

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3098

1 during a calendar year to less than 80 percent of the tax that would otherwise be due  
2 without applying that credit. Any portion of a credit not used under this subsection  
3 may be applied in a later period.

4 (f) The issuance of a transferable tax credit certificate under (d) of this section  
5 does not limit the department's ability to later investigate or audit a tax credit claim to  
6 which the certificate relates or to adjust or deny the claim if the department determines  
7 that the applicant was not entitled to the amount of the credit for which the certificate  
8 was issued. The tax liability of the applicant under AS 43.55.011(e) and 43.55.017 -  
9 43.55.170 is increased by the amount of the credit that exceeds that to which the  
10 applicant was entitled. That amount bears interest under AS 43.05.225 from the date  
11 the transferable tax credit certificate was issued. For purposes of this subsection, an  
12 applicant that is an explorer is considered a producer subject to the tax levied under  
13 AS 43.55.011(e).

14 (g) The department may adopt regulations to carry out the purposes of this  
15 section, including prescribing reporting, record keeping, and certification procedures  
16 and requirements to verify the accuracy of credits claimed and to ensure that a credit is  
17 not used more than once, and otherwise implementing this section.

18 (h) A person may not elect to take a tax credit under (a) or (i) of this section  
19 for an expenditure incurred to acquire an asset (1) the cost of previously acquiring  
20 which was a lease expenditure under AS 43.55.160(c) or would have been a lease  
21 expenditure under AS 43.55.160(c) if it had been incurred on or after July 1, 2006; or  
22 (2) that has previously been placed in service in the state. An expenditure to acquire an  
23 asset is not excluded under this subsection if not more than an immaterial portion of  
24 the asset meets a description under (1) or (2) of this subsection. For purposes of this  
25 subsection, "asset" includes geological, geophysical, and well data and interpretations.

26 (i) For the purposes of this section,

27 (1) a producer's transitional investment expenditures are the sum of the  
28 expenditures the producer incurred on or after July 1, 2001, and before July 1, 2006,  
29 that would be qualified capital expenditures if they were incurred on or after July 1,  
30 2006, less the sum of the payments or credits the producer received before July 1,  
31 2006, for the sale or other transfer of assets, including geological, geophysical, or well

1 data or interpretations, acquired by the producer as a result of expenditures the  
2 producer incurred before July 1, 2006, that would be qualified capital expenditures, if  
3 they were incurred on or after July 1, 2006;

4 (2) a producer may elect to take a tax credit against a tax due under  
5 AS 43.55.011(e) in the amount of 20 percent of the producer's transitional investment  
6 expenditures, but only to the extent that the amount does not exceed

7 (A) one-half of the producer's qualified capital expenditures  
8 that are incurred during the month for which the credit is taken, if the producer  
9 does not make an election under AS 43.55.160(f);

10 (B) 1/24 of the producer's qualified capital expenditures that  
11 are incurred during the calendar year that includes the month for which the  
12 credit is taken, if the producer makes an election under AS 43.55.160(f);

13 (3) a producer may not take a tax credit for a transitional investment  
14 expenditure

15 (A) in any month that ends after June 30, 2013;

16 (B) more than once; or

17 (C) if a credit for that expenditure was taken under  
18 AS 43.55.025;

19 (4) notwithstanding (d) - (f) of this section, a producer may not transfer  
20 a tax credit or obtain a transferable tax credit certificate for a transitional investment  
21 expenditure.

22 (j) In this section, "qualified capital expenditure" means, except as otherwise  
23 provided in (h) of this section, an expenditure that is a lease expenditure under  
24 AS 43.55.160 and is

25 (1) incurred for geological or geophysical exploration; or

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

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

31 (B) eligible to be deducted as an expense under 26 U.S.C.

1 263(c) (Internal Revenue Code), as amended.

2 \* Sec. 13. AS 43.55.025(a) is amended to read:

3 (a) Subject to the terms and conditions of this section, [ON OIL AND GAS  
4 PRODUCED ON OR AFTER JULY 1, 2004, FROM AN OIL AND GAS LEASE,  
5 OR ON GAS PRODUCED FROM A GAS ONLY LEASE,] a credit against the  
6 production tax due under AS 43.55.011(e) [THIS CHAPTER] is allowed for  
7 exploration expenditures that qualify under (b) of this section in an amount equal to  
8 one of the following:

9 (1) 20 percent of the total exploration expenditures that qualify only  
10 under (b) and (c) of this section;

11 (2) 20 percent of the total exploration expenditures for work performed  
12 before July 1, 2007, and that qualify only under (b) and (d) of this section;

13 (3) 40 percent of the total exploration expenditures that qualify under  
14 (b), (c), and (d) of this section; or

15 (4) 40 percent of the total exploration expenditures that qualify only  
16 under (b) and (e) of this section.

17 \* Sec. 14. AS 43.55.025(b) is amended to read:

18 (b) To qualify for the production tax credit under (a) of this section, an  
19 exploration expenditure must be incurred for work performed on or after July 1, 2003,  
20 and before July 1, 2016 [2007], except that an exploration expenditure for a Cook Inlet  
21 prospect must be incurred for work performed on or after July 1, 2005, [AND  
22 BEFORE JULY 1, 2010, AND EXCEPT THAT AN EXPLORATION  
23 EXPENDITURE, IN WHOLE OR IN PART, SOUTH OF 68 DEGREES, 15  
24 MINUTES, NORTH LATITUDE, AND NOT PART OF A COOK INLET  
25 PROSPECT MUST BE INCURRED FOR WORK PERFORMED ON OR AFTER  
26 JULY 1, 2003, AND BEFORE JULY 1, 2010,] and

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

29 (2) if for an exploration well,

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

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

2 and

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

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

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

16 \* Sec. 15. AS 43.55.025(f) is amended to read:

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

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

22 (2) an explorer shall agree, in writing,

23 (A) to notify the Department of Natural Resources, within 30  
24 days after completion of seismic or geophysical data processing, completion of  
25 a well, or filing of a claim for credit, whichever is the latest, for which  
26 exploration costs are claimed, of the date of completion and submit a report to  
27 that department describing the processing sequence and providing a list of data  
28 sets available; if, under (c)(2)(B) of this section, an explorer submits a claim  
29 for a credit for expenditures for an exploration well that is located within three  
30 miles of a well already drilled for oil and gas, in addition to the submissions  
31 required under (1) of this subsection, the explorer shall submit the information

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necessary for the commissioner of natural resources to evaluate the validity of the explorer's claim that the well is directed at a distinctly separate exploration target, and the commissioner of natural resources shall, upon receipt of all evidence sufficient for the commissioner to evaluate the explorer's claim, make that determination within 60 days;

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

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

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

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

(5) if the department is satisfied that the explorer's claimed expenditures are qualified under this section, the department shall issue to the explorer a production tax credit certificate for the amount of credit to be allowed against production taxes due under AS 43.55.011(e) [THIS CHAPTER]; however, notwithstanding any other provision of this section, after the end of the calendar year following the calendar year in which the total of production tax credit certificates issued by the department under this section based on exploration expenditures for Cook Inlet prospects reaches \$20,000,000, the department may not issue to an explorer a production tax credit certificate [IF THE TOTAL OF PRODUCTION TAX CREDITS SUBMITTED FOR COOK INLET PRODUCTION,] based on an exploration expenditure for a Cook Inlet prospect [EXPENDITURES FOR WORK PERFORMED DURING THE PERIOD DESCRIBED IN (b) OF THIS SECTION FOR THAT PRODUCTION, THAT HAVE

1 BEEN APPROVED BY THE DEPARTMENT EXCEEDS \$20,000,000].

2 \* Sec. 16. AS 43.55.025(h) is amended to read:

3 (h) A producer that purchases a production tax credit certificate may apply the  
4 credits against its production tax liability under AS 43.55.011(e) [THIS CHAPTER].  
5 Regardless of the price the producer paid for the certificate, the producer may receive  
6 a credit against its production tax liability for the full amount of the credit, but for not  
7 more than the amount for which the certificate is issued. A production tax credit  
8 allowed under this section may not be applied more than once.

9 \* Sec. 17. AS 43.55.025(i) is amended to read:

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

11 (1) the amount of the credit that may be applied against the production  
12 tax for each tax month may not exceed the total production tax liability under  
13 AS 43.55.011(e) of the taxpayer applying the credit for the same month; and

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

18 \* Sec. 18. AS 43.55.030(a) is amended to read:

19 (a) The tax shall be paid to the department, and the person paying the tax shall  
20 file with the department at the time the tax or a portion of the tax is required to be  
21 paid a statement, under oath, on forms prescribed by or acceptable to the department,  
22 giving, with other information required, the following:

23 (1) a description of each [THE] lease or property from which the oil  
24 and [OR] gas were [WAS] produced, by name, legal description, lease number, or  
25 [BY] accounting codes [CODE NUMBERS] assigned by the department;

26 (2) the names of the producer and the person paying the tax;

27 (3) the gross amount of oil and the gross amount of [OR] gas  
28 produced from each [THE] lease or property, and the percentage of the gross amount  
29 of oil and gas owned by each producer for whom the tax is paid;

30 (4) the gross [TOTAL] value at the point of production of the oil  
31 and of the [OR] gas produced from each [THE] lease or property owned by each

1 producer for whom the tax is paid; [AND]

2 (5) the name of the first purchaser and the price received for the oil  
3 and for the [OR] gas, unless relieved from this requirement in whole or in part by  
4 the department; and

5 (6) the producer's lease expenditures and adjustments as  
6 calculated under AS 43.55.160 [IF SOLD IN THE STATE].

7 \* Sec. 19. AS 43.55.030(d) is amended to read:

8 (d) Reports by or on behalf of the producer are delinquent the first day  
9 following the day the tax is due. [EACH PRODUCER IS SUBJECT TO A PENALTY  
10 OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH THE  
11 REPORT IS NOT FILED. THE PENALTY FOR FAILURE TO FILE A REPORT IS  
12 IN ADDITION TO THE PENALTY FOR DELINQUENT TAXES, AND IS A LIEN  
13 AGAINST THE ASSETS OF THE PRODUCER.]

14 \* Sec. 20. AS 43.55.030 is amended by adding a new subsection to read:

15 (e) In addition to other required information, the statement required to be filed  
16 on or before March 31 of a year must show any adjustments or corrections to the  
17 statements that were required under (a) of this section to be filed for the months of the  
18 preceding calendar year during which the oil or gas was produced.

19 \* Sec. 21. AS 43.55.040 is amended to read:

20 **Sec. 43.55.040. Powers of Department of Revenue.** Except as provided in  
21 AS 43.05.405 - 43.05.499, the department may

22 (1) require a person engaged in production and the agent or employee  
23 of the person, and the purchaser of oil or gas, or the owner of a royalty interest in oil  
24 or gas to furnish, whether by the filing of regular statements or reports or  
25 otherwise, additional information that is considered by the department as necessary to  
26 compute the amount of the tax; notwithstanding any contrary provision of law, the  
27 disclosure of additional information under this paragraph to the producer  
28 obligated to pay the tax does not violate AS 40.25.100(a) or AS 43.05.230(a);  
29 before disclosing information under this paragraph that is otherwise required to  
30 be held confidential under AS 40.25.100(a) or AS 43.05.230(a), the department  
31 shall

1                   (A) provide the person that furnished the information a  
2                   reasonable opportunity to be heard regarding the proposed disclosure and  
3                   the conditions to be imposed under (B) of this paragraph; and

4                   (B) impose appropriate conditions limiting

5                   (i) access to the information to those legal counsel,  
6                   consultants, employees, officers, and agents of the producer who  
7                   have a need to know that information for the purpose of  
8                   determining or contesting the producer's tax obligation; and

9                   (ii) the use of the information to use for that  
10                  purpose;

11                  (2) examine the books, records, and files of such a person;

12                  (3) conduct hearings and compel the attendance of witnesses and the  
13                  production of books, records, and papers of any person; and

14                  (4) make an investigation or hold an inquiry that is considered  
15                  necessary to a disclosure of the facts as to

16                               (A) the amount of production from any oil or gas location, or of  
17                               a company or other producer of oil or gas; and

18                               (B) the rendition of the oil and gas for taxing purposes.

19       \* Sec. 22. AS 43.55.080 is amended to read:

20                   Sec. 43.55.080. Collection and deposit of revenue. Except as otherwise  
21                   provided under art. IX, sec. 17, Constitution of the State of Alaska, the [THE]  
22                   department shall deposit in the general fund the money collected by it under  
23                   AS 43.55.011 - 43.55.170 [AS 43.55.011 - 43.55.150].

24       \* Sec. 23. AS 43.55.135 is amended to read:

25                   Sec. 43.55.135. Measurement. For the purposes of AS 43.55.011 - 43.55.170  
26                   [AS 43.55.011 - 43.55.150], oil is [SHALL BE] measured in terms of a "barrel of oil"  
27                   and gas is [SHALL BE] measured in terms of a "cubic foot of gas."

28       \* Sec. 24. AS 43.55.150(a) is amended to read:

29                   (a) For the purposes of AS 43.55.011 - 43.55.170 [AS 43.55.011 - 43.55.150],  
30                   the gross value at the point of production is [SHALL BE] calculated using the  
31                   reasonable costs of transportation of the oil or gas. The reasonable costs of

1 transportation are [SHALL BE] the actual costs, except when the

2 (1) [WHEN THE] parties to the transportation of oil or gas are  
3 affiliated;

4 (2) [WHEN THE] contract for the transportation of oil or gas is not an  
5 arm's length transaction or is not representative of the market value of that  
6 transportation;

7 (3) [WHEN THE] method of transportation of oil or gas is not  
8 reasonable in view of existing alternative methods of transportation.

9 \* Sec. 25. AS 43.55.150 is amended by adding a new subsection to read:

10 (d) Under regulations adopted by the department, if the department determines  
11 that an election under this subsection would improve the efficiency and economy of  
12 tax administration and would result in calculations that represent value and actual  
13 costs of transportation with reasonable accuracy and are not biased toward  
14 understating a producer's tax liability, the department may allow a producer, subject to  
15 limitations prescribed by the department as to the frequency of making elections, to  
16 elect prospectively to calculate the gross value at the point of production of oil or gas  
17 based in whole or part on

18 (1) a formula prescribed by the department that uses, with adjustments  
19 if appropriate, a royalty value or valuation methodology accepted by the

20 (A) Department of Natural Resources under AS 38.05, in the  
21 case of oil or gas produced from a lease issued by the Department of Natural  
22 Resources or produced from a lease or property that is part of a unit approved  
23 by the Department of Natural Resources; or

24 (B) United States Department of the Interior under applicable  
25 federal oil and gas leasing statutes, in the case of oil or gas produced from a  
26 lease issued by the United States Department of the Interior that is not part of a  
27 unit approved by the Department of Natural Resources, or produced from a  
28 lease or property that is part of a unit approved by the United States  
29 Department of the Interior but not approved by the Department of Natural  
30 Resources; or

31 (2) another formula prescribed by the Department of Revenue that

1 reasonably estimates a value for the oil or gas at a specific geographical location, such  
2 as the point of tender or delivery into a common carrier pipeline; the formula may use  
3 factors such as published price indices for oil or gas in or outside the state, quality  
4 differentials for oil or gas, transportation costs between markets, and inflation  
5 adjustments.

6 \* **Sec. 26.** AS 43.55 is amended by adding new sections to article 1 to read:

7 **Sec. 43.55.160. Determination of production tax value of oil and gas.** (a)

8 Except as provided in (f) of this section, for purposes of AS 43.55.011(e) and (g), the  
9 production tax value of the taxable oil and gas produced during a month is the total of  
10 the gross value at the point of production of the oil and one-third of the gross value at  
11 the point of production of the gas that are taxable under AS 43.55.011(e) and (g) and  
12 produced by the producer from all leases or properties in the state, less the producer's  
13 lease expenditures for the month as adjusted under (e) of this section. However, the  
14 production tax value calculated under this subsection may not be less than zero. If a  
15 producer does not produce taxable oil or gas during a month, the producer is  
16 considered to have generated a positive production tax value if the calculation  
17 described in this subsection yields a positive number because the producer's adjusted  
18 lease expenditures for a month are less than zero as a result of the producer's receiving  
19 a payment or credit under (e) of this section or otherwise.

20 (b) For purposes of administration of (a) of this section,

21 (1) any adjusted lease expenditures that would otherwise be deductible  
22 in a month but whose deduction would cause the production tax value calculated under  
23 (a) of this section of the taxable oil and gas produced during the month to be less than  
24 zero may be added to the producer's adjusted lease expenditures for one or more other  
25 months in the same calendar year; the total of any adjusted lease expenditures that are  
26 not deductible in any month during a calendar year because their deduction would  
27 cause the production tax value calculated under (a) of this section of the taxable oil  
28 and gas produced during one or more months to be less than zero may be used to  
29 establish a carried-forward annual loss under AS 43.55.024(b);

30 (2) an explorer that has taken a tax credit under AS 43.55.024(b) or  
31 that has obtained a transferable tax credit certificate under AS 43.55.024(d) for the

1 amount of a tax credit under AS 43.55.024(b) is considered a producer, subject to the  
2 tax levied under AS 43.55.011(c), to the extent that the explorer generates a positive  
3 production tax value as the result of the explorer's receiving a payment or credit  
4 described in (e) of this section.

5 (c) For purposes of this section,

6 (1) a producer's lease expenditures for a period are the total costs  
7 upstream of the point of production of oil and gas that are incurred on or after July 1,  
8 2006, by the producer during the period and that are direct, ordinary, and necessary  
9 costs of exploring for, developing, or producing oil or gas deposits located within the  
10 producer's leases or properties in the state or, in the case of land in which the producer  
11 does not own a working interest, direct, ordinary, and necessary costs of exploring for  
12 oil or gas deposits located within other land in the state; however, lease expenditures  
13 do not include the costs incurred to satisfy a work commitment under an exploration  
14 license under AS 38.05.132; in determining whether costs are direct, ordinary, and  
15 necessary costs of exploring for, developing, or producing oil or gas deposits located  
16 within a lease or property or other land in the state,

17 (A) the department shall give substantial weight to the typical  
18 industry practices and standards in the state and in the United States as to costs  
19 that an operator is allowed to bill a working interest owner that is not the  
20 operator, under unit operating agreements or similar operating agreements that  
21 were in effect on or before December 1, 2005, and were subject to negotiation  
22 with working interest owners, not the operator, with substantial bargaining  
23 power; and

24 (B) as to matters that are not addressed by the industry  
25 practices and standards described in (A) of this paragraph or as to which those  
26 practices and standards are not clear or are not uniform, the department shall  
27 give substantial weight to the standards adopted by the Department of Natural  
28 Resources as to the costs, other than interest, that a lessee is allowed to deduct  
29 from revenue in calculating net profits under a lease issued under  
30 AS 38.05.180(f)(3)(B), (D), or (E);

31 (2) the Department of Revenue may authorize a producer, including a

1 producer that is an operator, to treat as its lease expenditures under this section the  
2 costs paid by the producer that are billed to the producer by an operator in accordance  
3 with the terms of a unit operating agreement or similar operating agreement if the  
4 Department of Revenue finds that

5 (A) the pertinent provisions of the operating agreement are  
6 substantially consistent with the Department of Revenue's determinations and  
7 standards otherwise applicable under this subsection; and

8 (B) at least one working interest owner party to the agreement,  
9 other than the operator, has substantial incentive and ability to effectively audit  
10 billings under the agreement.

11 (d) For purposes of (c) of this section, "direct costs"

12 (1) includes

13 (A) an expenditure, when incurred, to acquire an item if the  
14 acquisition cost is otherwise a direct cost, notwithstanding that the expenditure  
15 may be required to be capitalized rather than treated as an expense for financial  
16 accounting or federal income tax purposes;

17 (B) payments of property taxes, sales and use taxes, motor fuel  
18 taxes, and excise taxes;

19 (C) a reasonable allowance, as determined under regulations  
20 adopted by the department, for overhead expenses directly related to exploring  
21 for, developing, and producing oil or gas deposits located within leases or  
22 properties or other land in the state;

23 (2) does not include

24 (A) depreciation, depletion, or amortization;

25 (B) royalty payments for oil or gas;

26 (C) taxes based on or measured by net income;

27 (D) interest or other financing charges or costs of raising equity  
28 or debt capital;

29 (E) acquisition costs for a lease or property or exploration  
30 license;

31 (F) costs arising from fraud, wilful misconduct, or negligence;

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(G) fines or penalties imposed by law;

(H) costs of arbitration, litigation, or other dispute resolution activities that involve the state or concern the rights or obligations among owners of interests in, or rights to production from, one or more leases or properties or a unit;

(I) donations;

(J) costs incurred in organizing a partnership, joint venture, or other business entity or arrangement;

(K) amounts paid to indemnify the state; the exclusion provided by this paragraph does not apply to the costs of obtaining insurance or a surety bond from a third-party insurer or surety;

(L) surcharges levied under AS 43.55.201 or 43.55.300;

(M) for a transaction that is an internal transfer or is otherwise not an arm's length transaction, expenditures incurred that are in excess of fair market value;

(N) an expenditure incurred to purchase an interest in any corporation, partnership, limited liability company, business trust, or any other business entity, whether or not the transaction is treated as an asset sale for federal income tax purposes;

(O) a tax levied under AS 43.55.011.

(e) A producer's lease expenditures must be adjusted by subtracting certain payments or credits received by the producer, as provided in this subsection. If one or more payments or credits subject to this subsection are received by a producer during a month or, under (f) of this section, during a calendar year, and if either the total amount of the payments or credits exceeds the amount of the producer's lease expenditures or the producer has no lease expenditures, the producer shall nevertheless subtract those payments or credits from the lease expenditures or from zero, respectively, and the producer's adjusted lease expenditures for that month or calendar year are a negative number and shall be applied to the calculation under (a) of this section as a negative number. The payments or credits that a producer shall subtract from the producer's lease expenditures, or from zero, under this subsection are

1 payments or credits received by the producer for

2 (1) the use by another person of a production facility in which the  
3 producer has an ownership interest or the management by the producer of a production  
4 facility under a management agreement providing for the producer to receive a  
5 management fee;

6 (2) a reimbursement or similar payment that offsets the producer's  
7 lease expenditures, including a payment from the state or federal government for  
8 reimbursement of the producer's upstream costs, including costs for gathering,  
9 separating, cleaning, dehydration, compressing, or other field handling associated with  
10 the production of oil or gas upstream of the point of production;

11 (3) the sale or other transfer of

12 (A) an asset, including geological, geophysical, or well data or  
13 interpretations, acquired by the producer as a result of a lease expenditure or an  
14 expenditure that would be a lease expenditure if it were incurred on or after  
15 July 1, 2006; for purposes of this subparagraph,

16 (i) if a producer removes from the state, for use outside  
17 the state, an asset described in this subparagraph, the value of the asset  
18 at the time it is removed is considered a payment received by the  
19 producer for sale or transfer of the asset;

20 (ii) for a transaction that is an internal transfer or is  
21 otherwise not an arm's length transaction, if the sale or transfer of the  
22 asset is made for less than fair market value, the amount subtracted  
23 must be the fair market value; and

24 (B) oil or gas

25 (i) that is not considered produced from a lease or  
26 property under AS 43.55.020(c); and

27 (ii) the cost of acquiring which is a lease expenditure  
28 incurred by the person that acquires the oil or gas.

29 (f) In place of the adjusted lease expenditures for a month under (a) of this  
30 section, a producer may, at any time, elect to substitute, for every month of a calendar  
31 year, 1/12 of the producer's adjusted lease expenditures for the calendar year. An

1 election made under this subsection applies to calculation of the tax under  
2 AS 43.55.011(e) and (g).

3 (g) The department shall specify or approve a reasonable allocation method  
4 for determining the portion of a cost that is appropriately treated as a lease expenditure  
5 under (c) of this section if a cost that would otherwise constitute a lease expenditure  
6 under (c) of this section is incurred to explore for, develop, or produce

7 (1) both an oil or gas deposit located within land outside the state and  
8 an oil or gas deposit located within a lease or property, or other land, in the state; or

9 (2) an oil or gas deposit located partly within land outside the state and  
10 partly within a lease or property, or other land, in the state.

11 (h) For purposes of AS 43.55.024(a) and (b) and only as to expenditures  
12 incurred to explore for an oil or gas deposit located within land in which an explorer  
13 does not own a working interest, the term "producer" in (b), (c), and (e) of this section  
14 includes "explorer."

15 (i) The department may adopt regulations that establish additional standards  
16 necessary to carrying out the purposes of this section.

17 (j) For purposes of this section,

18 (1) "explore" includes conducting geological or geophysical  
19 exploration, including drilling a stratigraphic test well;

20 (2) "ordinary and necessary" has the meaning given to "ordinary and  
21 necessary" in 26 U.S.C. 162 (Internal Revenue Code), as amended, and regulations  
22 adopted under that section;

23 (3) "stratigraphic test well" means a well drilled for the sole purpose of  
24 obtaining geological information to aid in exploring for an oil or gas deposit and the  
25 target zones of which are located in the state.

26 **Sec. 43.55.170. Additional nontransferable tax credit.** (a) For a month that  
27 ends before July 1, 2016, and for which a producer's tax liability under  
28 AS 43.55.011(e) exceeds zero before application of any credits under this chapter, a  
29 producer that qualifies under (c) of this section may take a credit under this section. If  
30 the average number of barrels of oil equivalent produced a day during that month and  
31 taxable under AS 43.55.011(e) is

1 (1) not more than 5,000, the amount of the credit is 22.5 percent of the  
2 producer's production tax value for that month under AS 43.55.160(a);

3 (2) 5,000 or more, the amount of the credit is 22.5 percent of the  
4 producer's production tax value for that month under AS 43.55.160(a) multiplied by  
5 the quotient of 5,000 divided by the average number of barrels of oil equivalent  
6 produced a day during that month and taxable under AS 43.55.011(e).

7 (b) A tax credit under this section

8 (1) may be applied only against the tax levied under AS 43.55.011(e);

9 (2) must be applied before any other credit is applied;

10 (3) is not transferable under AS 43.55.024(d) and may not be carried  
11 forward or used in a different month;

12 (4) except as provided in (5) of this subsection, may not be applied if it  
13 would cause the total of the tax credit applied under this section during a calendar year  
14 to exceed \$14,000,000; and

15 (5) may not be applied if it would cause the total of the tax credit  
16 applied under this section during 2016 to exceed \$7,000,000.

17 (c) On written application by a producer, including any information the  
18 department may require, the department shall determine whether the producer  
19 qualifies under this section for a calendar year. To qualify under this section, a  
20 producer shall demonstrate that the producer's operation in the state or the producer's  
21 ownership of an interest in a lease or property in the state as a distinct producer entity  
22 would not result in the division among multiple producer entities of any production tax  
23 liability under AS 43.55.011(e) that would be reasonably expected to be attributed to a  
24 single producer entity if the tax credit provision of (a) of this section did not exist.

25 (d) For purposes of this section, a barrel of oil equivalent is a barrel of oil, in  
26 the case of oil, or 6,000 cubic feet of gas, in the case of gas.

27 \* Sec. 27. AS 43.55.201 is amended to read:

28 **Sec. 43.55.201. Surcharge levied.** (a) Every producer of oil shall pay a  
29 surcharge of \$.01 [~~\$.02~~] per barrel of oil produced from each lease or property in the  
30 state, less any oil the ownership or right to which is exempt from taxation.

31 (b) The surcharge imposed by (a) of this section is in addition to the tax

1 imposed by AS 43.55.011 and is due on the last day of the month on oil produced  
2 from each lease or property during the preceding month. The surcharge [SHALL  
3 BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 -

4 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -

5 43.55.310.

6 (c) A producer of oil shall make reports of production in the same manner and  
7 under the same penalties as required under AS 43.55.011 - 43.55.170 [AS 43.55.011 -  
8 43.55.150].

9 \* Sec. 28. AS 43.55.201 is amended by adding a new subsection to read:

10 (d) Oil not considered under AS 43.55.020(e) to be produced from a lease or  
11 property is not considered to be produced from a lease or property for purposes of this  
12 section.

13 \* Sec. 29. AS 43.55.300 is amended to read:

14 Sec. 43.55.300. Surcharge levied. (a) Every producer of oil shall pay a  
15 surcharge of \$.04 [\$.03] per barrel of oil produced from each lease or property in the  
16 state, less any oil the ownership or right to which is exempt from taxation.

17 (b) The surcharge imposed by (a) of this section is in addition to the tax  
18 imposed by AS 43.55.011 and is due on the last day of the month on oil produced  
19 from each lease or property during the preceding month. The surcharge [SHALL  
20 BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 -  
21 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 -  
22 43.55.231.

23 (c) A producer of oil shall make reports of production in the same manner and  
24 under the same penalties as required under AS 43.55.011 - 43.55.170 [AS 43.55.011 -  
25 43.55.150].

26 \* Sec. 30. AS 43.55.300 is amended by adding a new subsection to read:

27 (d) Oil not considered under AS 43.55.020(e) to be produced from a lease or  
28 property is not considered to be produced from a lease or property for purposes of this  
29 section.

30 \* Sec. 31. AS 43.55.900(6) is repealed and reenacted to read:

31 (6) "gas" means

- 1 (A) all natural, associated, or casinghead gas;  
2 (B) all hydrocarbons that  
3 (i) are recovered by mechanical separation of well  
4 fluids or by gas processing; and  
5 (ii) exist in a gaseous phase at the completion of  
6 mechanical separation and any gas processing; and  
7 (C) all other hydrocarbons produced from a well not defined as  
8 oil;

9 \* Sec. 32. AS 43.55.900(7) is repealed and reenacted to read:

10 (7) "gross value at the point of production" means

11 (A) for oil, the value of the oil at the automatic custody transfer  
12 meter or device through which the oil enters into the facilities of a carrier  
13 pipeline or other transportation carrier in a condition of pipeline quality; in the  
14 absence of an automatic custody transfer meter or device, "gross value at the  
15 point of production" means the value of the oil at the mechanism or device to  
16 measure the quantity of oil that has been approved by the department for that  
17 purpose, through which the oil is tendered and accepted in a condition of  
18 pipeline quality into the facilities of a carrier pipeline or other transportation  
19 carrier or into a field topping plant;

20 (B) for gas, other than gas described in (C) of this paragraph,  
21 that is

22 (i) not subjected to or recovered by mechanical  
23 separation or gas processing, the value of the gas at the first point  
24 where the gas is accurately metered;

25 (ii) subjected to or recovered by mechanical separation  
26 but not gas processing, the value of the gas at the first point where the  
27 gas is accurately metered after completion of mechanical separation;

28 (iii) subjected to or recovered by gas processing, the  
29 value of the gas at the first point where the gas is accurately metered  
30 after completion of gas processing;

31 (C) for gas run through an integrated gas processing and gas

1 treatment facility that does not accurately meter the gas after the gas  
2 processing and before the gas treatment, the value of the gas at the first point  
3 where gas processing is completed or where gas treatment begins, whichever is  
4 further upstream;

5 \* Sec. 33. AS 43.55.900(10) is repealed and reenacted to read:

6 (10) "oil" means

7 (A) crude petroleum oil; and

8 (B) all liquid hydrocarbons that are recovered by mechanical  
9 separation of well fluids or by gas processing;

10 \* Sec. 34. AS 43.55.900 is amended by adding new paragraphs to read:

11 (17) "explorer" means a person who, in exploring for new oil or gas  
12 reserves, incurs expenditures;

13 (18) "gas processing"

14 (A) means processing a gaseous mixture of hydrocarbons

15 (i) by means of absorption, adsorption, externally  
16 applied refrigeration, artificial compression followed by adiabatic  
17 expansion using the Joule-Thomson effect, or another physical process  
18 that is not mechanical separation;

19 (ii) for the purpose of extracting and recovering liquid  
20 hydrocarbons; and

21 (iii) upstream of any gas treatment and upstream of the  
22 inlet of any gas pipeline system transporting gas to a market;

23 (B) does not include gas treatment;

24 (19) "gas treatment"

25 (A) means conditioning gas and removing from gas  
26 nonhydrocarbon substances for the purpose of rendering the gas acceptable for  
27 tender and acceptance into a gas pipeline system; and

28 (B) includes incidentally removing liquid hydrocarbons from  
29 the gas;

30 (2) "oil and gas lease" includes an oil and gas lease, a gas only lease,  
31 and an oil only lease.

1 \* Sec. 35. AS 43.55.011(a), 43.55.011(b), 43.55.011(c), 43.55.012, 43.55.013, 43.55.016,  
2 43.55.025(k)(1), 43.55.025(k)(3), 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12),  
3 and 43.55.900(16) are repealed.

4 \* Sec. 36. The uncodified law of the State of Alaska is amended by adding a new section to  
5 read:

6 REQUIRED REPORTS. (a) The Department of Revenue shall

7 (1) study

8 (A) the effects of the tax rates under AS 43.55.011(f) and of potential  
9 changes in those tax rates on state revenue and on oil and gas exploration,  
10 development, and production on private land; and

11 (B) the fairness of the tax rates under AS 43.55.011(f) and of potential  
12 changes in those tax rates with respect to private landowners; and

13 (2) prepare a report on or before the first day of the 2013 regular session of the  
14 legislature on the results of the study made under (1) of this subsection, including a  
15 recommendation as to whether those tax rates should be changed; the department shall notify  
16 the legislature that the report prepared under this paragraph is available.

17 (b) The Department of Revenue shall

18 (1) study the effects of the credit authorized by AS 43.55.170, added by sec.  
19 26 of this Act, on state revenue, on the encouragement of exploration, development, and  
20 production of oil and gas deposits located in the state, and on the encouragement of new  
21 entrants into the oil and gas industry in the state; and

22 (2) prepare a report on or before the first day of the 2015 regular session of the  
23 legislature on the results of the study made under (1) of this subsection, and shall include with  
24 the report a recommendation as to whether the legislature should extend the availability of the  
25 credit under AS 43.55.170, added by sec. 26 of this Act, beyond June 30, 2016; the  
26 department shall notify the legislature that the report prepared under this paragraph is  
27 available.

28 \* Sec. 37. The uncodified law of the State of Alaska is amended by adding a new section to  
29 read:

30 APPLICABILITY. (a) Sections 5, 7 - 10, 12, 13, 15 - 18, 20, and 24 - 35 of this Act  
31 apply to oil and gas produced on or after July 1, 2006.

1 (b) Section 11 of this Act applies to oil and gas produced before, on, or after the  
2 effective date of sec. 11 of this Act.

3 \* Sec. 38. The uncodified law of the State of Alaska is amended by adding a new section to  
4 read:

5 TRANSITIONAL PROVISIONS. (a) Notwithstanding any contrary provision of  
6 AS 43.55.024(a), enacted by sec. 12 of this Act, for oil and gas produced on or after July 1,  
7 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an  
8 amount equal to 2 1/12 percent" in AS 43.55.024(a)(1), enacted by sec. 12 of this Act, shall be  
9 replaced by the phrase "every month during the period July 1, 2006, through December 31,  
10 2006, an annualized tax credit in an amount equal to 4 1/6 percent."

11 (b) Notwithstanding any contrary provision of AS 43.55.024(e), enacted by sec. 12 of  
12 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the  
13 phrase "a calendar year" in AS 43.55.024(e), enacted by sec. 13 of this Act, shall be replaced  
14 by the phrase "the last six months of the calendar year."

15 (c) Notwithstanding any contrary provision of AS 43.55.024(i)(2), enacted by sec. 12  
16 of this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007,

17 (1) the number "1/24" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of this  
18 Act, shall be replaced by the number "1/12";

19 (2) the phrase "calendar year" in AS 43.55.024(i)(2)(B), enacted by sec. 12 of  
20 this Act, shall be replaced by the phrase "last six months of the calendar year."

21 (d) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 26 of  
22 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the  
23 phrase "for every month of a calendar year, 1/12 of the producer's adjusted lease expenditures  
24 for the calendar year" in AS 43.55.160(f), enacted by sec. 26 of this Act, shall be replaced by  
25 the phrase "for each of the last six months of 2006, one-sixth of the producer's adjusted lease  
26 expenditures for that six-month period."

27 (e) Notwithstanding any contrary provision of AS 43.55.170(b), enacted by sec. 26 of  
28 this Act, for oil and gas produced on or after July 1, 2006, and before January 1, 2007, the  
29 amount of "\$14,000,000" in AS 43.55.170(b)(4), enacted by sec. 26 of this Act, shall be  
30 replaced by "\$7,000,000."

31 (f) For oil and gas produced before July 1, 2006, the provisions of AS 43.55, and

1 regulations adopted under AS 43.55, that were in effect before July 1, 2006, and that were  
2 applicable to the oil and gas continue to apply to that oil and gas.

3 (g) Notwithstanding any contrary provision of AS 43.55.020(a), as repealed and  
4 reenacted by sec. 7 of this Act, for oil and gas produced on or after July 1, 2006, and before  
5 the first day of the first month that begins at least 180 days after the effective date of sec. 7 of  
6 this Act,

7 (1) the amount of the taxes that would have been levied on the producer under  
8 AS 43.55, as the provisions of that chapter read on June 30, 2006, is due on the last day of  
9 each calendar month on the oil and gas that was produced from each lease or property during  
10 the preceding month;

11 (2) the portion, if any, of the taxes levied under AS 43.55.011(e) - (g), enacted  
12 by sec. 5 of this Act, that is due under AS 43.55.020(a), as repealed and reenacted by sec. 7 of  
13 this Act, and that remains unpaid, net of any credits applied as allowed by law, is due on the  
14 last day of the first month that begins at least 180 days after the effective date of sec. 5 of this  
15 Act.

16 (h) Notwithstanding any contrary provision of AS 43.55.030(a), as amended by sec.  
17 18 of this Act, for oil and gas produced on or after July 1, 2006, and before the first day of the  
18 first month that begins at least 180 days after the effective date of sec. 18 of this Act, the  
19 person paying the tax shall file with the Department of Revenue, at the time an amount of tax  
20 is due

21 (1) under (g)(1) of this section, the statement required under former  
22 AS 43.55.030(a), as that subsection read on June 30, 2006; and

23 (2) under (g)(2) of this section, the statements required under  
24 AS 43.55.030(a), as amended by sec. 18 of this Act.

25 (i) For purposes of taxes to be calculated and due under (g)(1) of this section and  
26 statements to be filed under (h)(1) of this section, regulations that were adopted by the  
27 Department of Revenue under AS 43.55, as the provisions of that chapter read on June 30,  
28 2006, and that were in effect on that date apply to those taxes and statements.

29 \* Sec. 39. The uncodified law of the State of Alaska is amended by adding a new section to  
30 read:

31 TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS. (a)

1 The Department of Revenue may proceed to adopt regulations to implement the changes  
2 made by this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act),  
3 but not before the effective date of the law implemented by the regulation.

4 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by  
5 the Department of Revenue to implement, interpret make specific, or otherwise carry out the  
6 provisions of secs. 5, 7 - 10, 12, 13, 15 - 18, 20, 24 - 35, and 38 of this Act may apply  
7 retroactively as of July 1, 2006, if the Department of Revenue expressly designates in the  
8 regulation that the regulation applies retroactively to that date.

9 \* Sec. 40. The uncodified law of the State of Alaska is amended by adding a new section to  
10 read:

11 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the  
12 heading of

13 (1) AS 43.55 from "Oil and Gas Production Taxes and Oil Surcharge" to "Oil  
14 and Gas Production Tax and Oil Surcharge";

15 (2) article 1 of AS 43.55 from "Oil and Gas Properties Production Taxes" to  
16 "Oil and Gas Production Tax";

17 (3) AS 43.55.011 from "Oil production tax" to "Oil and gas production tax";

18 (4) AS 43.55.025 from "Tax credit for oil and gas exploration or gas only  
19 exploration" to "Alternative tax credit for oil and gas exploration";

20 (5) AS 43.55.150 from "Determination of gross value" to "Determination of  
21 gross value at the point of production."

22 \* Sec. 41. The uncodified law of the State of Alaska is amended by adding a new section to  
23 read:

24 **CONDITIONAL RETROACTIVITY.** If the sections of this Act that, under sec. 43 of  
25 this Act, are scheduled to take effect July 1, 2006, take effect on or after July 1, 2006, those  
26 sections of this Act are retroactive to July 1, 2006.

27 \* Sec. 42. Sections 1 - 4, 6, 11, 14, 19, 21 - 23, 37 - 39, and 41 of this Act take effect  
28 immediately under AS 01.10.070(c).

29 \* Sec. 43. Except as provided in sec. 42 of this Act, this Act takes effect July 1, 2006.



Official Business

# Alaska State Senate

## Senate Finance Committee

Mail Stop 3100  
State Capitol  
Juneau, Alaska 99801-1182

### FAX COVER SHEET

DATE: 22 April 2006 TIME: 3:30 pm

TO: Legal Services

NUMBER OF PAGES, INCLUDING COVER SHEET: 7

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

NOTES: Final Please

CS SB 305 (FIN) 24-652052\ P  
Chenoweth 4/18/06

Plus 9 amendments:

P.1, P.3, P.4, P.5, P.6, P.12, P.13

Amendment #7 as twice amended

Amendment #15

Thanks.  
Mindy



Official Business

# Alaska State Senate

## Senate Finance Committee

Mail Stop 3100  
State Capitol  
Juneau, Alaska 99801-1182

### FAX COVER SHEET

DATE: 22 April 2006 TIME: 2:20pm

TO: Legal Services - attn Jack

NUMBER OF PAGES, INCLUDING COVER SHEET: \_\_\_\_\_

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

NOTES: Hi Jack ~

These are the 7 amendments  
adopted to SB 305 24-652052\ P  
so far

The Committee isn't done yet but  
Darwin wanted to give you an opportunity  
to get started

Thanks  
Mindy

- \ P.5
- \ P.1
- \ P.4
- \ P.3
- \ P.6
- \ P.12

plus one not drafted  
by you



## SENATOR FRED DYSON

April 21, 2006

To: Senator Lyda Green, Co-Chair  
Senate Finance Committee

From: Senator Fred Dyson *Fred*

RE: Further Concerns/Questions Regarding SB 305(FIN) - PPT

---

After a cursory review of version "P" of subject bill, and after Dan Dickinson's testimony yesterday, I have the following concerns and/or questions.

**Page 2, lines 20 - 23**

From what may the taxpayer deduct taxes paid under AS 43.55?

"The taxpayer may deduct from \_\_\_\_\_ the tax levied and paid under AS 43.55."

**Page 3, line 21**

Should there be a comma after "state"?

**Page 3, line 29**

Which department? In other locations, such as Sec. 15 beginning on page 12, the CS refers to the Department of Natural Resources, and in other locations the document refers to the Department of Revenue.

**Page 4, lines 5 & 6**

Increases royalty tax on gas from Senate Resources version of 1.5% of the gross for Cook Inlet gas to 7.5% of gross production for gas anywhere in the state. For non-Cook Inlet the increase is from the previous 5% to 7.5%. Isn't that a pretty big increase for Cook Inlet gas? Especially when we want more Cook Inlet gas? It appears that this change increases the private royalty tax for gas. Do we really want to increase tax on gas?

**Page 5, lines 7 through 14**

Lines 7 & 8 say that overpayments can be applied to taxes due for a later month. Lines 13 & 14 indicate that interest is paid on overpayments are not refunded. Are we applying taxes to future liabilities or refunding them?

Further Concerns About SB 305(FIN) – PPT

April 21, 2006

Page 2 of 2

**Page 5, line 25**

Add comma after "gas"

**Page 5, line 26**

Add comma after "lease"

**Page 6, lines 3 – 10**

Like the Senate Resources CS the Senate Finance CS deletes the penalty currently found in AS 43.55.020(e) for wasteful flaring of gas.

**Page 8**

The CS refers to "person" whereas elsewhere it refers to "taxpayer," "producer," or explorer. Are we confident that "person" is satisfactorily defined?

**Page 10, line 9**

Should there be either an "and" or "or" after the semi-colon, i.e., must the conditions satisfy both conditions or only one?

**Page 17, line 6**

Add "or" after the semi-colon.

**Dan Dickinson's Presentation of April 20, 2006 re: 5,000 BOE allowance**

In **Dan Dickinson's** first slide of **April 20, 2006**, related to Daily Production of Oil and Gas in Cook Inlet, the slide seems to indicate that producers of oil and gas get two allowances – one for oil and one for gas – while the producers of only oil or gas get only one allowance.

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# STATE OF ALASKA

DEPARTMENT OF REVENUE

FRANK MURKOWSKI, GOVERNOR

550 W Seventh, Suite 500  
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Tax Division

[www.revenue.state.ak.us/tax](http://www.revenue.state.ak.us/tax)

April 5, 2005

Senator Lyda Green, Co-Chair  
Senate Finance Committee  
State Capitol, Room 516  
Juneau, AK 99801

Senator Gary Wilken  
Co-Chair, Senate Finance Committee  
State Capitol, Room 518  
Juneau, AK 99801

Re: SB 305 Petroleum Production Tax

Dear Senators Green and Wilken,

We are pleased to respond to a request made by members of the Senate Finance Committee for a "glossary" to the PPT legislation currently under consideration. We have included various useful acronyms and tax, accounting, and economic terms used during testimony at recent hearings.

We have provided common-use definitions, most of which were based on various accounting and taxation texts, as well as oil & gas reference books. This list is intended to facilitate discussions and provide a general familiarity with relevant concepts. It is not intended to restate or modify the precise meanings found in statute or regulation and does not constitute the Department's official interpretation of statutory or regulatory terms.

Please let us know if there are additional terms that you would like to see on this glossary and we can update it.

## GLOSSARY TO THE PPT

### ANNUALIZE

In general, this means to extend a part-year item to an annual basis. The PPT legislation contains a provision for a producer to elect to spread lease expenditures

over the entire year. For example, if a producer spends \$12M in January, the producer can elect to recognize 1/12, or \$1M per month, in place of \$12M in one month.

#### ANS

Alaska North Slope. When used in describing crude oil, this term refers to the crude oil that is produced in the North Slope area of Alaska. Because ANS is not traded frequently, daily reported prices for this medium quality crude are often determined between trades as a differential to prices set for West Texas Intermediate, a benchmark crude.

#### CAPEX

Capital Expenditures are made to acquire assets that are considered long-term assets that are not bought and sold in the ordinary course of business. The term usually refers to Fixed Assets such as buildings, machinery, and equipment. Such assets are expected to generate income over several years.

#### CGF or CENTRAL GAS FACILITY

In the Prudhoe Bay Unit, a large gas processing plant that processes roughly 9 billion cubic feet a day (or 9 million mcfs - (qv)), stripping out ngls (qv), and compressing the residue gas back up to a pressure where it can be put back in the ground.

#### CREDIT (compare to Deduction below)

Reduction in taxes payable to the state. A tax credit of \$200 is more beneficial to the taxpayer than a deduction of \$200, because the credit reduces taxes on a dollar-for-dollar basis. Put another way, though, please note that credits are frequently not for 100% but are 20% credits or 40% credits, in which case taxes are only reduced by 20 cents or 40 cents for every dollar that qualifies for the credit.

#### DEDUCTION (compare to Credit above)

Reduction of the tax base against which the tax is measured. In the case of a tax on net profit, a Deduction is a reduction of net profit. The value of a deduction is the amount of the deduction (For example: \$100) times the tax rate (for example: 20%) giving a net benefit of \$20 (\$100 times 20%).

## DEVELOPMENT

Development costs are incurred to obtain access to proved reserves and to provide facilities for extracting, treating, gathering, and storing the oil and gas. These costs include such things as expenditures to gain access to and prepare production well locations for drilling, including surveying well locations for the purpose of determining specific development drilling sites, clearing ground, road building, power lines, drilling and equipping development well; platforms; casing; tubing; pumping equipment; and the wellhead assembly

## DISCOUNTED CASH FLOWS

Today's value of future expected cash receipts and expenditures at a common date, which is calculated using net present value or internal rate of return and is a factor of analysis in capital investments.

## DOLLARS-OF-THE-DAY (See NOMINAL DOLLARS below)

## EFFECTIVE TAX RATE

In general, whenever there are several factors at play this measure cuts through all their effects, and typically divides the tax paid by some measure.

For an income tax, the effective tax rate is normally expressed as the actual income tax paid divided by taxable income, expressed as a percentage. For example:

Gross income	\$100
Less: deductions	<u>(90)</u>
Net income	\$ 10
Tax at 20%	\$ 2
Less: credits	<u>(1)</u>
Tax due	\$ 1

In this example, the effective tax rate is 10%, which compares the \$1 tax due with the taxable income of \$10.

## ELF (or Economic Limit Factor)

The Economic Limit Factor is embodied in current production tax law. It is a formula that yields a property-specific factor which is applied in the calculation of

the effective tax rate for each property. The ELF formula for oil is a multi-exponent formula, based on well-productivity and property size. For all properties, the ELF is between 0 and 1. With an ELF of 0, no production tax is paid on that property. With an ELF of 1, a property would pay the full effective tax rate of 15% or 12.25%, depending on the age of the property.

#### ENHANCED OIL RECOVERY (EOR)

The use of certain methods such as water flooding or solvent injection into wells to increase the oil recovery from a reservoir.

#### EXPLORATION

Exploration involves identifying areas that may warrant examination and examining specific areas that are considered to have prospects of containing oil and gas reserves. Exploration costs include drilling exploratory wells and exploratory-type stratigraphic test wells. Principal types of exploration costs include costs of topographical, geological, and geophysical studies.

#### FIELD COSTS

In Alaska's North Slope Units, a fee paid by the State of Alaska to the producer of its royalty oil and gas for every unit of production. Originally set in 1980 and adjusted every year for inflation, the figure is roughly a dollar per barrel of oil and a quarter per mcf of gas.

#### FISCAL SYSTEM

Technically, the legislated taxation structure for a country including royalty payments. In popular language, the term includes all aspects of contractual and fiscal elements that make up a given government-foreign oil company relationship.

#### GAS PROCESSING

Processing a gaseous mixture of hydrocarbons to remove liquid hydrocarbons (see Natural Gas Liquids) by a physical process that is not mechanical separation. These processes include, but are not limited to, refrigeration and adsorption. See full definition of Gas Processing included in the legislation. Gas Processing is distinguished from Gas Treatment.

## GAS TREATMENT

Conditioning gas and removing non-hydrocarbon substances, such as CO<sub>2</sub>, to make the gas acceptable for acceptance into a gas pipeline system. See full definition of Gas Treatment included in the legislation. Gas Treatment is distinguished from Gas Processing.

## GOVERNMENT TAKE

Sum of state take plus federal take. State take equals sum of royalty, production tax, property tax, and income tax. Federal take is federal income tax, and federal royalties on federal leases.

## GROSS (as in a "tax on Gross")

In general, Gross refers to gross revenues or sales. A sales tax is an example of a tax on Gross. For production tax purposes, Gross means the value of the oil and gas at the point of production, that is sales less the cost of getting the oil or gas from the point of production to the point of sale.

## HEAVY OIL

A type of crude oil which is very viscous and does not flow easily. It may be characterized as having an American Petroleum Institute (API) gravity less than 20°. The common characteristics are:

- high specific gravity
- low hydrogen to carbon ration
- high carbon residues
- high contents of asphaltenes, heavy metal, sulphur and nitrogen

## INCENTIVES

Fiscal or contractual elements emplaced by host government that make petroleum exploration or development more economically attractive includes such things as:

- Royalty Holidays
- Tax holidays
- Tax credits
- Reduced government participation
- Lower government take
- Investment credits/uplifts
- Accelerated depreciation

#### INTANGIBLE DRILLING COSTS

All necessary intangible expenditures incurred in drilling from the surface to the natural resource deposit. Such costs include labor, taxes, repairs, supplies, power, and equipment rentals. Sometimes referred to as the cost of the hole in the ground when all the salvageable assets have been accounted for.

#### INTERNAL RATE OF RETURN (or IRR)

The rate of return that would make the present value of future cash flows plus the final market value of an investment or business opportunity equal the current market price of the investment or opportunity. Also called dollar-weighted rate of return.

#### IRC

Internal Revenue Code

#### IRR (See INTERNAL RATE OF RETURN above)

#### JV

Joint Venture is, in effect, a partnership among companies. A great deal of the activity on the North Slope takes the form of JVs. All costs of a JV are run through a "JV billing" to the working interest owners or co-venturers.

#### LACT Meter

A Lease Automatic Custody Transfer meter, of sufficient accuracy that parties will use it to determine the amount of oil or gas at a point where the oil or gas changes hands and one party can bill the other for the amount of oil or gas that has changed title.

#### LESSEE and LESSOR

An oil and gas lease is between a lessor and a lessee. The lessors are the landowners (or those holding mineral rights in the land), and the lessees are companies that explore for and produce the oil and gas. In Alaska, the lessor under oil and gas leases is usually the state or federal government, but in some instances private entities that own mineral rights have also issued oil and gas leases. The lessor

usually retains a royalty interest. Often the amount of the retained royalty interest is 12.5% of the oil and gas produced, which can be paid in kind (as oil or gas) or in value (i.e. in money).

#### MARGINAL TAX RATE

According to WG&L Tax Dictionary (2004), a marginal tax rate is:

"The rate of tax applied to the last dollar of the tax base."

Therefore, if a tax is based on net income, a marginal tax rate is measured based on the last dollar of net income. This is most often found in income tax law such as AS 43.20.011 where the top marginal rate is 9.4% and this tax rate is applied to amounts of Alaska corporate taxable income over \$90,000.

#### MCF or more correctly MSCF

Thousand (as in the roman numeral M) cubic feet of gas at standard pressure and temperature. Sometimes abbreviated as an "M", this a pure volume measurement, and is different from an MMBTU (qv)

#### MMBTU or mmBtu

Million (or in roman numerals, a thousand thousand) British thermal units. This measures the heating capacity of a gas. Using this measurement accounts for non-hydrocarbon impurities like CO<sub>2</sub> which take up volume in the gas, but do not contribute to its ability to produce energy when burnt. This is a better measurement of the economic value of the gas than an mcf. For back of the envelope calculations, the two are often used interchangeably because North Slope gas has roughly a million Btus per thousand cubic feet. (For the technically minded, a Btu is the amount of energy required to raise one pound of water from 39 degrees to 40 degrees.)

#### NATURAL GAS LIQUIDS (NGLS)

Hydrocarbon liquids extracted from gas, typically at a gas processing plant. On the North Slope these are used for enhanced oil recovery as a miscible injectant, or put into TAPS where they are commingled with oil. Under our current tax system, they are taxed as gas. The principal component of natural gas is methane (or C1), while NGLs include propane (C3), butanes (C4), pentanes (C5), and some heavier hydrocarbons. Sometimes ethane (C2) is included as an NGL.

#### NET (as in a "tax on Net")

Net profit is gross revenue (sales) less expenses. For PPT purposes, Net means gross value (that is value at the point of production) less the operating expenses and capital investments necessary to get the oil out of the ground. This is different from federal taxable income which requires capital investments to be written off over their useful lives.

#### NETBACK

Many royalty and production tax calculations are based on gross value from some point of valuation, usually the last value off of a production platform or at the boundary of a field or license area. The point of sale, however, may be different than the point of valuation. The statutory royalty or tax calculation may allow the transportation costs from the point of valuation to the point of sale to be deducted. This is called the Netback Formula.

NGLs (see NATURAL GAS LIQUIDS above)

#### NOMINAL DOLLARS

A term usually associated with cost estimates that indicate the effects of anticipated inflation have been taken into account. For example, if a well costs \$5 million right now in "today's dollars" (the opposite of dollars-of-the-day), then the cost of the well two years from now might be estimated at \$5.51 million in dollars-of-the-day assuming a 5% inflation factor.

#### OPEX

Operating Expenditures are made to acquire goods and services which are considered to benefit the current year only. Examples of Operating Expenditures include labor, fuel, and repairs necessary to operate production equipment.

#### POINT OF PRODUCTION

The point in the production process at which oil and gas is considered "produced." In a "production tax," this is the point at which the oil and gas is valued, and the tax applied. The PPT legislation changes the point of production such that Gas Processing is considered upstream of the point of production. This means that the costs of Gas Processing will be deducted in the calculation of Net value, and capital

investments in Gas Processing will generate Credits under the legislation, as currently drafted.

#### PPT

Petroleum Production Tax

#### PRODUCER

The owner of a working interest; usually a lessee under an oil and gas lease.

#### PRODUCTION

Production involves lifting the oil and gas to the surface, gathering and field storage. Production costs are those costs incurred to operate and maintain wells and related equipment and facilities, such as labor to operate the wells, repairs and maintenance, and materials, supplies, and fuel consumed to operate wells.

#### PROGRESSIVE TAX

According to *Black's Law Dictionary* (2004), a progressive tax is

"A tax structured so that the effective tax rate increases more than proportionately as the tax *base* increases..."

This is consistent with taxation and economics literature.<sup>1</sup> In other words, a progressive tax is any tax in which the rate increases as the amount subject to taxation increases. If a tax is levied on "net income", then a progressive tax scheme will increase the tax rate based on increasing levels of net income. If a tax is levied on "gross income", then a progressive tax scheme will increase the tax rate based on increasing levels of gross income.

#### PROPORTIONAL TAX

According to *Black's Law Dictionary*, a proportional tax is:

"A tax whose rate remains fixed regardless of the amount of the tax base."

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<sup>1</sup> See *WG&L Tax Dictionary* written by Richard A. Weston (2004), and *Principles of Microeconomics* written by Karl E. Case and Ray C. Fair (1989).

Black's equates a "proportional tax" with the term "flat tax." Thus, a proportional tax is neutral since the relative share does not change with amount.

## ROYALTY

A share of oil and gas production free of the expenses of production. In particular, a landowner's royalty—often in the amount of one-eighth of the oil and gas produced from the lease—is part of the compensation a lessor receives from the lessee under an oil and gas.

## RSA

A Royalty Settlement Agreement is an agreement between Alaska Department of Natural Resources and a particular producer, resolving a dispute as to the determination of royalties to be paid under oil and gas leases and prescribing a method for calculating royalties to be paid by that producer in the future. A series of these were signed between 1980 and 1996 as various issues of the Amerada Hess litigation concerning royalties were settled. The 1980 agreement concerned field costs (qv); settlements signed in the early nineties concerned royalties on oil; and settlements signed in the mid nineties concerned royalties on gas.

## SEVERANCE TAX

A tax on the removal of minerals or petroleum from the ground. Essentially the same as a Production Tax.

## SQ

Status Quo is the short-hand method of referencing the tax law, as it currently exists.

## TIME VALUE OF MONEY

This concept states that the value of a dollar today is worth more than a dollar in the future. Two factors affect the value of money over time: inflation and opportunity cost. The presence of inflation acts to continually devalue money over time, while the opportunity cost of money is the foregone alternatives for its use, namely a rate of return on an investment. These two factors need to be considered when calculating the net present value of an amount of money that is to be received in the future.

#### WELLHEAD VALUE

This is often used as a synonym for gross value of the resource at the point of production, even though the point of production is not literally at the wellhead. Wellhead value is determined by subtracting transportation costs from the value of oil or gas at the point of sale or other disposition.

#### WORKING INTEREST

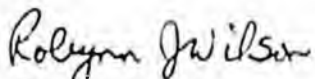
Also known as an operating interest, a working interest is the interest in property held by the person who has the right to produce oil and gas from the property. In the case of an oil and gas lease, the working interest belongs to the lessee..

#### WTI

West Texas Intermediate is a type of crude oil used as a benchmark in oil pricing. It is a light crude, "sweeter" (less sulfur) than Alaska North Slope crude. WTI is traded on world markets through "wet barrels" (actual oil), or "paper barrels" (futures).

I hope that this information proves helpful. Please let us know if we can be of further assistance.

Sincerely,

  
Robynn J. Wilson  
Director, Tax Division

**Suggested Amendments to Senate Bill 305 (RES)**

I. Progressive "Surtax" for Gas

Senate Resources Committee Substitute for Senate Bill 305 ("RES CS SB 305") amended AS 43.055.011 to add a new subsection (g) related to an additional tax that will be levied on gas producers in the event that the monthly average of Alaska North Slope West Coast crude oil prices ("ANS") exceed \$40 per barrel of oil. This additional tax is based on an ANS formula such that both the threshold for the application of this additional tax and the actual additional tax itself are linked to an ANS oil price marker.

However, the price realized on Alaskan gas production has historically been less than ANS prices. Furthermore, the price realized on Alaskan gas production does not have the volatility associated with ANS oil price movements. As such, it is not equitable to link the progressive "surtax" element of the PPT as applied to gas to an ANS oil price marker. Rather, such progressive surtax should be linked to the average price of gas realized from Alaskan gas producers – as currently reflected in the readily available Department of Revenue Prevailing Value figures.

*Suggested amendment:*

AS 43.055.011 is amended by adding new subsections to read:

"(g) In addition to the taxes levied under (e), and (f) of this section, for each month that the gas price index determined under (h) of this section is greater than zero, there is levied upon the producer of gas a tax for all gas produced during that month from each lease or property in the state, less any gas ownership or right to which is exempt from taxation. The tax is equal to two percent of the production tax value at the point of production of the gas multiplied by the gas price index as determined under (j) of this section.

(h) The gas price index for a month is the number equal to the average Department of Revenue Prevailing Value gas price as determined under (k) of this section for that month in dollars per million British thermal units, less eight, except that if the average price determined under (k) of this section is:

- (1) not more than \$8 per million British thermal units, the gas price index is zero;  
and
- (2) more than \$8 per million British thermal units, the gas price index is 18.75.

(i) For purposes of (g) and (h) of this section, the department may calculate the average price or may, by regulation, specify the method by which the average price shall be calculated with reference to a published source of price information, provided that such method must bear, as is reasonably possible, the same relationship to the actual realized price of Alaskan gas, as did the Department of Revenue Prevailing Value."

## II. Lower Gas PPT Rate for South of Brooks Range

RES CS SB 305 does not address the unique nature of the current Cook Inlet gas production business. Because of the particular concerns surrounding the Alaskan gas business, it is not equitable to apply the PPT to gas in a similar manner as applied to North Slope oil production.

Rather than entirely exclude the Alaskan gas business from the PPT, it is more proper to utilize the proposed PPT system as applied to gas, albeit modified to include a lower rate for gas. More specifically, Alaskan gas produced south of Brooks Range should be taxed under a lower 5/20 structure – 5% PPT rate and 20% credit system.

### *Suggested amendment:*

AS 43.55.011(a) is amended to read:

“(a) There is levied on the producer of oil or gas a tax for all oil and gas produced each month from each lease or property in the state less any oil and gas the ownership or right to which is exempt from taxation or constitutes a lessor’s royalty interest under an oil and gas lease. The tax is equal to 20% of the production tax value of the taxable oil and gas as calculated under AS 43.55.160, except that for any gas produced south of 68 degrees, 15 minutes, North latitude, the tax is equal to 5% of the production tax value of the taxable gas.”

## III. Credit in Lieu of \$73MM Standard Deduction

RES CS SB 305 amended the Governor’s original proposal to remove the application of the \$73MM standard deduction. However, this standard deduction was intended to help attract the additional investment necessary to address the significant decline in Alaskan oil and gas reserves facing our industry.

Instead of removing the standard deduction altogether, it is more appropriate to provide relief in the form of a standard \$12MM credit, limited by the annual/monthly amount of capital expenditures undertaken by a particular producer. This compromise helps to better balance the State’s dual mission of attracting the investment necessary to help find additional resources, while ensuring that the State continues to receive a fair share of revenue from such resources.

### *Suggested amendment:*

AS 43.55 is amended by adding new sections to article 1 to read:

#### **“Sec. 43.55.170. Additional Nontransferable Credit.**

- (a) For a month for which a producer’s tax liability under AS 43.55.011(a) exceeds zero before application of any credits under this chapter, a producer that is qualified under (b) of this section and, during the calendar year, has incurred a qualified capital expenditure, as that term is defined in AS 43.55.024, may apply a

tax credit, in an amount that does not exceed the amount of that expenditure, against the liability under this section. An unused portion of a tax credit may be applied to the extent otherwise allowed under this section for one or more months during the same calendar year. The tax credit authorized by this subsection may be calculated and applied so that:

- (1) the producer's tax liability under AS.43.55.011(a) for any month is not reduced below zero; and
  - (2) the total of the tax credits applied under this subsection during a calendar year does not exceed \$12,000,000, except that the total of the tax credits applied under this subsection during the calendar year 2016 does not exceed \$3,000,000.
- (b) On written application by a producer, including any information the department may require, the department shall determine whether the producer qualifies under this section for a calendar year. To qualify under this section, a producer must demonstrate that its operation in the state or its ownership of an interest in a lease or property in the state as a distinct producer entity would not result in the division among multiple producer entities of any production tax liability under AS 43.55.011(a) that would be reasonably expected to be attributed to a single producer entity if the tax credit provision of (a) of this section did not exist.
- (c) An unused tax credit or portion of a tax credit under this section is not transferable under AS 43.55.024(d) or refundable under AS 43.55.024(f), and may not be carried forward to or used in a later calendar year.
- (d) The use of a tax credit under this section does not prevent a producer from taking a tax credit under AS 43.55.024(a) or 43.55.025 for the same qualified capital expenditure.
- (e) A producer may not claim a credit under this section for a qualified capital expenditure incurred after March 31, 2016."

## **Alaska Can't Tax Its Way To A Gas Pipeline**

by Governor Frank H. Murkowski

**Word Count: 657**

Remember David Stockman and Art Laffer? They were the architects of President Reagan's tax plan to relieve the country of the high inflation and high unemployment of the Jimmy Carter years. Their basic idea was simple—lower taxes mean greater economic growth and thus increased overall wealth for the nation.

On February 20, the chief executive officers of the producer group, BP, ConocoPhillips and ExxonMobil, accepted my oil tax modernization plan, which included a 20 percent net profits tax rate and a 20 percent tax credit. This is the proposed replacement for the current oil production tax. Based upon this 20/20 proposal and the assumption that oil fiscal certainty would be included in the gas contract, the CEOs also agreed to move forward on the natural gas pipeline contract, which had been part of our negotiations.

Some legislators have proposed to change the agreement by increasing the tax rate from 20 to 25 percent. Their reason? Outside consultants recommended a range that went up to 25 percent. (The industry proposed 12 ½ percent.) Easy to propose, because the consultants do not bear the risk of underwriting a \$20-plus billion project that will not deliver gas until 2012. Moreover, none of the outside consultants put their Errors and Omissions Policy on the

line by guaranteeing that Alaska would still get a gas pipeline if the rate were raised to 25 percent! They can't do it because the risk is too great. Neither can Alaska take the risk of not getting a gas pipeline.

The Legislature needs to ask itself this question: is a short-term, five percent higher severance tax worth risking: a) a gas pipeline that returns \$70 billion, b) a 20 year extension of the Trans-Alaska oil pipeline; and, c) long-term oil taxes and royalties from the extended life of TAPS?

My 20/20 proposal will provide the following benefits to Alaska:

- The gas pipeline will extend the life of TAPS from 2030 to 2050, adding two billion barrels of production and bringing in increased royalties and severance taxes. At current oil prices (\$60/bbl), the TAPS extension will result in \$14 billion in additional revenues to Alaska.
- With gas at \$7.00 per MCF, the gas pipeline will bring the state more than \$70 billion in revenue over 35 years in real 2005 dollars. This assumes 4.5 billion cubic feet per day. The state will realize more if the gas pipeline is expanded to 5.9 billion cubic feet per day.
- My petroleum production tax legislation will bring the state approximately \$750 million more this year. That is nearly double what the industry is paying under the

current ELF (Economic Limit Factor) based tax system. This would likely grow to \$1.5 billion several years from now as revenues from an ELF-based production tax would have continued to decline.

My proposal has been accepted by the producers. As a consequence, my 20/20 proposal would get us the \$70 billion from a gas pipeline, and the life of TAPS would be extended for 20 years from 2030 to 2050. The state would earn \$14 billion in oil royalties and taxes between 2030 and 2050 that it would lose if there were no gas pipeline.

That revenue is at risk if the Legislature seeks to increase the tax rate. In essence, some legislators are risking \$70 billion in gas revenue and \$14 billion additional in oil revenue for a short term tax increase. Remember also that 25 percent of the royalties from this revenue stream will go right into the Permanent Fund.

Our Legislature should think seriously about the risk/reward balance, consider Alaska's financial well-being and adopt my 20/20 plan, which assures a gas pipeline for Alaska. Let's follow the path of our predecessors who realized that we cannot tax our way into prosperity. I am satisfied that this is a responsible path that meets the requirement of Alaska's Constitution, that resources be maximized for the benefit of all Alaskans.

# Regular Session

Step

1

## PPT

- Stands Alone
- Sets Oil Tax Policy

MAJOR SHIFT FROM GROSS  
TAX ON VOLUME BY FIELD TO  
NET PROFIT BY COMPANY

# Special Session

Step

2

## SGDA

Amendments  
(Including Oil  
Fiscal Certainty)

Step

3

## GAS Pipeline Contract

# STATE OF ALASKA

## DEPARTMENT OF REVENUE

OFFICE of the COMMISSIONER

FRANK MURKOWSKI, GOVERNOR

State Office Building  
PO Box 110400  
Juneau, AK 99811-0400

Telephone : 907-465-2300  
Fax : 907-465-2389

April 1, 2006

The Honorable Lyda Green  
Alaska State Capitol, Room 516  
Juneau, Alaska 99801

Dear Senator Green:

Yesterday Senator Wilken asked whether the Governor's Op Ed (attachment one), "changed the rules" by pointing out the risk the Legislature faced of losing the gasline by going above the 20 percent Petroleum Production Tax (PPT) rate which the Governor negotiated with the Producers' Chief Executive Officers (CEOs). I asked if I could respond in writing so that I could carefully separate out the **agreement** which the Governor reached from the **process** the Administration has proposed for securing that agreement.

### **The Agreement:**

On February 21, 2006 the Governor announced that the Producers had agreed to his proposal to change the Economic Limit Factor (ELF-based) production tax to a net production tax with a tax rate of 20 percent and a credit of 20 percent. In addition the CEOs agreed to move forward with the gasline agreement which had been reached with the Producers on February 18, 2006—including the economic terms of the Gas Contract.

Obtaining agreement to the 20 percent tax rate, which was first proposed to the Producers in August 2005, was the culmination of a consistent, determined effort by the State negotiating team. We never changed the 20 percent tax rate. The Governor increased the tax credit proposal from 15 percent to 20 percent because he wanted to enhance the opportunity for investment due to his concern about the six percent per year rate of decline of oil flow in the Trans-Alaska Pipeline System (TAPS).

The Administration has never been in doubt that the 20 percent tax rate is a ceiling as far as the Producers are concerned. Unfortunately it has been perceived by some in the Legislature as a floor from which to increase the tax rate. It is in fact a safe harbor by which Alaska is assured of moving forward on the gasline project and having a significant increase in the production tax. In the words of the old spiritual by "drifting away from the shore" of the safe

The Honorable Lyda Green  
April 1, 2006  
Page 2

harbor we risk the gasoline. For the reasons described in the Governor's Op Ed, this risk is not worth the "reward" of what we believe will be a short-lived, incremental increase in revenue from a higher tax rate. It will not maximize the return from Alaska's resources as the Constitution commands us to do.

### **The Process**

Attachment two is a diagram showing the process. The first step is stand-alone legislation, which changes severance tax policy from the current ELF structure. This new tax policy needs to be good for the State with or without the gasoline. The second step is authorization to place fiscal certainty on oil into the gasoline contract (assuming you grant the Administration such authority.) The third step is for the Legislature to consider ratifying the gas contract with oil fiscal certainty included. By oil fiscal certainty, I mean that the law setting out the tax policy for severance taxes (which maybe amended in step two) is locked in for the term agreed to in the contract.

This process resolves the chicken and egg problem, with which we were faced. We could not put out the contract without including fiscal certainty on oil. But until you granted us the authority to negotiate fiscal certainty on oil, we could not put out the contract. By fixing the tax policy and then getting authority to negotiate fiscal certainty on oil based on that policy, we have resolved the chicken and egg problem.

In conclusion, the Administration has been very transparent on this;

1. the Governor announced the 20-20/gasline package agreement on February 21, 2006 and has repeated on numerous occasions that this was the agreement, and
2. the process for securing this agreement has been discussed with Legislature and discussed publicly and with the press on numerous occasions.

Thank you for your consideration.

Very truly yours,



Bill Corbus  
Commissioner

**SB**

**305**

**(FILE 2)**

SFIN

FILE

# Petroleum Profits Tax (PPT)

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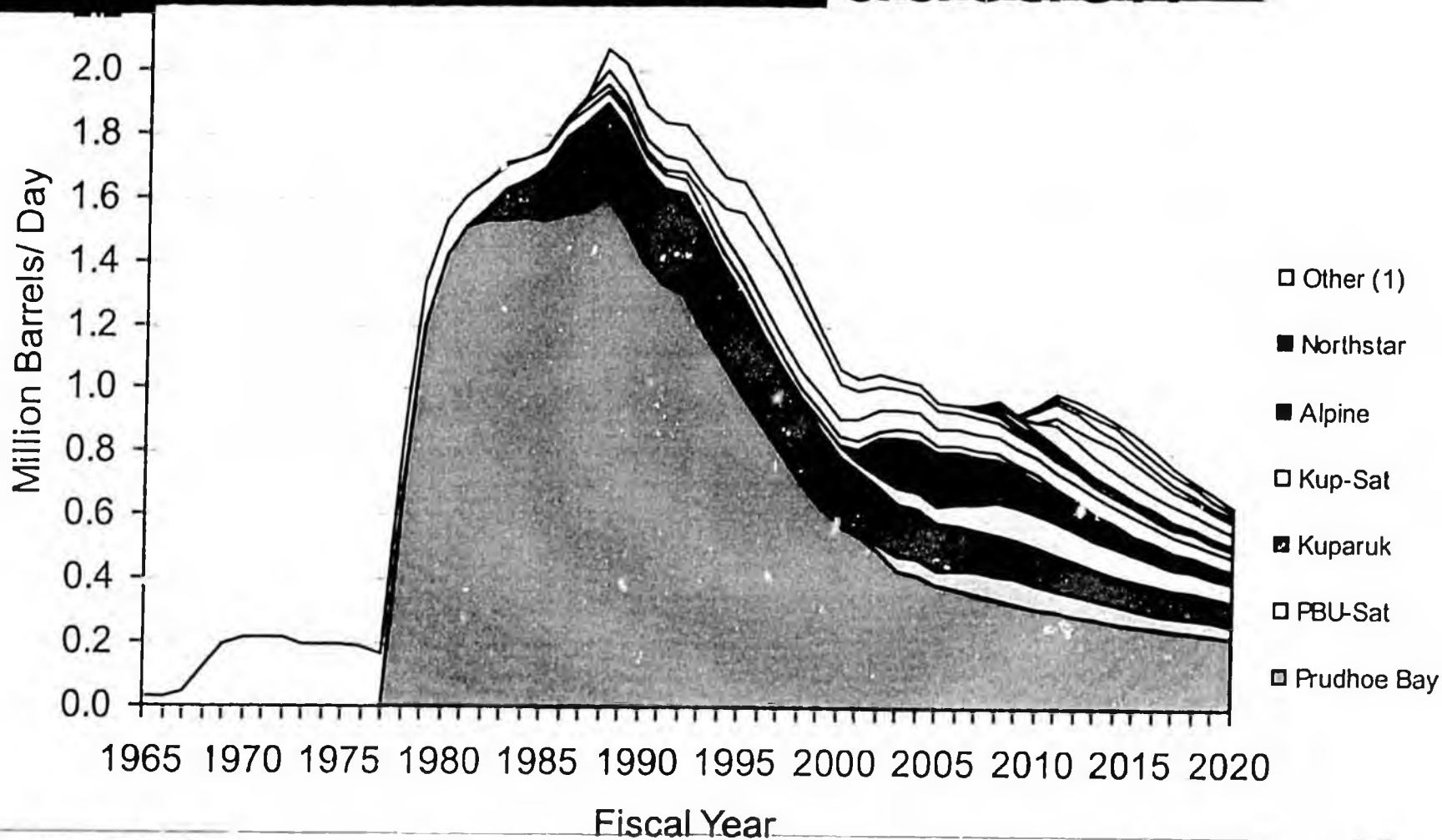
## CS for SB 305 (RES) Overview

Alaska Department of Revenue  
Before the Senate Finance Committee  
March 31, 2006

Robynn J. Wilson, CPA, Director, TAX Division, DOR  
Dan E. Dickinson, CPA

3/31/06 9:21 am

# Alaska Oil Production



Source: Fall 2005 Revenue Sources Book; Alaska Department of Revenue, Tax Division  
 (1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and N-PRA.

# The Governor's 3 Big Ideas

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- The current Production Tax system is broken.
- We need to use the tax system to encourage investment
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low

# The Governor's 3 Big Ideas

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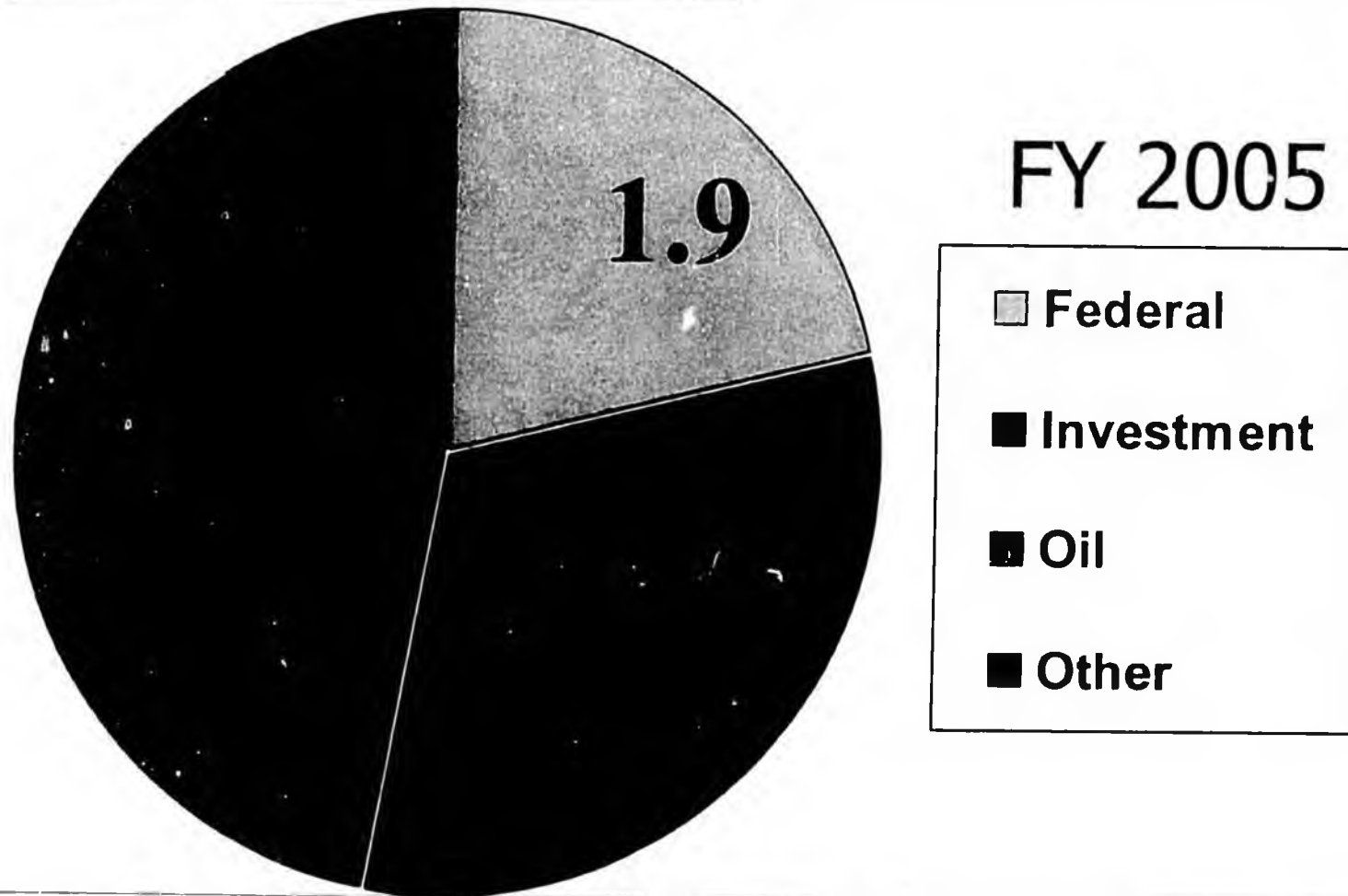
- The current Production Tax system is broken. *The CS also replaces it.*
- We need to use the tax system to encourage investment. *The CS has incentives for investment*
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low. The CS pushes the tax rate to 25%, maintains credit rate of 20%

# The Governor's 3 Big Ideas

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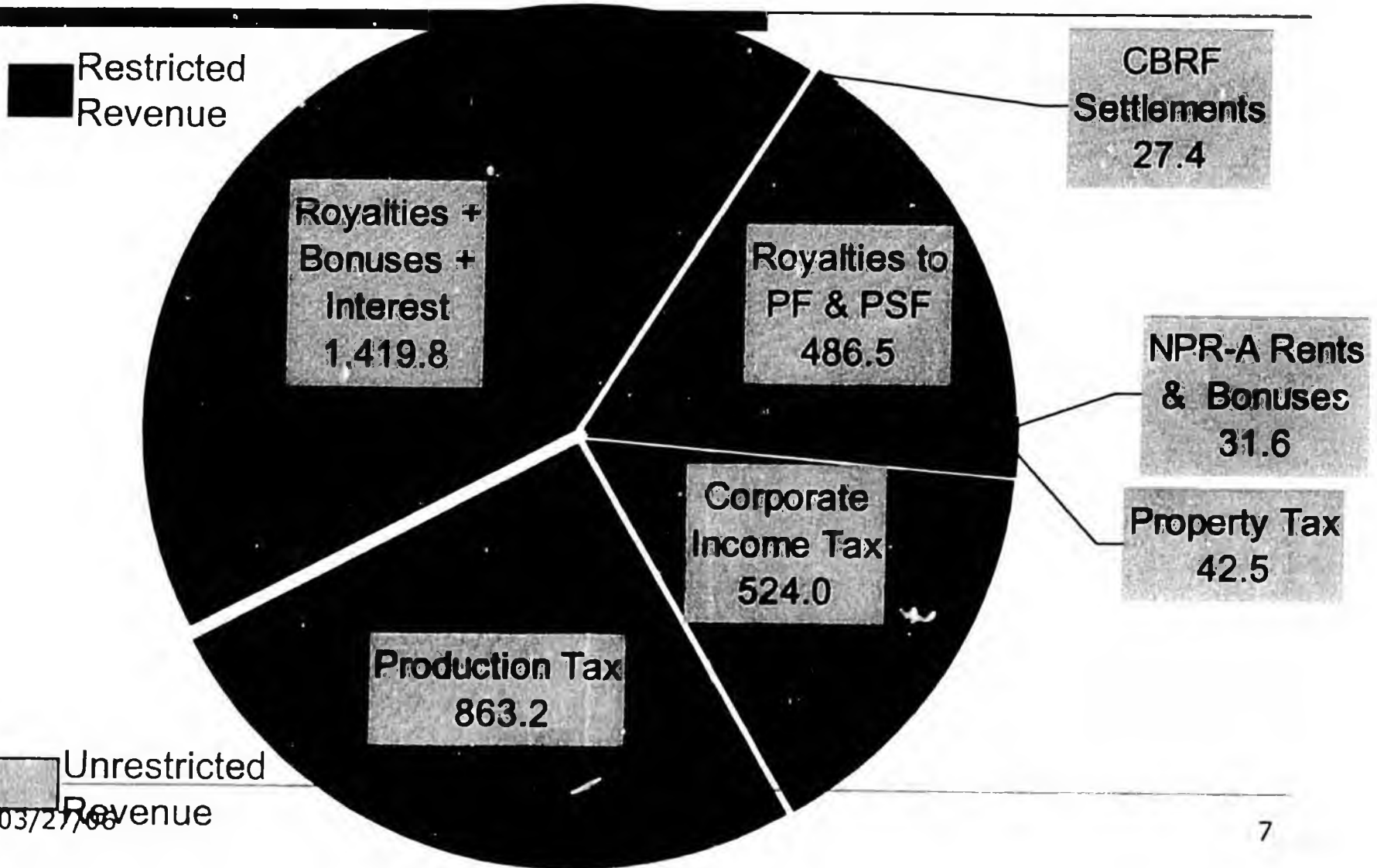
- Idea one: The Production Current Tax System is broken
  - We are not getting the investment we need – could the structure of the Production Tax be to blame
  - We are not getting a fair share of revenues when Prices are high and investment is low

# Unrestricted & Restricted Revenue \$ Billion



# FY 2005 Petroleum Revenue

## \$ Million



03/27/05

# 1. Destination Value at Market (2005)

	Volume Millions barrels	\$ per barrel	\$ Million
Destination Value at Market	330	\$43.43	\$14,332
Less Tankering & Pipelines	<u>330</u>	<u>\$ 4.51</u>	<u>(\$1,488)</u>
Gross Value at Point of Production	330	\$38.92	\$12,844
Less Upstream Costs			
Operating:		\$ 3.33	
Capital:		<u>\$ 3.18</u>	
Total	330	\$ <del>9</del> 6.52	(\$2,150)
Net Value at Point of Production	330	\$32.40	\$ 10,694

08/10/06

## 2. Current Production Tax

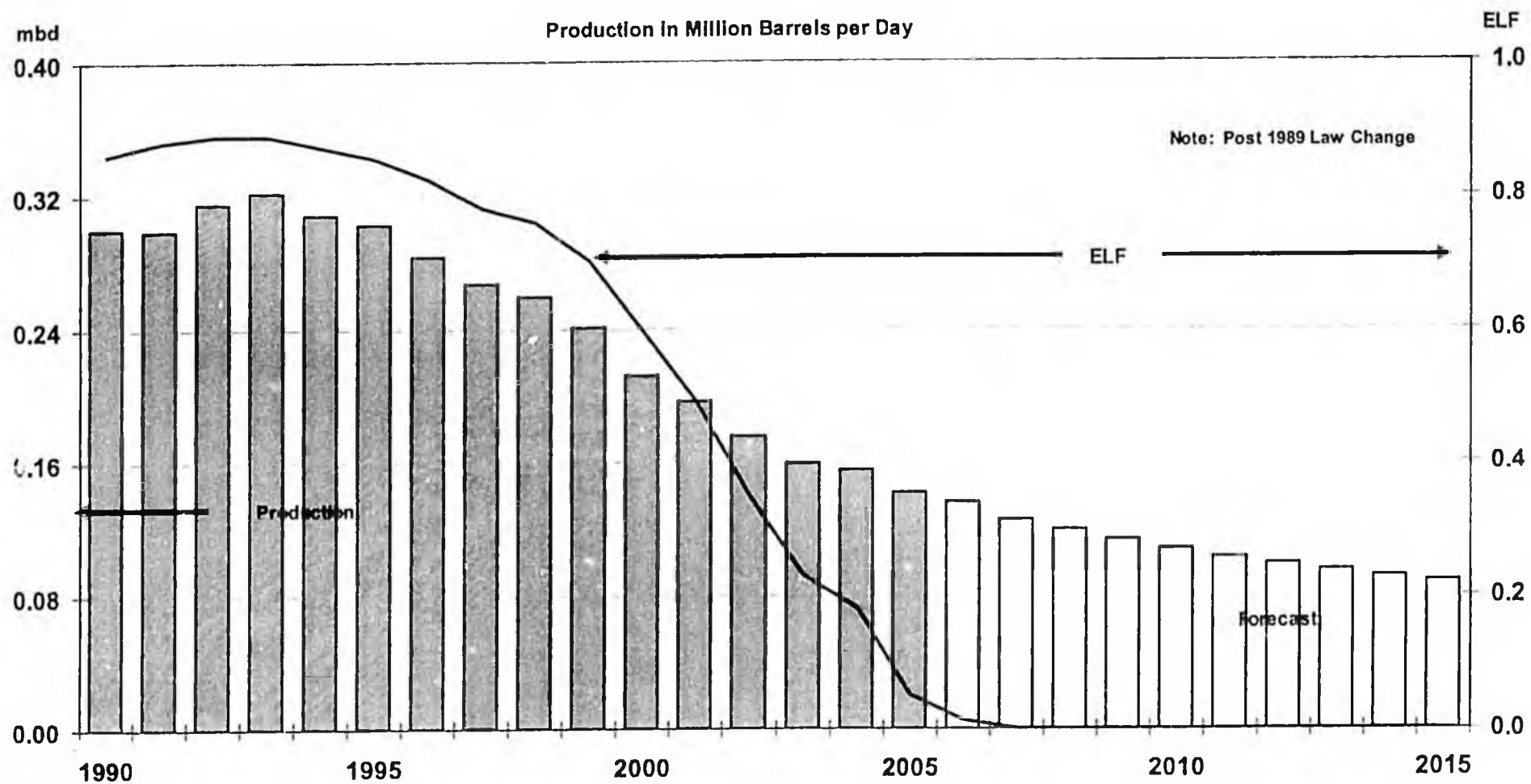
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	\$ in Billion
Gross Value at Point of Production	\$12,844
1- Royalty Rate	0.875
Value Net of Royalty	<u>\$11,238</u>
Tax Rate	0.15
ELF Rate	0.55
Tax	\$ 927

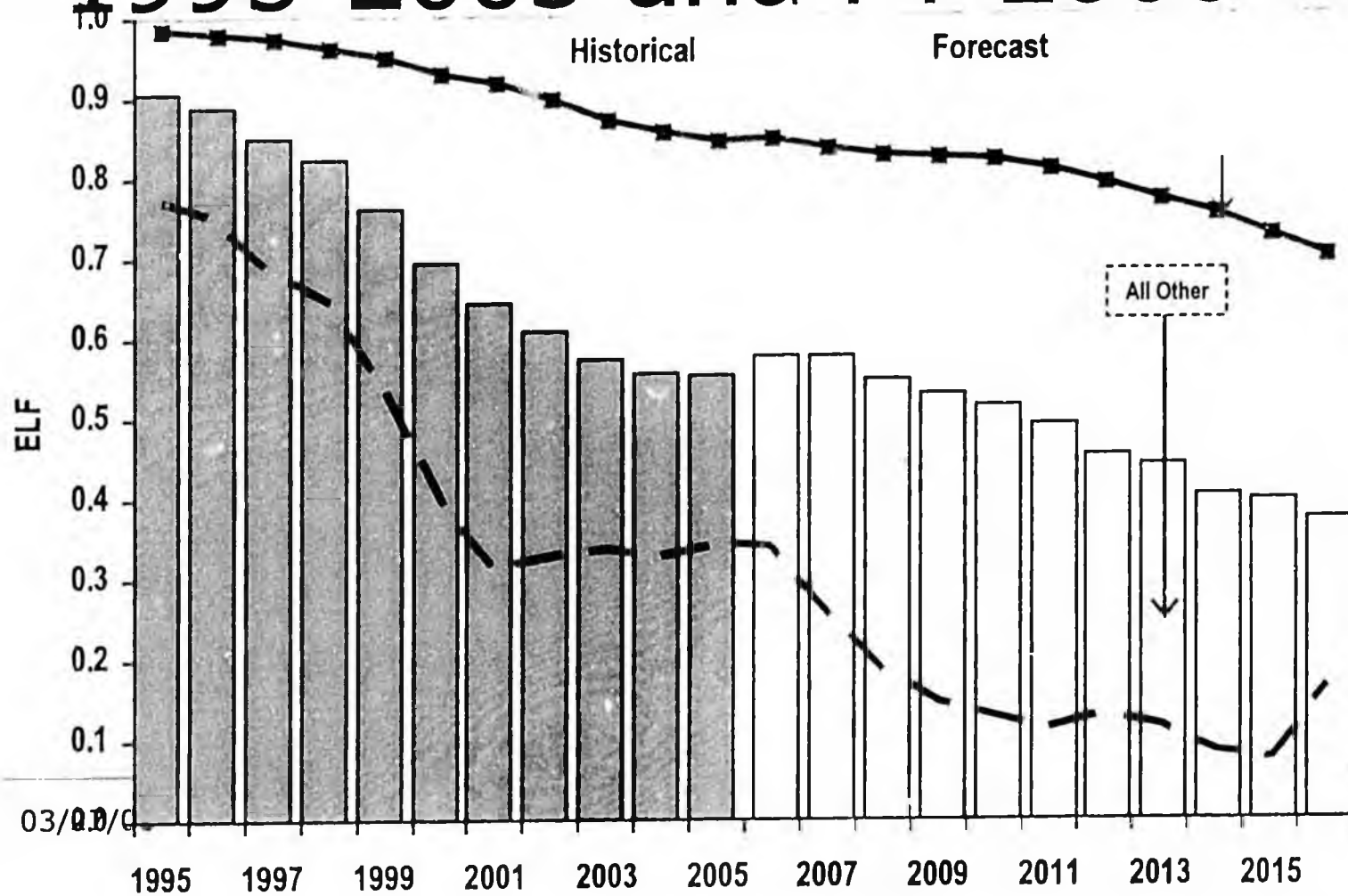
# Implicit Cost

	\$ in Billion
Production Tax Net of Royalty	\$11,238
Less Implicit Cost from Proxy	(\$ 5,057)
	\$ 6,181
Tax Rate	0.15
Proposed Production Tax	\$ 927

# Kuparuk Crude Oil Production & ELF



# Economic Limit Factor, FY 1995-2005 and FY 2006-2016



# The Governor's 3 Big Ideas

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- Idea Two: We need to use the Tax system to encourage investment
- Investment leads to more production
- More production leads to more revenue
- Four ways the bill recognizes investment

## Governor's Bill: 4 ways of encouraging investment

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- Net vs gross – all investment is a deduction
- 20% credits for capital investments
- Up to a \$73 million Annual Allowance
- Recognition of Transition Investment Expenditures

# CS: 4 ways of encouraging investment

---

- Net vs gross – all investment is a deduction *cs preserves*
- 20% credits for capital investments  
*cs preserves*
- Up to a \$73 million annual allowance  
*CS has a a tax-free allowance based on production*
- Recognition of Transition Investment Expenditures  
*CS changes this from a deduction to a credit with a requirement for current investment*

# Tax Based on Net Profits

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- Governor's bill provided a tax based on Net Profits
- CS maintains this approach

# Gross vs. Net

## Current Tax on Gross

Value at wellhead      \$50.00

Times: tax rate            15%

Tax before ELF            \$7.50

## PPT on Net

Value at wellhead      \$50.00

Less:

Lease op exps            (12.50)

Net taxable                \$37.50

Times: tax rate            20%

Tax before  
credits                      \$7.50

# Tax Base

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Gross value at point of production

# Determining value under current system

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West coast value

\$



# Gross Value under PPT

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Dept. of Revenue can allow a producer to elect the use of:

- Royalty value
- DOR formula that estimates a value at a specific location such as point of delivery into a common carrier pipeline

# Tax Based on Net Profits

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Gross value at point of production

Less: Lease expenditures

- ♦ operating costs
- ♦ capital expenditures
- ♦ allowance for overhead

Equals: Net Profits

# Non-deductible expenses

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- Depreciation
- Royalty payments
- Taxes based on net income
- Interest & financing charges
- Lease acquisition costs
- Other costs

# Governor's Bill: Credits to Encourage Investment

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- **20%** of qualified capital expenditures
  
- May be taken on:
  - ♦ Exploration costs
  - ♦ Capital costs **incurred on lease**
  
- Credits are transferable

# CS: Credits to Encourage Investment

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- CS maintains credits
- Credits may not be taken on:
  - Abandonment costs

# Friendly to New Investors

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- Ability to monetize credits
- Ability to monetize losses
- Base allowance
  - Governor's bill: \$73M deduction
  - CS: converts this to tax-free allowance based on production:  
$$(5000 - .2 \times [ADP - 5000]) / ADP$$

ADP = average daily production  
sunsets in 2013

# CS: 5,000 bbl plan

		percentage
Daily	PPT tax-free	of net income
Production	production	tax-free
5,000	5000	100%
6,000	4800	80%
7,000	4600	66%
8,000	4400	55%
9,000	4200	47%
10,000	4000	40%
15,000	3000	20%
20,000	2000	10%
25,000	1000	4%
30,000	0	0%

03/27/06

# Transition Provision

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- Governor's bill allowed deductions for recent capital expenditures
  - Last five years' capital expenditures
  - Allowed over ~~5~~<sup>6</sup> years
  - Allowable on when price of oil exceeded \$40

# Transition Provisions in CS

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- CS maintains 5 year look-back
- Allows recoupment of \$1 for every \$2 currently invested
- Removes oil price test
- Changes from a deduction to a credit