-field use of fuel products from a topping plant would be exempt from royalty.

Fuel gas and crude oil used in field operations is royalty free. The crude oil topping plants sell fuels on the slope. The oil that is consumed in the topping plants that goes into the diesel that is sold does pay royalty. The oil consumed by the topping plants is allocated to lease operations (royalty free) and sales (royalty payable), based upon the ratio of diesel consumption. Likewise the gas that powers the topping plants is also allocated based on the same factor. Royalty is due on the fraction of gas consumption due to third party diesel sales.

4. Representative Seaton asked whether value added petroleum products created in Alaska are taxed under the Alaska Production tax statute.

AS 43.55.020(e) excludes from the production tax, oil or gas produced from a lease that is used in the state for drilling, producing oil or gas, or for repressuring. Therefore, oil refined into diesel in a North Slope crude oil topping plant is not be subject to the production tax if the diesel is used in oil and gas operations. Oil refined into diesel not used for oil and gas operations would be subject to production tax.

5. Representative Roses asked how frequently production tax audits need to be completed beyond the current 3 year statute of limitations.

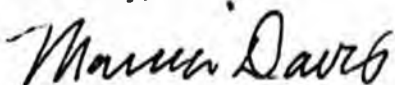
For the 4-5 smaller taxpayers who do not transport their own oil, the department performs what is known as a "desk audit". These taxpayers sell their oil at pump station one and very little information is needed from the taxpayer and the audits are all completed within the current three year statute of limitation. The remaining 6-7 taxpayers are the larger taxpayers whose audits are "full blown". They either move their own crude or sell at the Valdez terminal. Much more information is needed from these taxpayers and almost all require waiver and extension of the statute of limitations which only happens with taxpayer consent. One very large taxpayer refuses to sign an extension of the statute of limitations as a corporate policy. For the largest taxpayers, where we conduct full audits, we need extensions for 85% of those taxpayers.

6. Representative Gatto asked if personnel within DNR and DOR who violate the applicable confidentiality laws can be convicted of a class C felony.

If DOR employees unlawfully disclose confidential tax information, they are subject to a criminal penalty under AS 43.05.230(f), namely, a fine of not more than \$5,000, or by imprisonment for not more than two years, or by both. This offense is defined in AS 43, not in the criminal statutes, and there is no language classifying the offense as a type of felony or misdemeanor. However, the maximum imprisonment authorized in AS 43.05.230(f) is more than the one-year maximum for a Class A misdemeanor and is within the five year maximum for a Class C felony, so it appears to be equivalent to a Class C felony.

Pursuant to AS 38.05.036, if DNR employees use confidential oil and gas information obtained in connection with royalty and net profit audits for personal gain or not in connection with their official duties, they commit the crime of "Misuse of Confidential Information" under AS 11.56.860, and if convicted are guilty of a Class A misdemeanor.

Sincerely,



Marcia Davis

Deputy Commissioner Department of Revenue

STATE OF ALASKA

**DEPARTMENT OF TRANSPORTATION
AND PUBLIC FACILITIES**
OFFICE OF THE COMMISSIONER

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November 2, 2007

Ms. Marcia Davis
Deputy Commissioner
Department of Revenue
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Juneau, AK 99811-0400

Dear Ms. ^{Marcia} ~~Davis~~,

I am writing to recap recent email conversations between the Department of Revenue and the Department of Transportation & Public Facilities (DOT&PF) regarding the Dalton Highway (Haul Road). There were a number of questions your Department had for DOT&PF and I have outlined them below.

You have requested information regarding increased maintenance costs on the Dalton Highway as a result of increased truck traffic. You mentioned the operator contends that if the Kuparuk Crude Oil Topping Plant is not modified to produce extra ultra low sulfur diesel, the operator intends to provide the necessary diesel for slope activities by having it trucked from Fairbanks to Kuparuk. The operator estimates that the increased use of the Dalton Hwy (Haul Road) will be an additional 20 truck trips each day. I will assume this to be one-way trips.

If a deduction is not allowed for a crude oil topping plant on the North Slope, low-sulfur diesel may need to be trucked up the haul road from either Anchorage or Fairbanks. This is estimated to require roughly 20 trucks (or 3000bls) daily. What impact is this likely to have on haul road maintenance costs?

After years (decades) of marginal maintenance, over the past 4 years we have increased both our operating and capital efforts significantly. An increase of daily truck traffic on the Dalton of 50-70 trips will not result in any significant (<\$1.5 million) additional maintenance effort or cost. We do not expect the cost range to increase significantly until the daily truck traffic increases by 150 trucks (one way) a day.

ensuring the movement of people and goods and the delivery of services

Where are the maintenance stations located, and how long has DOT been supplying them via tanker?

We have 7 maintenance stations on the Dalton Highway, starting at Livengood at the end of the Steese Hwy and moving north.

- o Livengood
- o Seven Mile
- o Jim River
- o Coldfoot
- o Chandalar
- o Sag River
- o Deadhorse (Hwy station, airport and ARRF)

The stations (with the exception of Deadhorse to Sag) are located approximately 60 miles apart - that is the optimum distance for a road maintenance station. These stations are manned 24 hours a day, seven days a week, with the crews working seven days on and seven days off - crew members live predominantly in the Fairbanks area. To the best of my knowledge, DOT&PF has always supplied our remote maintenance stations by tanker. We bid fuel supply contracts with prices FOB each maintenance station.

I understand that fuel produced on the Slope is for the industrial uses there, and only there (although they do sell fuel to the villagers of Nuiqsut), and has no motor fuel taxes applied.

What impact will the increased haul-road traffic have on safety?

We do NOT allow double tankers on the Dalton Highway (capacity approximately 12,000 gallons) only single tankers (capacity approximately 9,000 gallons). Most fuel consumed on the slope is produced on the slope. We supply our seven maintenance stations on the Dalton out of Fairbanks via tanker with no history of mishap.

Do you know the average amount of fuel that DOT trucks up daily or how often the fuel runs happen?

We do not truck daily, but receive a delivery from private vendors on a "keep full" basis and store it in our tanks. The fuel trucks are approximately 9,000 gallons

bp



BP Exploration (Alaska) Inc
900 East Benson Boulevard
P.O. Box 196612
Anchorage, Alaska 99519-6612
(907) 561-5111

November 2, 2007

via hand delivery

The Honorable Carl Gatto
Co-Chair, House Resources Committee
State Capitol Rm. 108
Juneau, AK 99801-3100

The Honorable Craig Johnson
Co-Chair, House Resources Committee
State Capitol Rm. 126
Juneau, AK 99801-3100

Re: Response to questions which arose during BP's presentation on HB 2001 / CS 2001

Dear Representatives Gatto and Johnson:

During the course of our testimony to the House Resources Committee on October 31, 2007 several questions were asked where we indicated we would respond with specific and/or detailed answers.

How many wells have been drilled on the North Slope relative to BPs investment in 100 wells in 2006?

The total number of wells in which BP invested was 98. This was rounded to 100 wells. This represented 70% of all wells drilled on the North Slope in 2006. (source AOGCC new spudded wells in 2006)

Can you provide a separation of the operating costs in L48 from Alaska?

\$10.33/bbl US average cost (operating, transportation and production taxes) – source 2007 Global Upstream Performance Review – John S. Herold Inc.

In reviewing this information to identify L48 distinct from Alaska, we noted that in our preparation of the slide, we erroneously calculated the PPT/bbl using the daily production rate as an absolute production figure. \$2.1 billion of production revenue tax generated from 756,000bbl/day gives \$7.61/bbl versus the \$2.1 billion PPT generated on 756 million barrels which calculated at \$2.77/bbl. This correction has added \$4.84/bbl to our Alaskan cost raising this from \$16/bbl to \$21/bbl. A corrected slide is attached.

This particular report does not separate out the L48 and Alaska. We have made requests of both Wood Mackenzie and John S Herold for a more exact split of the costs. Pending more accurate numbers, below we have made a simple estimate using 2006 Alaska crude oil production as a percentage of total U.S. production. We appreciate that this is both simplistic and likely to overstate the average cost of a L48 barrel:

Comparison of operating expense, transportation costs, and production taxes	
U.S. Ave Cost/bbl	\$10.33
2006 U.S. Crude Oil Production, thousand barrels	1,862,259
Alaska Average Cost/bbl (2007)	\$21.20
2006 Alaska Crude Oil Production, thousand barrels	270,486
Total U.S. cost, \$thousand	19,237,135
Total Alaska Cost, \$thousand	5,734,303
Total L48 Cost, \$thousand	13,502,832
Estimated Average L48 Cost/bbl	\$8.48

* Alaska costs based on operating cost \$7.75 from August 2007 PPT Status Report, Transport cost of \$5.84 and production costs/bbl of \$7.61 are from the 2007 Spring Resource Book

How much of the total USA production is from Alaska?

Based on information extracted from the Energy Information Administration website, Alaska represents 14.5% of the 2006 US oil production.

What percentage of the BP employee and contractor workforce is Alaskan?

Of the current BP Alaska Employees, 82% are Alaska residents and of these 71% qualify for the PFD. The difference in the numbers reflects the timing of when individuals have joined BP Alaska.

While we do not have ready access to 100% of our contractor workforce we have, through working with our contractors, obtained the following information.

- Top Six Contractor breakouts:
 - o Company 1: 85% PFD Recipients
 - o Company 2: 74% PFD Recipients
 - o Company 3: 72% PFD Recipients
 - o Company 4: 71% PFD Recipients
 - o Company 5: 67% PFD Recipients
 - o Company 6: 67% PFD Recipients

What deductions would be available for topping plants under the existing PPT ?

A specific request was made of the DoR seeking confirmation that the understanding that this cost was deductible under PPT was correct. The proposed bill introduced by the Administration sets a policy indicating that this will not be eligible for deduction.

In the event credits were available for this particular project then the construction costs would attract the credit to improve the economics such that it becomes a viable project. This is part of the plant operations. There are currently existing topping units but they are not designed for Ultra Low Sulfur Diesel (ULSD).

The costs of running the plant would be part of the operating costs of running the field in the same way the existing plants are. The refined product stream would then be either used to fuel the field in which it was produced and there would not be an additional cost as there would be no 'purchase', or it would be sold to another field. In the case of a 'sale', the revenue would be taxable and the cost in the receiving field would be deductible.

In respect of Royalty, volumes produced and used within the unit for unit operations (e.g. fuel, well treatment, etc) are not subject to royalty. All volumes produced and sold to other units are subject to Royalty. It should be understood that the plants are not designed to produce large amounts of excess volumes. Also, within Unit use takes a priority over sales to other Units or Contractors. This is the current approach and this approach would be maintained.

What deductions are currently available for DR&R?

Currently, North Slope DR&R is addressed as part of the 18 excluded items under Sec. 43.55.165(e). Any investment made in upstream assets prior to April 2006 must be identified. The DR&R incurred on those assets is not subject to deduction under PPT. If there is an asset that was installed after April 2006, the DR&R associated with the removal of that asset is subject to deduction under PPT or is not excluded. There is an exception to the DR&R incurred on pre-April 2006 assets. If the DR&R is undertaken for the purpose of replacing, renovating or improving the asset, the DR&R would be considered a qualified lease expenditure.

The Honorable Carl Gatto
The Honorable Craig Johnson
November 2, 2007
Page -4-

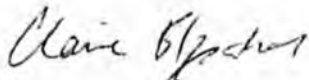
What are the calculations behind the indicative level of investment included in Slide 4 to reach a 3% decline rate?

In order to illustrate the benefits to both the state and industry of having more volumes from which to generate revenue, the level of investment would need to increase substantially. Rather than use different numbers we elected to use those which had been presented.

The 15% decline rate is the 'not do very much' scenario. We recognize that some investment would be required to access the 1.3bn barrels and that some level of facilities costs would be required. In moving through the scenarios however, no further upgrading or enhancing of facilities was assumed. In selecting which of the example fields to include in our illustration (attached), we did not include Field G as we do not believe that it is a likely estimate in respect of projects in Alaska in the future – while we would all be delighted to see fields discovered of the magnitude required for this cost/bbl to be achievable.

I hope these responses are clear. We remain available if we can be of any further assistance to the committee.

Yours sincerely

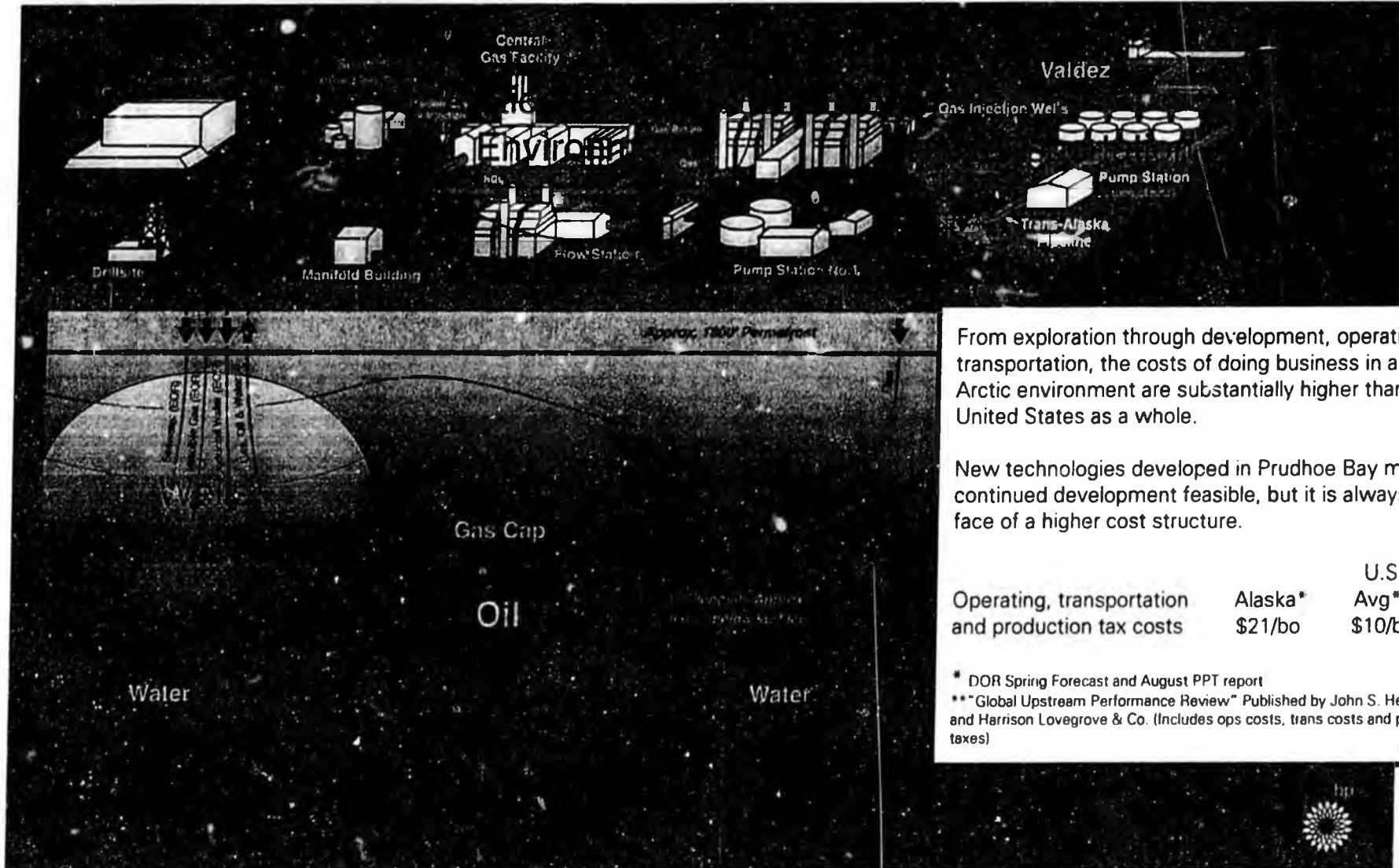
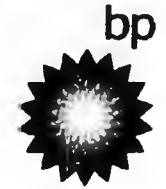


Claire Fitzpatrick
Commercial Senior Vice President

Attachments:

Corrected slide showing Alaska vs. Average US Cost Structure
Analysis of Slide 4

Alaska vs. Average U.S. Cost Structure



From exploration through development, operating and transportation, the costs of doing business in a remote Arctic environment are substantially higher than the United States as a whole.

New technologies developed in Prudhoe Bay make continued development feasible, but it is always in the face of a higher cost structure.

	Alaska*	U.S. Avg**
Operating, transportation and production tax costs	\$21/bo	\$10/bo

* DOR Spring Forecast and August PPT report
 ** "Global Upstream Performance Review" Published by John S. Herold, Inc and Harrison Lovegrove & Co. (Includes ops costs, trans costs and production taxes)



Analysis of Slide 4

Capital Cost Information Used

PPT Status Report August 3, 2007

Capital Costs / barrel \$6.81

ACES presentation: Senate Resources / House Oil and Gas
Characteristics of Seven Fields : Capital \$/bbl

A legacy field with heavy oil	\$11
B satellite field	\$10
C satellite field	\$11
D stand alone field	\$13
E satellite heavy oil	\$16
F offshore stand alone	\$8
G stand alone	\$5

Incremental Investment Scenario

Do Little' Scenario - 15% decline

	Billion barrels	\$ billion
Assume some investment:	0.3 existing cost of \$6.81	2.0
	1 no drilling requirement facilities maintenance	3.0
	1.3 Investment	5.0

Status Quo 6% decline

Incremental investment needed above 'do little'	2 existing cost of \$6.81	13.6
	0.6 heavier oil (ave of A & E is \$13.5/bbl)	8.1
	2.6	21.7

Reduce Decline to 3%

Further additional investment	2.4 Heavier oil at above ave (to reach BP 3bn estimate)	32.4
	0.6 existing cost	4.1
	0.6 Stand Alone	7.8
	3.6	44.3
Total	7.5	71.0

ALASKA STATE LEGISLATURE

House Resources Committee

Carl Gatto, Co-Chair

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Rep_Craig_Johnson@legis.state.ak.us

MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Carl Gatto, Co-Chair
Representative Craig Johnson, Co-Chair
House Resources Committee 

DATE: November 2, 2007

RE: Request for Additional Information for CS HB 2001 (O&G)

Below is a list of questions that House Resources Committee members asked that the administration address.

- 1) Rep. Seaton requested a follow up on definitions, levels of negligence, in provision 165(e) (19), page 28.
- 2) Rep. Johnson inquired about who determines "due care" in provision 165(e) (19), page 28, line 22, and that the regulations define specific terms and guidelines.
- 3) Rep. Roses asked how often audits continue beyond the current 3 year term.
- 4) Rep. Seaton requested better definitions for Sec. 33.AS 43.55.165(e).
- 5) Rep. Guttenberg inquired about whether the administration had spoken to the bargaining units with regard to exempt class of auditors.
- 6) Rep. Seaton requested a sectional analysis and side-by-side comparison with HB 2001 and CSHB 2001(O&G).

Memo to Commissioner Galvin
November 2, 2007
Page 2

7) Rep. Seaton asked about the retroactivity aspect in provision .030(d) of HB 2001, which was left out of CSHB 2001(O&G).

8) Rep. Gatto asked whether personnel in DOR or DNR would be convicted of a class C felony if they breached the confidentiality requirements.

ALASKA STATE LEGISLATURE
House Resources Committee

Carl Gatto, Co-Chair

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MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Carl Gatto, Co-Chair
Representative Craig Johnson, Co-Chair
House Resources Committee 

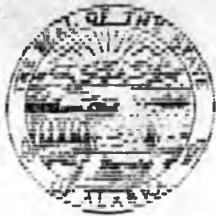
DATE: November 2, 2007

RE: Information Requested from Legislative Budget & Audit Committee

Attached are memos that were sent to you from Legislative Budget & Audit Committee Chair Rep. Samuels dated 10/16, 10/17, 10/21 and 10/23 with requests for information. The highlighted items on each of the attached memos represent the outstanding issues that have still not been responded to.

With CS HB 2001 (O&G) currently in House Resources Committee, we urge you to provide the requested information directly.

Thank you for your immediate attention to this request.



LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Ralph Samuels, Chair
Legislative Budget and Audit Committee

DATE: October 16, 2007

RE: Initial Questions

The Legislative Budget & Audit Committee has developed some initial questions surrounding the proposed ACES legislation and information presented in some of the briefings.

Some of the numbered questions actually have a series of questions that all relate and are not separately numbered. The attempt was to group those that corresponded with one another.

Thank you for your response.

**Questions for the Alaska Department of Revenue
Presented by the Legislative Budget and Audit Committee
October 16, 2007**

Initial Policy Question on Heavy Oil

1. What defines legacy fields? The Administration suggested that legacy fields will have a minimum or tax floor. Under the proposed definition, will fields not yet in development become legacy fields some point in the future - for example when their owners have recaptured their investments many times over?
2. How will the Administration's plan deal with investment in heavy oil fields in times of low oil prices? In other words, how does a gross floor fit with encouraging expensive heavy oil production? How will heavy oil produced from legacy fields be dealt with?
3. How does the Administration's plan reconcile encouraging management of the risks of relatively new and untested asset facilities required for heavy oil development with the notion that any costs associated with State defined "improper maintenance" will not be deductible?

HB 3001 Fiscal Note *PPT*

4. Does the Administration have reconciliation between the HB 3001 fiscal note and FY 2006 and 2007 actuals? (Has a general reconciliation been performed between the forecasting models and the specific models used for the fiscal notes? How do these compare with the differences between projections and actuals from prior years?) Please give us copies of the underlying HB 3001 model and data, and, if different, the current model used for ACE's projections.

The Department of Revenue recently published the PPT Implementation Status Report that stated "revenues are falling far short of what was expected when PPT was passed."

The PPT Implementation Status Report further states: "In FY 2008, based on forecasted price and production levels, the PPT is expected to generate about \$250 million over that which would have been generated under the ELF system. However, this is more than \$800 million less than what was predicted in the PPT fiscal note."

In the PPT fiscal note the DOR forecast revenue for FY 2008 was \$1.485 billion (approximately \$700 million more than the ELF status quo). Based on the PPT estimated monthly payments made to date, the PPT will bring in over \$2 billion this year. If the trend continues, a like amount will be paid in 2008. That is over a half billion dollars *more* than was projected in the FY 2003 fiscal note.

LB&A Questions to DOR

5. Please reconcile the projections shared with the public in the PPT Implementation Status Report with the actual payments being made by the producers. The payments made to date this year are:

January	\$125,314,170.38
February	\$126,442,395.30
March	\$140,441,189.71
April	\$158,210,793.88
May	\$193,260,239.50
June	\$184,572,810.28
July	\$213,518,760.18
August	\$166,661,938.33

**please provide Sept*

6. On the topic of forward looking projects, including FY 2008, what are current forward-looking DOR projections based on? Forward looking data from major taxpayers? Is the DOR getting this data voluntarily from taxpayers and should those same kinds of disclosures be made mandatory? Does the State have enough data to tell yet if forward looking projections from taxpayers are a good way of estimating forward costs? Are there better ways, or even if taxpayers' estimates are not a very good way, are they the best source we have?

7. In the September 18, 2007, presentation to House members, the DOR stated that it is trying to revise its models to incorporate a relationship between prices and costs. What do we know about the relationship between oil price and oilfield costs including the all important question of time lag and "stickiness"?

Higher Reported Costs

8. Are taxpayers filing aggressive returns which overstate or mischaracterize costs?

9. Does the Administration have any preliminary indications that taxpayers are filing aggressive returns which under current law (1) overstate deductions or credits or (2) mischaracterize operating costs as capital costs? Are there "unusual" or unexpected taxpayers who appear to be carved out of other taxpayers either for the specific ability to take advantage of the ability to use the \$12 million per producer filing under AS 43.55.024 (c) or that incidentally qualify for that credit?

10. Are the hoped for effects of the legislation occurring on a time scale and magnitude that was not anticipated?

11. We would like a break down of capital costs for the period 2001 through the most recent information (including those filed for purposes of the AS 43.55.023 TIE credits).

LB&A Questions to DOR

Please supplement this with any information the State may have received voluntarily. Please lay out any applications under the .025 Exploration Credit program since its inception. Please have the DNR provide a review of wells drilled in the state in that period. It would be helpful to also add seismic shot during the same time period with a breakdown by area, i.e. offshore state land, offshore federal land, onshore state land, NPRA, inside unit boundaries and outside unit boundaries. **[This subject is addressed again under the heading of "Exploration Credit" where two more questions are posed.]**

ask this
or on
14th page →

12. Have costs to do the same work actually increased?
13. What data does the State have that shows whether North Slope cost increases were more or less than cost inflation found elsewhere in the world wide oil patch?
14. Does the State have any data concerning "gold-plating"? Does the state have Authorization for Expenditures (AFEs) or other data from the TIE period that can be compared with AFEs or other data from the post July 2006 period and, if so, please present that information?
15. Does the State have any data on the relative costs of new opportunities compared with the relative costs of older opportunities? Does the state have any data on the relative costs of opportunities foregone in the past but undertaken recently?
16. Can the costs of corrosion and other costs that would be disallowed under SB 80 -- had it been in effect -- be identified or broken out from other costs submitted?

Modeling Data

At the September 4, 2007, press conference four projects were presented.

17. Please provide details, costs, timing, revenue, and other critical assumptions and modeling on each of these projects and comparisons.
18. Are these figures over the life of the field/project?
19. Were other state and federal taxes computed before measuring the producer's share?
20. Were the field/project figures based on producers that would have had access to TIE credits or to new investors?
21. Please provide a copy of the model or models that produced the revenue alternatives presented September 4, 2007, including work for years beyond FY 2008.

not
confidential }

LB&A Questions to DOR

22. Does the state have a North Slope model on a field by field basis? Can the state break down the data it has on a field by field basis? Does the state have information on an AFE or other project basis?

✶ 23. Please provide any additional models or modeling where "the numbers speak for themselves" if what they say is critical to the proposals, and that modeling has not been asked for directly elsewhere.

Government Take Metrics

24. Please make available the data and reports from experts and consultants behind the international comparison material presented at the September 4 and 18, 2007, presentations.

25. If not detailed in those reports, please provide details and assumptions and modeling behind the government take metrics. Are these for a given year, or at a single reference price, etc.? Who are our peers? Are these full cycle and do they include gas or are they purely oil?

Exploration Incentives

✶ 26. Please provide a history of all requests for exploration credits and which were denied and which were granted for the following two exploration incentive programs:
AS 38.05.180(i)
AS 41.09.010 (1994-2007)

Tradeable Credits

✶ 27. Please provide specific information on the rate at which credits are being traded. For instance, are they trading for less than 50 cents on the dollar, less than 75 cents on the dollars, and are nay trading in the 90 cents plus on the dollar range?

Total Petroleum Revenues

✶ 28. In order to have the full oil and gas industry payments to the State we are requesting the numbers for fall 2007 in the following categories:
a. Corporate Petroleum Tax
b. Petroleum Property Tax
c. Oil and Gas Royalties
d. Bonuses, Rents and Interest
e. Deposits to the CBRF



LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Ralph Samuels, Chair
Legislative Budget & Audit Committee

DATE: October 17, 2007

RE: Data Request

The Department of Revenue is preparing the fiscal note for the ACES legislation. I would request the model utilized to generate the fiscal note. Thank you for your response to this request.

* We understand that ~~to~~ a public model was created. Please provide it to us.

State of Alaska

Department of Revenue
Commissioner's Office



SARAH PALIN, GOVERNOR
333 Willoughby Avenue, 11th Floor
P.O. Box 110400
Juneau, Alaska 99811-0405
Phone: (907) 465-2300
Fax: (907) 465-2394

Representative Samuels
State Capitol, Room 204
Juneau, AK 99801-1182

October 19, 2007

Dear Representative Samuels:

Thank you for your memo dated October 17, 2007, in which you request that the Department of Revenue provide the Legislative Budget and Audit Committee with a copy of the model used to generate the fiscal note for the ACES tax proposal. Unfortunately, we are unable to comply with your request at this time.

The production tax forecast model contains highly sensitive taxpayer-specific information. We believe it would be a breach of Tax Division confidentiality provisions to release such information.

In recognition of this limitation on our ability to share our model, our staff has dedicated time to assisting LB&A consultants, Mr. Dan Dickenson and Mr. Steve Porter in the construction of their own models to aid their efforts on behalf of the legislature.

We appreciate your understanding in this matter. If you have any other requests for information, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Pat Galvin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Pat Galvin
Commissioner
Department of Revenue



LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Ralph Samuels, Chair
Legislative Budget & Audit Committee

DATE: October 21, 2007

RE: Data Request

The fiscal note for HB 2001 references the "Fall 2007 DOR Official Forecast" for its analysis. We request the Fall 2007 Revenue Sources Book in order to correctly analyze the fiscal note.

* When will they publish



LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

MEMORANDUM

TO: Commissioner Pat Galvin
Alaska Department of Revenue

FROM: Representative Ralph Samuels, Chair
Legislative Budget & Audit Committee

DATE: October 23, 2007

RE: Data Request

Our consultants have been asked to run some modeling information for the Senate Resources Committee. In order to adequately address this request, they require the following information:

- (1) Cost profile (over next 20 years – or, however far out they model) broken into operating and capital, with an indication of whether the 30 cent .165 (e) (18) adjustment has been made
- (2) Production profile over the same period
- * (3) Credit profiles over the same period showing number of companies estimated to be taking the .024 credits and the 40% .025 credits
- (4) Other critical parameters

Our consultants are Barry Pulliam, Dan Dickinson and Steve Porter. Thank you for your quick response.

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CSHB2001(O&G)
 () Publish Date: _____

Identifier (file name): HB2001CSO&G-DNR-O&G-11-02-07 Dept. Affected: Natural Resources
 Title Oil and Gas Tax Amendments RDU Resource Development
 Component Oil and Gas Development
 Sponsor Rules Committee
 Requester House Resources Component Number 439

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services	303.5		303.5	303.5	303.5	303.5	303.5	303.5
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING	303.5		303.5	303.5	303.5	303.5	303.5	303.5

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

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

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF	303.5		303.5	303.5	303.5	303.5	303.5	303.5
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other Interagency Receipts								
TOTAL	303.5	0.0	303.5	303.5	303.5	303.5	303.5	303.5

Estimate of any current year (FY2008) cost: 177.0

POSITIONS

Full-time								
Part-time								
Temporary								

ANALYSIS: (Attach a separate page if necessary)

The current supplemental tax is payable as a percentage of net income (after lease expenditures), with the percentage varying with a taxpayer's net income per barrel (AS 43.55.011(g)). This bill would replace the supplemental tax with a tax payable as a percentage of gross proceeds at the lease (without a deduction for lease expenditures), with the percentage varying based on a taxpayer's gross proceeds per barrel. The bill also limits the Transition Investment Expenditures allowable for a credit (assuming some matching current capital spend) to three years of capital expenditure (2003-2006) rather than five years (2001-2006).

Prepared by: Nan Thompson
 Division: Oil and Gas
 Approved by: Tom Irwin, Commissioner
Natural Resources

Phone 269-8800
 Date/Time 10/31/2007
 Date 11/2/2007

FISCAL NOTE

**STATE OF ALASKA
2008 LEGISLATIVE SESSION**

BILL NO. CSHB2001(O&G)

ANALYSIS CONTINUATION

The current supplemental tax is a tax on a taxpayer's oil and gas net income that would increase by 0.25% for every dollar the net income per barrel exceeded \$40. The bill proposes a supplemental tax on gross proceeds that would be based on a rate which would increase by 0.225% for every dollar the gross proceeds per barrel exceeded \$50.

For existing North Slope producers and new entrants thinking about developing a field, changing to a supplemental gross tax may lower the chance that a prospect would be developed. It is not possible to predict precisely how much the chance of development would be diminished.

Some factors that may determine the impact of the tax change on the project's economics are future prices, the relative profitability of existing production, and the profitability of the project in question.

Personal Services: Sections 9 and 40 would reclassify the current oil and gas auditors to exempt status employees. DO&G currently has seven oil and gas auditor positions. The total salary/benefit costs for these seven employees currently equals approximately \$849,147. An increase to exempt status is estimated to cost up to an additional \$303,500 in FY09. The FY08 amount of \$177,000 covers an estimated 7-months at the higher rate.

Handwritten scribbles and the number 70 in the top left corner.

**Progressivity in CS HB 2001
(O&G)
with requested alternative
information**

**Dan E. Dickinson
November 2, 2007
House Resources**

Progressivity Taxes

	PPT	ACES	HO&G
<u>BASE</u>			
Taxable bbls	244	244	244
ANS Market	87.00	87.00	87.00
Trans	7.00	7.00	7.00
GVPP	80.00	80.00	80.00
Lifting	20.00	20.00	-
PTV	60.00	60.00	80.00
bbls time \$/bbl	14,640	14,640	19,520
Base	14,640	14,640	19,520
<u>RATE (factor/dollar * dollars over starting point)</u>			
Starting place	40.00	30.00	50.00
Price index	20.00	30.00	30.00
Factor/dollar	0.2500%	0.2000%	0.2250%
Prog Factor	5.00%	6.00%	6.75%
<u>Tax = Rate * Base</u>			
Tax	732.00	878.40	1,317.60

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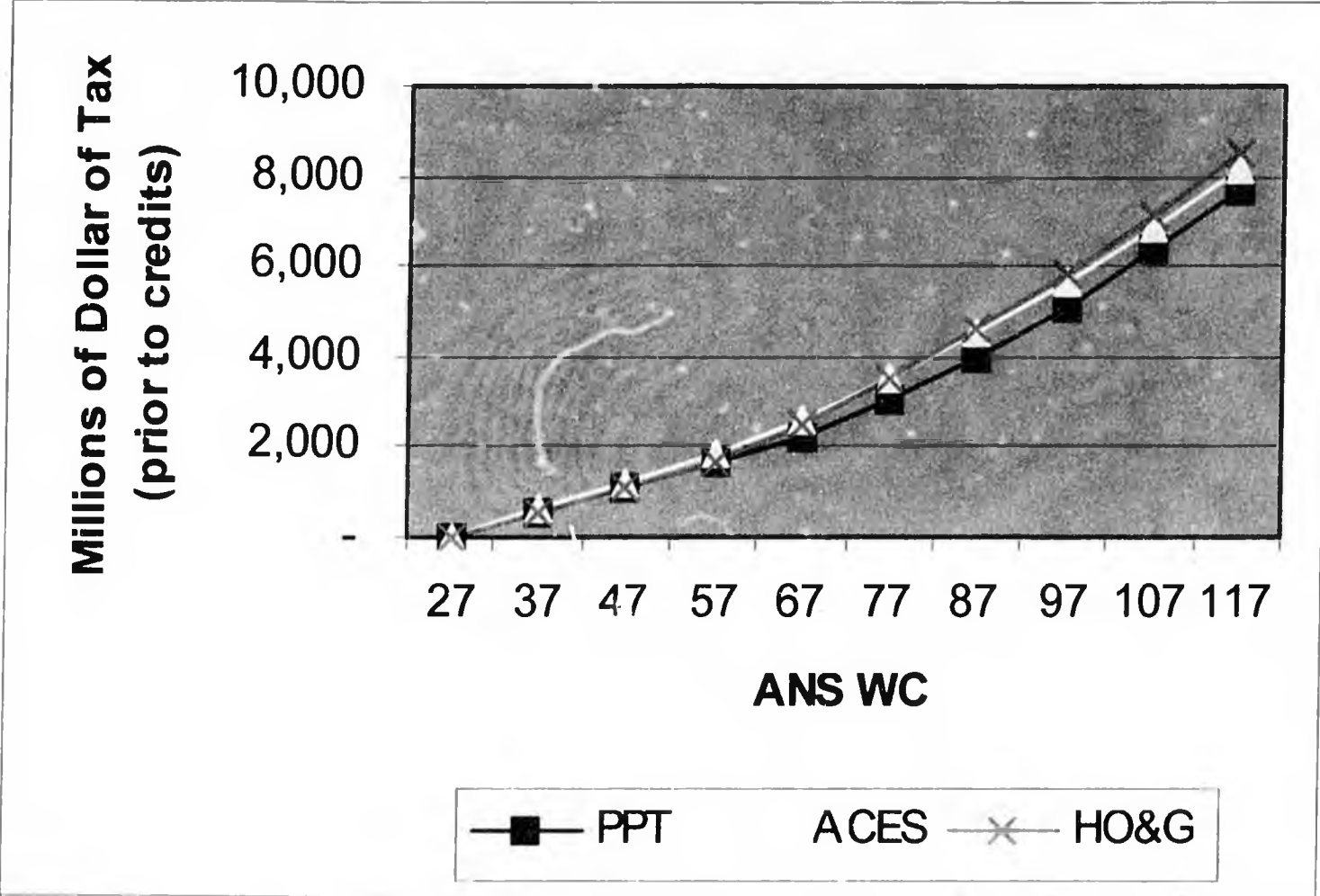
Progressivity Taxes (using 10/30 Daily Price and DOR cost and volume assumptions)

	PPT	ACES	HO&G
<u>BASE</u>			
Taxable bbls	230.5	230.5	230.5
ANS Market	89.09	89.09	89.09
Trans	6.73	6.73	6.73
GVPP	82.36	82.36	82.36
Lifting/Upstream	18.57	18.57	-
PTV	63.79	63.79	GVPP: 82.36
bbls time \$/bbl	14,704	14,704	18,984
Base	14,704	14,704	18,984
<u>RATE (factor/dollar * dollars over starting point)</u>			
Starting place	40.00	30.00	50.00
Price index	23.79	33.79	32.36
Factor/dollar	0.2500%	0.2000%	0.2250%
Prog Factor	5.95%	6.76%	7.28%
<u>Progressivity Tax = Progressivity Rate * Progressivity Base</u>			
Tax	874.50	993.67	1,382.22
Original Tax	732.00	878.40	1,317.60
Delta (increase)	142.50	115.27	64.62

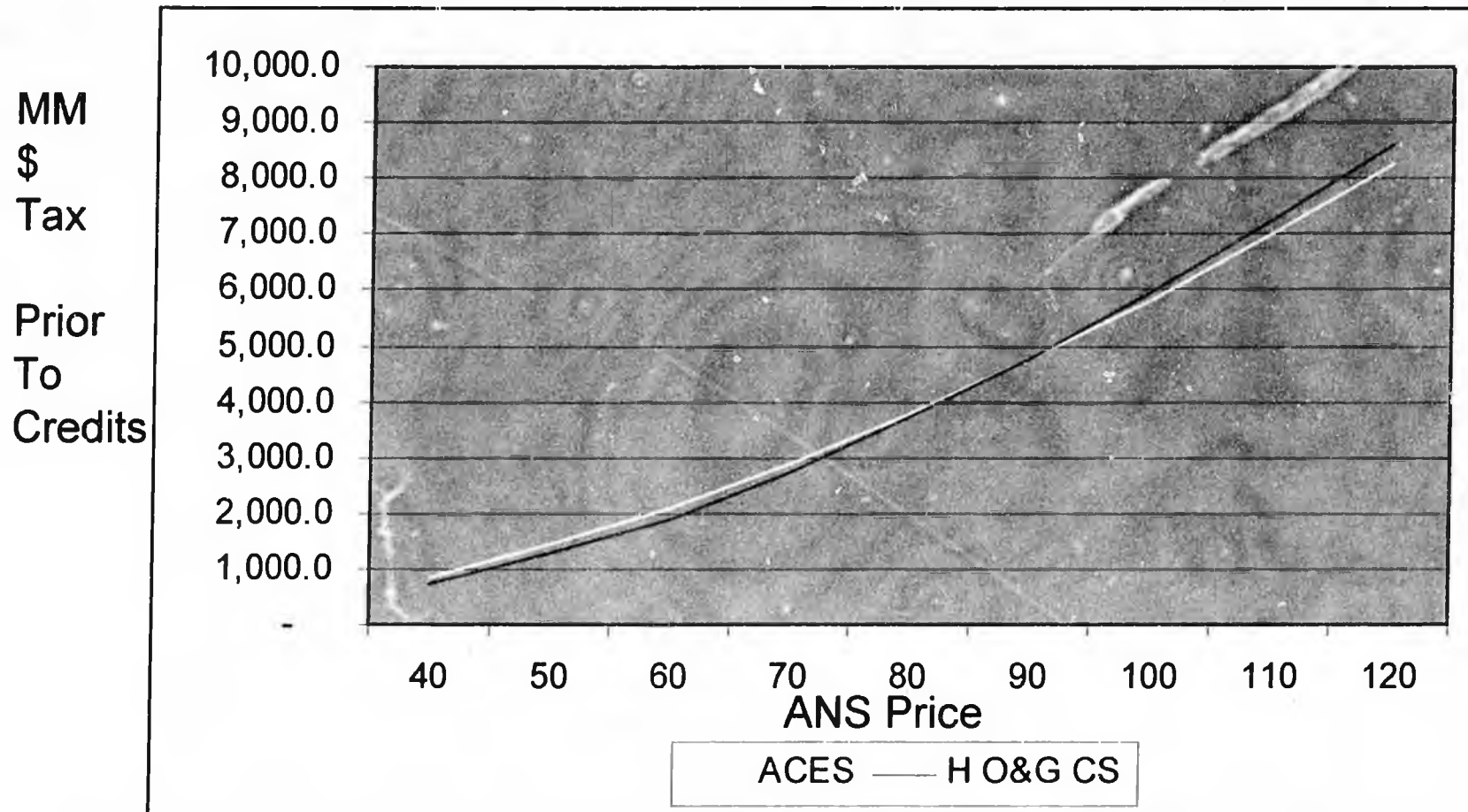
Are costs closer to \$15 or \$20 a barrel?

	Alternative Calculations		Econ One
	No Royalty Effect	Removing Royalty	"All Details"
Opex - (in millions) (from DOR)	2,146	2,146	
Capex - (in millions) (from DOR)	2,137	2,137	
Total - \$ numerator	4,283	4,283	4,264
Daily Volumes (millions) (from DOR)	0.722	0.722	
Days in year	365	365	
Annual Volumes (millions)	263.5	263.5	
Royalty Effect (estimate)	1	0.875	
Bbl Denominator	263.5	230.6	230.5
\$/bbl	16.25	18.57	18.50
"Actual" costs 30 cents per barrel higher			

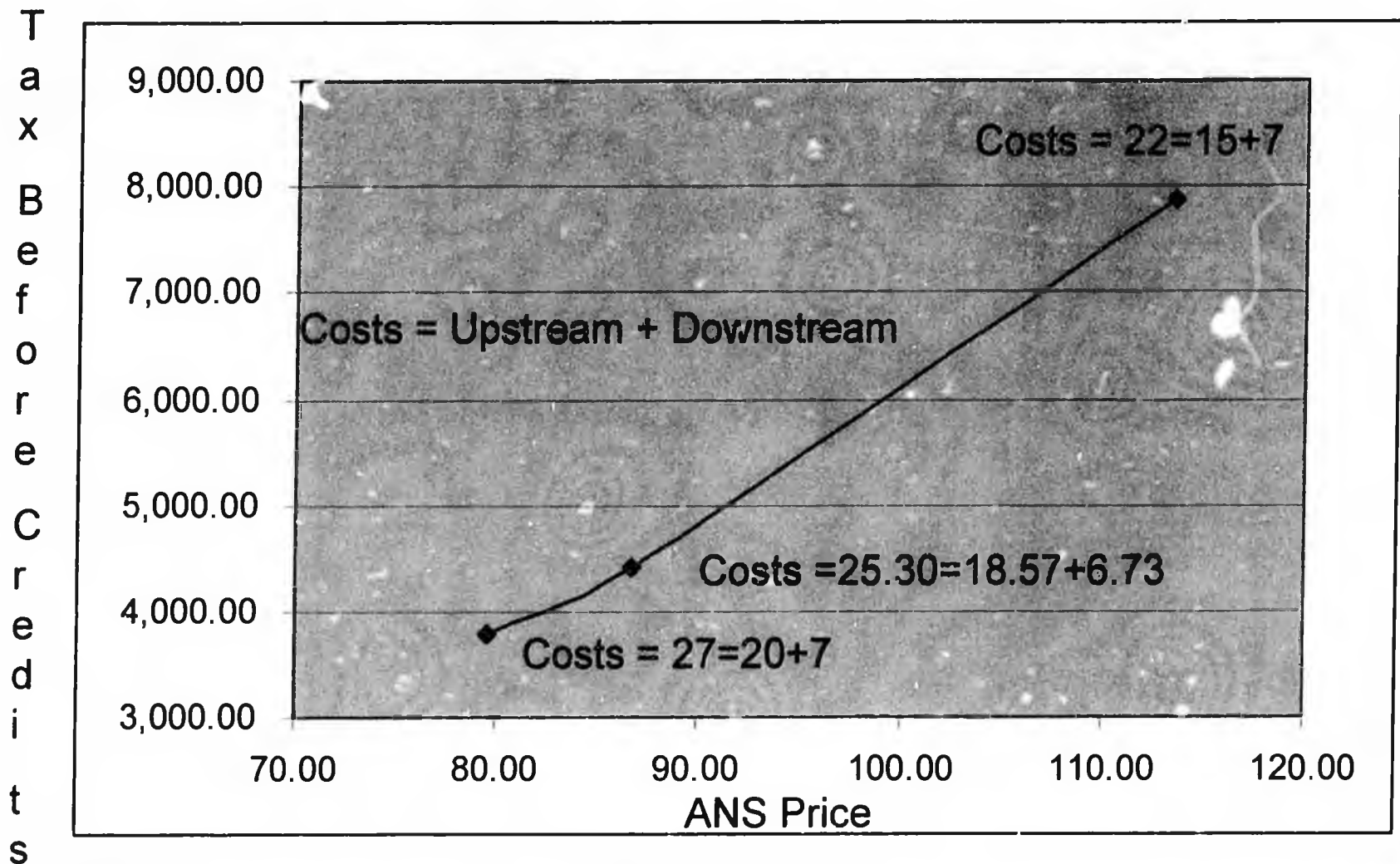
Progressivity Studies 10/28/07 (\$7 downstream costs, \$20 upstream)



Cross Over Point, ACES and H O&G CS (using 10/30 Daily Price and DOR cost and volume assumptions)



Cross Over Points (ANS price, millions of dollars of tax before credits) where HO&G CS revenues exceed ACES using different costs



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Algebraic Description of Progressivity

- R = Progressivity rate (per dollar per barrel above starting point)
- G = Gross Value at Point of Production of Taxable Oil
- N = Upstream Costs
- TB = Taxable Barrels
- Gross Progressivity
- Progressivity Tax = $R * (G/TB - 50) * G$
- Net Progressivity (ACES would use 30 instead of current 40)
- Progressivity Tax = $R * ((G-N)/TB - 40) * (G-N)$

The Credit Story

- Development Credits for New Entrants
- Development Credits for Incumbents
- Exploration Incentive Credits

Example 1: New Entrant Development

- A new entrant with no current production pursues a development requiring \$200 million in investment
- Company receives a 20% investment credit, worth \$40 million (PPT and ACES)
- Company also receives an additional credit for its “tax loss”, PPT – 20%, ACES – 25%

(PPT) - \$40M (ACES) - \$50M

Example 2: Incumbent Producer Development

- Incumbent with current production pursues a development requiring \$200 million investment
- Company receives a 20% investment credit, worth \$40 million
- The company reduces current-year tax by the total capital expense multiplied by the tax rate
(PPT) \$200 million * 22.5%, worth \$45 million
(ACES) \$200 million * 25%, worth \$50 million
- Finally, under PPT, the incumbent producer receives a 10% “claw-back” credit \$20 million

Development Comparison

	PPT	ACES
<u>New Entrant</u>		
Development Costs	\$200	\$200
Investment Credit	\$40	\$40
<u>Net Loss Credit</u>	<u>\$40</u>	<u>\$50</u>
Total State Credit	\$80	\$90
<u>Incumbent</u>		
Development Costs	\$200	\$200
Investment Credit	\$40	\$40
<u>Net Loss Credit</u>	<u>\$45</u>	<u>\$50</u>
Total State Credit	\$85	\$90

Exploration Incentive Credits (".025 Credits")

	PPT	ACES
Exploration Well Costs	\$100	\$100
(a) 3 miles from "existing well"? (b) 25 miles from unit?		
Yes to (a) only	\$20	\$30
Yes to (a) & (b)	\$40	\$40
<u>Net Loss Credit</u>		
Incumbent	\$22.50	\$25
New Entrant	\$20	\$25
<u>Total Credit</u>		
Incumbent (a) only	\$42.50	\$55
Incumbent (a) & (b)	\$62.50	\$65
New Entrant (a) only	\$40	\$55
New Entrant (a) & (b)	\$60	\$65