

SB

80

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

REPORTED OUT
 MAY 08 2007
 SENATE FINANCE COMMITTEE

DATE: 5/2/07

FURTHER:

DATE TURNED
 IN TO OFFICE: 8 May 2007

Finance Committee considered

SENATE BILL NO. 80

SB 80 OIL & GAS PRODUCTION TAX: EXPENDITURES

"An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date."

and recommends:

- [] be replaced with [] SCS or [] CS SB 80 (FIN)
- [] adopt previous [] SCS or [] CS _____ (_____)
- [] attached amendment(s)
- [] adopt _____ Letter of Intent
- [] further referral to _____ Committee

SENATE BILL:
 Same Title
 New Title

HOUSE BILL:
 Same Title
 Technical Title Change
 New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
DNR	7/8/07			✓	

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
Admin	4/20/07			✓	#1
DEC	7/20/07			✓	#2
Revenue	7/20/07	124.9			#3

[] APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
	ELTON	✓			
	THOMAS	✓			
	DYSON	✓			
	OLSON	-		✓	
	HUGGINS	✓			
CO-CHAIR:	HOFFMAN	✓			
CO-CHAIR:	STEDMAN	✓			

FISCAL NOTE

REPORTED OUT
MAY 08 2007
 SENATE FINANCE COMMITTEE

STATE OF ALASKA
 2007 LEGISLATIVE SESSION

Fiscal Note Number: SB080CS(RES)-DNR-O&G-05-08-07
 Bill Version: CSSB 80 (RES)
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title Oil & Gas Production Tax: Expenditures RDU Resource Development
 Component Petroleum Systems Integrity Office
 Sponsor Sen. Wagoner
 Requester Senate Finance Component No. 2847

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
 Mark 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)*
 SB 80 would prohibit oil and gas producers from deducting costs related to the repair and replacement of property or equipment, that was either not maintained or improperly maintained, when determining the taxable value of oil and gas production. In making the determinations as to which costs were related to improperly maintained property or equipment, the commissioner of Revenue would consult with the commissioners of Environmental Conservation and Natural Resources, and the coordinator of the Petroleum Systems Integrity Office (PSIO).

 There is no fiscal impact associated with the implementation of this bill.

Prepared by: Kevin Banks, Acting Director Phone 269-8800
 Division: Oil and Gas Date/Time 5/8/2007
 Approved by: Thomas Irwin, Commissioner Date 5/8/2007
 Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: 3
Bill Version: CSSB 80(RES)
(S) Publish Date: 5/2/07

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue 04
Title Oil & Gas Production Tax: Expenditures RDU Taxation and Treasury
Component Tax Division
Sponsor Senator Wagoner
Requester (S) Resources 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	124.9	124.9	124.9	124.9	124.9	124.9
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	124.9	124.9	124.9	124.9	124.9	124.9

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	124.9	124.9	124.9	124.9	124.9	124.9
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	124.9	124.9	124.9	124.9	124.9	124.9

Estimate of any current year (FY2007) cost: 31.2

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 add certain costs relating to improperly maintained property or equipment to the list of costs that do not qualify as lease expenditures under AS 43.55.165, the petroleum profits production tax system. Under the bill, the commissioner of revenue, in consultation with the commissioner of environmental conservation and the chair of the Alaska Oil and Gas Conservation Commission, would determine whether costs are specifically disallowed under this provision. The provision would disallow any costs incurred to (1) repair or replace improperly maintained property or equipment; and/or (2) maintain the operational capability of facilities or equipment that are either shut down or are diminished in capacity. The bill effective date is retroactive to April 1, 2006 - the effective date of the petroleum profits tax (PPT).

Prepared by: Jon Iverson and Cherie Nienhuis
Division: Tax
Approved by: Jerry Burnett
Agency: Department of Revenue

Phone: 269-1033
Date/Time: 2/20/07 2:00 PM
Date: 2/20/2007

FISCAL NOTE # 3

STATE OF ALASKA
2007 LEGISLATIVE SESSION

BILL NO. CSSB 80(RES)

ANALYSIS CONTINUATION

The impact this bill would have on petroleum tax revenues is indeterminate. Costs identified as disallowed under this bill could be categorized as either operating costs or capital costs. The PPT authorizes eligible operating costs to be deducted from the petroleum profits tax at a rate of 22.5%; the PPT authorizes capital costs to be both deducted at a rate of 22.5% and credited at a rate of 20%, for a combined production tax savings of 42.5%. Any set of disallowed costs is likely to be split between these two categories in a way that is distinct from that of another set of costs.

Administering this legislation would require one full-time equivalent (FTE) with expertise in oil and gas industry practices on the level of a petroleum engineer. The department currently contracts with a petroleum engineer for five years at a cost of \$624,650, or \$124,930 per year, for technical support related to petroleum production. It is anticipated that the department would be required to carry a second contract of this magnitude or greater in order to fulfill the requirements of this legislation.

FISCAL NOTE

REPORTED OUT
MAY 18 2007
 SENATE FINANCE COMMITTEE

STATE OF ALASKA
 2007 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: CSSB 80(RES)
 (S) Publish Date: 5/2/07

Revision Date/Time (Note if correction): _____ Dept. Affected: Dept of Environmental Conservation
 Title: OIL & GAS PRODUCTION TAX: EXPENDITURES RDU: Spill Prevention and Response
 Component: Director's Office
 Sponsor: Wagoner et al
 Requester: Senate Resources Component No.: 1392

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 (FY2006) 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						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)
 No additional costs are expected with this legislation.

Prepared by: Larry Dietrick Phone: 465-5250
 Division: Spill Prevention and Response Date/Time: 2/20/07 4:00 PM
 Approved by: Larry Hartig Date: 2/20/2007
 Agency: Department of Environmental Conservation

REVISED FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSSB 80(RES)
(S) Publish Date: 5/2/07

Revision Date/Time (Note if correction): _____ Dept. Affected: Administration
Title Oil and Gas Production Tax RDU AOGCC
Component AOGCC
Sponsor Senators Wagoner, Theriault, Dyson, et al.
Requester Senate Resource Component No. 2010

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
1162 AOGCC Receipts	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						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

Any consultation we provide as part of the Petroleum Systems Integrity Office (PSIO) working group will be part of our ongoing responsibilities at the Alaska Oil and Gas Conservation Commission (AOGCC). Therefore there will be no additional fiscal impact on the agency with the passing of this bill.

Prepared by: Jody J. Colombie, Special Assistant I
Division: Alaska Oil and Gas Conservation Commission
Approved by: Rachael Petro, Deputy Commissioner
Agency: Department of Administration

Phone 793-1221
Date/Time 4/26/07 3pm
Date 4/26/07

1 abandonment for which the cost is incurred is undertaken for the purpose of replacing,
2 renovating, or improving the facility, pipeline, well pad, platform, or other structure;
3 for the purposes of this paragraph, "barrel of oil equivalent" means

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

5 (B) in the case of gas, 6,000 cubic feet;

6 (16) costs incurred for containment, control, cleanup, or removal in
7 connection with any unpermitted release of oil or a hazardous substance and any
8 liability for damages imposed on the producer or explorer for that unpermitted release;
9 this paragraph does not apply to the cost of developing and maintaining an oil
10 discharge prevention and contingency plan under AS 46.04.030;

11 (17) costs incurred to satisfy a work commitment under an exploration
12 license under AS 38.05.132;

13 (18) that portion of expenditures, that would otherwise be qualified
14 capital expenditures as defined in AS 43.55.023(k), incurred during a calendar year
15 that are less than the product of \$0.30 multiplied by the total taxable production from
16 each lease or property, in BTU equivalent barrels, during that calendar year, except
17 that, when a portion of a calendar year is subject to this provision, the expenditures
18 and volumes shall be prorated within that calendar year;

19 (19) costs or that portion of the costs determined by the
20 commissioner, in consultation with the commissioner of environmental
21 conservation and the chair of the Alaska Oil and Gas Conservation Commission
22 and relying on the standard practices of the industry, to be

23 (A) related to the repair and replacement of improperly
24 maintained property or equipment;

25 (B) incurred to maintain the operational capability of
26 facilities or equipment shut down because of improper maintenance of
27 property or equipment; or

} insert
to
CS5890
(RES)

28 (C) for operating facilities or equipment at diminished
29 capacity in proportion to the amount of diminished capacity that is caused
30 by the improper maintenance of property or equipment.

31 * Sec. 2. The uncodified law of the State of Alaska is amended by adding a new section to

1 read:

2 APPLICABILITY. Section 1 of this Act applies to oil and gas produced after
3 March 31, 2006.

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

6 TRANSITIONAL PROVISIONS. (a) A person that filed a statement under
7 AS 43.55.030 before the effective date of this Act and deducted lease expenditures that may
8 not be deducted under AS 43.55.165(e), as amended by sec. 1 of this Act, shall file an
9 amended return and pay any additional tax within 90 days after the effective date of this Act.

10 (b) A person required to make an installment payment of estimated tax under
11 AS 43.55.020(a) for a period not included in a return required to be filed before the effective
12 date of this Act shall determine the amount of the underpayment, if any, that is attributable to
13 lease expenditures that may not be deducted under AS 43.55.165(e) as amended by sec. 1 of
14 this Act. The amount of any underpayment determined under this subsection shall be paid
15 within 90 days after the effective date of this Act.

16 * Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to
17 read:

18 RETROACTIVITY. Section 1 of this Act is retroactive to April 1, 2006.

19 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

1 abandonment for which the cost is incurred is undertaken for the purpose of replacing,
 2 renovating, or improving the facility, pipeline, well pad, platform, or other structure;
 3 for the purposes of this paragraph, "barrel of oil equivalent" means

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

5 (B) in the case of gas, 6,000 cubic feet;

6 (16) costs incurred for containment, control, cleanup, or removal in
 7 connection with any unpermitted release of oil or a hazardous substance and any
 8 liability for damages imposed on the producer or explorer for that unpermitted release;
 9 this paragraph does not apply to the cost of developing and maintaining an oil
 10 discharge prevention and contingency plan under AS 46.04.030;

11 (17) costs incurred to satisfy a work commitment under an exploration
 12 license under AS 38.05.132;

13 (18) that portion of expenditures, that would otherwise be qualified
 14 capital expenditures as defined in AS 43.55.023(k), incurred during a calendar year
 15 that are less than the product of \$0.30 multiplied by the total taxable production from
 16 each lease or property, in BTU equivalent barrels, during that calendar year, except
 17 that, when a portion of a calendar year is subject to this provision, the expenditures
 18 and volumes shall be prorated within that calendar year;

19 (19) costs or that portion of the costs determined by the
 20 commissioner, in consultation with the commissioner of environmental
 21 conservation, the commissioner of natural resources, and the person in the
 22 Department of Natural Resources who is the lead person for exercising oversight
 23 over the maintenance of oil and gas facilities, equipment, and infrastructure in
 24 the state, and taking into consideration good oil field practice, to be

25 (A) related to the repair and replacement of property or
 26 equipment that was not maintained or was improperly maintained;

27 (B) incurred to maintain the operational capability of
 28 facilities or equipment shut down because of improper maintenance of
 29 property or equipment; or

30 (C) incremental operating expenses incurred as a result of
 31 operating facilities or equipment at diminished capacity when that



Official Business

Alaska State Senate

Senate Finance Committee

Mail Stop 3100
State Capitol
Juneau, Alaska 99801-1182

FAX COVER SHEET

DATE: 8 May 2007 TIME: 9:50 am

TO: Legal Services

NUMBER OF PAGES, INCLUDING COVER SHEET: 2

FROM: MINDY ROWLAND
SENATE FINANCE COMMITTEE SECRETARY
PHONE: 465-4935
FAX: 465-2187

NOTES: Final Please.

CS SB 80 (FIN) 25-LS0425\L

Plus 1 amendment: page 3 line 27:

insert language of subparagraph (B)

of 25-LS0425\C

(attached)

Thanks,
Mindy



Official Business

ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

- Member, Resources
- Member, Community & Regional Affairs
- Member, World Trade

Session: January – May

State Capitol, #427

Juneau, AK 99801

Phone: 907-465-2828 Fax: 907-165-4779

Interim: May – December

145 Main Street Loop; Suite 226

Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

Sponsor Statement

SB 80 – Oil and Gas Production Tax: Expenditures

The language in this bill was offered as an amendment to HB 3001, the Petroleum Production Tax (PPT) on August 9, 2006 before the Senate Special Committee on Natural Gas Development.

The issue which prompted that proposed amendment last August remains, and perhaps is even expanded, given the problems associated with the ongoing BP corrosion crisis.

Simply put, this bill protects the State of Alaska by encouraging proper maintenance efforts; which costs would then be allowed as deductions or credits against the PPT.

However, if a company failed to conduct proper maintenance on a pipeline, they would not be allowed to utilize the deductions or credits authorized by the PPT for their costs to repair that improperly maintained pipeline.

The authority to make a determination on costs related to improperly maintained facilities rests with the Commissioner of the Department of Revenue, in consultation with the Commissioner of the Department of Environmental Conservation and the newly formed Petroleum Safety Integrity Office and relying on industry standards.

The bill is structured to be applicable on the same date as was the PPT tax – April 1, 2006.



THE ALLIANCE

...for responsible development of Alaska's Oil, Gas & Mineral Resources

360 West Benson Blvd., Suite 200 • Anchorage, AK 99503 • Phone (907) 553-2226 • Fax (907) 561-8870

FAXED APRIL 30, 2007

The Honorable Bert Stedman, Co-Chairman
The Honorable Lyman Hoffman, Co-Chairman
Senate Finance Committee
Alaska State Legislature
State Capitol (M5 3101)
Juneau, Alaska 99801-1182

Dear Senators Stedman and Hoffman,

The Alaska Support Industry Alliance, a trade association whose 400 members provide goods and services to Alaska's oil, gas and mining industries and more than 30,000 jobs for Alaskans, would like to express our opposition to Senate Bill 80. We believe the bill is unnecessary, unfair and premature. It will accomplish little but to spawn disputes and uncertainty, and it will be a further disincentive to the long-term oil and gas investment that's the lifeblood of Alaska's economy. We urge you not to pass it out of the Senate Finance Committee.

The bill is unnecessary. Current legislation already denies tax credits for lease expenditures resulting from fraud, willful misconduct or gross negligence, and disallows costs related to spills.

The bill is unfair, and would result in double taxation. The flat 30-cent-per-barrel tax credit exclusion in the new Petroleum Production Tax (PPT) explicitly was intended to cover all maintenance expenditures - those resulting from "proper" and "improper" maintenance. SB 80's additional exclusion for costs incurred due to "improper maintenance" constitutes double taxation. Producers across the board are denied deductions for maintenance costs under the umbrella of the 30-cent-per-barrel provision of the PPT, then would be denied additional tax credits on a case-by-case basis for some of the same maintenance expenditures under SB 80.

The bill is a petri dish for tax disputes. Terms in SB 80 such as "improper" maintenance and "diminished" capacity are vague and undefined, leaving interpretation in the hands of several commissioners, headed by the commissioner of Revenue. By contrast, the 30-cent provision offers clarity and certainty. We may not like it, but at least everyone understands the rules.

Alliance opposition to SB 80
Page 2

The bill is premature. It's been less than a year since the legislature retroactively imposed the largest tax increase in Alaska's history on North Slope producers, roughly tripling severance taxes. Regulations for the new PPT haven't even been drafted yet, and SB 80 proponents already want to change it. The Alliance believes additional changes at this time will further undermine Alaska's reputation as a stable and predictable place to invest, resulting in fewer jobs and business opportunities for Alaskans.

SB 80 may seem like prudent politics to some, but it's poor public policy. The Alliance opposes this proposed legislation and urges you not to move it out of the Senate Finance Committee. Thank you for your consideration.

Sincerely,

PAUL LAIRD

Paul Laird
General Manager

ENHANCEMENT OF THE "GROSS" CHARACTER OF THE PPT BILL

August 5, 2006

Pedro van Meurs

This memo has been written at the request of Senator Wagoner. The request was to provide ideas as to how the "gross" character of the PPT bill can be enhanced.

This memo does not reflect the views of the Administration and is solely meant to provide Senator Wagoner with my professional advice on these ideas.

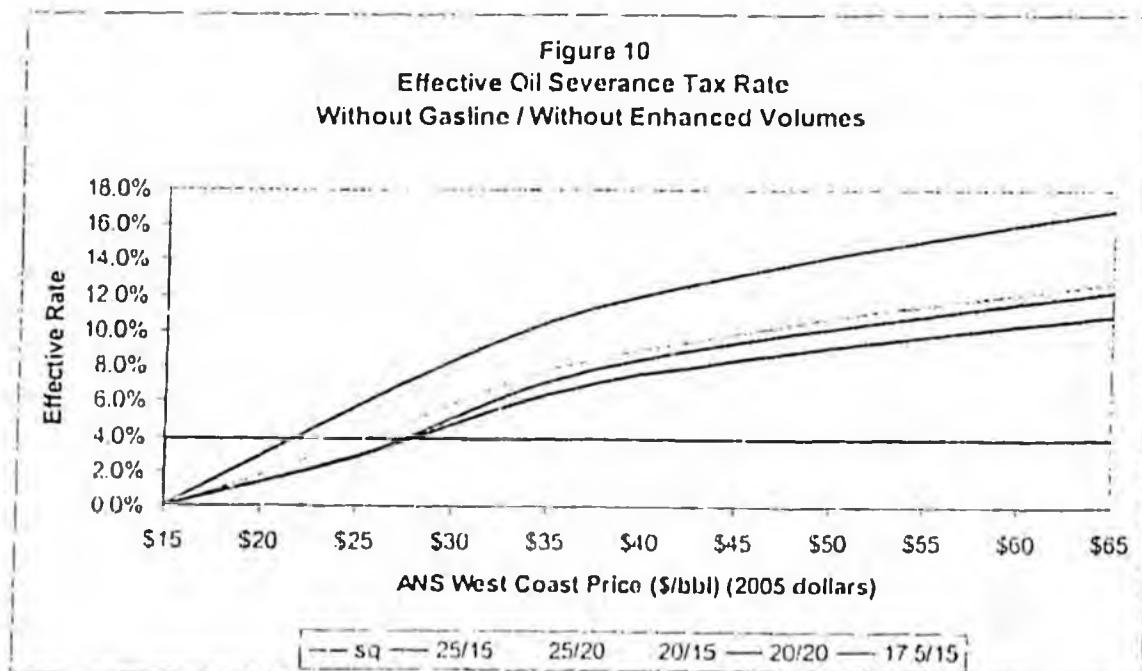
FLOOR

Considerable concern has been expressed about the fact that under some circumstances of low prices and high levels of investment, the PPT may result in less severance tax than we would have received otherwise under the current severance tax.

This can be prevented with the introduction of a "floor", very similar as was introduced in House Bill 3004.

The floor would be based on the gross value at the point of production of the taxable oil and gas.

Roger Marks presented to the Legislature in February this year a direct comparison between the various proposed PPT systems and the 4% average on gross that would be otherwise applicable to the year 2006.



These graphs prove that at about \$ 25 per barrel the current ELF produces about the same amount as a 22.5/20 PPT.

If we assume the adoption of a 22.5/20 PPT than one could take the position that the PPT should not be less than 4% of gross when the ANS West Coast price exceeds \$ 25 per barrel.

HB 3004 introduced the concept that at lower prices the North Slope oil becomes obviously less economic and it would be counter productive to continue to tax the oil industry. Therefore HB 3004 proposes a scale with a lower floor at lower prices.

This overall concept could be combined with the results of the analysis of Roger Marks as follows:

Over an ANS price of \$ 25 per barrel	--	4%
When ANS is between \$ 20 and \$ 25 per barrel	--	3%
When ANS is between \$ 17.50 and \$ 20 per barrel	--	2%
When ANS is between \$ 15 and \$ 17.50 per barrel	--	1%
Below \$ 15 per barrel	--	0%

Each year the floor would be compared with the tax payable under the PPT and if the floor is higher, the higher amount would be paid.

Following is an example how the floor would work based on a PPT tax rate of 20% and a floor of 4%:

Gross Revenues	100	100	100
Cost deductions	40	90	120
Net Revenues	60	10	- 20
PPT Tax	12	2	-4
Floor	4	4	4
Tax payable	12	4	4

If the Gross Revenue based PPT is higher than the Net Revenue based PPT this extra payment can not be recovered in following years as a deduction. In other words this excess cannot be carried forward in order to be recovered in future years.

Of course, the payment of the differential between the Gross and Net Revenue based PPT cannot be taken as a deduction for the Net Revenue based PPT.

However, any carry forward credits as a result of a tax loss based on the Net Revenue based PPT remain unaltered.

Also under this scheme companies would not lose their capital investment credits of 20%.

It is also suggested that the additional non-transferable tax credits under Sec. 43.55.024 of the proposed House Bill 3001 (FIN) will still be creditable against the Gross Revenue Based PPT if this is higher than the Net Revenue Based PPT. These additional non-transferable tax credits were meant to protect small companies and encourage companies outside Cook Inlet and the North Slope. The Gross Revenue based PPT should not harm such companies.

INCREASE THE NON DEDUCTABLE ITEMS

The more costs are being excluded from the Net Revenue calculation the more the overall calculation becomes more similar to a Gross Revenue calculation. Therefore, the Gross Revenue character of the tax can be enhanced by simply adding to the list of items that are not considered lease expenditures.

There are two important cost components that could be excluded from lease expenditures:

- Costs related to gas development under a stranded gas contract, and
- Capital maintenance expenditures.

Gas development costs under a stranded gas contract.

Much concern has been expressed about the fact that with a net revenue based system there could be a joint cost problem in Point Thomson and other similar fields if the stranded gas contract would be implemented.

It is argued that all Point Thomson development and operating costs would be deductible under the PPT. At the same time under the stranded gas contract, companies would provide a 7.25% share to the State on gross and not pay the 20% or 22.5% PPT on gas. It is perceived that Point Thomson is being cross subsidized from what otherwise would be tax on oil under the PPT.

My view is that this is not a fair comparison, since reasonably all costs can be absorbed by the condensates. Nevertheless, this issue remains a concern of the Legislators.

It would be possible to add a further item on the list of non deductible costs under proposed AS. 43.55.165 (c) of House Bill 3001 (FIN) written as follows (*non legal language*):

- "(19) 75% of the capital and operating costs associated with the Point Thomson Unit and other gas fields that are being developed under a contract under AS.43.82, with respect to working interest owners which have concluded such a contract."

The 75% is based on the energy equivalent value considering that Point Thomson may have 400 million barrels of condensates and 7 - 8 Tcf of gas. In other words, the capital and operating costs would be allocated on an energy equivalent basis between condensates and gas. It is believed that many potential gas fields on the North Slope will have condensates and that these percentages may vary. For purposes of the bill, this percentage would be simply fixed.

The 25% allocated to condensates would be deductible for PPT purposes and would receive the related tax credits.

The 75% allocated to gas would not be deductible for PPT purposes and would not receive the related tax credits.

It can be assumed that the PTU would require a \$ 2.5 billion capital expenditure. Based on a 100% working interest, this arrangement would not receive a PPT tax reduction of \$ 750 million during development of the field. Assuming a \$ 1 billion operating expenditure over the life time of the field, it would mean that over time companies would pay \$ 150 million more tax during the operation of the field.

This is a significant tax increase, but in the total scheme of PPT taxation over the next 30 years this may represent only 1%-2% more tax.

Nevertheless, it would make the economics of Point Thomson development less attractive on an incremental basis and it would therefore make the entire gas project less attractive economically.

An interesting side effect of this arrangement is that it would place Chevron and other minority interest holders in a much better position relative to the sponsors. These companies have expressed concern that they would be discriminated against relative to the three sponsors. If Chevron and others do not join the stranded gas contract or would not be able to enter into a uniform upstream contract, they would at least benefit considerably relative to the Sponsors since they would receive the full tax deductions and credits. At the same time such companies would, of course, have to pay the full PPT on their gas income and therefore it is logical to permit them these tax credits and deductions.

Deemed Capital Maintenance Costs

Another concern that is regularly expressed is that the State should not permit the deduction of costs related to replacing equipment that is becoming defective or gathering lines that need to be replaced because of corrosion or other problems. The argument is that these assets should have been better maintained in the first place.

It should be noted that in most oil and gas fields, assets will have to be replaced after the technical life of such assets has expired. Therefore, such replacements are reasonable lease expenditures and are required to protect the health and safety of the workers and to protect the environment. Nevertheless, it is possible to exclude them from the lease expenditures under AS 43.55.165 (e) if this is politically desirable. A section could be added as follows (*non legal language*):

- (20) deemed capital maintenance expenditures which shall be capital expenditures equal to US \$ 0.30 per BTU equivalent barrel taxable production.

The US \$ 0.30 per BTU equivalent barrel is based on reasonable capital maintenance costs of fields for which I have (confidential) information. Based on a production of 900,000 barrel equivalent per day, this means that about \$ 100 million in capital expenditures per year will not be deductible for PPT purposes. Based on a PPT rate of 22.5% and a tax credit rate of 20% this means that the companies will pay \$ 42.5 million more tax per year.

An interesting side effect is that companies that would have a low level of capital expenditure per barrel would feel the effect more on a relative basis than companies that would have a high level of capital expenditures per barrel. Companies that re-invest strongly are therefore harmed less by this provision than typical harvesters.

Disallowing "deemed capital maintenance" costs
August 8, 2006
Pedro van Meurs

The shut down of Prudhoe Bay has brought in sharp focus that some of the facilities on the North Slope may be in poor shape.

The repair of such facilities could involve billions of dollars over the next two decades.

This raises firstly a fairness issue. Should companies receive a tax deduction and tax credit together for 40% of the value (under the 20/20 system) for replacing a pipeline that was defective and not properly maintained (as BP admitted during their short presentation to the Senate Committee). The pipeline replacement may also be subject to the "2 for 1" formula which would raise the contribution of Alaska to 50%.

However, at the same time this raises a broader issue. It is likely that over time more defective equipment will be identified that needs repair or replacement. The Prudhoe Bay oil field is now 30 years old and the continued operation for the next 30 years may pose a variety of problems.

In cost control there has always been a rather important "grey area" between "repair" and "betterment or replacement".

Under accounting rules if expenditures are made to replace an asset or improve the asset in a manner that provides it with a longer technical asset life, these costs are typically considered "capital" expenditures, if an asset is merely repaired it is an "operating" expenditure. For auditors it is often difficult to determine the difference.

Under the PPT the capital expenditures can be deducted and also receive a tax credit of 20%. Operating costs can only be deducted. It is therefore logical for companies to try to consider repairs as much as possible as capital expenditures by arguing that they created a "betterment" of the equipment. Or they may decide to simply replace the asset even if it can be repaired because of the tax deductions and credits. This could be an area of misuse under the PPT. A significant percentage of the operating costs could slip into the capital costs to the detriment of the State.

For all these reasons one could simply disallow a small part of the total capital expenditures as "lease expenditures". In this case they cannot be deducted or used for tax credits.

My suggestion is to disallow the first \$ 0.30 per BTU equivalent barrel as "lease expenditures".

A section could be added to AS 43.55.165 (e) of the bill as follows under non deductible lease expenditures (*non legal language*):

- (20) deemed capital maintenance expenditures which shall be capital expenditures equal to US \$ 0.30 per BTU equivalent barrel taxable production.

The US \$ 0.30 per BTU equivalent barrel is based on reasonable capital maintenance costs of fields for which I have (confidential) information. Based on a production of 900,000 barrel equivalent per day, this means that about \$ 100 million in capital expenditures per year will not be deductible for PPT purposes. Based on a PPT rate of 20% and a tax credit rate of 20% this means that the companies will pay \$ 40 million more tax per year.

I believe that this would provide a good answer to possible public criticism that under the PPT we would provide 50% of the replacement costs of pipelines as a result of the Prudhoe Bay shut down. I believe this would be popular with the Senate and the House. This could enhance the probability that the PPT would pass.

AMENDMENT 7

Page 32, line 29, following "AS 38.05.132":

Insert ";

(19) that portion of capital expenditures incurred during a calendar year that are less than the product of \$.30 multiplied by the total taxable production from the lease in BTU equivalent barrels during that calendar year.

DR. VAN MEURS explained that there is a gray area in accounting between normal maintenance and improvement costs. If an expenditure were classified as betterment or replacement, it would be a capital expenditure and subject to the 20 percent tax credit as well as the 22.5 percent deduction. Maintenance is a reasonable deduction for PPT; but it is sometimes hard to decide which expenditures fall into that classification. The simplest solution is to take some base expenditure that really will be replacement and, over the next 20 or 30 years, disallow a modest floor of the capital expenditures. From an international perspective, \$.30 per barrel taxable production seems to be a reasonable figure. The intent of this amendment is to clarify that, when repairs turn into replacement, a certain amount of capital expenditures is not subject to deductions or credits.

CHAIR SEEKINS called for questions and removed his objection.

ROBYNN WILSON noted that the term "capital expenditures" is not defined anywhere in the amendment. She suggested inserting the phrase, "that would otherwise qualify as a qualified capital expenditure", because "Qualified capital expenditure" is defined on page 17, line 1 of the bill.

SENATOR RUNDE asked if she was suggesting the insertion of the word "qualified" before "capital expenditures".

ROBYNN WILSON replied that, after the word "expenditure", she suggests inserting the words "that would otherwise qualify as a

qualified capital expenditure".

SENATOR BUNDE asked if simply inserting "qualified", so it would read, "that portion of qualified capital expenditures", would work.

ROBYNN WILSON replied that it would work; but it might be necessary to move the definition from Section 024(k) [actually Section 43.55.023(k)] to the definition section in 900.

SENATOR WAGONER recommended that the amendment be set aside until the drafter can be present.

SENATOR BEN STEVENS saw no reason to question the drafter's work.

SENATOR DYSON wondered if the federal definition of what is allowed will include items that Dr. Van Meurs and Senator Wagoner are trying to prevent.

DR. VAN MEURS agreed with Robynn Wilson's suggested language.

SENATOR DYSON asked if he was implying that whatever is allowed under federal code is acceptable.

DR. VAN MEURS answered yes.

ROBYNN WILSON said that, as she understands the amendment, it falls within (e), which is the prohibited deductions list. The total production is multiplied by \$.30 to arrive at a figure that would not be allowed as a deduction or credit. She asked if that is correct.

DR. VAN MEURS answered yes.

CHAIR SEEKINS set the amendment aside pending a review by the drafter and sponsor.

AMENDMENT 9

Page 32, line 29, following "AS 38.05.132":

Insert":

(19) costs or a portion of the costs determined by the commissioner, in consultation with the commissioner of environmental conservation and the chair of the Alaska Oil and Gas Conservation Commission, to be

(A) related to the repair and replacement of improperly maintained property or equipment; or

(B) incurred to maintain the operational capability of facilities or equipment shut down or operating at diminished capacity because of improper maintenance of property and equipment"

SENATOR GREEN objected for explanation.

SENATOR WAGONER explained that he has presented this amendment on behalf of Senator Therriault.

SENATOR THERRIAULT said the amendment was prompted by the recent shutdown of a portion of the TAPS line due to maintenance issues, which raised the question of how repairs would be handled in a net-based PPI system. The amount of oil produced by the affected fields is approximately 375,000 barrels per day. His calculations indicate that the operating costs, even when there is no production, are about \$1 million per day. The amendment allows the commissioner of revenue, in consultation with the commissioner of the Department of Environmental Conservation (DEC), and the chairman of the Alaska Oil and Gas Conservation Commission (AOGCC) to determine what costs are attributable to lack of maintenance and disallow those costs.

1:38:20 PM

SENATOR BEN STEVENS commented that paragraph (B) on line 8 might encourage a complete shut down, because the operating expenses

would not be deductible when operating at diminished capacity.

SENATOR THERRIAULT said he does not think it would have that effect, because agency personnel have the latitude to look at the costs and agree what is and is not reasonable and allowable.

SENATOR BEN STEVENS reiterated that he believes it would encourage a total shutdown and that it might provide a disincentive to replacing bad equipment.

SENATOR THERRIAULT repeated that, because the commissioners have the flexibility to make determinations on a case-by-case basis, he does not believe that would be the case.

CHAIR SEEKINS used an automobile maintenance analogy to illustrate how the agency representatives might make the determination and asked if that is how Senator Therriault sees it working.

SENATOR THERRIAULT agreed with his analogy and emphasized that this refers specifically to improperly maintained equipment.

1:43:47 PM

MR. DICKINSON, Consultant to DOR, commented that his interpretation of the amendment is that all operating costs would be disallowed as long as the plant is operating at diminished capacity, and he does not think that is the intent.

SENATOR THERRIAULT pointed out that line 2 says "costs or a portion of the costs", so there is flexibility.

MR. DICKINSON responded that he would like to see the criteria used to determine that portion.

SENATOR THERRIAULT said that could be fleshed out in regulation through discussion with the companies.

1:45:59 PM

CHAIR SEEKINS asked if Mr. Dickinson was saying that, if capacity were diminished by 10 percent, all operating costs would be disallowed.

MR. DICKINSON answered yes, that it is not clear what portion is being disallowed.

1:47:32 PM

SENATOR GREEN asked whether this could open the state to litigation regarding the interpretation of "improper maintenance". She also asked if there is an appeal process in place.

SENATOR THERRIAULT replied that there is an established process for appealing a determination by the commissioner(s).

CHAIR SEEKINS said he would feel more comfortable if it were "additional costs" rather than just "costs".

SENATOR STEDMAN wondered how the retroactive portion of this would work without regulations in place, as it appears to target the current situation on the North Slope.

SENATOR THERRIAULT replied that most of the costs associated with the partial shutdown have not occurred yet and may not for some time. He feels that our legal process can accommodate this while addressing the pressing concerns of the constituency.

SENATOR STEDMAN said that his constituents are more concerned about the revenue loss than they are about tax issues related to getting the pipe back on line.

1:52:02 PM

SENATOR BEN STEVENS wondered if the committee is creating something that already exists in the bill. Under Section 43.55.160, the determination of production tax value is calculated by taking the gross value less the producer's lease expenditures under 43.55.165, which are identified in the bill.

SENATOR THERRIAULT said that the cost of repairs qualifies for deductions under this system. Since the tax is imposed at the corporate level, that would include normal maintenance and any additional expenses due to operating the field during a shutdown or partial shutdown. If the expenditure stems from improperly maintained property or equipment, it is not appropriate to charge that back against state revenues, and this amendment seeks to address that.

CHAIR SEEKINS said he believes the intent is to prohibit deductions on additional costs incurred to maintain operations, not normal costs, and suggested inserting the word "additional" on line 3.

1:57:49 PM

SENATOR THERRIAULT said the amendment applies to "the cost incurred to maintain the operational capabilities of facilities or equipment shutdown or operating at diminished capacity because of improper maintenance". The state has agreed to share the costs because it is getting production; but it makes no sense to deduct the expenses of a field that is shut down or partially shut down against production from other fields.

CHAIR SEEKINS responded that, as long as we are talking about additional costs, he would have fewer objections to the amendment. He is concerned that, as written, it might not accomplish what is intended.

1:58:10 PM

SENATOR BEN STEVENS reiterated that one would not know if the costs were incurred due to misconduct or negligence until an investigation is completed, and this amendment creates a disincentive to operate at diminished capacity while that is underway.

SENATOR DYSON supported Senator B. Stevens' comments and suggested that the insertion of "additional" on line 3 should

allay his concerns. He thought there would have to be an overwhelming tax advantage for a company to choose to shut down.

CHAIR SEEKINS asked Senator Therriault to point to an example when this amendment might come into play.

SENATOR THERRIAULT replied that, if Prudhoe Bay were shut down, the operating costs would continue to accrue at about \$3 per barrel, or roughly \$1 million per day for normal, day-to-day operation of the field. Because of inadequate maintenance however, that cost would not be offset by income from production.

CHAIR SEEKINS asked if Senator Therriault is considering the lack of maintenance referenced in his amendment as wilful misconduct or gross negligence.

SENATOR THERRIAULT replied that he was not sure what legal standard would be used.

CHAIR SEEKINS noted that not pigging the line is a cost already covered by an exclusion in the bill [sub-section (e) paragraph (e), page 31].

2:04:53 PM

SENATOR THERRIAULT said those were fairly high standards and were not applicable to this provision.

SENATOR BEN STEVENS said he does not want the costs associated with improper maintenance or negligence to be deductible; but instead of being determined by the commissioners, he suggests that the amendment read, "A portion of the costs determined by the court."

SENATOR THERRIAULT replied that a company could appeal the commissioners' decision to disallow costs and, if it were dissatisfied with the result of the appeal, could take it to court. He does not agree that every decision should go to court.

when it could be handled at the agency level.

SENATOR DYSON asked if all of the commissioners' decisions can be appealed in court.

CHAIR SEEKINS said yes.

SENATOR BEN STEVENS pointed out that, since the term "improperly maintained" is probably not defined in the chapter, every instance would be litigated.

CHAIR SEEKINS contended that the bill already addresses this issue and, if a change is needed, it might be more reasonable to simply add "or improperly maintained" to paragraph (6) on page 31.

SENATOR THERRIAULT said he thinks it is important to add language to clarify what operating expenses and capital expenses are not allowable.

SENATOR DYSON said he does not agree that every instance under this amendment would end up in court.

SENATOR BEN STEVENS said that he still objects to the amendment because he does not want to put anything into statute that would discourage operation of a facility, even at a diminished capacity.

At ease 2:13:30 PM to 2:19:35 PM

CHAIR SEEKINS asked Ms. Wilson how her department would audit this process if the amendment passes.

MS. WILSON answered that she has a real problem with the lack of definition of "improper maintenance". Because it is not defined, every expenditure would have to be audited for improper maintenance. Her department has a three-year statute of limitations on audits, and it could take some time for the court

to determine what is improper, making it difficult to evaluate the costs within that time frame.

SENATOR ELTON said he does not know whether it is possible to define "improper maintenance" and thinks the state has to rely on the good judgment of state regulators and commissioners.

MS. WILSON added that rewriting the amendment using the phrase "without reasonable care", which is a standard understood by the court, might resolve the definition issue.

2:25:37 PM

SENATOR BUNDE said the committee has "gone around the block" six times on this and called for the question.

CHAIR SEEKINS overruled the call in order to allow continued discussion.

SENATOR WILKEN moved Amendment 1 to Amendment 3 and objected to explain. After the second "or" on line 9, insert "the incremental costs of:". This would cause lines 8-9 of the amendment to read, "incurred to maintain the operational capability of the facilities or equipment shut down, or the incremental costs of operating at a diminished capacity." He removed his objection.

2:28:44 PM

SENATOR THERRIAULT supported Senator Wilken's amendment to Amendment 9.

There being no objection, Amendment 1 to Amendment 9 was adopted.

SENATOR THERRIAULT said that Mr. Dickinson recommended that, on line 3, the word "a" before portion be replaced with "that", so it reads "costs or that portion of the costs".

SENATOR DYSON moved Amendment 2 to Amendment 9.

There being no objection, Amendment 2 to Amendment 9 was adopted.

2:31:05 PM

CHAIR SEEKINS said he would feel better if there were a legal standard for improper maintenance.

SENATOR DYSON agreed. He recommended the following definition: "divergence from prudent industry standards and practice" and suggested that it either be inserted as sub-paragraph (C) in the amendment, or after gross-negligence on line 15, page 31 of the bill.

SENATOR ELTON offered that a third option is to strike "improperly maintained" and insert Senator Dyson's language.

SENATOR THERRIault said that he would work with a drafter on this definition.

CHAIR SEEKINS set the amendment aside while Senator Therriault re-drafts the language.

AMENDMENT 10

Page 32, line 29, following "AS 38.05.132":

Insert";

(19) that portion of expenditures that would otherwise be qualified capital expenditures as defined in AS 43.55.024(k), incurred during a calendar year that are less than the product of \$.30 multiplied by the total taxable production from the lease in BTU equivalent barrels during that calendar year, except when a portion of a calendar year is subject to this provision, the expenditures and volumes shall be prorated within that calendar year.

CHAIR SEEKINS objected for discussion.

SENATOR WAGONER said this amendment is the former Amendment 7, with changes. The word "capital" was deleted on line 4 and the following language was inserted on that line after the comma, "that would otherwise be qualified capital expenditures as defined in AS 43.55.024(k)". On line 8, after "year", is inserted "except when a portion of a calendar year is subject to this provision, the expenditures and volumes shall be prorated within that calendar year." The intent is to establish a floor on maintenance costs with the calculation of \$.30 per barrel times total taxable production.

CHAIR SEEKINS removed his objection and Amendment 10 was adopted.

3:57:50 PM at case 3:02:57 PM

SENATOR WAGONER moved Amendment 11 (24-GH2096\F.34).

AMENDMENT 13

Page 32, line 29, following "AS 38.05.132":

Insert ";

(19) costs or that portion of the costs determined by the commissioner, in consultation with the commissioner of environmental conservation and the chair of the Alaska Oil and Gas Conservation Commission and relying on the standard practices of the industry, to be

(A) related to the repair and replacement of improperly maintained property or equipment; or

(B) incurred to maintain the operational capability of facilities or equipment shut down or for the incremental cost of operating at diminished capacity because of improper maintenance of property or equipment"

SENATOR BEN STEVENS objected.

SENATOR WAGONER explained that the difference between Amendment 13 and Amendment 9 is found on line 3, where "a" was replaced by "that", and line 9 after the second "or", where "incremental cost of" was added.

SENATOR THERRIAULT noted that the second change Senator Wagoner referred to is on line 10, where the drafter also added "or for" before the words "the incremental cost". The drafter also modified lines 5-6 to specify that the commissioners could rely on "the standard practices of the industry" in determining whether the equipment was improperly maintained.

4:01:06 PM

SENATOR WAGONER moved Amendment 1 to Amendment 13, to renumber paragraph (19) on line 3 to (20), because the committee did pass a paragraph (19) previously.

There being no objection, Amendment 1 to Amendment 13 was adopted.

4:01:26 PM

CHAIR SEEKINS said that, while he understands that the state does not want to authorize deductions for improper maintenance, he is extremely nervous about the size of the bureaucracy that will result from this amendment, and the process that the producers will have to go through to make a pre-determination of what costs should be considered repair or replacement due to improper maintenance based on other standards in the industry. He is not concerned about catastrophic events, but those that effect the day-to-day operations.

4:06:02 PM

SENATOR GREEN suggested that the words "gross deviation" be inserted on line 5, before "standard".

SENATOR THERRIAULT replied that the addition of that language would set the standard very high and make it difficult to prove.

4:07:18 PM

The roll was called on Amendment 13.

Yea: Senator Dyson, Senator Wilken, Senator Elton,
Senator Kookesh, Senator Wagoner

Nay: Senator Olson, Senator Hoffman, Senator B.
Stevens, Senator Stedman, Senator Bunde, Senator
Green, Senator, Senator Seekins

Amendment 13 failed adoption by 5 yea - 7 nay.

**SENATE COMMITTEE REPORT
First Committee of Referral**

DATE: 2/9/07

FURTHER: Finance

Date of 5-Day Notice: 2/15/07
(in accordance with Uniform Rule 23)

DATE TURNED
IN TO OFFICE: 5/1/07

Resources Committee considered SENATE BILL NO. 80

SB 80 OIL & GAS PRODUCTION TAX: EXPENDITURES

"An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date."

and recommends:

- be replaced with SCS or CS SB 80 (RES)
- adopt previous SCS or CS _____ (_____)
- attached amendment(s)
- adopt _____ Letter of Intent
- further referral to _____ Committee

SENATE BILL:	
<input checked="" type="checkbox"/>	Same Title
<input type="checkbox"/>	New Title
<hr/>	
HOUSE BILL:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	Technical Title Change
<input type="checkbox"/>	New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
ADM	4/26			✓	1
DEC	2/20			✓	2
REV	2/20	✓			3

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
<i>Lyla Green</i>	Green			✓	
<i>Michelle McGuine</i>	McGuine			✓	
<i>Steve Stevens</i>	STEVENS			 	
<i>Steve Stehman</i>	Stehman			✓	
<i>Wielechowski</i>	wielechowski				✓
<i>Wagner</i>	WAGNER				✓
CHAIR: <i>[Signature]</i>	<i>[Signature]</i>			 	