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Sponsor Statement HB 61

HB 61 creates a new income tax credit to encourage increased exploration and development of natural gas reserves south of the Brooks Range. To qualify for the credit, operators must successfully drill and develop hydrocarbon reserves that produce gas for sale and delivery. The credit can offset no more than 50% of an operator's annual income tax liability and would be effective for a period of ten years.

The tax credit would amount to 10% of qualified capital investment (and 100% of services) for each year. For example, an operator who spends \$20 million in a given year successfully developing natural gas reserves would receive an income tax credit of \$2 million -- applicable up to one-half of its income tax liability for that year. Credits in excess of 50% of the operator's income tax liability can be carried forward to future years. No credits will be given for dry holes or for development of crude oil reserves.

The Cook Inlet region continues to have great potential for additional natural gas production as do other areas outside of the North Slope. However, the combination of high development costs and relatively low natural gas prices, create a disincentive to drill for new gas reserves in this area compared to other places. By providing a credit for successful exploration efforts, more drilling will occur in Southern Alaska leading to much-needed new natural gas reserves. This will benefit all residents and businesses at little cost to the state.

In addition to the benefit of developing new gas reserves, increased Cook Inlet drilling will also aid the general economic status on the Kenai Peninsula and in Anchorage as well as other areas of the Alaska. Moreover, increased tax revenue from additional hydrocarbon production should largely mitigate any fiscal impact of the proposed credit.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 61
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title Oil and Gas Tax Credit for Exploration. BRU Oil and Gas Development
 Component Oil and Gas Development
 Sponsor Chenault, Kohring, Wolf
 Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 61 would authorize the Dept. of Revenue to grant credits against a taxpayer's state corporate income tax liability for certain oil or gas exploration and development investments made in the state.

Prepared by: Mark D. Myers Phone 269-8800
 Division Oil and Gas Date/Time 2/4/03 7:46 AM
 Approved by: Tom Irwin, Commissioner Date 2/4/2003
 Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HB 61
() Publish Date: _____

Revisor: Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title Oil and Gas Tax Credit BRU Revenue Operations
for Exploration/Development Component Tax Division
Sponsor Representative Chenault
Requester House Committee on Oil and Gas Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	See Analysis
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill allows a tax credit equal to 10 percent of qualified capital investment and 100 percent of annual labor, seismic and associated costs related to oil and gas exploration and development work to be applied against corporate income tax (AS 43.20) for up to 50% of a corporation's total tax liability. The credit applies only to oil and gas exploration and development of reserves south of the Brooks Range. The credit can only be taken if the reserves produce less than 150 barrels of oil per day or produce gas for sale and delivery.

Further analysis follows on Page 2. Although the tax credit in this bill is intended to assist in the exploration and development of smaller fields outside the North Slope, corporations could use their tax credits under this legislation to reduce taxes paid to the state for North Slope production. This could reduce state revenues, although the question remains whether the gain from new oil and gas production would offset the loss from the tax credits.

Oil and gas corporate income tax collections in FY 2003 and FY 2004 are currently projected at \$160 and \$200 million per year, respectively.

Prepared by: Chuck Logsdon, Chief Petroleum Economist Phone 269-1019
Division Tax Division Date/Time 2/3/03 2:05 PM
Approved by: Larry Persily, Deputy Commissioner Date 2/3/2003
Agency Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 61

ANALYSIS CONTINUATION

It is not easy to evaluate the overall revenue effect of this proposed tax credit. On the plus side, if exploration activity discovers developable reserves, the state could receive royalty and production taxes that could more than offset the revenue loss due to the tax credit. The availability of the credit could enhance the attractiveness of exploring for new oil and gas resources, though the effect of the credit would differ depending whether the corporation had a tax liability that it could reduce by using the credits.

The credit is targeted to exploration and development south of the Brooks Range, while the bulk of current oil and gas corporate income tax against which this credit could be taken is from production of high-value oil on the North Slope. Furthermore, the credit is focused on the development of much lower-valued natural gas or extremely small oil reserves. As a result, an oil and gas corporation that has profitable operations on the North Slope could, with enough qualifying expenditures south of the Brooks Range, reduce its total oil and gas corporate income tax liability by up to 50% under this legislation. Additionally, an oil and gas corporation that does not currently have any activities in Cook Inlet could buy into an existing Cook Inlet operation if for no other reason than to qualify for the tax credits while also hoping to find new oil and gas reserves.

The key state revenue issue with regard to this tax credit is the extent to which the additional incentive is needed to encourage exploration and development. Existing statute, AS 38.180(f)(5), allows a specific royalty reduction to 5% on the first 35 million mcf of gas and 25 million barrels of oil produced from a number of Cook Inlet oil and gas fields including Falls Creek, Nicolai Creek, North Fork, Point Starichkof, Redoubt Shoal and West Foreland. The commissioner of Natural Resources also has the ability to reduce the royalty rates on any field in the state for which the producers can demonstrate that this is necessary to make the production economic. The Cook Inlet also currently benefits from a discovery royalty provision under AS 38.05.180(f)(4) and the ability to apply for an exploration incentive credit under AS 38.05.180 and AS 41.09.010.

NOTE: There is an issue in the bill with respect to the oil production limit to qualify for the credit. Section (g)(1) that limits the credit to "reserves that produce less than 150 barrels of oil a day..." is vague with respect to the time period for which this limit is calculated. If this is an annual average or some other measure, it should be stated as such -- or there will be alternative interpretations as to how to calculate the limit that would potentially have revenue consequences.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
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MEMORANDUM

February 3, 2003

SUBJECT: House Bill 61, establishing an exploration and development tax incentive tax credit for persons engaged in the exploration for and development of less than 150 barrels of oil or gas for sale and delivery without reference to volume from a lease or property in the state -- sectional analysis (Work Order No. 23-LS0270\A)

TO: Representative Vic Kohring, Chair
House Special Oil and Gas Committee

FROM: Jack Chenoweth
Assistant Revisor of Statute 

The bill proposes to add, for the period before its repeal, provision for an oil and gas exploration and development incentive tax credit against the taxpayer's tax liability under the Alaska Net Income Tax Act (AS 43.20).

Bill section 1: This bill provision adds a new codified section, AS 43.20.043, that authorizes the credit and establishes its limitations:

-- subsection (a) authorizes the tax credit, applicable to any tax year beginning after 2002, against tax liability due under the Alaska Net Income Tax Act (AS 43.20); the amount of the allowable credit is based on 10 percent of the taxpayer's "qualified capital investment" (later defined) and 100 percent of the "qualified services" (also later defined) incurred by the taxpayer relating to a qualified capital investment;

-- subsection (b) sets parameters on what may qualify as a "qualified capital investment": those include cash expenditures or binding payment agreements made after December 31, 2002, for assets first placed in service during the tax year, as that phrase is defined in paragraph (2) of this subsection;

-- subsection (c) sets a maximum limit that may be claimed as a credit against the taxpayer's Net Income Tax liability: that limit is set at 50 percent of liability; expenditures that qualify for the credit in excess of the limit may be carried forward and applied in later tax years until exhausted or for not more than five years;

-- subsection (d) sets out the procedural requirements for claiming the credit and assigns the burden of proof for entitlement to the credit;

-- subsection (e) sets out conditions on what may be done with a credit to which the taxpayer becomes entitled, under threat of forfeiture of any portion of an unused credit carry-forward;

-- subsection (f) imposes a geographic limitation on activity that may qualify for the credit: the credit is not available if an otherwise satisfactory "qualified capital investment" or "qualified services" associated with that investment occur north of 68 degree North latitude (generally, Alaska's Arctic Slope);

-- subsection (g) defines applicable key terms: it is within the definition that the substantive limitation of "property used . . . in the exploration and development of oil and gas reserves" is capped at production of oil of less than 150 barrels per day (though investment for recovery of gas for sale and delivery is set without limitation as to amount).

Bill section 2 repeals the oil and gas exploration and development incentive tax credit.

Bill section 3: This transitional provision is included so that a taxpayer, entitled by AS 43.20.043 to a full five-year period in which to claim as a carry-forward any unused portion of the tax credit, may make the claim on or after January 1, 2013 (the date set in **bill section 5** for repeal of the authority to claim the credit), until the earlier of the date on which any unused portion of the carry-over is exhausted or until December 31, 2017 (the day before the fifth anniversary of the credit's repeal). In other words, a taxpayer basing a claim of credit on qualifying improvements or services made as late as December 31, 2012, may have the full five years to exhaust its use.

Bill section 4 is included so that claims of the credit may apply to qualified investment made on or after January 1, 2003, the start of the current tax year.

Bill section 5 sets the effective date of the repeal of the credit at January 1, 2013.

Bill section 6, an effective date provision for the bill, gives the substantive provisions of the measure an immediate effective date.

61

ANALYSIS

This bill allows a tax credit of 10 percent of qualified capital investment and 100 percent of annual labor, seismic and associated service costs related to a corporation's qualified oil and gas exploration south of the Brooks Range. The credit would be applied against corporate income taxes (AS 43.20), and would be limited to 50% of a corporation's tax liability in any one year. The credit would only be allowed for oil reserves that produce less than 150 barrels of oil per day or for any gas reserves that produce any volume - large or small - of gas for sale and delivery.

The state oil and gas corporate income tax in FY 2001 brought in \$338 million. FY 2002 collections are projected at \$150 million, due to lower oil prices. If corporations were able to accumulate enough exploration and development credits under the legislation, the state's corporate tax revenue could be cut in half in any given year.

It is difficult to evaluate the overall revenue effect of a tax credit. If exploration activity leads to the discovery of new reserves that go into production, then the state would receive new royalty and production taxes that may or may not offset the revenue loss due to the tax credit.

The bulk of the oil and gas industry's current state corporate tax liability is from production of high-value oil on the North Slope, while the credit is primarily focused on the development of much lower-value natural gas reserves. Although most of the taxable oil and gas corporate income is earned north of the Brooks Range, only qualifying exploration and development expenditures south of the Brooks Range could be taken against total oil and gas corporate tax liability. For example, an oil and gas corporation that already has operations in Cook Inlet and the North Slope could, with enough qualifying expenditures, reduce its total oil and gas corporate income tax liability by 50%. Additionally, an oil and gas corporation that does not currently have any activities in Cook Inlet could buy into an existing Cook Inlet operation and thus qualify for the credits.

The key issue to tax credits is the extent to which the additional incentive is needed to make a project economic. The current law, AS 38.180(f)(5), already allows a specific royalty reduction to 5% on the first 35 million mcf of gas and 25 million barrels of oil produced from a number of Cook Inlet fields: Falls Creek, Nicolai Creek, North Fork, Point Starichkof, Redoubt Shoal and West Foreland. The commissioner of Natural Resources also has the ability to reduce the royalty rates on any field in the state for which the producers can demonstrate that it is necessary to make the production economic. Cook Inlet fields also currently benefit from a discovery royalty provision in AS 38.05.180(f)(4) and the ability to apply for an exploration incentive credit in AS 38.05.180 and AS 41.09.010.

This bill allows the credit without regard to the specific economics of development.

Supplemental Edition
1999

Changes and Additions to the 1998 Edition

Investments in Energy Security

State Incentives to Maximize Oil and Gas Recovery



Interstate Oil and Gas
Compact Commission



The
Energy Council

ALABAMA (continued)

Citation: Act 96-277, House Bill No. 54; amends Ala. Code §§ 40-20-2(a) and 9-17-25 (1975)

Effective date: July 1, 1996

UPDATED Gilbertown Field Project, Geological Survey of Alabama

Investigators have concluded a three-year program called, "Area Balance and Strain in an Extensional Fault System: Strategies for Improved Oil Recovery in Fractured Chalk, Gilbertown Field, Southwestern Alabama." The program developed new balanced structural models that were applied to fractured reservoirs in extensional growth-fault systems and helped guide redevelopment of Gilbertown Field where oil production has declined to marginally economic levels. The program was 50% supported by federal funds and 50% supported by the Geological Survey of Alabama and the University of Alabama.

Effective Date: March 1996; through September 1998

Goals: To develop and apply advanced structural theory to fractured oil reservoirs and to suggest ways that oil recovery can be improved.

Impact: Interest in this program by operators in the Gulf Coast region has been strong, and results are being disseminated through a vigorous technology transfer program. Results have provided an unprecedented view of the geometry, kinematics and reservoir characteristics of fractured chalk in the eastern Gulf Coast basin and the first production wells have been drilled since 1985.

Core and Sample Library, Geological Survey and State Oil and Gas Board

The Geological Survey of Alabama maintains a core and well sample library that includes cuttings from 4,000 oil and gas wells, core from 1,700 oil and gas wells, cuttings from 2,800 water and stratigraphic test wells and core from 350 industrial mineral core holes. Rules and regulations of the State Oil and Gas Board require that exploration companies submit cores and drill cuttings following the completion of wells. Rule 400-1-3-.10 of the Code of Alabama (1975) states in part that "A complete set of cuttings, correctly labeled and identified as to depth, shall be filed with the Board within 30 days from the time of completion of any well unless otherwise approved by the Supervisor. If cores are taken, a complete set of cores, either whole or at least quarter slabs, correctly labeled and identified as to depth, shall be filed with the Board within six months from the time of completion of any well unless otherwise approved by the Supervisor." The facility has four viewing rooms for use by operators and researchers.

Goals: Encourage oil and gas production by making useful data available to producers. Counteract the loss of infrastructure in the independent industry.

ALASKA

NEW Cook Inlet Royalty Reduction

Firms shall pay a royalty of 5% on the first 25,000,000 barrels (25mmbls) of oil and the first 35,000,000 Mcf of gas (35 Bcf) produced for sale from that field that occurs 10 years following production. Production must begin prior to January 1, 2004. Fields eligible are Falls Creek, Nicolas Creek, North Fork, Point Starichkof, Redoubt Shoal and West Foreland.

Effective Date: August 8, 1998 *End date:* Ten years after production begins. Production

ALASKA (continued)

must begin prior to January 1, 2004.

Goal: To initiate production from undeveloped or shut-in oil and gas fields in the Cook Inlet that were discovered prior to January 1, 1998, and have been undeveloped or shut-in from at least December 31, 1997.

Active Supporters: Industry and legislature

NEW Areawide Lease Sales

Provide an established time each year that acreage within a geographical region will be available for lease. This will increase the number of lease sales conducted by the state.

Effective date: January 1, 1997 *End date:* Ongoing

Goal: To allow companies to plan and develop their exploration strategies and budgets years in advance. This will result in more efficient exploration and earlier development of oil and gas resources.

Active Supporters: Industry, Gov. Knowles, legislature

Stranded Gas Development Act

This is not a strict incentive but rather an authorization for redesign of portions of Alaska's tax system. The Law authorizes the Commissioner of Revenue, via an application process, to negotiate contracts with project sponsors to provide fiscal terms to improve the economic feasibility of developing Alaska's stranded gas resources for a liquefied natural gas export project. It allows fiscal arrangements to be tailored to the specific economics of a project. Those arrangements must be consistent with the long-term fiscal interests of the state. The state's 12.5% royalty share is unchanged.

Goal: Development of Alaska's North Slope gas reserves for an LNG export project.

Supporters: The legislation was submitted by the governor of Alaska. It is supported by the Alaska Legislature and by private industry.

Oil and Gas Policy Council

The Oil and Gas Policy Council, created by Alaska Gov. Tony Knowles, consists of oil and gas industry representatives, state officials and representatives from labor, the environmental community and business. The council meets four times each year to develop recommendations to the governor about oil and gas policy. The council focuses on bringing new development into Alaska and sharing information.

Economic Limitation Factor

The severance tax rates for oil and gas are reduced by a field's Economic Limitation Factor (ELF). During the life of a field, production income diminishes while some operating costs remain fixed. At some point the total costs including operating costs, royalties and production taxes will exceed gross revenue and the field becomes unprofitable. This is called the economic limit. As production diminishes, the tax rate on the field decreases as well. The ELF provides for lower tax rates based on daily per well production and the productivity of the field.

Citation: Alaska Stat. 43.55.012

Effective date: 1989

Goals: Keep fields in production as they decline and encourage operators to drill development wells.

Impact: Severance tax rate is effectively zero in all but the very largest oil fields in Alaska.

ALASKA (continued)

Enhanced Oil Recovery and Idle Wells

Enhanced oil recovery projects receive a 50% severance tax reduction on incremental production. Wells inactive for 12 consecutive months receive total severance tax exemption for all restored production from any zone previously productive. Incremental production in an active field due to new research technology has total severance tax exemption. This tax reduction does not apply to natural gas.

Citation: H.B. 1314

Shallow Gas Leasing

Over-the-counter leases are available specifically for the development of coalbed methane and shallow (less than 3000 feet) gas sands. There is no bonus payment to the state and annual rental payments are kept at 50 cents per acre. A reduced royalty of 6.25%, rather than 12.5%, applies if the shallow gas is sold to a local utility. The royalty reduction applies only if the shallow gas is not in direct competition with higher royalty, deeper gas. The bond requirement is \$25,000, rather than \$1 million for other gas drilling.

Citation: Alaska Stat. 38.05.177

Effective date: Adopted July 1996, no sunset

Goal: To locate local sources of gas that can be delivered to consumers in remote areas at less cost than alternative energy sources.

Active Supporters: Industry, native corporations and rural utilities

Impact: Jim Haynes, Alaska Division of Oil and Gas, has reviewed the effectiveness of this incentive.

Exploration Incentive Credit

Operators drilling on state lands may earn Exploration Incentive Credit (EIC) based on footage drilled and the region in which drilling takes place. Credits may be as high as 50% of eligible costs if performed on state land, and as high as 25% of eligible costs if performed on federal land or private land. Work must be performed within two years of the lease sale, and geophysical data from these activities must be made public after the sale.

Citation: Alaska Stat. 38.05.180(1)

Effective date: November 9, 1979

Goal: To encourage exploration on state land.

Impact: A reported \$60 million in credits have been claimed. Twenty wells have been drilled, including one discovery.

The Commissioner of Natural Resources may grant an EIC for exploratory drilling, stratigraphic test well drilling, and for geophysical work on other lands within the state (this includes federal as well as private land owned by Native Alaskan regional corporations formed under the Alaska Native Claims Settlement Act). Wells must be drilled three or more miles from another well or within three miles of an oil or gas well when the commissioner finds that they are drilled in separate exploration targets. Credits may be as high as 50% for wells drilled on federal land, and 25% for wells on private land. The amount of drilling credits is based on feet drilled. Exploration data remains confidential for two years. The amount of credit may not exceed \$5 million per project, and the total of credits may not exceed \$30 million.

Citation: Alaska Stat. 41.09.010

Effective date: July 7, 1994, through July 7, 2004

Goals: To encourage exploration in remote parts of the state and to provide a means for the state to obtain exploration data from state, federal and certain private lands.

Active Supporters: Division of Oil and Gas, Department of Natural Resources and industry

Impact: Not yet known.

ALASKA (continued)

Exploration License Program

The Exploration License Program (ELP) offers large unexplored areas of Alaska for exploration. The license confers the exclusive right to explore, for up to ten years, areas between 10,000 and 500,000 acres in size. Applicants bid on the license, and the applicant willing to spend the most on exploration wins the license fee. No licensee may hold more than 2 million acres under license at any given time.

Citation: Alaska Stat. 38.05.131-134

Effective date: 1996

Goal: To encourage exploration in Alaska's interior and unexplored areas (not applicable to the Alaskan North Slope or Cook Inlet, which are known oil and gas provinces)

Impact: One application was received but later withdrawn. It is still too early to judge.

Cook Inlet Discovery Royalty

Permits the granting of discovery royalty for wells in the Cook Inlet Sedimentary Basin that have discovered oil or gas in a previously undiscovered oil or gas pool, provided the wells are capable of producing in payable quantities. The discovery royalty is set at 5% for 10 years following the date of discovery.

Citation: Alaska Stat. 38.05.134

Effective date: July 1996

End date: Ongoing

Goal: To encourage exploration for oil and gas in the Cook Inlet.

Active Supporters: Alaska legislature, small Cook Inlet exploration & production firms

Royalty Reduction

If a delineated field or pool has not previously produced, the royalty can be lowered to 5%. If an existing producing field or pool, the royalty may be reduced to 3% in order to prolong its economic life as costs per barrel increase. The royalty may also be reduced to 3% to establish production of shut-in oil or gas.

Citation: Alaska Stat. 38.05.180

Effective date: July 1995; through July 1, 2015

Goal: To encourage otherwise uneconomic production of oil and gas.

Active Supporters: Industry, Alaska Department of Natural Resources Division of Oil and Gas.

Note: A notice of proposed changes in regulations of the Alaska Oil and Gas Conservation Commission was published in October 1996. Proposed changes would comprehensively revise existing oil and gas regulations. Proposed regulations may be obtained by writing the AOGCC, 3001 Porcupine Drive, Anchorage, Alaska 99501-3192.

ARIZONA

Property Tax Reduction

The Property Tax Reform and Reduction Act, passed by the 42nd Legislature in July 1996, reduced the property tax assessment ratio for all real and personal property used by producing oil, gas and geothermal interests to 28% of full cash value from 100%. The tax rate will decrease an additional 1% per year until holding at 25% in 2000 and thereafter.

Citation: Amendment to § 15-971-A-3(c), Ariz. Rev. Stat. Ann.

Effective date: 1996 tax year; no sunset