

**SB**

**305**

<target><bill>SB 305</bill><subject>SB  
305</subject><comm>SF26</comm></target>

# SENATE FINANCE COMMITTEE REPORT

## First Committee of Referral

DATE: 3/8/10

FURTHER:

Date of 5-Day Notice: \_\_\_\_\_  
(in accordance with Uniform Rule 23)

DATE TURNED  
IN TO OFFICE: \_\_\_\_\_

**Finance Committee** considered SENATE BILL NO. 305

### SB 305 SEPARATE OIL & GAS PRODUCTION TAX

"An Act relating to the tax on oil and gas production; and providing for an effective date."

and recommends:

- be replaced with  SCS or  CS SB 305 (FIN)
- adopt previous  SCS or  CS \_\_\_\_\_
- attached amendment(s)
- adopt \_\_\_\_\_ Letter of Intent
- further referral to \_\_\_\_\_ Committee

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

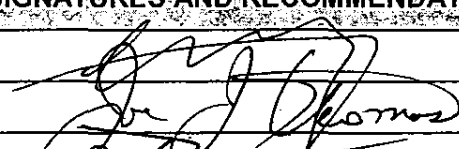




**NEW FISCAL NOTE(S):**

Department	Date	Fiscal	Indet	Zero	FN#
5FIN Rev for	3/3/10			✓	

**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
	Huggins	✓			X
	EGAN	✓			
	Ellison	✓			
	ELLIS	✓			
CO-CHAIR: 	Sherman	✓			

# FISCAL NOTE

*A dopted  
3/31/10*

**STATE OF ALASKA  
2010 LEGISLATIVE SESSION**

Fiscal Note Number: \_\_\_\_\_  
 Bill Version: CSSB305(FIN)  
 (S) Publish Date: 3/31/2010

Identifier (file name): 2010 03 31 FN CSSB305 SFIN  
 Title: \_\_\_\_\_  
 Sponsor: Senate Finance Committee  
 Requester: Senate Finance Committee  
 Dept. Affected: Revenue  
 RDU: Taxation and Treasury  
 Component: Tax Division  
 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	0.0							
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>0.0</b>
<b>CAPITAL EXPENDITURES</b>								
<b>CHANGE IN REVENUES ( )</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>0.0</b>

**FUND SOURCE** (Thousands of Dollars)

	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
1002 Federal Receipts							
1003 GF Match							
1004 GF	0.0						
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: 0.0

**POSITIONS**

	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Full-time	0.0						
Part-time							
Temporary							

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

This bill separates oil and natural gas for purposes of calculating the progressivity portion of the production tax under AS 43.55. Under this bill the progressivity surcharges for oil and Cook Inlet and in-state gas would be calculated together, but distinctly from export gas, instead of the current practice on all oil and gas combined. The progressivity structure itself would be unchanged, based on 0.4% of the production that value that exceeds \$30 per barrel for oil, and \$30 per BTU barrel of oil equivalent for gas. The base tax rate is unchanged at 25% of production tax value.

Prepared by: Miles Baker, Finance Aide  
 Division: Senate Finance Committee  
 Approved by: Senator Stedman, Co-Chair  
Senate Finance Committee

Phone: (907) 465-3873  
 Date/Time: 3/30/2010 7:00pm  
 Date: 3/31/2010 8:00am

## FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

BILL NO. CSSB305(FIN)

### ANALYSIS CONTINUATION

Under current law the tax rate is based on the combined BTU value of oil and gas. However, oil and gas can have vastly different values on a BTU basis. Currently a BTU of oil is worth much more than a BTU of gas. Accordingly, once a major gas sale would start up, overlaying the existing oil production, the BTU value of the combined oil and gas would be much lower than it was for oil alone. This could cause a significant reduction in oil taxes as a result of a major gas sale.

This structure, in conjunction with the inherent uncertainty of future oil and gas prices, exposes the state to significant financial risk were a major gas sale to occur. The structure also creates economic instability for entities looking to participate in the development and financing of a natural gas pipeline project in Alaska.

Under the tax inducement provisions of the Alaska Gasline Inducement Act (AGIA), the tax structure in place at the time of the first binding open season (May 1, 2010), may be locked in for the first ten years of gas commercialization. Consequently, to the extent there is interest in decoupling our tax structure, it needs to be done before April 30, 2010.

The bill removes the dilution effect by having progressivity calculated distinctly for oil and gas. This will result in no reduction in oil taxes from a major gas sale.

As in current law, the bill gives the Department of Revenue the authority to adopt regulations to allocate costs between oil and gas, with the added instruction that a method based on relative BTU barrel of oil equivalents should be considered. That method was the one adopted by the department under the same authority for implementation of the current law, for the same purposes as would be for the proposed law.

Some producers currently produce Cook Inlet gas or other in-state gas along with North Slope oil. If all gas were separated from oil these producers would see an immediate tax increase. The bill is not intended to increase taxes on current activity. Having the progressivity for Cook Inlet gas and other in-state gas calculated together replicates the current situation, so these producers will see no tax increases. Only progressivity on export gas, like the gas from a major gas sale, would be calculated distinctly. This will prevent a major gas sale from diluting progressivity on oil.

#### **Expenditures**

The Tax Division is in the process of developing a new, single, comprehensive, integrated tax management system for all tax types. The new system will incorporate tax programs and recent tax changes as necessary to improve the efficiency and accuracy of the Division's revenue collection efforts. There is a \$300,000 request in the Governor's FY2011 Capital Budget to complete the agency's IT plan for submission and review by the Enterprise Investment Board. It is assumed that the tax structure changes contained in this bill will be addressed by this systemwide review and eventual restructuring project.

3/18/10

# SB 305: CS Version S & Amendments

## Senate Finance Committee

March 18, 2010

Roger Marks, L.B. & A. Consultant

Logsdon & Associates

## **Version S Committee Substitute**

- Title has tightened scope further
- Technical change in Section 5
  - Some of the proposed changes to AS 43.55.020(a)(1) did not need to be there – CS reverses those changes
- Technical change – new Section 8
  - Gives authority to department to adopt regulations to allocate AS 43.55.170 adjustments to lease expenditures between oil and gas

## **Amendment 1: Tax Neutrality on Current Activity**

- Currently some producers produce both oil and gas
- If you separate oil & gas for calculating progressivity, progressivity on oil will be undiluted by gas and taxes will increase
- Is it not intent of this bill to raise taxes on current oil & gas activity
- Amendment # 1
  - Credit equal to difference between tax determined under bill and tax determined now
  - Credit expires in 2015

## **Amendment 2: Cost Allocation**

- Retain current agency authority, and
- Consider BOE approach

## **Amendment 2: Cost Allocation**

- Costs to produce oil and gas are truly joint costs: the same process that produces one produces the other
- Benefit of current approach (AS 43.55.165(h)) that gives department authority to adopt regulations for allocating costs between oil and gas:
  - As recipients of confidential cost data they are in the best position to evaluate costs
  - A regulatory process allows more time
  - The regulatory process is public

## BTU Equivalent Barrel (BOE) Approach

- Same approach that is currently embraced in departmental regulations (15 AAC 55.215)
- Mechanics (AS 43.55.900(3))
  - 1 barrel of oil = 1 BOE
  - 6 mmbtu's to the barrel
  - Gas mmbtu's / 6 = gas BOE's
- Rationale for BOE approach
  - The same costs that produce oil produce gas
  - Since produced together, costs are allocated based on amounts produced
  - BOE method: putting oil & gas on apples/apples basis in terms of relative produced volumes

## Problems with Other Methods

- Item by item attribute
  - Inappropriate where costs are truly joint
- Dominant use (either all oil or all gas)
  - Inappropriate when large volumes of both produced
- Deemed approach (deemed one unless item is 100% the other)
  - Inappropriate when large volumes of both produced
- Reserves
  - Uncertain numbers / subject to taxpayer control
- Gross value
  - Upstream costs should not change with downstream prices

## A Note on 15 AAC 55.220

- DOR's proposed regulation on AGIA uses the Gross value approach to allocate the total tax between oil and gas
- Allocating tax is different than allocating costs
- Gross value is a very material determinant of the differences in tax value between oil and gas
- Allocating tax by gross value for this purpose is reasonable

## **A Note on Allocation of Capital Costs Associated with Developing Pt. Thomson**

- High development costs will be incurred prior to gas sales: these costs will be allocated against oil
- Pt. Thomson is also an oil (condensate) field (est. 300 million barrels)
- Could be developed such that it produces condensate years before it produces gas
- PPT/ACES were deliberately designed so that cost deductions and credits would be utilized immediately

*adopted* *no* *3/12/10*

*Replaced* *3/18/10*  
26-LS1577E  
Bullock  
3/10/10

**CS FOR SENATE BILL NO. 305(FIN)**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**TWENTY-SIXTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE FINANCE COMMITTEE**

**Offered:  
Referred:**

**Sponsor(s): SENATE FINANCE COMMITTEE**

**A BILL**

**FOR AN ACT ENTITLED**

1 **"An Act relating to that part of the tax on oil and gas production that increases the rate**  
2 **of tax as the production tax value increases above \$30 and limiting the effect of that rate**  
3 **increase to the production of oil; and providing for an effective date."**

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

5 **\* Section 1.** AS 43.55.011(e) is amended to read:

6 (e) There is levied on the producer of oil or gas a tax for all oil and gas  
7 produced each calendar year from each lease or property in the state, less any oil and  
8 gas the ownership or right to which is exempt from taxation or constitutes a  
9 landowner's royalty interest. Except as otherwise provided under (f), (j), (k), and (o) of  
10 this section, the tax is equal to the sum of

11 (1) the annual production tax value of the taxable oil and gas as  
12 calculated under AS 43.55.160(a)(1) multiplied by 25 percent; and

13 (2) the sum, over all months of the calendar year, of the tax amounts  
14 determined under (g) of this section on the production of oil.

1 \* **Sec. 2.** AS 43.55.011(g) is amended to read:

2 (g) For each month of the calendar year for which the producer's average  
3 monthly production tax value under AS 43.55.160(a)(2) of a [PER BTU  
4 EQUIVALENT] barrel of [THE] taxable oil [AND GAS] is more than \$30, the  
5 amount of tax for purposes of (e)(2) of this section is determined by multiplying the  
6 monthly production tax value of the taxable oil [AND GAS] produced during the  
7 month by the tax rate calculated as follows:

8 (1) if the producer's average monthly production tax value of a [PER  
9 BTU EQUIVALENT] barrel of [THE] taxable oil [AND GAS] for the month is not  
10 more than \$92.50, the tax rate is 0.4 percent multiplied by the number that represents  
11 the difference between the producer's [THAT] average monthly production tax value  
12 of a [PER BTU EQUIVALENT] barrel of oil and \$30; or

13 (2) if the producer's average monthly production tax value of a [PER  
14 BTU EQUIVALENT] barrel of [THE] taxable oil [AND GAS] for the month is more  
15 than \$92.50, the tax rate is the sum of 25 percent and the product of 0.1 percent  
16 multiplied by the number that represents the difference between the producer's  
17 average monthly production tax value of a [PER BTU EQUIVALENT] barrel of oil  
18 and \$92.50, except that the sum determined under this paragraph may not exceed 50  
19 percent.

20 \* **Sec. 3.** AS 43.55.011(j) is amended to read:

21 (j) For a calendar year before 2022, the tax levied by (e)(1) [(e)] of this section  
22 for gas produced from a lease or property in the Cook Inlet sedimentary basin may not  
23 exceed

24 (1) for a lease or property that first commenced commercial production  
25 of gas before April 1, 2006, the product obtained by multiplying (A) the amount of  
26 taxable gas produced during the calendar year from the lease or property, times (B) the  
27 average rate of tax that was imposed under this chapter for taxable gas produced from  
28 the lease or property for the 12-month period ending on March 31, 2006, times (C) the  
29 quotient obtained by dividing the total gross value at the point of production of the  
30 taxable gas produced from the lease or property during the 12-month period ending on  
31 March 31, 2006, by the total amount of that gas;

1 (2) for a lease or property that first commences commercial production  
2 of gas after March 31, 2006, the product obtained by multiplying (A) the amount of  
3 taxable gas produced during the calendar year from the lease or property, times (B) the  
4 average rate of tax that was imposed under this chapter for taxable gas produced from  
5 all leases or properties in the Cook Inlet sedimentary basin for the 12-month period  
6 ending on March 31, 2006, times (C) the average prevailing value for gas delivered in  
7 the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by  
8 the department under AS 43.55.020(f).

9 \* **Sec. 4.** AS 43.55.011(o) is amended to read:

10 (o) Notwithstanding other provisions of this section, for a calendar year before  
11 2022, the tax levied under (e)(1) [(e)] of this section for each 1,000 cubic feet of gas  
12 for gas produced from a lease or property outside the Cook Inlet sedimentary basin  
13 and used in the state may not exceed the amount of tax for each 1,000 cubic feet of gas  
14 that is determined under (j)(2) of this section.

15 \* **Sec. 5.** AS 43.55.020(a) is amended to read:

16 (a) For a calendar year, a producer subject to tax under AS 43.55.011(e) - (i)  
17 shall pay the tax as follows:

18 (1) an installment payment of the estimated tax levied by  
19 AS 43.55.011(e), net of any tax credits applied as allowed by law, is due for each  
20 month of the calendar year on the last day of the following month; except as otherwise  
21 provided under (2) of this subsection, the amount of the installment payment is the  
22 sum of the following amounts, less 1/12 of the tax credits that are allowed by law to be  
23 applied against the tax levied by AS 43.55.011(e) for the calendar year, but the amount  
24 of the installment payment may not be less than zero:

25 (A) for oil and gas produced from leases or properties in the  
26 state outside the Cook Inlet sedimentary basin but not subject to  
27 AS 43.55.011(o), other than leases or properties subject to AS 43.55.011(f),  
28 [THE GREATER OF]

29 (i) [ZERO; OR

30 (ii)] the sum of 25 percent and the tax rate calculated  
31 for the month under AS 43.55.011(g) multiplied by the remainder

1 obtained by subtracting 1/12 of the producer's adjusted lease  
 2 expenditures for the calendar year of production applicable to the oil  
 3 produced by the producer from those leases and properties under  
 4 AS 43.55.165 and 43.55.170 that are deductible for the leases or  
 5 properties under AS 43.55.160 from the gross value at the point of  
 6 production of the oil [AND GAS] produced from the leases or  
 7 properties during the month for which the installment payment is  
 8 calculated; and

9 (ii) 25 percent of the remainder obtained by  
 10 subtracting 1/12 of the producer's adjusted lease expenditures for  
 11 the calendar year of production applicable to the gas produced by  
 12 the producer from those leases and properties under AS 43.55.165  
 13 and 43.55.170 that are deductible for the leases or properties under  
 14 AS 43.55.160 from the gross value at the point of production of the  
 15 gas produced from the leases or properties during the month for  
 16 which the installment payment is calculated;

17 (B) for oil and gas produced from leases or properties subject  
 18 to AS 43.55.011(f), the greater [GREATEST] of

19 (i) [ZERO;

20 (ii)] zero percent, one percent, two percent, three  
 21 percent, or four percent, as applicable, of the gross value at the point of  
 22 production of the oil and gas produced from all leases or properties  
 23 during the month for which the installment payment is calculated; or

24 (ii) 25 percent of the remainder obtained by  
 25 subtracting 1/12 of the producer's adjusted lease expenditures for  
 26 the calendar year of production applicable to the gas produced by  
 27 the producer from those leases and properties under AS 43.55.165  
 28 and 43.55.170 that are deductible for those leases or properties  
 29 under AS 43.55.160 from the gross value at the point of production  
 30 of the gas produced from those leases or properties during the  
 31 month for which the installment payment is calculated and

1 [(iii)] the sum of 25 percent and the tax rate calculated  
2 for the month under AS 43.55.011(g) multiplied by the remainder  
3 obtained by subtracting 1/12 of the producer's adjusted lease  
4 expenditures for the calendar year of production applicable to the oil  
5 produced by the producer from those leases and properties under  
6 AS 43.55.165 and 43.55.170 that are deductible for those leases or  
7 properties under AS 43.55.160 from the gross value at the point of  
8 production of the oil [AND GAS] produced from those leases or  
9 properties during the month for which the installment payment is  
10 calculated;

11 (C) for oil and gas produced from each lease or property  
12 subject to AS 43.55.011(j), (k), or (o), 25 percent of the remainder obtained  
13 by subtracting 1/12 of the producer's adjusted lease expenditures for the  
14 calendar year of production applicable to the gas produced by the  
15 producer from those leases and properties under AS 43.55.165 and  
16 43.55.170 that are deductible for those leases or properties under  
17 AS 43.55.160 from the gross value at the point of production of the gas  
18 produced from those leases or properties during the month for which the  
19 installment payment is calculated and [THE GREATER OF

20 (i) ZERO; OR

21 (ii)] the sum of 25 percent and the tax rate calculated  
22 for the month under AS 43.55.011(g) multiplied by the remainder  
23 obtained by subtracting 1/12 of the producer's adjusted lease  
24 expenditures for the calendar year of production applicable to the oil  
25 produced by the producer from those leases and properties under  
26 AS 43.55.165 and 43.55.170 that are deductible under AS 43.55.160  
27 for oil [OR GAS, RESPECTIVELY,] produced from the lease or  
28 property from the gross value at the point of production of the oil [OR  
29 GAS, RESPECTIVELY,] produced from the lease or property during  
30 the month for which the installment payment is calculated;

31 (2) an amount calculated under (1)(C) of this subsection for oil or gas

1 produced from a lease or property subject to AS 43.55.011(j), (k), or (o) may not  
2 exceed the product obtained by carrying out the calculation set out in  
3 AS 43.55.011(j)(1) or (2) or 43.55.011(o), as applicable, for gas or set out in  
4 AS 43.55.011(k)(1) or (2), as applicable, for oil, but substituting in  
5 AS 43.55.011(j)(1)(A) or (2)(A) or 43.55.011(o), as applicable, the amount of taxable  
6 gas produced during the month for the amount of taxable gas produced during the  
7 calendar year and substituting in AS 43.55.011(k)(1)(A) or (2)(A), as applicable, the  
8 amount of taxable oil produced during the month for the amount of taxable oil  
9 produced during the calendar year;

10 (3) an installment payment of the estimated tax levied by  
11 AS 43.55.011(i) for each lease or property is due for each month of the calendar year  
12 on the last day of the following month; the amount of the installment payment is the  
13 sum of

14 (A) the applicable tax rate for oil provided under  
15 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
16 oil taxable under AS 43.55.011(i) and produced from the lease or property  
17 during the month; and

18 (B) the applicable tax rate for gas provided under  
19 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
20 gas taxable under AS 43.55.011(i) and produced from the lease or property  
21 during the month;

22 (4) any amount of tax levied by AS 43.55.011(e) or (i), net of any  
23 credits applied as allowed by law, that exceeds the total of the amounts due as  
24 installment payments of estimated tax is due on March 31 of the year following the  
25 calendar year of production.

26 \* Sec. 6. AS 43.55.160(a) is amended to read:

27 (a) Except as provided in (b) of this section, for the purposes of

28 (1) AS 43.55.011(e), the annual production tax value of the taxable

29 (A) oil and gas produced during a calendar year from leases or  
30 properties in the state that include land north of 68 degrees North latitude is the  
31 gross value at the point of production of the oil and gas taxable under

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AS 43.55.011(e) and produced by the producer from those leases or properties, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil and gas produced by the producer from those leases or properties, as adjusted under AS 43.55.170; this subparagraph does not apply to gas subject to AS 43.55.011(o);

(B) oil and gas produced during a calendar year from leases or properties in the state outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude, is the gross value at the point of production of the oil and gas taxable under AS 43.55.011(e) and produced by the producer from those leases or properties, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil and gas produced by the producer from those leases or properties, as adjusted under AS 43.55.170; this subparagraph does not apply to gas subject to AS 43.55.011(o);

(C) oil produced during a calendar year from a lease or property in the Cook Inlet sedimentary basin is the gross value at the point of production of the oil taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(D) gas produced during a calendar year from a lease or property in the Cook Inlet sedimentary basin is the gross value at the point of production of the gas taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the gas produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(E) gas produced during a calendar year from a lease or property outside the Cook Inlet sedimentary basin and used in the state is the gross value at the point of production of that gas taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less the producer's lease expenditures under AS 43.55.165 for the calendar year

1 applicable to that gas produced by the producer from that lease or property, as  
2 adjusted under AS 43.55.170;

3 (2) AS 43.55.011(g), the monthly production tax value of the taxable

4 (A) oil [AND GAS] produced during a month from leases or  
5 properties in the state that include land north of 68 degrees North latitude is the  
6 gross value at the point of production of the oil [AND GAS] taxable under  
7 AS 43.55.011(e) and produced by the producer from those leases or properties,  
8 less 1/12 of the producer's lease expenditures under AS 43.55.165 for the  
9 calendar year applicable to the oil [AND GAS] produced by the producer from  
10 those leases or properties, as adjusted under AS 43.55.170; [THIS  
11 SUBPARAGRAPH DOES NOT APPLY TO GAS SUBJECT TO  
12 AS 43.55.011(o);]

13 (B) oil [AND GAS] produced during a month from leases or  
14 properties in the state outside the Cook Inlet sedimentary basin, no part of  
15 which is north of 68 degrees North latitude, is the gross value at the point of  
16 production of the oil [AND GAS] taxable under AS 43.55.011(e) and produced  
17 by the producer from those leases or properties, less 1/12 of the producer's  
18 lease expenditures under AS 43.55.165 for the calendar year applicable to the  
19 oil [AND GAS] produced by the producer from those leases or properties, as  
20 adjusted under AS 43.55.170; [THIS SUBPARAGRAPH DOES NOT APPLY  
21 TO GAS SUBJECT TO AS 43.55.011(o);]

22 (C) oil produced during a month from a lease or property in the  
23 Cook Inlet sedimentary basin is the gross value at the point of production of  
24 the oil taxable under AS 43.55.011(e) and produced by the producer from that  
25 lease or property, less 1/12 of the producer's lease expenditures under  
26 AS 43.55.165 for the calendar year applicable to the oil produced by the  
27 producer from that lease or property, as adjusted under AS 43.55.170 [;

28 (D) GAS PRODUCED DURING A MONTH FROM A  
29 LEASE OR PROPERTY IN THE COOK INLET SEDIMENTARY BASIN IS  
30 THE GROSS VALUE AT THE POINT OF PRODUCTION OF THE GAS  
31 TAXABLE UNDER AS 43.55.011(e) AND PRODUCED BY THE

1 PRODUCER FROM THAT LEASE OR PROPERTY, LESS 1/12 OF THE  
2 PRODUCER'S LEASE EXPENDITURES UNDER AS 43.55.165 FOR THE  
3 CALENDAR YEAR APPLICABLE TO THE GAS PRODUCED BY THE  
4 PRODUCER FROM THAT LEASE OR PROPERTY, AS ADJUSTED  
5 UNDER AS 43.55.170;

6 (E) GAS PRODUCED DURING A MONTH FROM A  
7 LEASE OR PROPERTY OUTSIDE THE COOK INLET SEDIMENTARY  
8 BASIN AND USED IN THE STATE IS THE GROSS VALUE AT THE  
9 POINT OF PRODUCTION OF THAT GAS TAXABLE UNDER  
10 AS 43.55.011(e) AND PRODUCED BY THE PRODUCER FROM THAT  
11 LEASE OR PROPERTY, LESS 1/12 OF THE PRODUCER'S LEASE  
12 EXPENDITURES UNDER AS 43.55.165 FOR THE CALENDAR YEAR  
13 APPLICABLE TO THAT GAS PRODUCED BY THE PRODUCER FROM  
14 THAT LEASE OR PROPERTY, AS ADJUSTED UNDER AS 43.55.170].

15 \* Sec. 7. AS 43.55.160(c) is amended to read:

16 (c) Notwithstanding any contrary provision of AS 43.55.150, for purposes of  
17 calculating a monthly production tax value under (a)(2) of this section, the gross value  
18 at the point of production of the oil [AND GAS] is calculated under regulations  
19 adopted by the department that provide for using an appropriate monthly share of the  
20 producer's costs of transportation for the calendar year.

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

23 APPLICABILITY. Sections 1 - 7 of this Act are applicable on and after the first day  
24 of the calendar month immediately following the effective date of this Act.

25 \* Sec. 9. This Act takes effect immediately under AS 01.10.070(c).

# FISCAL NOTE

Adopted  
3/31/10

**STATE OF ALASKA**  
**2010 LEGISLATIVE SESSION**

Fiscal Note Number: \_\_\_\_\_  
Bill Version: CSSB305(FIN)  
(S) Publish Date: 3/31/2010

Identifier (file name): 2010 03 31 FN CSSB305 SFIN Dept. Affected: Revenue  
Title: \_\_\_\_\_ RDU: Taxation and Treasury  
Component: Tax Division  
Sponsor: Senate Finance Committee  
Requester: Senate Finance Committee 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 -	0.0							
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>0.0</b>
<b>CAPITAL EXPENDITURES</b>								
<b>CHANGE IN REVENUES ( )</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>0.0</b>

**FUND SOURCE** (Thousands of Dollars)

	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
1002 Federal Receipts							
1003 GF Match							
1004 GF	0.0						
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: 0.0

**POSITIONS**

	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Full-time	0.0						
Part-time							
Temporary							

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

This bill separates oil and natural gas for purposes of calculating the progressivity portion of the production tax under AS 43.55. Under this bill the progressivity surcharges for oil and Cook Inlet and in-state gas would be calculated together, but distinctly from export gas, instead of the current practice on all oil and gas combined. The progressivity structure itself would be unchanged, based on 0.4% of the production that value that exceeds \$30 per barrel for oil, and \$30 per BTU barrel of oil equivalent for gas. The base tax rate is unchanged at 25% of production tax value.

Prepared by: Miles Baker, Finance Aide  
Division: Senate Finance Committee  
Approved by: Senator Stedman, Co-Chair  
Senate Finance Committee

Phone (907) 465-3873  
Date/Time 3/30/2010 7:00pm  
Date 3/31/2010 8:00am

## FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

BILL NO. CSSB305(FIN)

### ANALYSIS CONTINUATION

Under current law the tax rate is based on the combined BTU value of oil and gas. However, oil and gas can have vastly different values on a BTU basis. Currently a BTU of oil is worth much more than a BTU of gas. Accordingly, once a major gas sale would start up, overlaying the existing oil production, the BTU value of the combined oil and gas would be much lower than it was for oil alone. This could cause a significant reduction in oil taxes as a result of a major gas sale.

This structure, in conjunction with the inherent uncertainty of future oil and gas prices, exposes the state to significant financial risk were a major gas sale to occur. The structure also creates economic instability for entities looking to participate in the development and financing of a natural gas pipeline project in Alaska.

Under the tax inducement provisions of the Alaska Gasline Inducement Act (AGIA), the tax structure in place at the time of the first binding open season (May 1, 2010), may be locked in for the first ten years of gas commercialization. Consequently, to the extent there is interest in decoupling our tax structure, it needs to be done before April 30, 2010.

The bill removes the dilution effect by having progressivity calculated distinctly for oil and gas. This will result in no reduction in oil taxes from a major gas sale.

As in current law, the bill gives the Department of Revenue the authority to adopt regulations to allocate costs between oil and gas, with the added instruction that a method based on relative BTU barrel of oil equivalents should be considered. That method was the one adopted by the department under the same authority for implementation of the current law, for the same purposes as would be for the proposed law.

Some producers currently produce Cook Inlet gas or other in-state gas along with North Slope oil. If all gas were separated from oil these producers would see an immediate tax increase. The bill is not intended to increase taxes on current activity. Having the progressivity for Cook Inlet gas and other in-state gas calculated together replicates the current situation, so these producers will see no tax increases. Only progressivity on export gas, like the gas from a major gas sale, would be calculated distinctly. This will prevent a major gas sale from diluting progressivity on oil.

#### **Expenditures**

The Tax Division is in the process of developing a new, single, comprehensive, integrated tax management system for all tax types. The new system will incorporate tax programs and recent tax changes as necessary to improve the efficiency and accuracy of the Division's revenue collection efforts. There is a \$300,000 request in the Governor's FY2011 Capital Budget to complete the agency's IT plan for submission and review by the Enterprise Investment Board. It is assumed that the tax structure changes contained in this bill will be addressed by this systemwide review and eventual restructuring project.

*adopted 3/31/10 n/d*

26-LS1577T  
Bullock  
3/30/10

**CS FOR SENATE BILL NO. 305(FIN)**

**IN THE LEGISLATURE OF THE STATE OF ALASKA  
TWENTY-SIXTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE FINANCE COMMITTEE**

**Offered:  
Referred:**

**Sponsor(s): SENATE FINANCE COMMITTEE**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to that part of the tax on oil and gas production that increases the rate  
2 of tax as the production tax value of oil or the BTU equivalent barrel of gas increases  
3 above \$30, separating the determination of that rate between oil and gas, and making  
4 that rate distinct between oil and gas; relating to availability of a portion of the money  
5 received from the tax on oil and gas production for appropriation to the community  
6 revenue sharing fund; relating to the allocation of lease expenditures and adjustments to  
7 lease expenditures; and providing for an effective date."

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

9 \* **Section 1.** AS 29.60.850(b) is amended to read:

10 (b) Each fiscal year, the legislature may appropriate to the community revenue  
11 sharing fund an amount equal to 20 percent of the money received by the state during  
12 the previous calendar year under AS 43.55.011(g) and (p). The amount may not  
13 exceed

- 1 (1) \$60,000,000; or  
2 (2) the amount that, when added to the fund balance on June 30 of the  
3 previous fiscal year, equals \$180,000,000.

4 \* Sec. 2. AS 43.55.011(e) is amended to read:

5 (e) There is levied on the producer of oil or gas a tax for all oil and gas  
6 produced each calendar year from each lease or property in the state, less any oil and  
7 gas the ownership or right to which is exempt from taxation or constitutes a  
8 landowner's royalty interest. Except as otherwise provided under (f), (j), (k), and (o) of  
9 this section, the tax is equal to the sum of

10 (1) the annual production tax value of the taxable oil and gas as  
11 calculated under AS 43.55.160(a)(1) multiplied by 25 percent; and

12 (2) the sum, over all months of the calendar year, of the tax amounts  
13 determined under

14 (A) subsection (g) of this section; and

15 (B) subsection (p) of this section.

16 \* Sec. 3. AS 43.55.011(g) is amended to read:

17 (g) For each month of the calendar year for which the producer's average  
18 monthly production tax value under AS 43.55.160(a)(2)(A) - (E) of a  
19 [AS 43.55.160(a)(2) PER] BTU equivalent barrel of [THE] taxable oil and gas is more  
20 than \$30, the amount of tax for purposes of (e)(2)(A) [(e)(2)] of this section is  
21 determined by multiplying the monthly production tax value of the taxable oil [AND  
22 GAS] produced during the month, gas produced during the month from a lease or  
23 property in the Cook Inlet sedimentary basin, and gas produced during the  
24 month from a lease or property outside the Cook Inlet sedimentary basin and  
25 used in the state by the tax rate calculated as follows:

26 (1) if the producer's average monthly production tax value under  
27 AS 43.55.160(a)(2)(A) - (E) of a [PER] BTU equivalent barrel of [THE] taxable oil  
28 and gas for the month is not more than \$92.50, the tax rate is 0.4 percent multiplied by  
29 the number that represents the difference between the producer's [THAT] average  
30 monthly production tax value under AS 43.55.160(a)(2)(A) - (E) of a [PER] BTU  
31 equivalent barrel of taxable oil and gas and \$30; or

1 (2) if the producer's average monthly production tax value under  
2 AS 43.55.160(a)(2)(A) - (E) of a [PER] BTU equivalent barrel of [THE] taxable oil  
3 and gas for the month is more than \$92.50, the tax rate is the sum of 25 percent and  
4 the product of 0.1 percent multiplied by the number that represents the difference  
5 between the producer's average monthly production tax value under  
6 AS 43.55.160(a)(2)(A) - (E) of a [PER] BTU equivalent barrel of taxable oil and gas  
7 and \$92.50, except that the sum determined under this paragraph may not exceed 50  
8 percent.

9 \* Sec. 4. AS 43.55.011 is amended by adding a new subsection to read:

10 (p) For each month of the calendar year for which the producer's average  
11 monthly production tax value under AS 43.55.160(a)(2)(F) and (G) of a BTU  
12 equivalent barrel of taxable gas is more than \$30, the amount of tax on the production  
13 of gas for purposes of (e)(2)(B) of this section is determined by multiplying the  
14 monthly production tax value of the taxable gas produced during the month other than  
15 gas produced from a lease or property in the Cook Inlet sedimentary basin or gas  
16 produced outside the Cook Inlet sedimentary basin and used in the state by the tax rate  
17 calculated as follows:

18 (1) if the producer's average monthly production tax value under  
19 AS 43.55.160(a)(2)(F) and (G) of a BTU equivalent barrel of taxable gas for the  
20 month is not more than \$92.50, the tax rate is 0.4 percent multiplied by the number  
21 that represents the difference between the producer's average monthly production tax  
22 value under AS 43.55.160(a)(2)(F) and (G) of a BTU equivalent barrel of gas and \$30;  
23 or

24 (2) if the producer's average monthly production tax value under  
25 AS 43.55.160(a)(2)(F) and (G) of a BTU equivalent barrel of taxable gas for the  
26 month is more than \$92.50, the tax rate is the sum of 25 percent and the product of 0.1  
27 percent multiplied by the number that represents the difference between the producer's  
28 average monthly production tax value under AS 43.55.160(a)(2)(F) and (G) of a BTU  
29 equivalent barrel of gas and \$92.50, except that the sum determined under this  
30 paragraph may not exceed 50 percent.

31 \* Sec. 5. AS 43.55.020(a) is amended to read:

1 (a) For a calendar year, a producer subject to tax under AS 43.55.011(e) - (i)  
2 **and (p)** shall pay the tax as follows:

3 (1) an installment payment of the estimated tax levied by  
4 AS 43.55.011(e), net of any tax credits applied as allowed by law, is due for each  
5 month of the calendar year on the last day of the following month; except as otherwise  
6 provided under (2) of this subsection, the amount of the installment payment is the  
7 sum of the following amounts, less 1/12 of the tax credits that are allowed by law to be  
8 applied against the tax levied by AS 43.55.011(e) for the calendar year, but the amount  
9 of the installment payment may not be less than zero:

10 (A) for oil and gas produced from leases or properties in the  
11 state outside the Cook Inlet sedimentary basin but not subject to  
12 AS 43.55.011(o), other than leases or properties subject to AS 43.55.011(f), the  
13 greater of

14 (i) zero; or

15 (ii) **an amount equal to** the sum of 25 percent and the  
16 tax rate calculated for the month under AS 43.55.011(g) multiplied by  
17 the remainder obtained by subtracting 1/12 of the producer's adjusted  
18 lease expenditures for the calendar year of production **applicable to**  
19 **the oil produced by the producer from those leases and properties**  
20 **under AS 43.55.165 and 43.55.170 that are deductible for the leases or**  
21 **properties under AS 43.55.160, from the gross value at the point of**  
22 **production of the oil [AND GAS] produced from the leases or**  
23 **properties during the month for which the installment payment is**  
24 **calculated added to the sum of 25 percent and the tax rate**  
25 **calculated for the month under AS 43.55.011(p) multiplied by the**  
26 **remainder obtained by subtracting 1/12 of the producer's adjusted**  
27 **lease expenditures for the calendar year of production applicable**  
28 **to the gas produced by the producer from those leases and**  
29 **properties under AS 43.55.165 and 43.55.170 that are deductible**  
30 **for the leases or properties under AS 43.55.160 from the gross**  
31 **value at the point of production of the gas produced from the leases**

1 or properties during the month for which the installment payment  
2 is calculated;

3 (B) for oil and gas produced from leases or properties subject  
4 to AS 43.55.011(f), the greatest of

5 (i) zero;

6 (ii) zero percent, one percent, two percent, three  
7 percent, or four percent, as applicable, of the gross value at the point of  
8 production of the oil and gas produced from all leases or properties  
9 during the month for which the installment payment is calculated; or

10 (iii) an amount equal to the sum of 25 percent and the  
11 tax rate calculated for the month under AS 43.55.011(g) multiplied by  
12 the remainder obtained by subtracting 1/12 of the producer's adjusted  
13 lease expenditures for the calendar year of production applicable to  
14 the oil produced by the producer from those leases and properties  
15 under AS 43.55.165 and 43.55.170 that are deductible for those leases  
16 or properties under AS 43.55.160, from the gross value at the point of  
17 production of the oil [AND GAS] produced from those leases or  
18 properties during the month for which the installment payment is  
19 calculated added to the sum of 25 percent and the tax rate  
20 calculated for the month under AS 43.55.011(p) multiplied by the  
21 remainder obtained by subtracting 1/12 of the producer's adjusted  
22 lease expenditures for the calendar year of production applicable  
23 to the gas produced by the producer from those leases and  
24 properties under AS 43.55.165 and 43.55.170 that are deductible  
25 for those leases or properties under AS 43.55.160 from the gross  
26 value at the point of production of the gas produced from those  
27 leases or properties during the month for which the installment  
28 payment is calculated;

29 (C) for oil and gas produced from each lease or property  
30 subject to AS 43.55.011(j), (k), or (o), the greater of

31 (i) zero; or

1 (ii) an amount equal to the sum of 25 percent and the  
2 tax rate calculated for the month under AS 43.55.011(g) multiplied by  
3 the remainder obtained by subtracting 1/12 of the producer's adjusted  
4 lease expenditures for the calendar year of production applicable to  
5 the oil produced by the producer from those leases and properties  
6 under AS 43.55.165 and 43.55.170 that are deductible under  
7 AS 43.55.160 for oil [OR GAS, RESPECTIVELY,] produced from the  
8 lease or property, from the gross value at the point of production of the  
9 oil [OR GAS, RESPECTIVELY,] produced from the lease or property  
10 during the month for which the installment payment is calculated  
11 added to the sum of 25 percent and the tax rate calculated for the  
12 month under AS 43.55.011(g) multiplied by the remainder obtained  
13 by subtracting 1/12 of the producer's adjusted lease expenditures  
14 for the calendar year of production applicable to the gas produced  
15 by the producer from the lease or property under AS 43.55.165 and  
16 43.55.170 that are deductible under AS 43.55.160 for gas produced  
17 from the lease or property, from the gross value at the point of  
18 production of the gas produced from the lease or property during  
19 the month for which the installment payment is calculated;

20 (2) an amount calculated under (1)(C) of this subsection for oil or gas  
21 produced before 2022 from a lease or property subject to AS 43.55.011(j), (k), or (o)  
22 may not exceed the product obtained by carrying out the calculation set out in  
23 AS 43.55.011(j)(1) or (2) or 43.55.011(o), as applicable, for gas or set out in  
24 AS 43.55.011(k)(1) or (2), as applicable, for oil, but substituting in  
25 AS 43.55.011(j)(1)(A) or (2)(A) or 43.55.011(o), as applicable, the amount of taxable  
26 gas produced during the month for the amount of taxable gas produced during the  
27 calendar year and substituting in AS 43.55.011(k)(1)(A) or (2)(A), as applicable, the  
28 amount of taxable oil produced during the month for the amount of taxable oil  
29 produced during the calendar year;

30 (3) an installment payment of the estimated tax levied by  
31 AS 43.55.011(i) for each lease or property is due for each month of the calendar year

1 on the last day of the following month; the amount of the installment payment is the  
2 sum of

3 (A) the applicable tax rate for oil provided under  
4 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
5 oil taxable under AS 43.55.011(i) and produced from the lease or property  
6 during the month; and

7 (B) the applicable tax rate for gas provided under  
8 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
9 gas taxable under AS 43.55.011(i) and produced from the lease or property  
10 during the month;

11 (4) any amount of tax levied by AS 43.55.011(e) or (i), net of any  
12 credits applied as allowed by law, that exceeds the total of the amounts due as  
13 installment payments of estimated tax is due on March 31 of the year following the  
14 calendar year of production.

15 \* Sec. 6. AS 43.55.020(d) is amended to read:

16 (d) In making settlement with the royalty owner for oil and gas that is taxable  
17 under AS 43.55.011, the producer may deduct the amount of the tax paid on taxable  
18 royalty oil and gas, or may deduct taxable royalty oil or gas equivalent in value at the  
19 time the tax becomes due to the amount of the tax paid. If the total deductions of  
20 installment payments of estimated tax for a calendar year exceed the actual tax for that  
21 calendar year, the producer shall, before April 1 of the following year, refund the  
22 excess to the royalty owner. Unless otherwise agreed between the producer and the  
23 royalty owner, the amount of the tax paid under AS 43.55.011(e) - (g) and (p) on  
24 taxable royalty oil and gas for a calendar year, other than oil and gas the ownership or  
25 right to which constitutes a landowner's royalty interest, is considered to be the gross  
26 value at the point of production of the taxable royalty oil and gas produced during the  
27 calendar year multiplied by a figure that is a quotient, in which

28 (1) the numerator is the producer's total tax liability under  
29 AS 43.55.011(e) - (g) and (p) for the calendar year of production; and

30 (2) the denominator is the total gross value at the point of production  
31 of the oil and gas taxable under AS 43.55.011(e) - (g) and (p) produced by the

1 producer from all leases and properties in the state during the calendar year.

2 \* Sec. 7. AS 43.55.160(a) is amended to read:

3 (a) Except as provided in (b) of this section, for the purposes of .

4 (1) AS 43.55.011(e), the annual production tax value of the taxable

5 (A) oil [AND GAS] produced during a calendar year from  
6 leases or properties in the state that include land north of 68 degrees North  
7 latitude is the gross value at the point of production of the oil [AND GAS]  
8 taxable under AS 43.55.011(e) and produced by the producer from those leases  
9 or properties, less the producer's lease expenditures under AS 43.55.165 for the  
10 calendar year applicable to the oil [AND GAS] produced by the producer from  
11 those leases or properties, as adjusted under AS 43.55.170; [THIS  
12 SUBPARAGRAPH DOES NOT APPLY TO GAS SUBJECT TO  
13 AS 43.55.011(o);]

14 (B) oil [AND GAS] produced during a calendar year from  
15 leases or properties in the state outside the Cook Inlet sedimentary basin, no  
16 part of which is north of 68 degrees North latitude, is the gross value at the  
17 point of production of the oil [AND GAS] taxable under AS 43.55.011(e) and  
18 produced by the producer from those leases or properties, less the producer's  
19 lease expenditures under AS 43.55.165 for the calendar year applicable to the  
20 oil [AND GAS] produced by the producer from those leases or properties, as  
21 adjusted under AS 43.55.170; [THIS SUBPARAGRAPH DOES NOT APPLY  
22 TO GAS SUBJECT TO AS 43.55.011(o);]

23 (C) oil produced during a calendar year from a lease or  
24 property in the Cook Inlet sedimentary basin is the gross value at the point of  
25 production of the oil taxable under AS 43.55.011(e) and produced by the  
26 producer from that lease or property, less the producer's lease expenditures  
27 under AS 43.55.165 for the calendar year applicable to the oil produced by the  
28 producer from that lease or property, as adjusted under AS 43.55.170;

29 (D) gas produced during a calendar year from a lease or  
30 property in the Cook Inlet sedimentary basin is the gross value at the point of  
31 production of the gas taxable under AS 43.55.011(e) and produced by the

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producer from that lease or property, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the gas produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(E) gas produced during a calendar year from a lease or property outside the Cook Inlet sedimentary basin and used in the state is the gross value at the point of production of that gas taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to that gas produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(F) gas produced during a calendar year from leases or properties in the state that include land north of 68 degrees North latitude is the gross value at the point of production of the gas taxable under AS 43.55.011(e) and produced by the producer from those leases or properties, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the gas produced by the producer from those leases or properties, as adjusted under AS 43.55.170; this subparagraph does not apply to gas used in the state;

(G) gas produced during a calendar year from leases or properties in the state outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude, is the gross value at the point of production of the gas taxable under AS 43.55.011(e) and produced by the producer from those leases or properties, less the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the gas produced by the producer from those leases or properties, as adjusted under AS 43.55.170; this subparagraph does not apply to gas used in the state;

(2) AS 43.55.011(g) and (p), the monthly production tax value of the taxable oil produced during a month from

(A) oil [AND GAS] produced during a month from leases or properties in the state that include land north of 68 degrees North latitude is the

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gross value at the point of production of the oil [AND GAS] taxable under AS 43.55.011(e) and produced by the producer from those leases or properties, less 1/12 of the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil [AND GAS] produced by the producer from those leases or properties, as adjusted under AS 43.55.170; [THIS SUBPARAGRAPH DOES NOT APPLY TO GAS SUBJECT TO AS 43.55.011(o);]

(B) oil [AND GAS] produced during a month from leases or properties in the state outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude, is the gross value at the point of production of the oil [AND GAS] taxable under AS 43.55.011(e) and produced by the producer from those leases or properties, less 1/12 of the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil [AND GAS] produced by the producer from those leases or properties, as adjusted under AS 43.55.170; [THIS SUBPARAGRAPH DOES NOT APPLY TO GAS SUBJECT TO AS 43.55.011(o);]

(C) oil produced during a month from a lease or property in the Cook Inlet sedimentary basin is the gross value at the point of production of the oil taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less 1/12 of the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the oil produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(D) gas produced during a month from a lease or property in the Cook Inlet sedimentary basin is the gross value at the point of production of the gas taxable under AS 43.55.011(e) and produced by the producer from that lease or property, less 1/12 of the producer's lease expenditures under AS 43.55.165 for the calendar year applicable to the gas produced by the producer from that lease or property, as adjusted under AS 43.55.170;

(E) gas produced during a month from a lease or property outside the Cook Inlet sedimentary basin and used in the state is the gross value at the point of production of that gas taxable under AS 43.55.011(e) and

1 produced by the producer from that lease or property, less 1/12 of the  
2 producer's lease expenditures under AS 43.55.165 for the calendar year  
3 applicable to that gas produced by the producer from that lease or property, as  
4 adjusted under AS 43.55.170;

5 (F) gas produced during a month from leases or properties  
6 in the state that include land north of 68 degrees North latitude is the  
7 gross value at the point of production of the gas taxable under  
8 AS 43.55.011(e) and produced by the producer from those leases or  
9 properties, less 1/12 of the producer's lease expenditures under  
10 AS 43.55.165 for the calendar year applicable to the gas produced by the  
11 producer from those leases or properties, as adjusted under AS 43.55.170;  
12 this subparagraph does not apply to gas used in the state;

13 (G) gas produced during a month from leases or properties  
14 in the state outside the Cook Inlet sedimentary basin, no part of which is  
15 north of 68 degrees North latitude, is the gross value at the point of  
16 production of the gas taxable under AS 43.55.011(e) and produced by the  
17 producer from those leases or properties, less 1/12 of the producer's lease  
18 expenditures under AS 43.55.165 for the calendar year applicable to the  
19 gas produced by the producer from those leases or properties, as adjusted  
20 under AS 43.55.170; this subparagraph does not apply to gas used in the  
21 state.

22 \* Sec. 8. AS 43.55.165(h) is amended to read:

23 (h) The department shall adopt regulations that provide for reasonable  
24 methods of allocating costs between oil and gas, between gas subject to  
25 AS 43.55.011(o) and other gas, and between leases or properties in those  
26 circumstances where an allocation of costs is required to determine lease expenditures  
27 that are costs of exploring for, developing, or producing oil deposits or costs of  
28 exploring for, developing, or producing gas deposits, or that are costs of exploring for,  
29 developing, or producing oil or gas deposits located within different leases or  
30 properties. When determining a reasonable method of allocating lease  
31 expenditures between the production of oil and the production of gas, the

1 **department shall consider allocating lease expenditures in proportion to the BTU**  
2 **equivalent barrels of oil produced and gas produced from each lease or property.**

3 \* **Sec. 9.** AS 43.55.170 is amended by adding a new subsection to read:

4 (d) The department shall adopt regulations that provide for reasonable  
5 methods of allocating the adjustments to a producer's lease expenditures in (a) of this  
6 section and the payments and credits described in (b) of this section between oil and  
7 gas, between gas subject to AS 43.55.011(o) and other gas, and between leases or  
8 properties in those circumstances where an allocation of costs is required to determine  
9 lease expenditures that are costs of exploring for, developing, or producing oil  
10 deposits, or costs of exploring for, developing, or producing gas deposits, or that are  
11 costs of exploring for, developing, or producing oil or gas deposits located within  
12 different leases or properties. When determining a reasonable method of allocating the  
13 adjustments to a producer's lease expenditures between the production of oil and the  
14 production of gas, the department shall consider allocating the adjustments in  
15 proportion to the lease expenditures allocated to the production of oil and the  
16 production of gas under regulations adopted by the department under  
17 AS 43.55.165(h).

18 \* **Sec. 10.** The uncoded law of the State of Alaska is amended by adding a new section to  
19 read:

20 **TRANSITION: INSTALLMENT PAYMENTS OF TAX.** A producer required to  
21 make an installment payment of tax under AS 43.55.020(a)(1) after December 31, 2009, and  
22 before the effective date of this Act, and that underpaid the amount due for the installment  
23 payment because of the retroactive application of secs. 2 - 4 and 7 of this Act, shall submit the  
24 amount of any underpayment on the date the first installment payment is due under  
25 AS 43.55.020(a)(1) after the effective date of this Act. Interest on the amount of an  
26 underpayment due because of the retroactive application of secs. 2 - 4 and 7 of this Act does  
27 not accrue until the day after the date the first installment payment is due under  
28 AS 43.55.020(a)(1) after the effective date of this Act.

29 \* **Sec. 11.** The uncoded law of the State of Alaska is amended by adding a new section to  
30 read:

31 **RETROACTIVITY.** Sections 2 - 4 and 7 of this Act are retroactive to January 1, 2010.

1

**\* Sec. 12.** This Act takes effect immediately under AS 01.10.070(c).

3/31/10

## LEGAL SERVICES

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

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

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

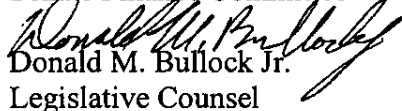
### MEMORANDUM

March 30, 2010

**SUBJECT:** Sectional summary of CSSB 305(RIN), Draft Version "T" with comparison to Draft Version "P" (Work Order No. 26-LS1577\T and 26-LS1577\P)

**TO:** Senate Finance Committee

**FROM:**

  
Donald M. Bullock Jr.  
Legislative Counsel

**Section 1.** Amends AS 29.60.850(b) to reference the new separate progressive tax on gas as a source of money that may be appropriated to the community revenue sharing fund. The "community revenue sharing fund" was established in AS 29.60.850(a), "for the purpose of making community revenue sharing payments to municipalities, reserves, and communities for any public purpose." *There is no amendment to AS 29.60.850(b) in CSSB 305(FIN), Draft Version "P" because the progressive tax on oil in AS 43.55.011(g) continued and would continue to be a source for appropriation.*

**Section 2.** Amends AS 43.55.011(e) to make separate references to the monthly progressive taxes on oil and gas. The progressive tax on oil, gas produced in Cook Inlet, and gas produced elsewhere and used in the state is in AS 43.55.011(g). The progressive tax on other gas is in AS 43.55.011(p). *Section 1 of CSSB 305(FIN), Draft Version "P" amended AS 43.55.011(e)(2) to refer only to the progressive tax on oil.*

**Section 3.** Amends AS 43.55.011(g) to have the tax rate determined using the production tax values of oil and the production tax values on a BTU equivalent basis of gas produced in Cook Inlet and gas produced elsewhere and used in the state. Applies the tax rate only to that oil and gas production. Makes no change in the tax rates or the range of production tax values within which the two tax rates apply. *Section 2 in CSSB 305(FIN), Draft Version "P" determined the progressive rate only on the production tax value of oil and applied that rate only to oil.*

**Section 4.** Adds a new subsections, (p), to AS 43.55.011. Provides for a progressive tax applicable to gas production that is not included in AS 43.55.011(g) as amended in sec. 3 of the bill. Provides that the tax rate is applied to the production tax value of a BTU equivalent of gas. Uses the same tax rates and ranges of production tax values as AS 43.55.011(g) under current law. *The progressive tax on gas in new subsection AS 43.55.011(p) has no counterpart in CSSB 305(FIN), Draft Version "P."*

**Section 5.** Amends AS 43.55.020(a) to describe the determination of the amount of a monthly installment payment for production taxes when the progressive tax on oil, Cook Inlet gas, and other gas used in the state, and the progressive tax applicable to other gas are determined separately. *Section 6 of CSSB 305(FIN), Draft Version "P" amended AS 43.55.020(a)(1) by excluding gas from the determination of that part of the installment payment that was based on the progressive tax applicable only to oil.*

**Section 6.** Amends AS 43.55.020(d), relating to a settlement with the royalty owner, by adding references to the progressive tax on the gas to which AS 43.55.011(p) is applicable. *There is no similar provision in CSSB 305(FIN), Draft Version "P" because the reference to AS 43.55.011(g) was still applicable.*

**Section 7.** Amends AS 43.55.160(a), relating to the determination of the production tax value of oil and gas, by providing the means for determining the production tax value of oil and the production tax value of gas separately. Reorders the subparagraphs so that the subparagraphs related to the production tax value of gas produced outside of Cook Inlet and other gas not used in the state are at the end. *Section 7 in CSSB 305(FIN), Draft Version "P" also amended AS 43.55.160(a), but amended the subsection by removing references to gas when determining the production tax value of oil for purposes of the progressive tax on oil.*

**Section 8.** Amends AS 43.55.165(h), relating to the requirement that the Department of Revenue adopt regulations for allocating lease expenditures, by requiring that the Department of Revenue consider allocating lease expenditures in proportion to the BTU equivalent barrels of oil produced and gas produced from each lease or property. *Section 9 in CSSB 305(FIN), Draft Version "P" also amended AS 43.55.165(h) in the same manner.*

**Section 9.** Adds a new subsection, AS 43.55.170(d), which is similar to the amendment to AS 43.55.165(h) in sec. 8, but is applicable to allocating adjustments to lease expenditures. Directs the Department of Revenue to consider allocating adjustments based on the proportion of the BTU equivalents of oil and gas produced. *Section 10 in CSSB 305(FIN), Draft Version "P" also amended AS 43.55.170 by adding a new subsection in the same manner.*

**Section 10.** Requires a producer that underpays an installment payment after December 31, 2009 and before the effective date because of the retroactive application of the new progressive tax section to pay the amount of the underpayment on the date the first installment payment is due after the effective date of the Act. *There is no similar section in CSSB 305(FIN), Draft Version "P" because the changes in that version were applicable after the effective date of the Act.*

**Section 11.** Makes the progressive tax provisions of the bill - secs. 2 - 4 and 7 - retroactive to January 1, 2010. *There is no similar section in CSSB 305(FIN), Draft Version "P" because the changes in that version were applicable after the effective date of the Act.*

**Section 12.** Makes the Act take effect immediately. *The immediate effective date is the same as the immediate effective date in sec. 11 of CSSB 305(FIN), Draft Version "P."*

Bill sections in CSSB 305(FIN), Draft Version "P" that have no counterpart in  
CSSB 305(FIN), Draft Version "T"

**Sec. 3 in CSSB 305(FIN), Draft Version "P"**, that amends AS 43.55.011(j) by adding a reference to AS 43.55.011(e)(1), rather and AS 43.55.011(e) because of the exclusion of the progressive tax on gas in that bill, has no counterpart in CSSB 305(FIN), Draft Version "T", which has a progressive tax on gas.

**Sec. 4 in CSSB 305(FIN), Draft Version "P"** that amends AS 43.55.011(o) by adding a reference to AS 43.55.011(e)(1), rather and AS 43.55.011(e) because of the exclusion of the progressive tax on gas in that bill, has no counterpart in CSSB 305(FIN), Draft Version "T", which has a progressive tax on gas.

**Sec. 8 in CSSB 305(FIN), Draft Version "P"** that amends AS 43.55.160(c) by removing a reference to gas for the purpose of determining the progressive tax rate on gas has no counterpart in CSSB 305(FIN), Draft Version "T", which has a progressive tax on gas.

**Sec. 11 in CSSB 305(FIN), Draft Version "P"** made the Act applicable after the effective date of the Act; CSSB 305(FIN), Draft Version "T" has no similar provision because of the retroactive effect of provisions in the bill.

DMB:med  
10-022.lmb

*adopted*  
*3/31/10* *n/o*

26-LS1577T.1  
Bullock  
3/31/10

AMENDMENT

1

OFFERED IN THE SENATE

BY SENATOR STEDMAN

TO: CSSB 305(FIN), Draft Version "T"

- 1 Page 9, line 29:
- 2 Delete "oil produced during a month from"

*old*

# FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

Fiscal Note Number: \_\_\_\_\_  
Bill Version: CSSB 305  
( ) Publish Date: \_\_\_\_\_

Identifier (file name): CSSB305(FIN)-REV-TAX-03-20-10 Dept. Affected: Revenue  
Title: Separate Oil & Gas Production Tax RDU: Taxation and Treasury  
Component: Tax Division  
Sponsor: (S) Finance Committee  
Requester: (S) Finance Committee 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	230.0							
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
<b>TOTAL OPERATING</b>	<b>230.0</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>0.0</b>
<b>CAPITAL EXPENDITURES</b>								
<b>CHANGE IN REVENUES ( )</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>**</b>	<b>**</b>

\*\*\* Significant Impact Beyond FY 2016 - See Analysis Section for Additional Information \*\*\*

**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF	230.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other Interagency Receipts								
<b>TOTAL</b>	<b>230.0</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>0.0</b>

Estimate of any current year (FY2010) cost: 0.0

**POSITIONS**

Full-time	0.0	0.00	0	0	0	0	0
Part-time							
Temporary							

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

**Bill Language**  
This bill separates oil and natural gas for purposes of calculating the progressivity portion of the production tax under AS 43.55. Under this bill, the progressivity surcharge is calculated on oil only instead of on oil and gas combined. The progressivity surcharge remains unchanged at 0.4% per \$1 of production tax value over \$30 per barrel, then 0.1% per \$1 of production tax value over \$92.50. Under this bill, natural gas is always taxed at 25% of production tax value with no progressivity surcharge.

Currently some companies have both oil sales from the North Slope and gas sales from Cook Inlet and elsewhere, both of which are included in their progressivity calculations that are applied to oil. By removing gas from the progressivity calculation these companies will likely face a higher tax rate and therefore an increase in tax liability. This bill contains a credit, which expires in 2015, that would offset any increase in tax from removing gas from the progressivity calculation. (continued)

Prepared by: Dan Stickel, Petroleum Economist  
Division: Tax Division  
Approved by: Ginger Blaisdell, Director  
Administrative Services Division

Phone 907-465-3279  
Date/Time 03-20-10; 6:36pm  
Date 03-20-10; 6:40pm

## FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

BILL NO. CSSB 305

### ANALYSIS CONTINUATION

#### Revenues

Removing gas from the progressivity calculation could potentially raise tax rates and increase tax for companies that currently produce both oil and gas (from Cook Inlet or elsewhere). The impact will vary from year to year, driven largely by oil and gas prices. Analysis of data from confidential tax returns yields estimates of what the revenue impact might have been in recent years. For CY 2008, removing gas from the progressivity calculation would have increased production tax revenue by about \$140 million. For CY 2009, the production tax increase would have been about \$20 million, and for CY 2010 the production tax increase would be about \$50 million. At current prices (around \$80 per barrel for North Slope oil, \$7 per million cubic feet for Cook Inlet gas, \$0.942 per million cubic feet for North Slope gas sold for in-state use) and assuming costs and production levels similar to 2009, removing gas from the progressivity calculation would cause an increase in tax liability of about \$50-60 million per year. These estimates assume that costs are allocated on a British Thermal Unit (BTU) equivalency basis; other allocation methods would yield different estimates.

For years before 2015 the increase in tax liability would be fully offset by the new tax credit provided by this bill. Therefore, for FY 2011 - FY 2014 the fiscal impact is projected to be zero because any increase in tax will be offset by the new tax credit provided in this bill. For FY 2015, the credit will only apply for the first half of the fiscal year and for FY 2016 and beyond the credit will not apply. The revenue impact is presented as indeterminate for FY 2015 and FY 2016 because of the high degree of uncertainty regarding the impact of removing gas from the progressivity calculation, as well as the material impact of regulations yet to be developed for allocating costs between oil and gas.

Once major gas sales begin, applying progressivity to oil only is generally expected to result in higher state revenues than a combined tax. This effect occurs for two reasons: first, oil has historically commanded a price premium to natural gas on an energy equivalency basis; and second, transportation costs are lower in percentage terms for oil than for natural gas, resulting in a higher wellhead value. The revenue impact will be a function of numerous variables including oil and gas prices and production, lease expenditures, and the method chosen for allocating lease expenditures between oil and natural gas.

There are some scenarios under which the state could see a reduction in revenues from this bill. Without a progressivity surcharge on natural gas, this bill could reduce state revenue if the price relationship between oil and natural gas normalized (on an energy equivalency basis) at a time when natural gas was selling at a relatively high price. Also, since this bill will generally increase taxes on the major producers, it is possible that the tax change could be viewed as a disincentive to oil and gas exploration and development.

#### Expenditures

With the change in tax structure the Department will need to change its monthly reporting forms, annual tax returns, and databases. The contractual services costs for programming changes to the online tax information system and the monthly reporting system are estimated at \$230,000. Aside from one-time costs, the provisions of this bill can be implemented using existing staff and resources.

#### Other Issues

This bill provides for an immediate effective date and the provisions are effective on the first day of the month following the effective date. Since the production tax is levied on an annual basis (payable in monthly installments), changing the tax calculations for only a portion of the tax year would create an additional burden with additional complexity for both the Department and the taxpayers for the 2010 tax year. Applying the tax change retroactive to January 1, 2010 would be preferred from a tax administration standpoint.

## Alaska Oil and Gas Association

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

March 28, 2010

TO: Members of the Senate Finance Committee

Re: DRAFT CSSB 305 (Work Draft P)

Dear Chairman Stedman and Members of the Committee:

The Alaska Oil and Gas Association (AOGA) is the private, nonprofit trade association for the oil and gas industry in Alaska, and our 14 members account for the majority of oil and gas activities in the state. We appreciate the opportunity to provide you with AOGA's concerns about the current Committee Substitute to Senate Bill 305.

In reviewing CSSB 305, our members considered whether the proposed legislation would improve the investment climate in Alaska, lead to more investment to help stem the annual oil production decline, simplify and add clarity to Alaska's complicated tax structure and whether it is something that should be enacted now. AOGA's 14 member companies unanimously agree that CSSB 305 fails all of those tests and thus should not be adopted.

I feel it is important that I reiterate AOGA's belief that the overall production tax structure in Alaska needs to be re-examined carefully. As we have stated many times before, our primary concern is that the tax rates under ACES are too high and place Alaska at a competitive disadvantage for oil industry investment. Based on the testimony you have heard this session and the Department of Revenue's own forecasts about expected future continuing decline in oil production and in projected industry investment, it is clear that a comprehensive evaluation and revision of ACES needs to be undertaken if it is to achieve the objective of providing Alaska jobs, increasing Alaska production and maximizing State revenues.

CSSB 305 proposes to alter Alaska's current production tax structure by removing the application of the progressivity tax to gas production, revenues and costs to avoid the potential for state revenue "dilution" when major gas sales are commingled with the oil stream. The impetus to pass this legislation this session appears to be driven by the AGIA provision that purports to provide gas tax fiscal certainty through a lock-in provision on May 1 to any company committing gas during the first open season. And that failure to address the dilution issue prior to that May 1 deadline might prohibit a future correction.

Without getting into the merits of whether such dilution will occur and if so to what extent, or whether any legislation needs to be passed prior to May 1 or not, we are concerned that the apparent rush to address this issue will yield a "fix" that will result in further complexity to Alaska's already complex production tax system and will lead to adverse unintended tax and administrative consequences, further

reducing an already shaky future investment climate—a potential result that neither the State of Alaska nor our industry can afford.

Potential changes to any tax regime need to be carefully considered and designed to ensure the desired objective of resource development is achieved. This is especially true for Alaska. It is our understanding that Attorney General Sullivan has provided counsel to the legislature that there is no need to rush into any legislative amendments prior to May 1 to address the dilution issue. If that is true, AOGA would recommend that advice be followed and sufficient time be allowed to fully examine the potential impacts and costs of CSSB 305.

Under CSSB 305, taxpayers would immediately be required to begin allocating costs between oil and gas long before any major gas development would necessitate that need. Currently the insignificant gas production occurring in the state, especially on the North Slope, does not justify compounding Alaska's already intricate production tax structure with more complexity or increasing tax and administrative costs by requiring lease expenditure allocations prior to major gas development.

Developing a cost allocation methodology is a highly complex issue. Determining the proper allocation methodology and understanding its potential impacts on the administration of and compliance with the underlying tax and on current and future investments is something that should be fully evaluated and studied. It is not something that should be legislatively required yet left to the discretion of the Department of Revenue to design and implement through regulations simply because insufficient time was allowed or spent to fully examine the issue and consider options and their impacts.

Currently, under AS 43.55.165(h), the Department of Revenue is authorized to develop, when needed, cost allocation methods to determine lease expenditures that are costs of exploring for, developing, or producing oil and gas deposits. If cost allocations are required prior to major gas development, how would costs associated for any lease or property (1) which contains both oil and gas, and (2) currently produces only oil (and possibly trace amounts of gas), be handled when the production of the oil provides information about the reservoir and its potential for major gas development? If, for example, current costs are required to be allocated to the gas reservoir prior to its development, would the costs create a current year loss which would then be converted into a tax credit in the next year allowable against current oil revenues? Or would the carry-forward loss tax credit be allowed only against future gas revenues, thereby diminishing the value of the credit and jeopardizing the decision to make the current investment that generated that credit?

How would cost allocations be determined and reported between an operator and non-operator of a lease or property? As you have heard in prior AOGA testimony, all the information a non-operator has about what's being spent for the operation of a lease or property is what it obtains from its billings from the operator, plus whatever it may learn by auditing those invoices. How would the cost allocation be made and who would determine, the operator or non-operator?

These are but a few of the questions and issues that need to be carefully considered before cost allocation is required, especially before major gas development. If, however, this Committee still believes it is necessary to pass CSSB 305 at this time and include cost allocations, AOGA would recommend you adopt BP's proposal, expressed in its letter to this Committee dated March 12 of this year, to defer the effective date of the cost allocations until commencement of major gas sale deliveries from the North Slope into a gas pipeline for shipment.

March 28, 2010

Page 3

This Committee adopted two amendments to CSSB 305 on March 18, 2010. The first provides a tax credit for any additional tax incurred before 2015 by a producer due to the decoupling of the oil and gas revenues. The second provides non-binding guidance to the Department of Revenue on a possible cost allocation methodology. Given our concerns on cost allocations as addressed above, we will only comment on the first amendment.

While AOGA opposes CSSB 305, we commend the intent behind amendment one to keep taxpayers whole from any increase in production taxes due to the decoupling. We offer two comments for the Committee to consider. First, why limit the tax credit to years before 2015? At a minimum, the tax credit should be extended to the later of commencement of major gas sales or 2022 to be consistent with the provisions of AS 43.55.011 (j), (k) and (o). Second, it is unclear how the language in the first sentence of the amendment that provides the tax credit to a person that produces oil and gas from a lease or property in the state would operate. Would this require the person to produce oil and gas from a lease or property to qualify for the tax credit or would the person need only produce oil or gas from a lease or property? Guidance from legislative legal could save future disputes.

Thank you again for the opportunity to provide comments CSSB 305.

Sincerely,

A handwritten signature in cursive script that reads "Marilyn Crockett".

MARILYN CROCKETT  
Executive Director

# FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

Fiscal Note Number: \_\_\_\_\_  
 Bill Version: CSSB 305  
 () Publish Date: \_\_\_\_\_

Identifier (file name): CS SB305-REV-TAX-03-16-10  
 Title: Separate Oil & Gas Production Tax  
 Sponsor: (S) Finance  
 Requester: (S) Finance  
 Dept. Affected: Revenue  
 RDU: Taxation and Treasury  
 Component: Tax Division  
 Component Number: 2476

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

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

OPERATING EXPENDITURES	Appropriation Required	Information					
	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Personal Services							
Travel							
Contractual	230.0						
Supplies							
Equipment							
Land & Structures							
Grants & Claims							
Miscellaneous							
<b>TOTAL OPERATING</b>	<b>230.0</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>							
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<b>CHANGE IN REVENUES</b>	**	0.0	**	**	**	**	**
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\*\* Significant Impact Beyond FY 2016 - See Analysis Section for Additional Information \*\*\*

FUND SOURCE	(Thousands of Dollars)						
1002 Federal Receipts							
1003 GF Match							
1004 GF	230.0	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
<b>TOTAL</b>	<b>230.0</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: 0.0

**POSITIONS**

Full-time	0.0	0.00	0	0	0	0	0
Part-time							
Temporary							

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

**Bill Language**

This bill separates oil and natural gas for purposes of calculating the progressivity portion of the production tax under AS 43.55. Under this bill, the progressivity surcharge is calculated on oil only instead of on oil and gas combined. The progressivity surcharge remains unchanged at 0.4% per \$1 of production tax value over \$30 per barrel, then 0.1% per \$1 of production tax value over \$92.50. Under this bill, natural gas is always taxed at 25% of production tax value with no progressivity surcharge.

Currently some companies have both oil sales from the North Slope and gas sales from Cook Inlet and elsewhere, both of which are included in their progressivity calculations that are applied to oil. By removing gas from the progressivity calculation these companies will likely face a higher tax rate and therefore an increase in tax liability. This bill contains no provisions that would offset any increase in tax from removing gas from the progressivity calculation. (continued)

Prepared by: Dan Stickel, Petroleum Economist  
 Division: Tax Division  
 Approved by: Ginger Blaisdell, Director  
Administrative Services Division

Phone 907-465-3279  
 Date/Time 03-15-10; 8:52pm  
 Date 03-16-10; 8:05am

## FISCAL NOTE

STATE OF ALASKA  
2010 LEGISLATIVE SESSION

BILL NO. CSSB 305

### ANALYSIS CONTINUATION

#### Revenues

The revenue impact of this bill is indeterminate for the time horizon of this fiscal note. The removal of gas from the progressivity calculation could potentially raise tax rates and increase tax for companies that currently produce both oil and gas (from Cook Inlet or elsewhere). The impact will vary from year to year; based on analysis of recent years the impact could range from tens of millions of dollars to over \$100 million. Most likely there will be an increase in tax liability and therefore revenue ranging from \$40 million to \$100 million per year.

Once major gas sales begin, applying progressivity to oil only is generally expected to result in higher state revenues than a combined tax. This effect occurs for two reasons: first, oil has historically commanded a price premium to natural gas on an energy equivalency basis; and second, transportation costs are lower in percentage terms for oil than for natural gas, resulting in a higher wellhead value. The revenue impact will be a function of numerous variables including oil and gas prices and production, lease expenditures, and the method chosen for allocating lease expenditures between oil and natural gas.

There are some scenarios under which the state could see a reduction in revenues from this bill. Without a progressivity surcharge on natural gas, this bill could reduce state revenue if the price relationship between oil and natural gas normalized at a time when natural gas was selling at a relatively high price. Also, since this bill will generally increase taxes on the major producers, it is possible that the tax change could be viewed as a disincentive to oil and gas exploration and development.

#### Expenditures

With the change in tax structure the Department will need to change its monthly reporting forms, annual tax returns, and databases. The contractual services costs for programming changes to the online tax information system and the monthly reporting system are estimated at \$230,000. Aside from one-time costs, the provisions of this bill can be implemented using existing staff and resources.

#### Other Issues

This bill provides for an immediate effective date. Since the production tax is levied on an annual basis (payable in monthly installments), the immediate effective date would create an additional burden with additional complexity for both the Department and the taxpayers for the 2010 tax year. An effective date retroactive to January 1, 2010 would be preferred from a tax administration standpoint.

3/18/10 pm  
adopted  
without  
objection

26-LS1577AS.2  
Bullock  
3/17/10

AMENDMENT 2

OFFERED IN THE SENATE

BY SENATOR STEDMAN

TO: CSSB 305(FIN), Draft Version "S"

1 Page 1, line 4, following "gas;":

2 Insert "relating to the allocation of lease expenditures and adjustments to lease  
3 expenditures;"

4  
5 Page 9, following line 21:

6 Insert a new bill section to read:

7 "\* Sec. 8. AS 43.55.165(h) is amended to read:

8 (h) The department shall adopt regulations that provide for reasonable  
9 methods of allocating costs between oil and gas, between gas subject to  
10 AS 43.55.011(o) and other gas, and between leases or properties in those  
11 circumstances where an allocation of costs is required to determine lease expenditures  
12 that are costs of exploring for, developing, or producing oil deposits or costs of  
13 exploring for, developing, or producing gas deposits, or that are costs of exploring for,  
14 developing, or producing oil or gas deposits located within different leases or  
15 properties. When determining a reasonable method of allocating lease  
16 expenditures between the production of oil and the production of gas, the  
17 department shall consider allocating lease expenditures in proportion to the BTU  
18 equivalent barrels of oil produced and gas produced from each lease or  
19 property."

20  
21 Renumber the following bill sections accordingly.

22

23 Page 9, line 31, following "properties.":

1           Insert "When determining a reasonable method of allocating the adjustments to a  
2 producer's lease expenditures between the production of oil and the production of gas, the  
3 department shall consider allocating the adjustments in proportion to the lease expenditures  
4 allocated to the production of oil and the production of gas under regulations adopted by the  
5 department under AS 43.55.165(h)."

6

7   Page 10, line 3:

8           Delete "Sections 1 - 8"

9           Insert "Sections 1 - 9"

3.18.10 pm  
adopted  
no objection

26-LS1577S.1  
Bullock  
3/13/10

AMENDMENT

1

OFFERED IN THE SENATE

BY SENATOR STEDMAN

TO: CSSB 305(FIN), Draft Version "S"

1 Page 3, following line 15:

2 Insert a new bill section to read:

3 **\*\* Sec. 5.** AS 43.55.011 is amended by adding a new subsection to read:

4 (p) Before January 1, 2015, a person that produces oil and gas from a lease or  
5 property in the state may claim an annual credit against the tax determined under (e) -  
6 (o) of this section in an amount equal to the difference between the tax amounts  
7 determined under (e) - (o) of this section and the tax amounts determined under (e) -  
8 (o) of this section as (e) - (o) of this section read before the effective date of this  
9 subsection. The amount of the credit may not be less than zero."

10

11 Renumber the following bill sections accordingly.

12

13 Page 10, line 3:

14 Delete "Sections 1 - 8"

15 Insert "Sections 1 - 9"

A dated  
3/18/10 PM

26-LS1577S  
Bullock  
3/13/10

**CS FOR SENATE BILL NO. 305(FIN)**

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-SIXTH LEGISLATURE - SECOND SESSION

BY THE SENATE FINANCE COMMITTEE

Offered:  
Referred:

Sponsor(s): SENATE FINANCE COMMITTEE

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to that part of the tax on oil and gas production that increases the rate  
2 of tax as the production tax value increases above \$30, eliminating the effect of gas  
3 production in the determination of that rate, and making that rate inapplicable to the  
4 production of gas; and providing for an effective date."

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

6 \* Section 1. AS 43.55.011(e) is amended to read:

7 (e) There is levied on the producer of oil or gas a tax for all oil and gas  
8 produced each calendar year from each lease or property in the state, less any oil and  
9 gas the ownership or right to which is exempt from taxation or constitutes a  
10 landowner's royalty interest. Except as otherwise provided under (f), (j), (k), and (o) of  
11 this section, the tax is equal to the sum of

12 (1) the annual production tax value of the taxable oil and gas as  
13 calculated under AS 43.55.160(a)(1) multiplied by 25 percent; and

14 (2) the sum, over all months of the calendar year, of the tax amounts

1 determined under (g) of this section on the production of oil.

2 \* Sec. 2. AS 43.55.011(g) is amended to read:

3 (g) For each month of the calendar year for which the producer's average  
4 monthly production tax value under AS 43.55.160(a)(2) of a [PER BTU  
5 EQUIVALENT] barrel of [THE] taxable oil [AND GAS] is more than \$30, the  
6 amount of tax for purposes of (e)(2) of this section is determined by multiplying the  
7 monthly production tax value of the taxable oil [AND GAS] produced during the  
8 month by the tax rate calculated as follows:

9 (1) if the producer's average monthly production tax value of a [PER  
10 BTU EQUIVALENT] barrel of [THE] taxable oil [AND GAS] for the month is not  
11 more than \$92.50, the tax rate is 0.4 percent multiplied by the number that represents  
12 the difference between the producer's [THAT] average monthly production tax value  
13 of a [PER BTU EQUIVALENT] barrel of oil and \$30; or

14 (2) if the producer's average monthly production tax value of a [PER  
15 BTU EQUIVALENT] barrel of [THE] taxable oil [AND GAS] for the month is more  
16 than \$92.50, the tax rate is the sum of 25 percent and the product of 0.1 percent  
17 multiplied by the number that represents the difference between the producer's  
18 average monthly production tax value of a [PER BTU EQUIVALENT] barrel of oil  
19 and \$92.50, except that the sum determined under this paragraph may not exceed 50  
20 percent.

21 \* Sec. 3. AS 43.55.011(j) is amended to read:

22 (j) For a calendar year before 2022, the tax levied by (e)(1) [(e)] of this section  
23 for gas produced from a lease or property in the Cook Inlet sedimentary basin may not  
24 exceed

25 (1) for a lease or property that first commenced commercial production  
26 of gas before April 1, 2006, the product obtained by multiplying (A) the amount of  
27 taxable gas produced during the calendar year from the lease or property, times (B) the  
28 average rate of tax that was imposed under this chapter for taxable gas produced from  
29 the lease or property for the 12-month period ending on March 31, 2006, times (C) the  
30 quotient obtained by dividing the total gross value at the point of production of the  
31 taxable gas produced from the lease or property during the 12-month period ending on

1 March 31, 2006, by the total amount of that gas;

2 (2) for a lease or property that first commences commercial production  
3 of gas after March 31, 2006, the product obtained by multiplying (A) the amount of  
4 taxable gas produced during the calendar year from the lease or property, times (B) the  
5 average rate of tax that was imposed under this chapter for taxable gas produced from  
6 all leases or properties in the Cook Inlet sedimentary basin for the 12-month period  
7 ending on March 31, 2006, times (C) the average prevailing value for gas delivered in  
8 the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by  
9 the department under AS 43.55.020(f).

10 \* Sec. 4. AS 43.55.011(o) is amended to read:

11 (o) Notwithstanding other provisions of this section, for a calendar year before  
12 2022, the tax levied under (e)(1) [(e)] of this section for each 1,000 cubic feet of gas  
13 for gas produced from a lease or property outside the Cook Inlet sedimentary basin  
14 and used in the state may not exceed the amount of tax for each 1,000 cubic feet of gas  
15 that is determined under (j)(2) of this section.

16 \* Sec. 5. AS 43.55.020(a) is amended to read:

17 (a) For a calendar year, a producer subject to tax under AS 43.55.011(e) - (i)  
18 shall pay the tax as follows:

19 (1) an installment payment of the estimated tax levied by  
20 AS 43.55.011(e), net of any tax credits applied as allowed by law, is due for each  
21 month of the calendar year on the last day of the following month; except as otherwise  
22 provided under (2) of this subsection, the amount of the installment payment is the  
23 sum of the following amounts, less 1/12 of the tax credits that are allowed by law to be  
24 applied against the tax levied by AS 43.55.011(e) for the calendar year, but the amount  
25 of the installment payment may not be less than zero:

26 (A) for oil and gas produced from leases or properties in the  
27 state outside the Cook Inlet sedimentary basin but not subject to  
28 AS 43.55.011(o), other than leases or properties subject to AS 43.55.011(f), the  
29 greater of

30 (i) zero; or

31 (ii) an amount equal to the sum of 25 percent and the

1 tax rate calculated for the month under AS 43.55.011(g) multiplied by  
2 the remainder obtained by subtracting 1/12 of the producer's adjusted  
3 lease expenditures for the calendar year of production applicable to  
4 the oil produced by the producer from those leases and properties  
5 under AS 43.55.165 and 43.55.170 that are deductible for the leases or  
6 properties under AS 43.55.160, from the gross value at the point of  
7 production of the oil [AND GAS] produced from the leases or  
8 properties during the month for which the installment payment is  
9 calculated; added to 25 percent of the remainder obtained by  
10 subtracting 1/12 of the producer's adjusted lease expenditures for  
11 the calendar year of production applicable to the gas produced by  
12 the producer from those leases and properties under AS 43.55.165  
13 and 43.55.170 that are deductible for the leases or properties under  
14 AS 43.55.160, from the gross value at the point of production of the  
15 gas produced from the leases or properties during the month for  
16 which the installment payment is calculated;

17 (B) for oil and gas produced from leases or properties subject  
18 to AS 43.55.011(f), the greatest of

19 (i) zero;

20 (ii) zero percent, one percent, two percent, three  
21 percent, or four percent, as applicable, of the gross value at the point of  
22 production of the oil and gas produced from all leases or properties  
23 during the month for which the installment payment is calculated; or

24 (iii) an amount equal to 25 percent of the remainder  
25 obtained by subtracting 1/12 of the producer's adjusted lease  
26 expenditures for the calendar year of production applicable to the  
27 gas produced by the producer from those leases and properties  
28 under AS 43.55.165 and 43.55.170 that are deductible for those  
29 leases or properties under AS 43.55.160, from the gross value at the  
30 point of production of the gas produced from those leases or  
31 properties during the month for which the installment payment is

1 calculated; added to the sum of 25 percent and the tax rate calculated  
2 for the month under AS 43.55.011(g) multiplied by the remainder  
3 obtained by subtracting 1/12 of the producer's adjusted lease  
4 expenditures for the calendar year of production applicable to the oil  
5 produced by the producer from those leases and properties under  
6 AS 43.55.165 and 43.55.170 that are deductible for those leases or  
7 properties under AS 43.55.160, from the gross value at the point of  
8 production of the oil [AND GAS] produced from those leases or  
9 properties during the month for which the installment payment is  
10 calculated;

11 (C) for oil and gas produced from each lease or property  
12 subject to AS 43.55.011(j), (k), or (o), the greater of

13 (i) zero; or

14 (ii) an amount equal to 25 percent of the remainder  
15 obtained by subtracting 1/12 of the producer's adjusted lease  
16 expenditures for the calendar year of production applicable to the  
17 gas produced by the producer from those leases and properties  
18 under AS 43.55.165 and 43.55.170 that are deductible for those  
19 leases or properties under AS 43.55.160, from the gross value at the  
20 point of production of the gas produced from those leases or  
21 properties during the month for which the installment payment is  
22 calculated; added to the sum of 25 percent and the tax rate calculated  
23 for the month under AS 43.55.011(g) multiplied by the remainder  
24 obtained by subtracting 1/12 of the producer's adjusted lease  
25 expenditures for the calendar year of production applicable to the oil  
26 produced by the producer from those leases and properties under  
27 AS 43.55.165 and 43.55.170 that are deductible under AS 43.55.160  
28 for oil [OR GAS, RESPECTIVELY,] produced from the lease or  
29 property, from the gross value at the point of production of the oil [OR  
30 GAS, RESPECTIVELY,] produced from the lease or property during  
31 the month for which the installment payment is calculated;

1 (2) an amount calculated under (1)(C) of this subsection for oil or gas  
2 produced from a lease or property subject to AS 43.55.011(j), (k), or (o) may not  
3 exceed the product obtained by carrying out the calculation set out in  
4 AS 43.55.011(j)(1) or (2) or 43.55.011(o), as applicable, for gas or set out in  
5 AS 43.55.011(k)(1) or (2), as applicable, for oil, but substituting in  
6 AS 43.55.011(j)(1)(A) or (2)(A) or 43.55.011(o), as applicable, the amount of taxable  
7 gas produced during the month for the amount of taxable gas produced during the  
8 calendar year and substituting in AS 43.55.011(k)(1)(A) or (2)(A), as applicable, the  
9 amount of taxable oil produced during the month for the amount of taxable oil  
10 produced during the calendar year;

11 (3) an installment payment of the estimated tax levied by  
12 AS 43.55.011(i) for each lease or property is due for each month of the calendar year  
13 on the last day of the following month; the amount of the installment payment is the  
14 sum of

15 (A) the applicable tax rate for oil provided under  
16 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
17 oil taxable under AS 43.55.011(i) and produced from the lease or property  
18 during the month; and

19 (B) the applicable tax rate for gas provided under  
20 AS 43.55.011(i), multiplied by the gross value at the point of production of the  
21 gas taxable under AS 43.55.011(i) and produced from the lease or property  
22 during the month;

23 (4) any amount of tax levied by AS 43.55.011(e) or (i), net of any  
24 credits applied as allowed by law, that exceeds the total of the amounts due as  
25 installment payments of estimated tax is due on March 31 of the year following the  
26 calendar year of production.

27 \* Sec. 6. AS 43.55.160(a) is amended to read:

28 (a) Except as provided in (b) of this section, for the purposes of

29 (1) AS 43.55.011(e), the annual production tax value of the taxable

30 (A) oil and gas produced during a calendar year from leases or  
31 properties in the state that include land north of 68 degrees North latitude is the

1 gross value at the point of production of the oil and gas taxable under  
2 AS 43.55.011(e) and produced by the producer from those leases or properties,  
3 less the producer's lease expenditures under AS 43.55.165 for the calendar year  
4 applicable to the oil and gas produced by the producer from those leases or  
5 properties, as adjusted under AS 43.55.170; this subparagraph does not apply  
6 to gas subject to AS 43.55.011(o);

7 (B) oil and gas produced during a calendar year from leases or  
8 properties in the state outside the Cook Inlet sedimentary basin, no part of  
9 which is north of 68 degrees North latitude, is the gross value at the point of  
10 production of the oil and gas taxable under AS 43.55.011(e) and produced by  
11 the producer from those leases or properties, less the producer's lease  
12 expenditures under AS 43.55.165 for the calendar year applicable to the oil and  
13 gas produced by the producer from those leases or properties, as adjusted under  
14 AS 43.55.170; this subparagraph does not apply to gas subject to  
15 AS 43.55.011(o);

16 (C) oil produced during a calendar year from a lease or  
17 property in the Cook Inlet sedimentary basin is the gross value at the point of  
18 production of the oil taxable under AS 43.55.011(e) and produced by the  
19 producer from that lease or property, less the producer's lease expenditures  
20 under AS 43.55.165 for the calendar year applicable to the oil produced by the  
21 producer from that lease or property, as adjusted under AS 43.55.170;

22 (D) gas produced during a calendar year from a lease or  
23 property in the Cook Inlet sedimentary basin is the gross value at the point of  
24 production of the gas taxable under AS 43.55.011(e) and produced by the  
25 producer from that lease or property, less the producer's lease expenditures  
26 under AS 43.55.165 for the calendar year applicable to the gas produced by the  
27 producer from that lease or property, as adjusted under AS 43.55.170;

28 (E) gas produced during a calendar year from a lease or  
29 property outside the Cook Inlet sedimentary basin and used in the state is the  
30 gross value at the point of production of that gas taxable under  
31 AS 43.55.011(e) and produced by the producer from that lease or property, less

1 the producer's lease expenditures under AS 43.55.165 for the calendar year  
2 applicable to that gas produced by the producer from that lease or property, as  
3 adjusted under AS 43.55.170;

4 (2) AS 43.55.011(g), the monthly production tax value of the taxable

5 (A) oil [AND GAS] produced during a month from leases or  
6 properties in the state that include land north of 68 degrees North latitude is the  
7 gross value at the point of production of the oil [AND GAS] taxable under  
8 AS 43.55.011(e) and produced by the producer from those leases or properties,  
9 less 1/12 of the producer's lease expenditures under AS 43.55.165 for the  
10 calendar year applicable to the oil [AND GAS] produced by the producer from  
11 those leases or properties, as adjusted under AS 43.55.170; [THIS  
12 SUBPARAGRAPH DOES NOT APPLY TO GAS SUBJECT TO  
13 AS 43.55.011(o);]

14 (B) oil [AND GAS] produced during a month from leases or  
15 properties in the state outside the Cook Inlet sedimentary basin, no part of  
16 which is north of 68 degrees North latitude, is the gross value at the point of  
17 production of the oil [AND GAS] taxable under AS 43.55.011(e) and produced  
18 by the producer from those leases or properties, less 1/12 of the producer's  
19 lease expenditures under AS 43.55.165 for the calendar year applicable to the  
20 oil [AND GAS] produced by the producer from those leases or properties, as  
21 adjusted under AS 43.55.170; [THIS SUBPARAGRAPH DOES NOT APPLY  
22 TO GAS SUBJECT TO AS 43.55.011(o);]

23 (C) oil produced during a month from a lease or property in the  
24 Cook Inlet sedimentary basin is the gross value at the point of production of  
25 the oil taxable under AS 43.55.011(e) and produced by the producer from that  
26 lease or property, less 1/12 of the producer's lease expenditures under  
27 AS 43.55.165 for the calendar year applicable to the oil produced by the  
28 producer from that lease or property, as adjusted under AS 43.55.170 [;

29 (D) GAS PRODUCED DURING A MONTH FROM A  
30 LEASE OR PROPERTY IN THE COOK INLET SEDIMENTARY BASIN IS  
31 THE GROSS VALUE AT THE POINT OF PRODUCTION OF THE GAS

1 TAXABLE UNDER AS 43.55.011(e) AND PRODUCED BY THE  
2 PRODUCER FROM THAT LEASE OR PROPERTY, LESS 1/12 OF THE  
3 PRODUCER'S LEASE EXPENDITURES UNDER AS 43.55.165 FOR THE  
4 CALENDAR YEAR APPLICABLE TO THE GAS PRODUCED BY THE  
5 PRODUCER FROM THAT LEASE OR PROPERTY, AS ADJUSTED  
6 UNDER AS 43.55.170;

7 (E) GAS PRODUCED DURING A MONTH FROM A  
8 LEASE OR PROPERTY OUTSIDE THE COOK INLET SEDIMENTARY  
9 BASIN AND USED IN THE STATE IS THE GROSS VALUE AT THE  
10 POINT OF PRODUCTION OF THAT GAS TAXABLE UNDER  
11 AS 43.55.011(e) AND PRODUCED BY THE PRODUCER FROM THAT  
12 LEASE OR PROPERTY, LESS 1/12 OF THE PRODUCER'S LEASE  
13 EXPENDITURES UNDER AS 43.55.165 FOR THE CALENDAR YEAR  
14 APPLICABLE TO THAT GAS PRODUCED BY THE PRODUCER FROM  
15 THAT LEASE OR PROPERTY, AS ADJUSTED UNDER AS 43.55.170].

16 \* **Sec. 7.** AS 43.55.160(c) is amended to read:

17 (c) Notwithstanding any contrary provision of AS 43.55.150, for purposes of  
18 calculating a monthly production tax value under (a)(2) of this section, the gross value  
19 at the point of production of the oil [AND GAS] is calculated under regulations  
20 adopted by the department that provide for using an appropriate monthly share of the  
21 producer's costs of transportation for the calendar year.

22 \* **Sec. 8.** AS 43.55.170 is amended by adding a new subsection to read:

23 (d) The department shall adopt regulations that provide for reasonable  
24 methods of allocating the adjustments to a producer's lease expenditures in (a) of this  
25 section and the payments and credits described in (b) of this section between oil and  
26 gas, between gas subject to AS 43.55.011(o) and other gas, and between leases or  
27 properties in those circumstances where an allocation of costs is required to determine  
28 lease expenditures that are costs of exploring for, developing, or producing oil  
29 deposits, or costs of exploring for, developing, or producing gas deposits, or that are  
30 costs of exploring for, developing, or producing oil or gas deposits located within  
31 different leases or properties.

1     \* **Sec. 9.** The uncodified law of the State of Alaska is amended by adding a new section to  
2 read:

3             **APPLICABILITY.** Sections 1 - 8 of this Act are applicable on and after the first day  
4 of the calendar month immediately following the effective date of this Act.

5     \* **Sec. 10.** This Act takes effect immediately under AS 01.10.070(c).

**SB 305:**  
**The Separation of Oil from Gas**  
**for the Oil & Gas Production Tax**

Logsdon & Associates

March 9, 2010

## Premise of the Bill

- Under current law oil and gas are taxed together
- Oil is worth much more than gas
- The combining mechanism materially reduces oil taxes even though oil operations are unaffected

# Oil is Different than Gas

- Oil more geographically concentrated (fewer sellers: OPEC)
- Oil supplies more depleted
- Gas is more plentiful
- Oil has fewer substitutes
- Gas has more substitutes

# BTU 10:1

## West Coast ANS

- Market Price \$80/bbl
- Less:
  - Shipping \$2.07
  - TAPS \$4.18
- Gross Value \$73.75

## North Slope Gas

- Market Price \$6/mmbtu
- Less:
  - Tariff AK to AB \$3.54
  - AB Hub \$0.24
  - Tariff AB to L48 \$0.85
- Gross Value \$1.37/mmbtu
- BOE Basis (X 5.5) = \$7.54
- On a straight BTU to BTU basis oil is worth nearly 10 X as much as gas

## Some Things that have BTUs

- Oil
- Gas
- Coal
- Wood
- Asphalt
- Shoe Leather
- Rubber
- Coffee grounds
- Citrus rinds
- Corn cobs
- Dung

## Mechanics of Current Tax

- 1) Oil gross value (market price less transport cost)
- 2) Gas gross value (market price less transport cost)
- 3) Oil + gas gross value = Combined gross value
- 4) Combined gross value – lease capital and operating costs = Combined oil & gas net value
- 5) Combined oil & gas net value / total oil & gas BOEs = p/BOE net value (see Slide #6)
- 6) Progressivity factor (based on per BOE net value) plus 25% base rate = tax rate
- 7) Single tax rate applied to combined oil & gas net value

## Barrel of Oil Equivalents (BOEs):

### Putting Oil & Gas on an Apples / Apples Basis

- 4.5 billion cubic feet per day (bcf/d) of natural gas
- A cubic foot of North Slope gas will have about 1,100 BTUs
- Natural gas is measured in millions of BTUs (mmbtu)
- 4.5 billion cubic feet per day will have 4.95 million mmbtu's (4.5 X 1,100)
- A barrel of oil has about 5,500 BTUs
- 4.5 billion cubic feet per day will have the BTU equivalence of 900,000 barrels of oil (BOEs) (4,950,000 / 5.5)
- If there are 500,000 barrels of oil, total BOEs will total 500,000 + 900,000 = 1,400,000

## Progressivity Mechanics

- “Trigger” = \$30 net / BOE value
- “Slope” = 0.4%\*
- Progressivity surcharge = (Net per BOE value - \$30) X .004
- Example: if net value = \$50
  - Base tax rate = 25%
  - Progressivity =  $(\$50 - \$30) \times .004 = 8\%$
  - Total tax of 33% on net value

\* Slope changes to 0.1% after \$92.50 net per BOE value

## HOW GAS IMPACTS OIL TAXES

	Oil	Gas	Combined Oil & Gas
	Alone		
	(p/bbl)	(p/mmbtu)	
Market Price	\$80.00	\$6.00	Oil
Transp cost	\$5.00	\$4.50	p/bbl net value
Gross Value	\$75.00	\$1.50	Barrels (millions)
			Total oil net value (\$mm)
Costs	\$20.00	\$0.50	Gas
			p/mmbtu net value
Net (p/barrel or p/mmbtu)	\$55.00	\$1.00	mmbtu's (millions)
			Total gas net value (\$mm)
Base rate	25.00%		
Progressivity	10.00%		Total oil & gas net value
Total tax rate	35.00%		Total BOEs
			Net value / BOE
Daily bbls (oil) or mmbtu (gas)	500,000	4,950,000	NO PROGRESSIVITY!
Daily BOEs	500,000	900,000	
Annual BOEs (millions)	183	329	
			\$55.00
			183
			\$10,038
			\$1.00
			1,807
			\$1,807
			\$11,844
			511
			\$23.18

**DEPARTMENT OF REVENUE EXAMPLES  
FROM FEBRUARY 24, 2010 PRESENTATION  
TO SENATE FINANCE  
"Progressivity Profitability Parity Gas"**

Oil Price	Gas Price	Oil Alone Progressivity Factor	Oil & Gas Combined Progressivity Factor	Reduction in Progressivity Factor	Oil Alone Tax (\$billions)	Oil Alone Tax (\$billions)	Gas Alone Tax (\$billions)	Total Tax if Taxed Separately (\$billions)	Combined Tax (\$billions)	Annual Tax Reduction from Combining (\$billions)
\$75	\$8.00	5.38%	0.00%	5.38%	\$1.7	\$1.1	\$1.1	\$2.8	\$2.5	\$0.3
\$100	\$8.00	15.38%	3.59%	11.79%	\$4.0	\$1.1	\$1.1	\$5.1	\$4.0	\$1.1
\$120	\$8.00	23.38%	6.79%	16.59%	\$6.4	\$1.1	\$1.1	\$7.5	\$5.5	\$2.0

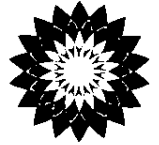
## How the Bill Works

- Under the current law there is a base tax rate of 25%
  - Plus progressivity based on the combined oil & gas net value / BOE
- The bill removes progressivity on gas
- Progressivity on oil continues to be calculated just on oil net value / barrel
- Exclusion of gas in the progressivity calculation does not reduce oil taxes

Bill Section	Change	Notes
	<p><b>“An Act relating to the tax on oil and gas production; and providing for an effective date.”</b></p>	<p>The Bill is intended to separate oil and gas production into two separate substances for purposes of the oil and gas production tax ACES AS 43.55</p>
<p><b>Sec. 1.</b></p>	<p><b>AS 43.55.011(e)(2)</b> Adds language that specifically identifies the production of oil for progressivity rate purposes</p>	<p>Section (e) defines a base tax rate of 25% and a progressivity surcharge defined in Section (g). Progressivity only applies to oil.</p>
<p><b>Sec. 2.</b></p>	<p><b>AS 43.55.011(g)</b> The language referring to gas and its per BTU equivalent is removed to isolate the progressive rate tax calculation for oil. <b>AS 43.55.011(g)(1)</b> The language referring to gas and its per BTU equivalent is removed to apply the progressive rate calculation only to oil with a progressive rate of an additional 0.4% for each \$/bbl above \$30 up to \$92.50 per barrel. <b>AS 43.55.011(g)(2)</b> The same changes are made in this subsection as in AS 43.55.011(g) (1) eliminating references to gas and per BTU equivalent to calculate the progressive rate for net production values greater than \$92.50 at the rate of an additional 0.1%</p>	<p>This isolates the progressive tax rate calculation to apply to oil not gas.</p> <p>Since gas has been deleted from the calculation of the progressive rate, the rate on gas is set at 25% as set out in AS 43.55.011(e)(1)</p>
<p><b>Sec. 3.</b></p>	<p><b>AS 43.55.011(j)</b> In comparing the lower of Sec. (e) tax and ELF tax for Cook Inlet production, progressivity does not apply for gas.</p>	<p>This change serves to make the comparison between the old ELF tax for gas and a tax on the net production value of gas multiplied by 25%</p>

Bill Section	Change	Notes
Sec. 4.	<b>AS 43.011(o)</b> Same as Sec.3 for non-Cook Inlet gas used in-state.	This change serves to preserve the ELF limitation of the tax for gas developed outside the Cook Inlet before 2022 and used in State.
Sec. 5.	<b>AS43.55.020(a)(1)</b> The monthly installment payments for gas does not include a progressivity component	All other segregated leases or properties defined in statute only have a progressivity rate for oil
Sec. 6.	<b>AS 43.55.160(a)(2)</b> Monthly production tax values for deriving progressivity apply only to oil. (A) Applies only to North Slope oil (B) Applies only to Outside Cook inlet not North Slope Oil	
Sec. 7.	<b>AS 43.55.160(c)</b> Calculating the monthly share of the producers's costs of transportation for the calendar year for deriving production tax value for progressivity is for only oil.	
Sec. 8	<b>Takes effect immediately under AS 01.10.070(c)</b>	The bill takes effect after the governor's signature or the day after the expiration period on gubernatorial action.

bp



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March 12, 2010

Senator Bert Stedman, Co-Chair  
Senate Finance Committee  
State Capitol, Room 516  
Juneau, AK 99501

Re: Senate Bill 305

Dear Senator Stedman:

Please accept my apologies for being out of state and unable to return to Juneau in time for the Senate Finance Committee's hearing today on SB 305. I hope, though, that you and the Committee will receive this letter in time for your consideration of the Bill.

Our understanding of SB 305 is that it would determine the taxable net "production tax value" for oil under AS 43.55.160 of ACES separately from that for gas, so that the respective production-tax values would then be taxed separately as well. We further understand that the stimulus for this decoupling is concern that tax revenues under the present version of ACES could be materially reduced when major gas sales begin from the North Slope into a gas pipeline. Specifically, the concern is that the gross netback value for major North Slope gas sales into a pipeline may initially be significantly less on a BTU-equivalent barrel basis than the gross netback value per barrel for oil.

All other things being equal, such a development could indeed reduce state revenues under ACES. But not all other things will be equal. Major gas sales would also greatly increase the number of BTU-equivalent over which the deductible lease expenditures are spread, thereby significantly reducing the deductible cost per BTU-equivalent barrel. State revenues under ACES would decrease only if the reduction in gross netback value per Btu-equivalent barrel is greater than the offsetting reduction in deductible costs per Btu-equivalent barrel. State revenues could actually increase under the current version of ACES if the reduction in cost per barrel is greater than the reduction in netback per barrel.

Our concern with SB 305 as it now reads is that, in addressing this potential problem that may arise a decade from now, it would come into effect today and require allocation of costs between oil and gas long before the potential risk it addresses could begin to materialize. SB 305 does not change the present rule in AS 43.55.011(o) that North Slope gas sold for in-state consumption is taxed under a tax cap similar to the cap for Cook Inlet production. So the allocation of costs under SB 305 would only be for gas that is already capped under AS 43.55.011(o) or any small sales that don't qualify under section .011(o). Allocation threatens to make a mountain out of a molehill because the change in gas taxes due to cost allocation during the coming decade will be tiny relative to the tax when major gas sales begin, but the Department of Revenue will have to apply the allocation rules with strictest rigor lest it create a bad precedent for the major gas sales.

Senator Bert Stedman, Chair  
Senate Finance Committee  
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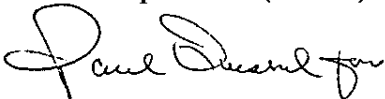
We understand that the impetus for enacting SB 305 this session is to avoid locking in the risk under the present law that major North Slope gas sales could materially reduce the overall tax under ACES. But we see a straightforward way to achieve that without all the problems and disputes that will arise by allocating costs to gas now. The solution is to add a Bill Section that defers the effective date for Sections 1 – 7 of SB 305 to the start of major gas sale deliveries from the North Slope into a gas pipeline for shipment. The Bill Section making such a deferral would be on the books as of the tax lock-in date and would thus be part of “the gas production tax in effect at the start of the first binding open season held under this chapter” for purposes of AS 43.90.320 — especially if the Committee adopts a letter of intent (or adds a statement of intent as a section of SB 305 itself) that specifically declares the deferred-effective-date provision to be part of the “tax in effect” as of that date for lock-in purposes. In other words, the substance in SB 305 could be locked in as of this year for AGIA purposes without triggering prematurely all the disputes and difficulties over allocating costs to gas before production for major North Slope gas sales begins.

Finally, whether or not you adopt our suggestion of deferring the effective date for decoupling, we would also ask that you not follow the pattern used during the ACES debate, where significant matters were left to the determination of the Department of Revenue. SB 305 currently uses the term “applicable to” to describe the allocation of lease expenditures between oil and gas. Such a broad term does not provide the industry or the Department of Revenue enough guidance of the legislative intent. There are instances already in use and available in the tax arena to model an allocation between oil and gas. For instance, ACES uses “BTU equivalent barrels” as a method to determine gas production in oil-equivalent terms in AS 43.55.024(c), the phase-out of the small-producer tax credit. Or, if you prefer, the allocation could be done on a basis of relative volumes as determined for the “extraction factor” in AS 43.55.072(f) for the oil and gas corporate income tax. The point is, no matter what cost allocation is performed for decoupling, you should make your choice clear in the Bill because that will clarify the obligation that taxpayers are held to, reducing latitude for argument about what compliance requires and making it easier for the Department of Revenue to enforce.

Thank you for your consideration of these comments.

Sincerely,

BP Exploration (Alaska) Inc.



Claire Fitzpatrick  
Senior Vice President

cc: Senate Finance Committee  
House Resources Committee