

**HB**

**229**

<target><bill>HB 229</bill><subject>HB  
229</subject><comm>HFIN26</comm></target>

# Alaska State Legislature

State Capitol, Room 208  
Juneau, Alaska 99801-1182  
Phone: 907-465-3779  
Fax: 907-465-2833  
Toll Free: 800-469-3779



145 Main St. Loop  
Second Floor  
Kenai, Alaska 99611  
Phone: 907-283-7223  
Fax: 907-283-7184

## REPRESENTATIVE MIKE CHENAULT SPEAKER OF THE HOUSE

### SPONSOR STATEMENT

#### COMMITTEE SUBSTITUTE FOR HOUSE BILL 229 (RES)

*"An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas from a lease or property in the state; providing for an effective date by amending the effective date by amending the effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."*

Committee Substitute for House Bill 229 (RES) amends and extends the exploration and development incentive tax credit that was originally enacted in the 23rd legislature in 2003 as HB 61. This tax credit continues to apply under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of natural gas primarily in the Cook Inlet area.

To more strongly encourage companies to invest additional capital in exploring for and developing new natural gas reserves, this legislation makes the following changes to current law:

1. Increasing the amount of the credit from 10% to 25% of the amount of qualified capital investment and qualified services spending.
2. Removes the 50% limitation on the amount of credits that can apply in a single year increasing the "time-value of money" for the credits.
3. Removes the "successful efforts" requirement that disallows the credit for wells that are drilled, with all the same costs, but end up being non-productive.
4. Clarifies that the credits can be taken on a current tax return, on a timely filed tax return or on a timely filed tax return for the year immediately following the year the qualified capital investment is made.
5. Clarifies that the credits can be applied to a gas reserve regardless of whether or not there has been previous gas production in the area.
6. Clarifies that the credits do not apply to North Slope gas that is brought into Southcentral.
7. Extends the sunset date of the investment tax credit from January 1, 2013 to January 1, 2020.

This legislation makes no changes to definitions of qualified capital investment or qualified services.

Annual natural gas production and supply in the Cook Inlet area have been declining for a number of years. During the same time, demand has been increasing steadily. Therefore, a sharp increase in drilling to find new reserves is drastically needed. The original Investment Tax Credit enacted in 2003, while modestly successful in stimulating new drilling, needs to be made a much more effective incentive to developers to increase capital spending in a large manner. These changes will go a long way to achieving that goal.

# Alaska State Legislature

State Capitol, Room 208  
Juneau, Alaska 99801-1182  
Phone: 907-465-3779  
Fax: 907-465-2833  
Toll Free: 800-469-3779



145 Main St. Loop  
Second Floor  
Kenai, Alaska 99611  
Phone: 907-283-7223  
Fax: 907-283-7184

## REPRESENTATIVE MIKE CHENAULT SPEAKER OF THE HOUSE

### SECTIONAL ANALYSIS

#### COMMITTEE SUBSTITUTE FOR HOUSE BILL 229 (RES)

*"An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas from a lease or property in the state; providing for an effective date by amending the effective date by amending the effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."*

**Section 1:** Amends 43.20.043(a), Gas exploration and development tax credit. Adds before January 1, 2010, to the time in a tax year for which a credit against state tax liability may be applied. Also further adds language that for a tax year beginning after December 31, 2009, 25 per cent of the taxpayer's qualified investment and 25 per cent of the annual cost incurred by the taxpayer for qualified services in the state during each tax year for which a credit is allowable for a qualified capital investment for any gas reserve of the taxpayer or for each year that qualified costs are incurred for a gas reserve for which the taxpayer previously elected to claim a credit.

**Section 2:** Amends AS 43.20.043(b), Gas exploration and development tax credit. Adds before July 1, 2010, if a claim is made under (a)(1)(A) found in Section 1 or December 31, 2009, if the claim of credit is made under (a)(2)(A) also found in Section 1. Replaces the word "reserves" with wells and "paragraph" with "subparagraph". It adds language that includes expenditures for a gas well that is determined not to be capable of production in commercial quantities as qualifying for the taxpayer's qualified investment credit.

**Section 3:** Amends AS 43.20.043(c), Gas exploration and development tax credit. States the credit allowed will be made for each tax year rather than per year and eliminates the 50 per cent provision of the taxpayer's total tax liability.

**Section 4:** Amends AS 43.20.043(e), Gas exploration and development tax credit. Adds language that disallows a taxpayer from including in any rate base for a regulated facility the cost of any qualified capital investment or qualified services that have been offset by the receipt of a credit under this chapter.

**Section 5:** Amends AS 43.20.043(i)(1), Qualified capital investment. Deletes "reserves in a gas reservoir for which there has not been commercial production if the reserves produce gas for sale and delivery". It adds language that includes any gas reserve

regardless of whether there has been commercial production in the area or whether the exploration and development activity results in the production of gas or a well not capable of production in commercial quantities.

Amends AS 43.20.043(i)(1)(C)(ii), Amends the language regarding what can be included as "property". Topping plants and processing units are deleted. Power plants are constrained to only those designed for field operations. Gas processing plants and gas treatment plants are added with the exclusion of liquefied natural gas or manufacturing plants.

**Section 6:** Amends AS 43.20.043, Adds a new subsection that reads: A taxpayer shall claim the credit authorized in (a) of this section on a timely filed tax return for the year in which the qualified capital investment is made, on a timely filed amended tax return, or on a timely filed tax return for the year immediately following the year in which the qualified capital investment is made. The election to apply the credit authorized in (a) of this section may not be an irrevocable election.

**Section 7:** Amends uncodified law enacted by Section 3, Chapter 61, SLA 2003. Adds secs. 2 and 5, ch. 61, SLA 2003 as amended by Section 8 of this bill. Also amends the carry forward of the tax xcredit from 2017 to 2024.

**Section 8:** Amends uncodified law enacted by Section 5, Chapter 61, SLA 2003. Adds ch. 61, SLA 2003 to take effect on January 1, 2020 instead of 2013.

**Section 9:** Immediate effective date.

**Hypothetical example of Cook Inlet exploration well costs vs state contribution**

Prepared 04/05/10 by Dan Stickle

	<u>Current - law</u>	<u>Current law - with 40% EIC</u>	<u>SB 290 - #1</u>	<u>SB 280 - #2</u>	<u>SB 290 - #3</u>	<u>HB 280</u>	<u>SB 309 / HB 229</u>	<u>SB 271 / HB 337</u>	<u>Notes</u>
<b>Exploration Well Capital Cost</b>	\$20,000,000	\$20,000,000	\$20,000,000	\$20,000,000	\$20,000,000	\$20,000,000	\$20,000,000	\$20,000,000	For illustrative purposes only
<b>.025 Exploration Credit or .023 Capital Expenditure Credit</b>									
Rate	NA	40%	100%	75%	50%	40%	40%	40%	Current law allows for a 30% or 40% credit when certain parameters are met. SB 290 would increase this rate for qualifying wells.
Amount	NA	\$8,000,000	\$20,000,000	\$15,000,000	\$10,000,000	\$8,000,000	\$8,000,000	\$8,000,000	
<b>.023 (a) Cap Ex Credit</b>									
Rate	20%	20%	20%	20%	20%	20%	20%	30%	Current law allows for a 20% production tax credit for qualifying capital costs. SB 271 / HB 337 would increase this amount to 30% for well-related expenditures.
Amount	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000	\$6,000,000	
<b>Higher of ETC or CapEx Credit</b>	\$4,000,000	\$8,000,000	\$20,000,000	\$15,000,000	\$10,000,000	\$8,000,000	\$8,000,000	\$8,000,000	Company can take the exploration tax credit OR the capital credit but not both.
<b>Lease Expense deduction or .023 (b) NOL credit</b>	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	Assumes 25% tax rate (or NOL credit)
<b>Exploration Incentive Credit - against Corporate Income Tax</b>									
Rate	10%	10%	10%	10%	10%	10%	25%	10%	A company claiming the EIC may not "claim a tax credit or royalty modification provided for under any other title" - AS 43.20.043 (g). We assume language will be changed to also disallow a tax credit under rule 43. In most cases the exploration incentive credit will NOT be claimed because production tax credits provide greater benefit.
Amount	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$5,000,000	\$2,000,000	
<b>.024 Small Producer Credit</b>	Can provide up to a \$12 million / year benefit against production tax; cannot be used to reduce liability below zero.								
<b>Other</b>	Capital, exploration and NOL credits for production tax may be eligible for state purchase under AS 43.55.028								
<b>Total State Contribution</b>	\$9,000,000	\$13,000,000	\$25,000,000	\$20,000,000	\$15,000,000	\$13,000,000	\$13,000,000	\$13,000,000	State contribution is Capital or exploration credit + Lease expenditure or NOL credit
<b>State contribution % of cost</b>	45%	65%	125%	100%	75%	65%	65%	65%	

Assumes Well will qualify as an exploration well for Exploration Tax Credit purposes.

# FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

Fiscal Note Number: 1  
Bill Version: CSHB 229(RES)  
(H) Publish Date: 3/25/10

Identifier (file name): HB229-REV-TAX-2-23-10 Dept. Affected: Revenue  
Title: Gas Exploration / Development Tax Credit RDU: Taxation and Treasury  
Component: Tax Division  
Sponsor: Representative Chenault  
Requester: (H) Resources Component Number: 2476

**Expenditures/Revenues** (Thousands of Dollars)

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

	Appropriation Required	Information						
		FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
<b>TOTAL OPERATING</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>								
-----------------------------	--	--	--	--	--	--	--	--

<b>CHANGE IN REVENUES ( )</b>	***	***	***	***	***	***	***	***
-------------------------------	-----	-----	-----	-----	-----	-----	-----	-----

**FUND SOURCE** (Thousands of Dollars)

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

Estimate of any current year (FY2010) cost: \_\_\_\_\_

**POSITIONS**

Full-time								
Part-time								
Temporary								

**ANALYSIS:** (Attach a separate page if necessary)

See Attached.

Prepared by: Tim Harper, Economist III/Robynn Wilson, Revenue Audit Supervisor  
Division: Tax Division  
Approved by: Ginger Blaisdell, Director  
Administrative Services Division

Phone (907) 269-1020  
Date/Time 2-22-10; 12:06pm  
Date 2-23-10; 9:48am

FISCAL NOTE #1

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

BILL NO. CSHB 229(RES)

**ANALYSIS CONTINUATION**

**Bill Language:**

This bill extends the existing Gas Exploration and Development tax credit for investment in qualified capital expenditures and related qualified services, dealing with those capital expenditures. The Gas Exploration and Development tax credit is taken against the Corporate Income Tax (CIT), before any other federal or state credits are taken. One hundred percent of a company's tax liability can be offset by this credit in a given tax year. Additionally, credits from prior years must be used before current year credits can be used. A credit must be used within five years, otherwise it expires.

Currently, 10% of qualifying capital expenditures and operating expenditures can be taken as capital credits, sunseting in 2013. The bill would increase the credit rate to 25% for qualifying capital and service expenditures incurred after June 30, 2011 for tax years beginning after December 31, 2010. The 25% rate would sunset on January 1, 2020. Under existing law all remaining tax credits under AS 43.20.043 expire December 31, 2017. This bill would change the sunset date to expire the tax year ending December 31, 2024.

In order for an expenditure to qualify for the 10% rate, cash expenditures or binding payment agreements must be made between June 30, 2003 and before July 1, 2011. Expenditures qualify for the 25% rate cash expenditures or binding payment agreements must be made after June 30, 2011.

The credit is limited to activities south of 68 degrees North latitude and exempts delivery of Alaska North Slope natural gas to tidewater.

**Revenues:**

It is difficult to determine the number of taxpayers who would take advantage of this tax credit, the degree to which the credit would be utilized, and other exogenous variables impacting the revenues the state would collect. Reduction in CIT are indeterminate at this time.

Additionally, the State of Alaska would most likely see a decline in the use of other credits. For example, since a taxpayer would have to utilize the Gas Exploration and Development tax credit first, it is likely we would see a reduction in the Education Credits. Especially, if the taxpayer has limited tax liabilities.

**Expenditures:**

The provisions of this bill could be implemented with existing state resources. No additional personnel or resources would be needed, since the DOR is already performing these duties.

# Cook Inlet Natural Gas: The Way Forward

Study conducted by  
Petrotechnical Resources of Alaska



Sponsored by:

ENSTAR Natural Gas  
Chugach Electric Association  
Municipal Light & Power

# Why Do Utilities Care About Cook Inlet Gas?

- ▶ **ENSTAR**
  - Cook Inlet gas provides 100% of supply
  - 2009 consumption: 32.5 Bcf
- ▶ **Chugach**
  - Cook Inlet gas used for 90% of generation
  - 2009 consumption: 26 Bcf
- ▶ **ML&P**
  - Cook Inlet gas used for 88% of generation
  - 2009 consumption: 10.8 Bcf

# Where Does Gas Come From?

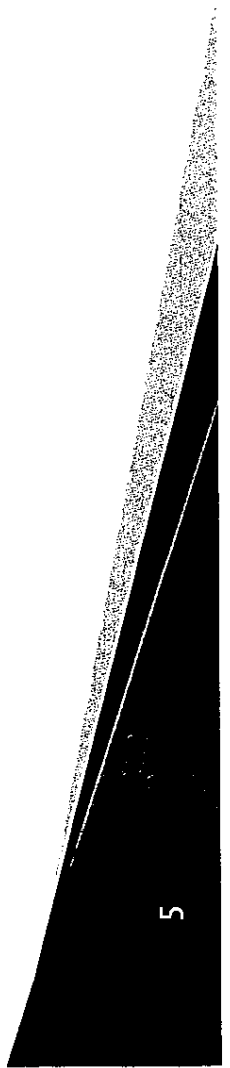
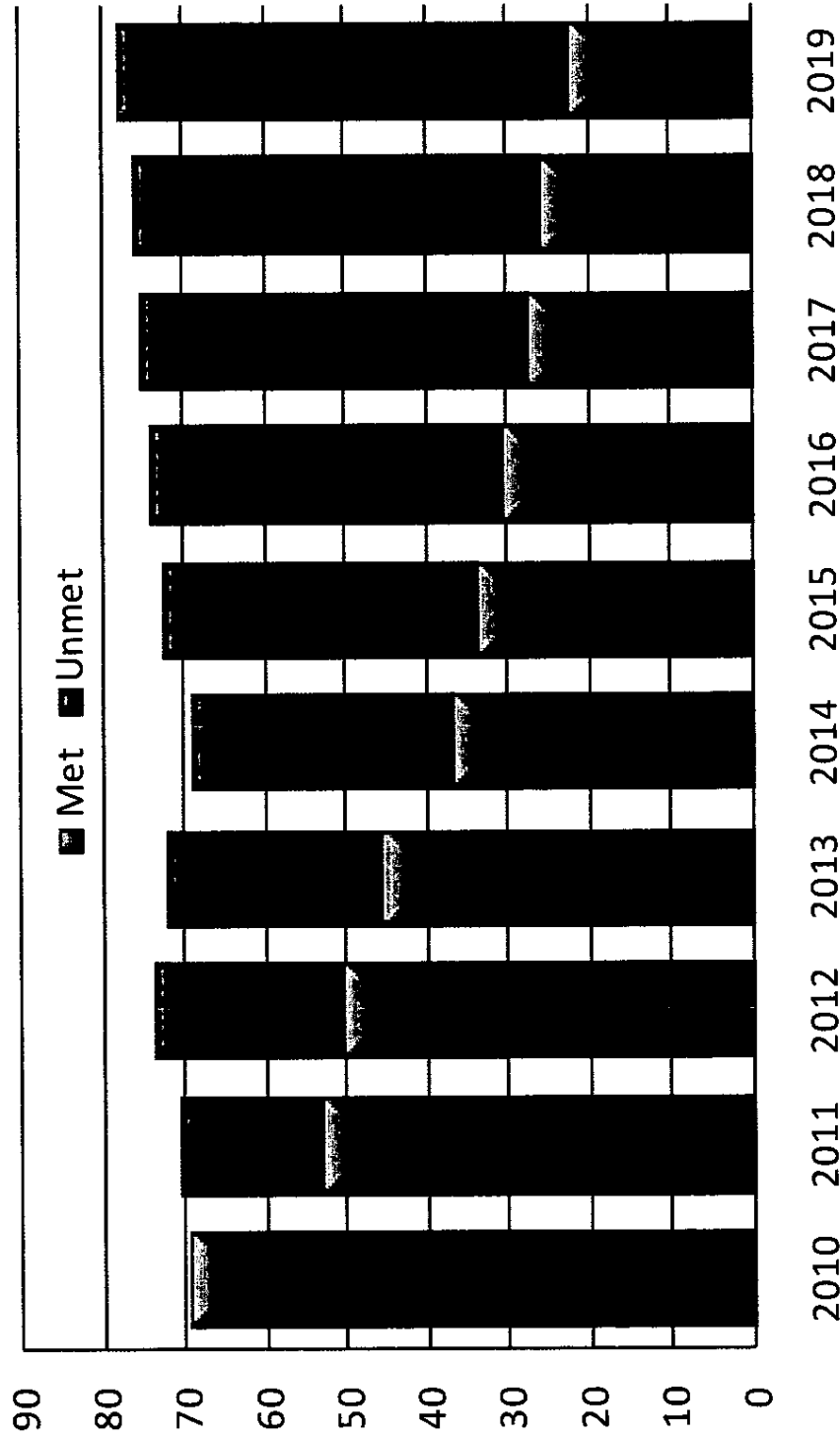


**PRA**  
Professional Refining Assets

## Gas Under Contract/Ownership

- ▶ **ENSTAR**
  - 100% of needs met through 2010
  - Approximately 25% unmet needs beginning 2011
- ▶ **Chugach**
  - 100% of needs met to spring 2011
  - 50% met through 2014; 60% in 2015; 29% in 2016
- ▶ **ML&P**
  - Share of Beluga field estimated to meet majority of needs through 2015

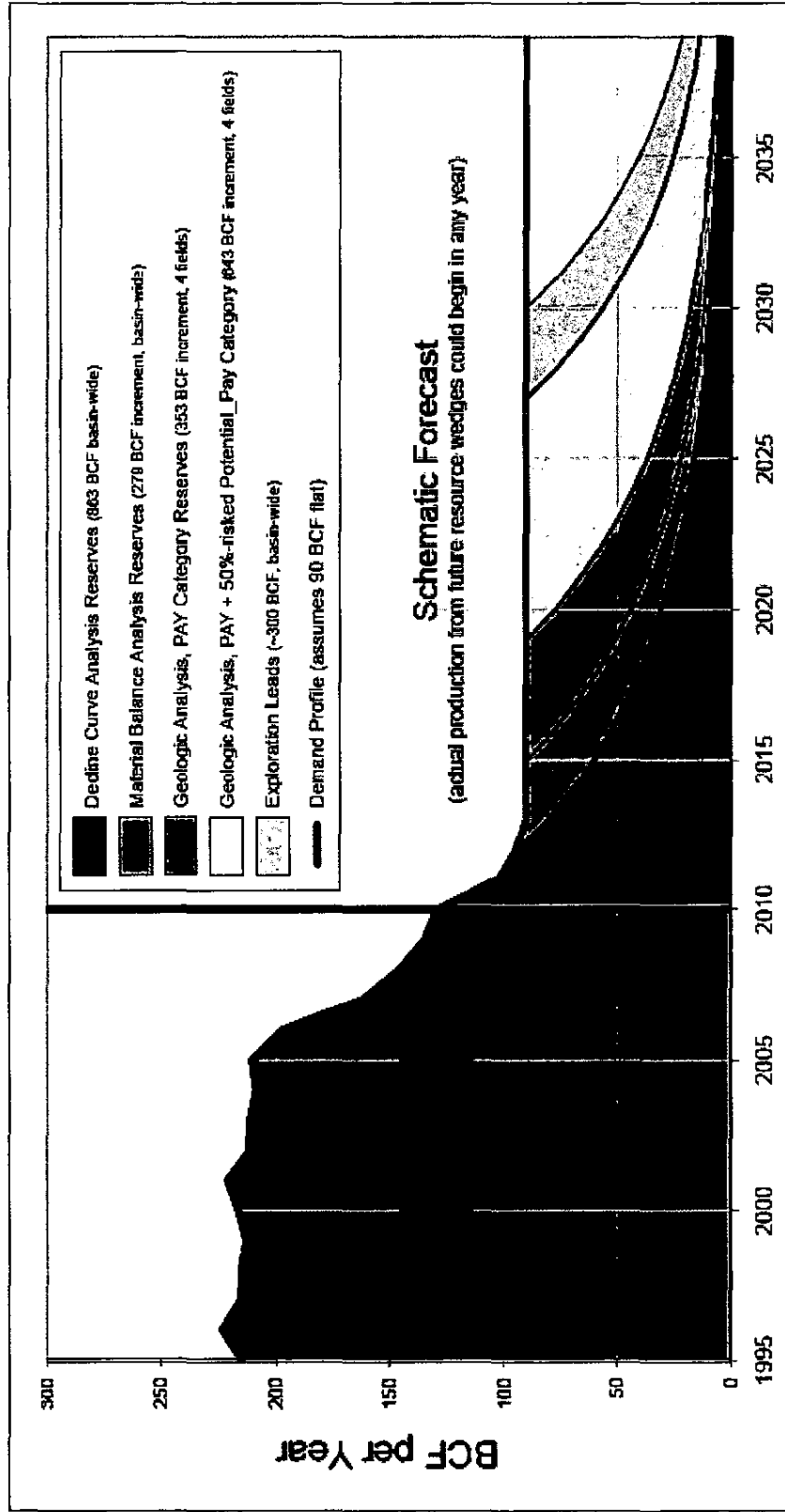
# Combined Utility Met and Unmet Gas Demand



# Supply Concepts

- ▶ Reserves
  - Proven
  - Probable
  - Possible
- ▶ Annual supply
- ▶ Deliverability (seasonal demand)
  - Storage
    - Needed by winter 2011-2012
    - Agreement in progress

# Annual Supply



Source: AK DNR December 2009 Study



# Cook Inlet Gas Study



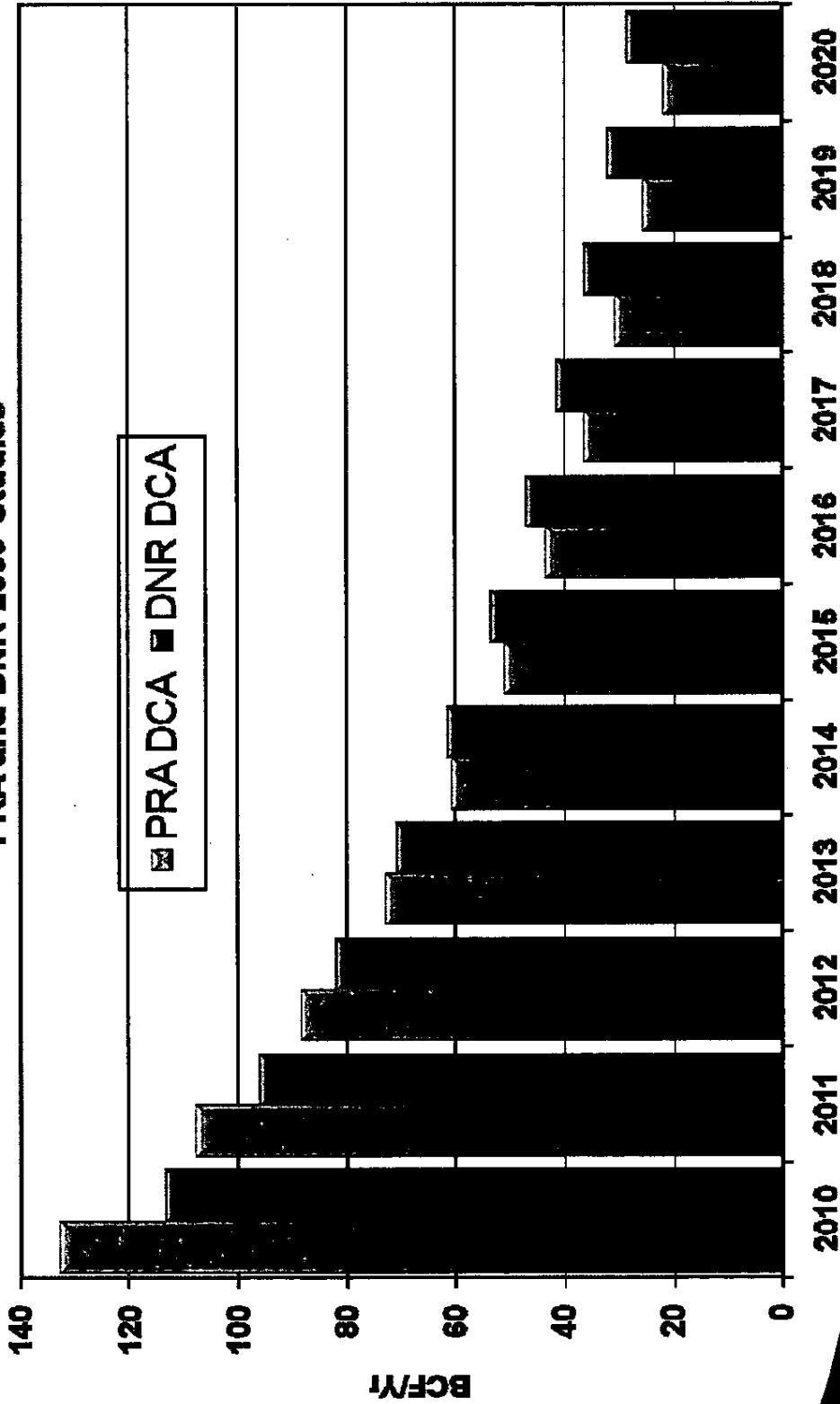
## The Study

- ▶ Commissioned by ENSTAR, Chugach and ML&P
- ▶ Performed by PRA
- ▶ Completed March 2010

## Study Objectives

- ▶ Review DNR reserves analysis
- ▶ Review the deliverability of Cook Inlet gas wells drilled from 2001-2009
- ▶ Forecast deliverability of existing and future gas wells
- ▶ Analyze timing required for delivery of non-Cook Inlet gas sources

### Cook Inlet Gas Production Forecast from Decline Curve Analysis PRA and DNR 2009 Studies



# Methodology

- ▶ Field-level decline curve analysis
- ▶ Individual well decline curve analysis
  - Initial Production
  - Production profile
- ▶ IP progression through time
- ▶ Calculate activity required to meet demand
- ▶ POD review
- ▶ Analysis of business drivers

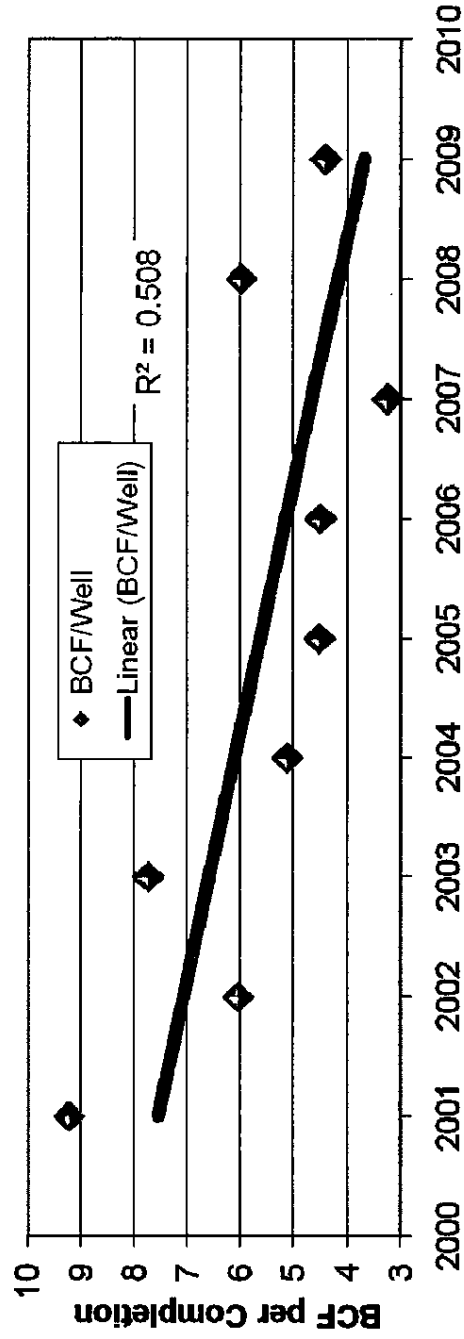
# Cook Inlet Drilling Results

Period	Gas Wells Drilled	Gas Wells Completed	Initial Production (MMCF/day)
2001-2009	128	105	3.6 per well
2007-2009	34	34	3.1 per well



# Cook Inlet Gas Development

Cook Inlet Gas Development 2001-2009  
BCF Developed per Average Completed Well

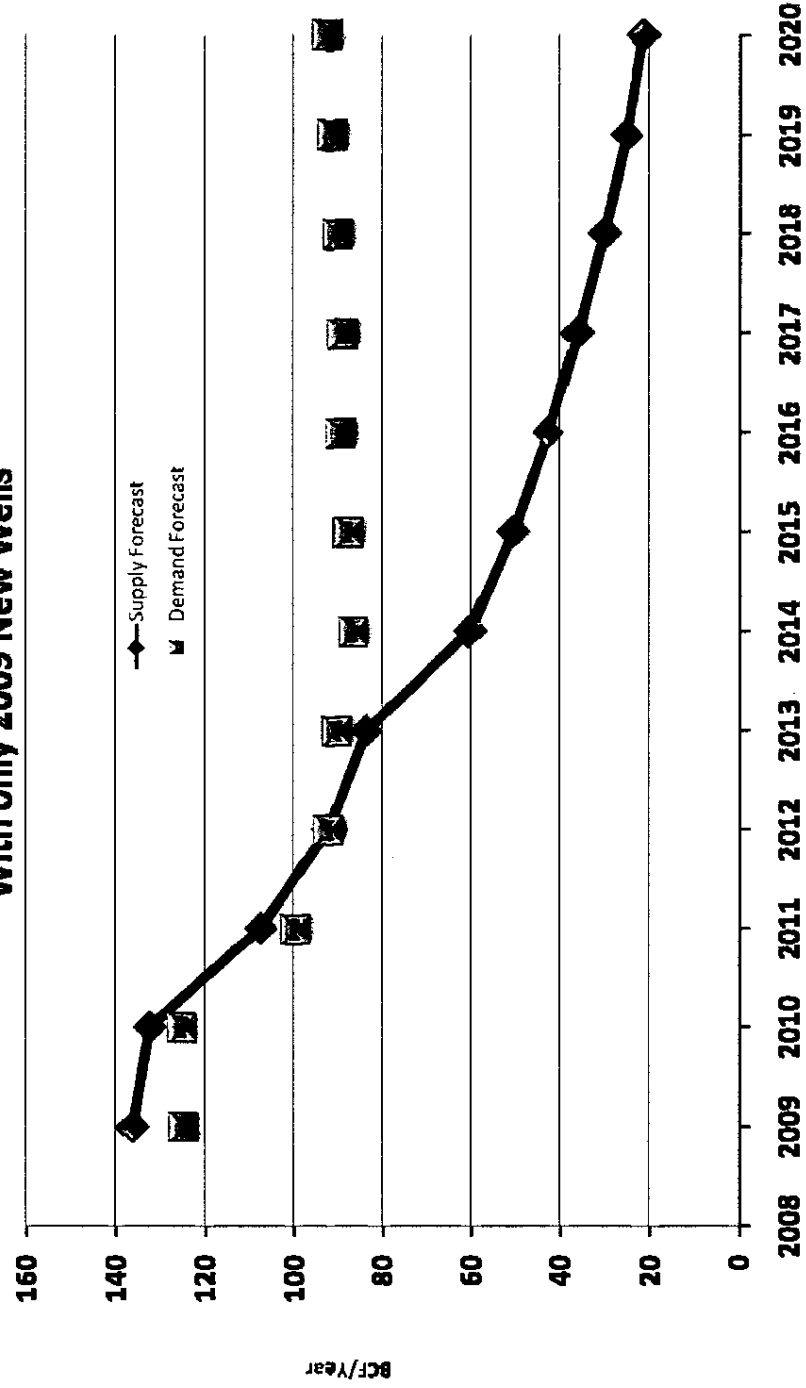


## The Problem

- ▶ Both PRA and DNR conclude from decline curves we have annual supply problems by 2013 if no new wells are drilled
- ▶ PRA study concludes that significant development activity is required

# Annual Supply

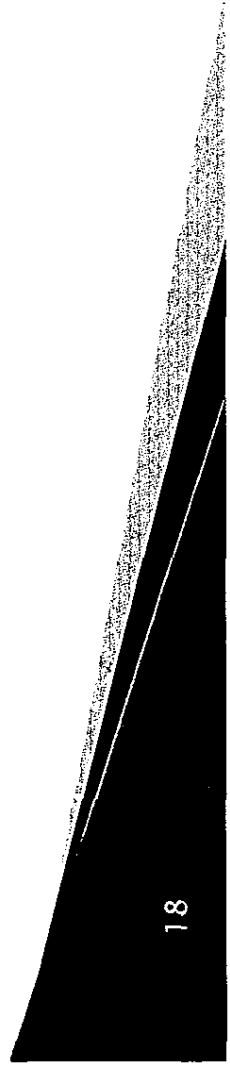
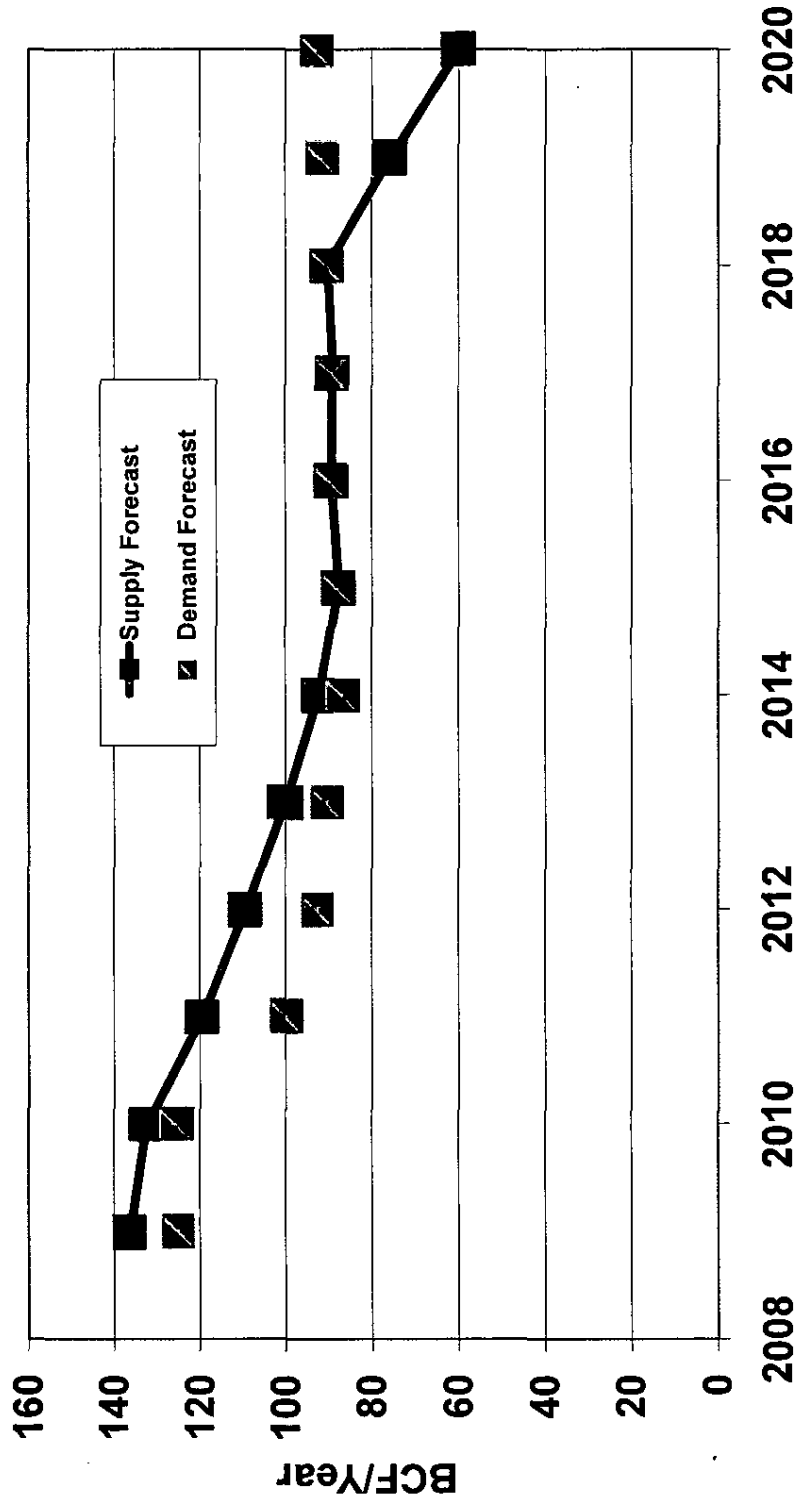
Cook Inlet Supply and Demand  
PRA Forecast December 2009  
With only 2009 New Wells



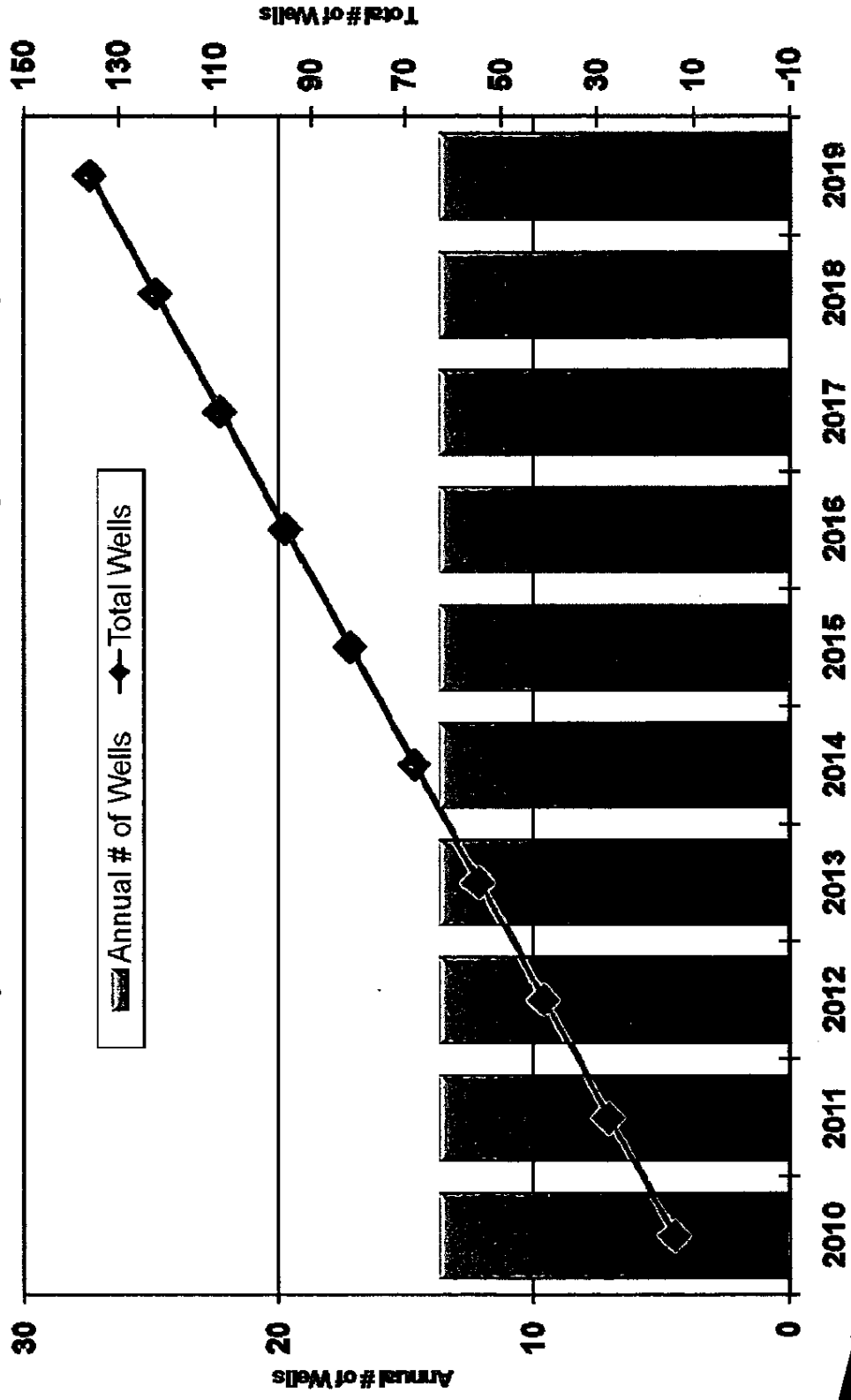
## Scenarios

- ▶ With development drilling continuing at the same pace as in 2007-2009, supply is sufficient to meet demand until 2018, assumes 136 new wells being drilled

Cook Inlet Supply and Demand  
PRA Forecast December 2009  
Assumes 2007-09 Drilling Activity of 13.6 Completions/Yr 2010 to 2019



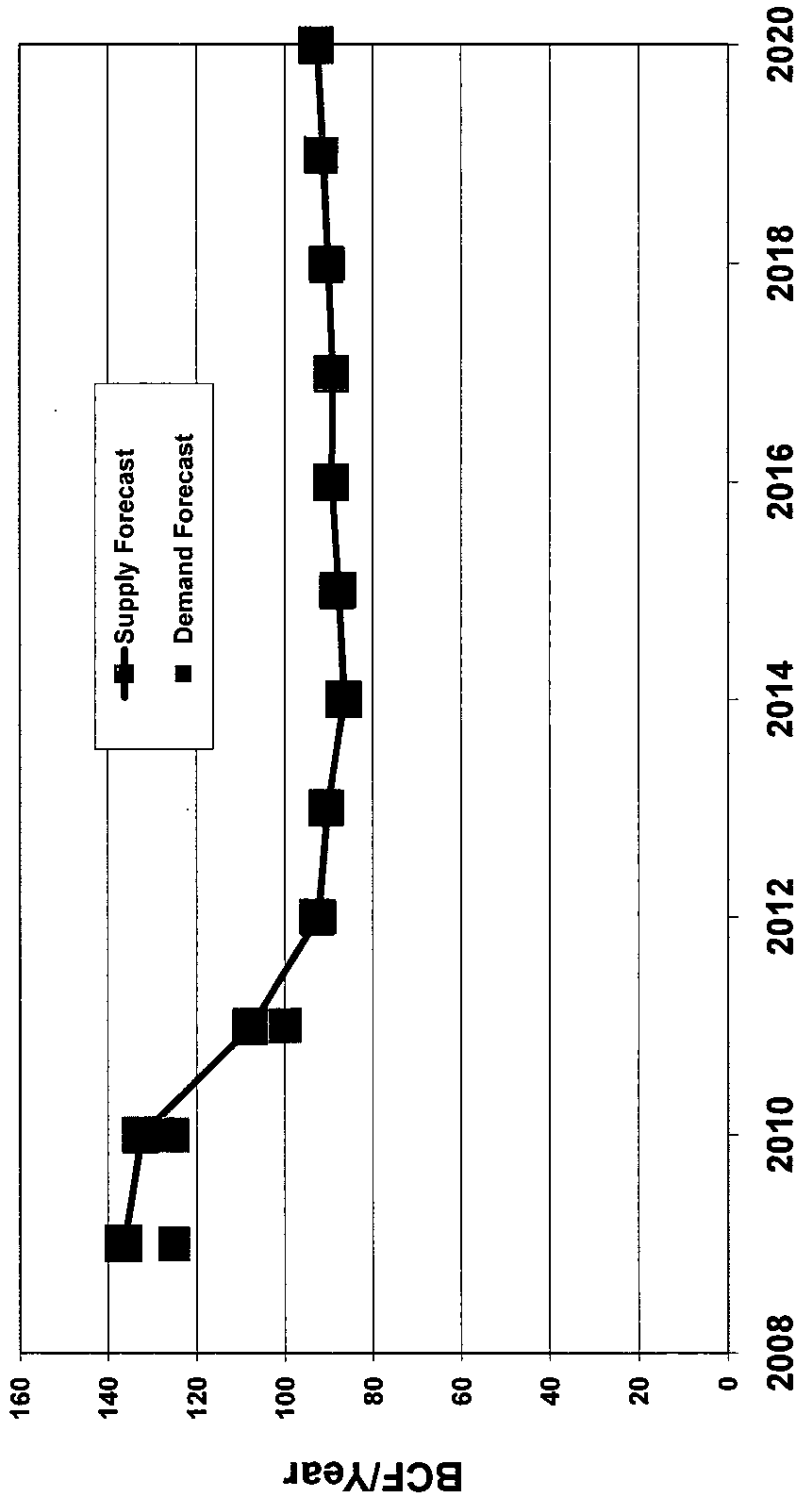
**136 Wells Completed 2010 to 2019  
(2007-09 Level of 13.6 Completions/Yr)**



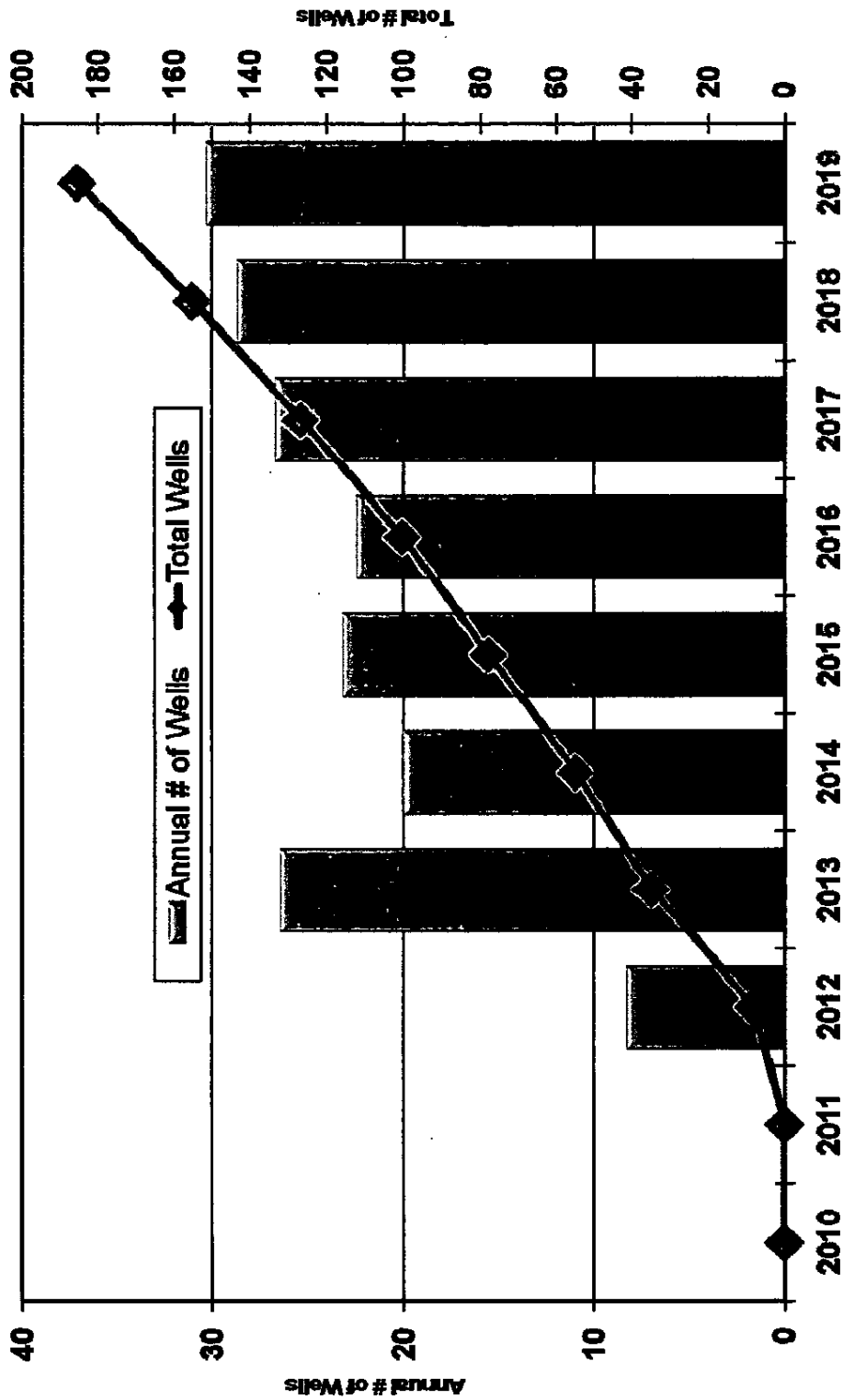
## Scenarios

- ▶ If current trends in drilling success rates continue, an estimated 185 new wells must be drilled to meet utility needs between now and 2020

### Cook Inlet Supply and Demand PRA Forecast December 2009 Includes 185 Wells Completed to Meet Demand to 2020



### 185 Wells Completed 2012 to 2019 Meet Demand Through 2020



## The Cost

- ▶ The estimated cost of drilling & development in the past decade was \$1 – \$1.2 billion
- ▶ The estimated cost of drilling & development in the coming decade is \$1.9 - \$2.8 billion
- ▶ Higher production costs will lead to higher prices for energy

## Caveats

- ▶ Near-term drilling must be successful or gas resources from outside the Cook Inlet could be required as early as 2013
- ▶ If near-term drilling does not keep pace with demand, the only viable option is LNG imports; that option requires immediate action
- ▶ LNG imports could be necessary for several years until an in-state gas line is available

# Where Must We Go From Here?

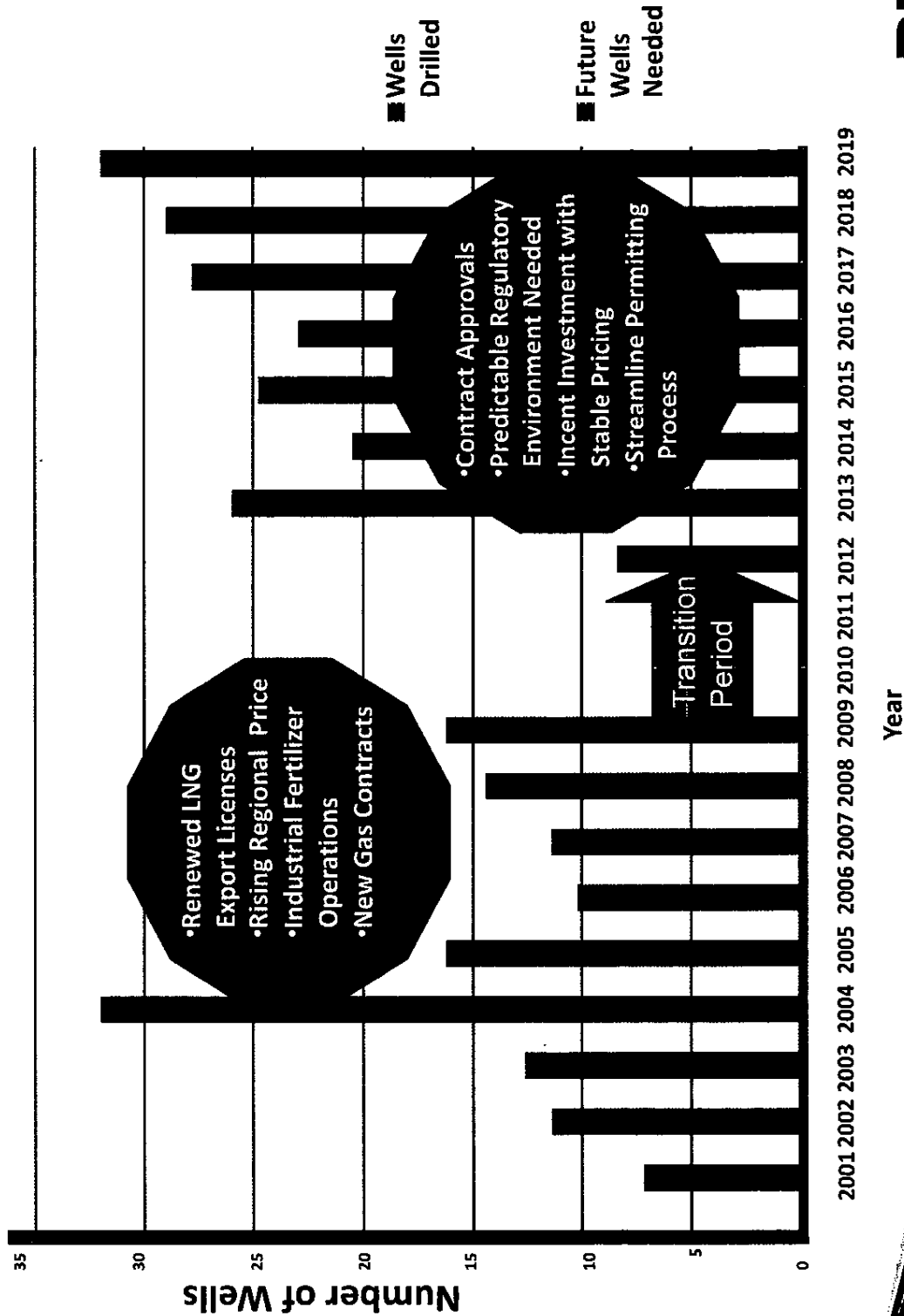
## Immediate Actions Needed

- ▶ New gas supply agreements between Cook Inlet Utilities and producers
- ▶ Predictable timelines and standards for RCA approval of agreements
- ▶ Utilities must secure storage
- ▶ Continue customer awareness, conservation and curtailment plans

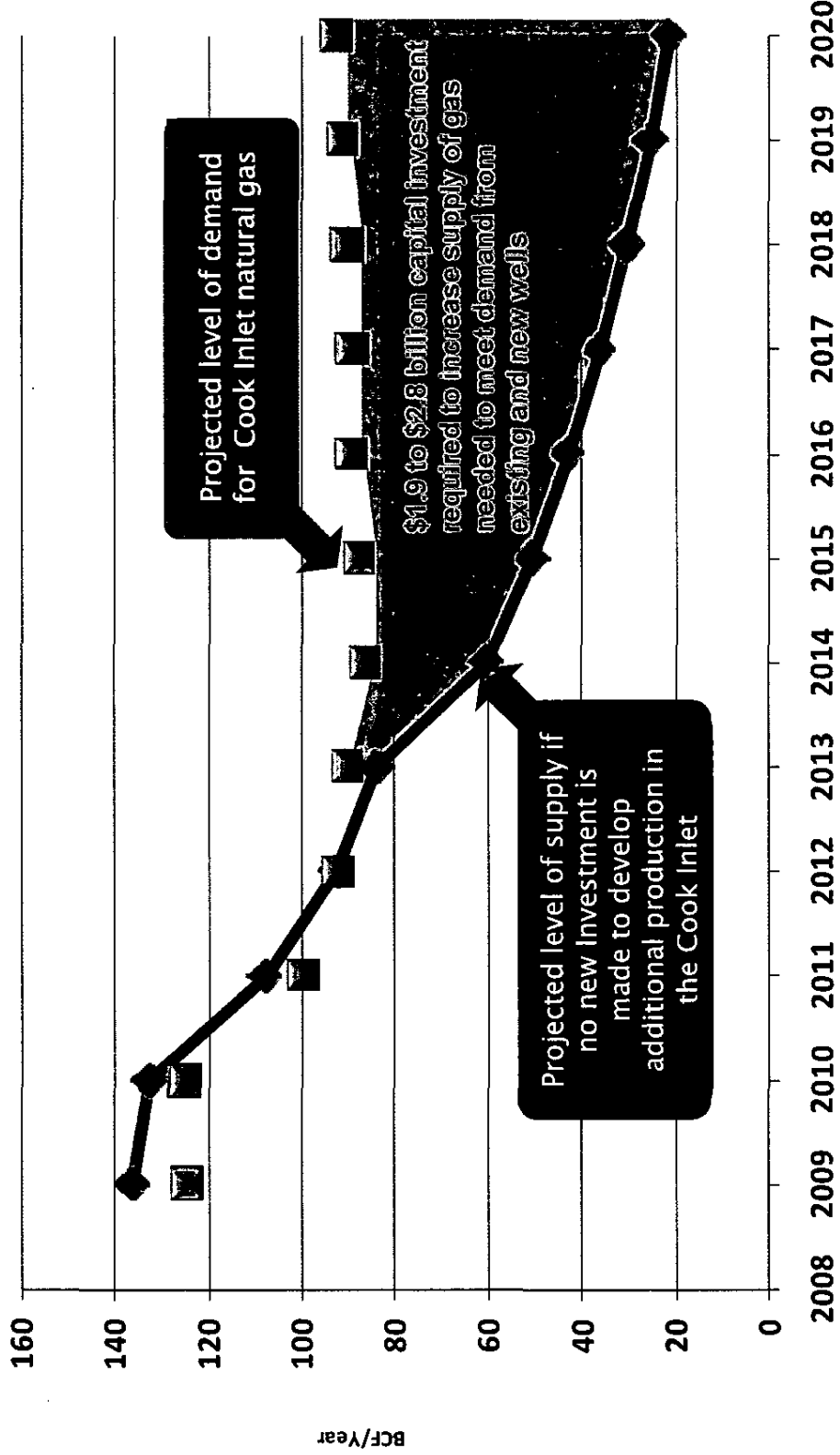
## Immediate Actions Needed (cont.)

- ▶ Land management processes must be streamlined
- ▶ Determine how gas will come to the region to meet long-term needs of consumers
- ▶ Attract exploration & development companies

# Wells Drilled, Wells Required & Influencing Factors



# Summary



## The Way Forward

- ▶ Increase drilling in Cook Inlet
  - Streamline resource development processes
  - Timely contract approval to incent drilling
- ▶ Facilitate natural gas storage
- ▶ To backstop drilling program, develop LNG import options for 2013
- ▶ In-state gas line offers long term solutions

**State of Alaska**  
Department of Revenue  
Commissioner's Office



SEAN PARNELL, GOVERNOR  
333 Willoughby Avenue, 11<sup>th</sup> Floor  
P.O. Box 110400  
Juneau, Alaska 99811-0405  
Phone: (907) 465-2300  
Fax: (907) 465-2394

ALASKA DEPARTMENT OF REVENUE  
TAX DIVISION

REPORT ON THE GAS EXPLORATION AND DEVELOPMENT TAX CREDIT  
UNDER AS 43.20.043

August 7, 2009

The uncodified law of Alaska requires the Department of Revenue to prepare and publish a report, not later than November 30, 2008, on the effect of the gas exploration credit under AS 43.20.043 Gas Exploration and Development Tax Credit.

The scope of the study is defined by

- legislation enacted in 2003
- tax year beginning after December 31, 2002
- NOT located in the area of Alaska lying north of 68 degrees north latitude

The metrics established to measure the effect are

- number of successful gas discoveries
- volume of new gas reserves
- credits allowed that are applied to the tax liability
- credits applied for that are not yet approved
- royalties obtained and production taxes paid

This report addresses each item in Sec. 4 according to the above metrics and scope.


*(1) the number of successful gas discoveries for which a tax credit is provided under AS 43.20.043.*

The Department has received claims for three operating units.

*(2) the volume or amount of new gas reserves brought into production for which a tax credit is provided under AS 43.20.043.*

None. The three operating units for which the Department received claims had already announced the discoveries prior to enactment of the legislation. The natural gas reserves associated with those discoveries are not considered new in the sense of being attributable to the legislation.

*(3) the total credits allowed under AS 43.20.043 that are applied to the tax liability through the date of preparation of the report.*



Confidentiality precludes disclosing the amount of credits claimed due to the number of credit claimants.

*(4) the total credits applied for under AS 43.20.043 that are not yet approved as of the date of preparation of the report.*


AS 43.20.043 does not contain any requirement for pre-approval. Pre-approval is not a customary provision for business tax credits in either the federal or state corporate income tax codes.

*(5) royalties obtained and oil and gas property (and) production taxes paid from new gas production and anticipated from gas production for which credits are allowed under AS 43.20.043.*

None. Companies applying for credits have not announced any new gas discoveries since enactment of the legislation. Without discoveries after the enactment of the legislation, there are no "new" reserves from which to produce "new" gas and thereby collect the associated royalties and taxes.

*(6) any other information that, in the judgment of the commissioner of revenue, would evaluate the effectiveness of the gas exploration and development tax credit authorized under AS 43.20.043.*

The Commissioner offers no additional information at this time.



**Testimony of Carri Lockhart, Marathon Oil Co, in  
support of State of Alaska HB 229  
House Resources Committee  
March 15, 2010  
DRAFT**

Good afternoon. My name is Carri Lockhart and I am the Production Manager for Marathon Oil Company's Alaska Business. Before I begin, I would like to extend the appreciation of Marathon Oil Company, for this opportunity to testify in support of House Bill 229.

By way of background, Marathon Oil Company's Alaska operations are focused on natural gas production operations, limited to Cook Inlet. In 2009, our natural gas sales from Alaska averaged 87 mmcf/d. We sold to essentially every natural gas market available including the local utilities - Enstar and Chugach Electric, Tesoro, and the Department of Defense. We also provided natural gas to the ConocoPhillips/Marathon LNG plant. Marathon

has been in business in AK for over 55 years and we remain committed to serving the natural gas needs of SouthCentral AK through our various contractual commitments.

As you are aware, in 2003 the Legislature passed, and the Governor signed several bills directed at providing incentives for new exploration and development activities. Marathon was particularly interested in House Bill 61, which was intended to incentivize the exploration and development of natural gas reserves in the Cook Inlet. The bill under consideration by this committee, HB 229, will merely strengthen the incentives provided for by the earlier bill.

One might ask about the need to provide incentives for natural gas development in the Cook Inlet. The answer to this question is found by considering the long-term decline in natural gas reserves and deliverability which the Cook Inlet has experienced. What must be addressed is whether there is currently sufficient exploration and development activity to address such decline in reserves and deliverability, and not simply to ask whether the Cook

Inlet is running out of gas. At the current minimal level of Cook Inlet activity it is unlikely that Cook Inlet reserve additions will replace annual production on an ongoing long-term basis. As such, natural gas reserves and deliverability are at risk for continued decline in the Cook Inlet, resulting in the exposure to unmet utility needs in the future.

The lack of Cook Inlet activity (especially exploration) is an artifact of the historic oversupply of natural gas which kept prices well below lower-48 indexed prices, creating a lack of incentive for additional drilling. Furthermore the regulatory processes and deterioration in market availability have added to project uncertainty. The project economics and market uncertainties have made it difficult for projects to complete effectively for finite funding.

So how will HB 229 help?

As we are all painfully aware, Alaskan project economics are not considered solely on their absolute merit. They are also scrutinized on a relative scale in comparison to other worldwide opportunities in which companies such as Marathon may invest. The intent of HB 229 is to help level the playing field between Alaskan projects and other investment opportunities around the world.

HB 229 is intended to continue to provide an incentive to oil and gas exploration and development activities through an investment tax credit. You should have before you the committee substitute for HB229 (version E). Since this is the first hearing for HB229, let me walk through the main points of this new legislation: This legislation makes six significant changes to current law:

1. Section 1 increases the amount of the credit from 10% to 25% of the amount of qualified capital investment and qualified services spending as well as clarifying that the credits can apply to costs incurred for a gas reserve for which the taxpayer previously elected to claim a credit.

2. Section 2 adjusts the dates for when qualified expenditures must be made to qualify for the old 10% and new 25% credits. It also changes the term “reserves” to “wells” to clarify that “wells” produce gas whereas “reserves” are what is being produced.
3. Section 3 removes the 50% limitation on the amount of credits that can apply in a single year, increasing the time value of money for the credits.
4. Section 4 clarifies that the credits do not apply to North Slope gas that is brought into Southcentral.
5. Section 5 removes the “successful efforts” requirement that developers must find and deliver new gas resources to market to qualify for the credit. It also clarifies that the credits can be applied to a gas reserve regardless of whether or not there has been previous gas production in the area.
6. Section 6 clarifies that the credits can be taken on a current tax return, on a timely filed tax return or on a timely filed tax

return for the year immediately following the year the qualified capital investment is made.

7. Section 7 adjusts the date the credits expire from 2017 to 2024.
8. Section 8 extends the sunset date of the investment tax credit from January 1, 2013 to January 1, 2020.
9. Section 9 is gives this legislation an immediate effective date.

In summary, Marathon Oil Company believes HB 229 is one part of the equation to enhance Cook Inlet exploration and development activities, attempting to create more certainty in the overall natural gas deliverability in Cook Inlet. I would also add that timing is important. It takes multiple years to properly plan and execute drilling activity in Cook Inlet, which is necessary to meet future overall deliverability needs in SouthCentral AK.

I would be happy to answer any questions the committee may have.

# AIDEA Role and Approach for HCR 19

Prepared for the House Finance Committee

By AIDEA

29 March 2010

## HCR 19

Urging the Alaska Industrial Development and Export Authority to *present a business case* to the Alaska State Legislature that includes a method for financing, a plan to solicit proposals for a public and private venture, and an objective *analysis of the economic and business feasibility* of a state-built and privately operated fuel storage facility that would serve the public interest.

## AIDEA's Role

- Provide an objective analysis examining both the economic development impact and feasibility of a storage facility as well as the long term viability of the project
- As part of the analysis identify potential private and public sector users of the facility
- In conjunction with EconOne, look all aspects of the fuel supply system in the State and the impact additional storage would have for the different regions
- Examine possible ways of financing this project which could include AIDEA financing through ownership as a Development Finance Project (AS 44..88)
- As a possible owner of the storage facility, act as a consolidator for multiple users and demands assuring open access to storage

## Economic and Business Feasibility Analysis

- Examine jet fuel security, including:
  - Commercial – Air Cargo
  - Military – Elmendorf (currently short 350,000 barrels of storage), Eielson
- Examine opportunities and threats to the existing fuel supply chain
- Address potential storage opportunities for fuel delivery to Western Alaska
- Examine the supply needs for Railbelt gasoline
- Conduct an economic impact analysis on current and additional storage capacity with regards to net economic activity, job retention and growth, and economic diversification.
- Identify potential way forward to secure users of the facility (obtaining operator, open access to users, open season on storage commitments) prior to financing

## Action Plan

1. Market Analysis – EconOne (Currently being performed under the direction of the Department of Law)
2. Engineering Layout and Cost Estimate (AIDEA)
3. Develop the requested business case looking at potential unmet market needs, impact on businesses, impact of market risks, impact of supply risks as well as determining the “best fit (AIDEA and EconOne)
4. Report back to the Legislature (AIDEA)

The mission of the Alaska Industrial Development and Export Authority is to promote, develop and advance economic growth and diversification in Alaska by providing various means of financing and investment

DESCRIPTIVE NAME	STATUTE	NORTH SLOPE	COOK INLET	NOTES AND EXCEPTIONS
<b>Exploration Incentive Credits (EICs)</b> <b>AS38.05.180(l)</b>  AS41.09.010 -- expired Jul. 1, 2007	AS38.05.180(l)  AS41.09.010	up to 50% of drilling based on depth & location up to 50% of geophysics costs if within 2 yrs of lease sale  N/A	up to 50% of drilling based on depth & location up to 50% of geophysics costs if within 2 yrs of lease sale  N/A	N/A for unleased, Federal- or private-owned lands  up to 50% of drilling & seismic costs on unleased state land, 25% on non-state land, expired 7/1/2007
<b>Exploration Tax Credit</b> AS43.55.025  Expires 7/1/2016  AS43.20.043 -- expires 1-1-2013 for below 68° latitude*** (see note at bottom)	AS 43.55.025  AS43.20.043	Up to 40% of seismic costs 1) 30% of drill costs if > 25 miles from existing unit & <3mi from a well 2) 30% if pre-approved new target and >3 mi. & < 25 mi. from a unit 3) Up to 40% of drilling costs if both 1) & 2)  N/A if north of 68° latitude	Up to 40% of seismic costs 1) 30% of drill costs if > 25 miles from existing unit & <3mi from a well 2) 30% if pre-approved new target and >3 mi. & < 25 mi. from a unit 3) Up to 40% of drilling costs if both 1) & 2)  10% of capital investment  10% of annual cost	(same as column 1) applies to all lands onshore or in state waters  outside of Cook Inlet  (if below 68° latitude, same as column 2) applies to all lands onshore or in state waters
<b>Royalty Modification</b> <b>AS38.05.180(j)</b>  <b>AS38.05.180(f)(6)</b>	AS38.05.180(j)  AS38.05.180(f)(6)	Down to 5%, if new production  Down to 3%, if producing or shut-in  N/A	Down to 5%, if new production  Down to 3%, if producing or shut-in  As low as 5% for oil production from CI platforms if production falls below specified levels	N/A for unleased, Federal- or private-owned lands  N/A for unleased, Federal- or private-owned lands
<b>Discovery Royalty</b> <b>Discov. Roy. South of T18N, Cook In.</b>  <b>Discov. Roy. For Pre-1969 leases</b>  Field specific, for the following fields only: Falls Creek, Nicolai Cr., Redoubt Shoals, & West Foreland, North Fork & Starichkof not in prod. Before 1/1/2004.	AS38.05.180(f)(4)  [DL-1 Lease Form]  AS38.05.180(f)(5)	N/A  5% royalty for 10 yrs.  N/A	5% royalty for 10 yrs.  5% royalty for 10 yrs.  5% on 1st 25 MM bbls for 10 yrs  5% on 1st 35 BCF for 10 yrs field must be in prod. by 1/1/2004	N/A for unleased, Federal- or private-owned lands  N/A for unleased, Federal- or private-owned lands  N/A for unleased, Federal- or private-owned lands
<b>PPT/ACES Tax Credits</b> <b>Qualified CapEx Credits</b> transferrable credit against PPT paid out over 2 years  <b>Loss Carry-Forward Credits</b> transferrable credit against PPT, but	AS43.55.023(a)  AS43.55.023(b)	up to 20% of capital expenditures, max 50% of credit in any one calendar year  up to 25% of capital expenditures	(same as column 1)  (same as column 1)	
<b>Transition Investment Expenditure Credits</b> non-transferrable credit against PPT, expires at the end of 2013  <b>Frontier Basin Production Credit</b> non-transferrable credit against PPT, for production south of 68 lat. & outside CI basin, expires at the end of 2013  <b>Small Producer Credit</b> non-transferrable credit against PPT eligibility ends 9 years after 1st tax pmt.  <b>Economic Limit Factor based Ceiling</b>	AS43.55.023(i)  AS43.55.024(a)  AS43.55.024(c)  AS43.55.011(j)&(k)	up to 20% of 2001-2006 capital expenditures for explorers with no commercial production prior to 1/1/2008  N/A  \$12 MM for production <50,000 BOE/day, declining on a sliding scale to \$0 for production >100,000 BOE/day  No	(same as column 1)  N/A  (same as column 1)	Available only on state-owned lands not in sale areas up to \$6MM
<b>INCENTIVES AS PART OF A PROGRAM</b>				
<b>Exploration Licensing</b>	AS38.05.132	N/A	N/A	Available only on state-owned lands not in sale areas  Up to 500,000 acres per license  One-time \$1/acre license fee No bonus bid or annual rental Sole right to convert to O & G leases
<b>Nonconventional Gas Incentive</b>	AS38.02.180(n)(2)	Reduced rental, 6.25% royalty if no competition with 12.5% leasee	(same as column 1)	Can apply to license areas after conversion to lease, then same as column 1

\*\*\* If requesting this credit, not eligible for any other tax credits or royalty modifications

Sec. 43.20.043. Gas exploration and development tax credit.

(a) Subject to the terms and conditions of this section, and in addition to any other credit authorized to the taxpayer by this chapter, a taxpayer that is an operator or working interest owner directly engaging in the exploration for and development of gas may apply as a credit against the state tax liability that may be imposed on the taxpayer under this chapter, for a tax year beginning after December 31, 2002,

(1) 10 percent of the taxpayer's qualified capital investment; and

(2) 10 percent of the annual cost incurred by the taxpayer for qualified services in the state during each tax year for which a credit is allowable for a qualified capital investment under (1) of this subsection.

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

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

(2) made for assets first placed in service in the state in or before the tax year in which the credit is claimed through the date the reserves produce gas for sale and delivery; for purposes of this paragraph, "placed in service in the state" means that the first use of the qualified investment is in this state; if the property on which the claim of the credit is based has been used elsewhere in the tax year of acquisition and is brought to this state during that year or a subsequent year, the property does not qualify for the investment credit.

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

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

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

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

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

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

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

- (A) disposes of the qualified capital investment;
- (B) takes the qualified investment out of service; or
- (C) transfers the qualified investment out of this state.

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

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

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

(i) In this section,

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

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

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

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

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

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

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

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

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

(2) "qualified services"

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

(B) does not include lease operating expenses.

History -

(Sec. 1 ch 61 SLA 2003)

Postponed Repeal Effective Date -.

Delayed repeal of section. - Under Sec. 2 and 5, ch. 61, SLA 2003, this section is repealed January 1, 2013.

Cross References -

For provision relating to the manner of handling the unused portion of the tax credit as a carry-forward during the period on or after January 1, 2013, and until December 31, 2017, see Sec. 3, ch. 61, SLA 2003, in the 2003 Temporary and Special Acts. For obligation of the Department of Revenue to prepare a report to the legislature on the effect of the tax credit authorized by this section, and to present the report at the beginning of the First Regular Session of the 26th Alaska Legislature, see Sec. 4, ch. 61, SLA 2003, in the 2003 Temporary and Special Acts.

Effective Date Notes -

Section 6, ch. 61, SLA 2003 makes this section effective June 12, 2003, in accordance with AS 01.10.070(c).

-

Submitted by the office of Speaker Chenault

**State of Alaska**  
Department of Revenue  
Commissioner's Office



**SEAN PARNELL, GOVERNOR**  
333 Willoughby Avenue, 11<sup>th</sup> Floor  
P.O. Box 110400  
Juneau, Alaska 99811-0405  
Phone: (907) 465-2300  
Fax: (907) 465-2394

ALASKA DEPARTMENT OF REVENUE  
TAX DIVISION

REPORT ON THE GAS EXPLORATION AND DEVELOPMENT TAX CREDIT  
UNDER AS 43.20.043

August 7, 2009

The uncodified law of Alaska requires the Department of Revenue to prepare and publish a report, not later than November 30, 2008, on the effect of the gas exploration credit under AS 43.20.043 Gas Exploration and Development Tax Credit.

The scope of the study is defined by

- legislation enacted in 2003
- tax year beginning after December 31, 2002
- NOT located in the area of Alaska lying north of 68 degrees north latitude

The metrics established to measure the effect are

- number of successful gas discoveries
- volume of new gas reserves
- credits allowed that are applied to the tax liability
- credits applied for that are not yet approved
- royalties obtained and production taxes paid

This report addresses each item in Sec. 4 according to the above metrics and scope.

*(1) the number of successful gas discoveries for which a tax credit is provided under AS 43.20.043.*

The Department has received claims for three operating units.

*(2) the volume or amount of new gas reserves brought into production for which a tax credit is provided under AS 43.20.043.*

None. The three operating units for which the Department received claims had already announced the discoveries prior to enactment of the legislation. The natural gas reserves associated with those discoveries are not considered new in the sense of being attributable to the legislation.

*(3) the total credits allowed under AS 43.20.043 that are applied to the tax liability through the date of preparation of the report.*

Confidentiality precludes disclosing the amount of credits claimed due to the number of credit claimants.

*(4) the total credits applied for under AS 43.20.043 that are not yet approved as of the date of preparation of the report.*

AS 43.20.043 does not contain any requirement for pre-approval. Pre-approval is not a customary provision for business tax credits in either the federal or state corporate income tax codes.

*(5) royalties obtained and oil and gas property (and) production taxes paid from new gas production and anticipated from gas production for which credits are allowed under AS 43.20.043.*

None. Companies applying for credits have not announced any new gas discoveries since enactment of the legislation. Without discoveries after the enactment of the legislation, there are no "new" reserves from which to produce "new" gas and thereby collect the associated royalties and taxes.

*(6) any other information that, in the judgment of the commissioner of revenue, would evaluate the effectiveness of the gas exploration and development tax credit authorized under AS 43.20.043.*

The Commissioner offers no additional information at this time.



# LAWS OF ALASKA

2003

**Source**  
SCS CSHB 61(RES)

**Chapter No.**  
\_\_\_\_\_

## AN ACT

Establishing an exploration and development incentive tax credit for operators and working interest owners directly engaged in the exploration for and development of gas for sale and delivery without reference to volume from a lease or property in the state; and providing for an effective date.

---

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

THE ACT FOLLOWS ON PAGE 1

Enrolled HB 61

AN ACT

1 Establishing an exploration and development incentive tax credit for operators and working  
2 interest owners directly engaged in the exploration for and development of gas for sale and  
3 delivery without reference to volume from a lease or property in the state; and providing for  
4 an effective date.

5

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

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

13                           (1) 10 percent of the taxpayer's qualified capital investment; and

14                           (2) 10 percent of the annual cost incurred by the taxpayer for qualified

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

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

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

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

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

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

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

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

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

31 (1) may not convey, assign, or transfer the credit to another taxpayer or

1 business entity unless the conveyance, assignment, or transfer of the credit is part of  
2 the conveyance, assignment, or transfer of the taxpayer's business;

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

7 (A) disposes of the qualified capital investment;

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

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

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

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

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

23 (i) In this section,

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

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

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

1 operating lease; and

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

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

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

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

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

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

16 (2) "qualified services"

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

19 (B) does not include lease operating expenses.

20 \* Sec. 2. AS 43.20.043 is repealed.

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

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

31 \* Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to

1 read:

2 REPORT ON EFFECT OF GAS EXPLORATION AND DEVELOPMENT TAX  
3 CREDIT. Not later than November 30, 2008, the Department of Revenue shall prepare and  
4 publish a report on the effect of the gas exploration and development tax credit authorized by  
5 AS 43.20.043, added by sec. 1 of this Act. The department shall advise the legislature of the  
6 availability of the report and, within the first 10 days of the First Regular Session of the  
7 Twenty-Sixth Alaska State Legislature, transmit copies of the report to the chairs or co-chairs  
8 of the House and Senate Resources Committees and the chairs or co-chairs of the House and  
9 Senate Special Committees on Oil and Gas, if established. The report must address

10 (1) the number of successful gas discoveries for which a tax credit is provided  
11 under AS 43.20.043;

12 (2) the volume or amount of new gas reserves brought into production for  
13 which a tax credit is provided under AS 43.20.043;

14 (3) the total credits allowed under AS 43.20.043 that are applied to the tax  
15 liability through the date of preparation of the report;

16 (4) the total credits applied for under AS 43.20.043 that are not yet approved  
17 as of the date of preparation of the report;

18 (5) royalties obtained and oil and gas property production taxes paid from new  
19 gas production and anticipated from gas production for production for which credits are  
20 allowed under AS 43.20.043; and

21 (6) any other information that, in the judgment of the commissioner of  
22 revenue, would evaluate the effectiveness of the gas exploration and development tax credit  
23 authorized under AS 43.20.043.

24 \* Sec. 5. Section 2 of this Act takes effect January 1, 2013.

25 \* Sec. 6. Except as provided in sec. 5 of this Act, this Act takes effect immediately under  
26 AS 01.10.070(c).