292A HRES HB 346

292A

A	3%	of 1st	300
B	5%		700
C	6%		1500
D	8%	>	2,500

AGO 513804

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

COMMITTEE REPORT

3/26/75 HOUSE FINANCE

Mr. Speaker: Date 4-14-76

The Committee on RESOURCES has had HB 346 under consideration. A Majority of the members of the Committee

(X) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

(X) recommends it BE REPLACED WITH CS FOR HB 346 AND THAT CS FOR HB 346 DO PASS

( ) "and" recommends it BE REFERRED TO THE ________ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

[signatures]

Members NOT concurring in the Majority report:

________ recommends:

________ recommends:

________ recommends:

________ recommends:

________ recommends:

________ Chairman

AGO 513805

#HD (File)

STATE OF ALASKA

JAY S. HAMMOND, Governor

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER / *POUCH S—JUNEAU 99801*

April 28, 1975

The Honorable Nels Anderson
Chairman
House Resources Committee
Alaska State Legislature
State Capitol
Juneau, Alaska 99811

Dear Mr. Anderson:

re House Bill No. 346

House Bill No. 346, an Act relating to the oil and gas properties production tax was introduced in the House on April 26, 1975 and was referred to the House Resources and Finance Committees.

For the consideration of the House Resources Committee, I am enclosing a copy of a memorandum dated April 2 1975 from O. K. Gilbreth, Jr., Director, Oil and Gas Division, Department of Natural Resources, Anchorage, Alaska concerning effect on Treasury, administrative problems and indicating that there would be no additional costs of administration.

Very truly yours,

R. D. Stevenson

R. D. Stevenson
Special Assistant

Enclosure

cc: The Honorable Hugh Malone
Chairman
House Finance Committee
Alaska State Legislature
State Capitol
Juneau, Alaska

Mr. O. K. Gilbreth, Jr.
Director, Oil and Gas Division
Department of Natural Resources
3001 Porcupine Drive
Anchorage, Alaska 99504
(Phone: 279-1433)

MEMORANDUM

State of Alaska

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS

TO: R. D. Stevenson
Special Assistant
Dept. of Revenue

DATE: April 24, 1975

FILE NO:

TELEPHONE NO:

FROM: O. K. Gilbreth, Jr. OKG
Director

SUBJECT: HB #346

We have examined the subject bill and have discussed in detail some of the ramifications of the bill with Mr. John Messenger, Tom Williams and Will Condon of the Attorney General's office. We pointed out to these attorneys that the proposed bill provides that the tax will be levied on "the gross value at the point of production of the gas and liquids produced each month". The present tax is levied on oil and gas sold during the month and this volume is considerably different from the volume produced each month. The oil and gas conservation regulations require reporting of the volume produced. All production may not be sold and some may be retained in storage at the end of the month. When a sale is made the quality of the oil and gas is determined and run tickets are prepared and values paid on the basis of the quality of the oil sold. If the proposed change in the law could be interpreted to be levied on oil produced there is no way to determine the value of the oil produced. The attorneys, however, have advised me that for purposes of this particular law, "the gross value at the point of production" is in reality the point of sale and even though the law says oil produced it really means oil sold. All three attorneys have advised that this is the case and such being the case I see no objections to it. I should point out, however, that common usage in oil field terminology throughout the remainder of the United States provides that oil and gas produced means just that and oil and gas sold means that. Our law, I think, will be confusing if the proposed wording is adopted.

As you know, the tax is levied on the basis of individual wells and the amount of oil sold. Only on the oil sold can we determine the quality. I have talked with John Messenger and suggested that the law be changed to permit the value to be determined on a lease basis and alotted back to the individual wells based on routine well tests. This as a practical matter, is being done now, because there is no way to audit production records and production values according to the present law. If the proposal were changed to permit determining value on the basis of the lease runs then we would have a law that provides a legal means for auditing. John Messenger advised me that this could be done and he would so recommend it to Representative Cowper. I certainly recommend the change in order to comply with the law.

From [illegible] standpoint of fiscal effects of the bill, most oil being sold [illegible] state at the present time has a value such that the cent[illegible] barrel tax applies. Hence HB #346 would have no effect on i[illegible]e of the state since the cents per barrel law is effective. Howe[illegible], should crude oil prices increase and the Department of Labor

AGO 513807

cost index increase at a lower rate to the extent that the tax would be collected on percent of value, then there would be an increase in wellhead value of approximately 5 cents per barrel on each barrel of oil produced in the Cook Inlet area. As a maximum on one hundred ninety thousand barrels per day of production, this would amount to additional taxes of one hundred ninety two thousand dollars per year. Thus this law could have a fiscal effect of increasing tax receipts anywhere from zero to one hundred ninety two thousand dollars per year depending on the method of calculating the taxes.

I see no additional administrative costs associated with changing the law as the additional auditing burden would be minimal.

cc: Guy R. Martin, Commissioner

Bristol Bay Native Corporation 445 E. 5TH STREET / ANCHORAGE / ALASKA 99501 / PH. (907) 277-9511

April 9, 1976

The Honorable Nels A. Anderson, Jr., Chairman
House Resource Committee
Pouch "V"
Juneau, AK 99801

Dear Mr. Anderson:

I respectfully request this letter be made part of the record when your committee holds hearings on HB 346 next week.

In the past Bristol Bay Native Corporation representatives have testified and have written several letters for the record explaining that we will be a producing oil company once commercial production is established on our lands.

The amendments in HB 346 are penalties to the producer who historically has used oil or gas on the lease or property to clean and treat the oil or gas to pipeline quality and shipment. This is a provision in both State and Federal lease forms, however taxing that portion of the royalty oil or gas is not a part of the lease forms. There are many variables and it is difficult to determine the amount of revenue this might produce, although it would be minor. Regardless, this bill would require additional metering, records, accounting and reporting which is punitive and would be costly to our Corporation. Therefore BBNC is opposed to the provisions of the entire bill.

Very truly yours,

BRISTOL BAY NATIVE CORPORATION

W. C. Bishop
W.C. Bishop
Petroleum Consultant

cc: Directors
Regions
AFN

AGO 513809

Recd 4/12

Bristol Bay Native Corporation 445 E. 5TH STREET / ANCHORAGE / ALASKA 99501 / PH. (907) 277-9511

April 9, 1976

The Honorable Nels A. Anderson, Jr., Chairman
House Resource Committee
Pouch "V"
Juneau, AK 99801

Dear Mr. Anderson:

I respectfully request this letter be made a part of the record when your committee holds hearings on the Second SS for HB 803 next week.

Bristol Bay Native Corporation is an Alaska Corporation subject to normal corporate income taxes, however this bill, if passed, will require seperate accounting and would appear to be an accounting department nightmare.

Without a final copy of the bill, BBNC's objections will be limited general statements and not specific paragraphs as follows:

1) General administrative costs should not be tied to a cents per barrel.
2) No deductions paid for services used or provided outside Alaska could and probably would be an exceptionally high burden on our Corporation.
3) Limiting deductions of exploration costs incurred in any calendar year to 20% could be prohibitive and contrary to normal accounting procedures.
4) By not allowing engineering or design costs incurred outside Alaska as a deduction, would again be an excessive burden on our Corporation. For example, with established production, BBNC will build and own 100% of a topping plant to supply fuel for our joint operations. The engineering and major construction would be performed outside Alaska.
5) Limiting interest to 9% per annum on funds used during construction of facilities used and useful in the production of a field may be capitalized, certainly ignores the financial facts that interests rates vary over a rather wide range. It may also be considered as an attempt to regulate similar to utility regulations.

Overall this bill would penalize our Corporation by requiring additional accounting, limiting normal deductions, reduce our income and thusly increasing

AGO 513810

our Corporate taxes over the present corporate income taxes. Therefore BBNC is opposed to this bill in its entirety. We expect to be good corporate citizens and pay our fair share of taxes without being penalized as an Alaskan corporation.

Very truly yours,

BRISTOL BAY NATIVE CORPORATION

W. C. Bishop

W.C. Bishop
Petroleum Consultant

cc: Directors
Regions
AFN

AREAS OF CONTINUING CONCERN

Wellhead value litigation was first instituted in March of 1970. No judgment has been issued and the Petroleum Revenue Auditor is still unable to verify or take issue with wellhead values used by oil and gas producers to determine royalty and tax obligations.

Recently the Deputy Attorney General received permission from the present Administration to pursue individual settlements with as many of the 13 oil producers involved as possible.

Because of the extensive time already taken to approach an acceptable resolution we support individual settlements as long as there is no legal precedent being set to effect North Slope production.

There should be a joint effort by the Departments of Law and Natural Resources to insure that full guidelines and regulations are in force when North Slope production begins.

Legislative efforts are also being proposed to address this same problem. There is a current effort to change the point of taxation from a per well basis to the point of transfer to a common carrier. This approach would solve problems of per well production allocation as well as fluctuating transportation deductions effecting wellhead value. For this reason, we encourage any constructive activity in this area.

The Federal Department of the Interior continues to make semi-annual payments to the State for 90% of the royalty revenue received from oil and gas produced on federal lands within Alaska. This revenue continues to be inadequately supported and as yet the Petroleum Revenue Auditor has been unable to verify the reasonableness of any of the payments.

Only recently has the Petroleum Revenue Auditor established a line of communication with United States Geological Survey personnel in an effort to independently compute the semi-annual receivables. As yet, it is too early to determine if this effort will be fruitful. For this reason we continue to recommend that the State require oil and gas producers to file a copy of their federal royalty return along with the State production tax return. The oil produced on federally-owned land is subject to production tax and the federal royalty is a deduction on the State tax return.

---

3. Analyze calculated taxes and royalty vs. actual receipts.

4. Analyze actual receipts vs. forecast fees."

We encourage further development of the automated system for auditing Production Tax and Royalty returns. The automated audit procedures should include cross checking returns to valid supporting documents and comparing information reported in tax and royalty returns to production information required to be submitted directly to the Division of Oil and Gas by the producers.

5. There is a need for guidelines in determining "wellhead value" of oil for royalty and tax purposes.

On July 3, 1969, a directive was issued by the Commissioner of the Department of Natural Resources which was intended to define the value of State royalty oil.

A suit was filed against the State and the State filed suit in connection with the question of the value of the oil. Since the matter was referred to the courts, the Petroleum Revenue Auditor has been unable to verify the reasonableness of "wellhead value" used by oil and gas producers to determine royalty and tax due.

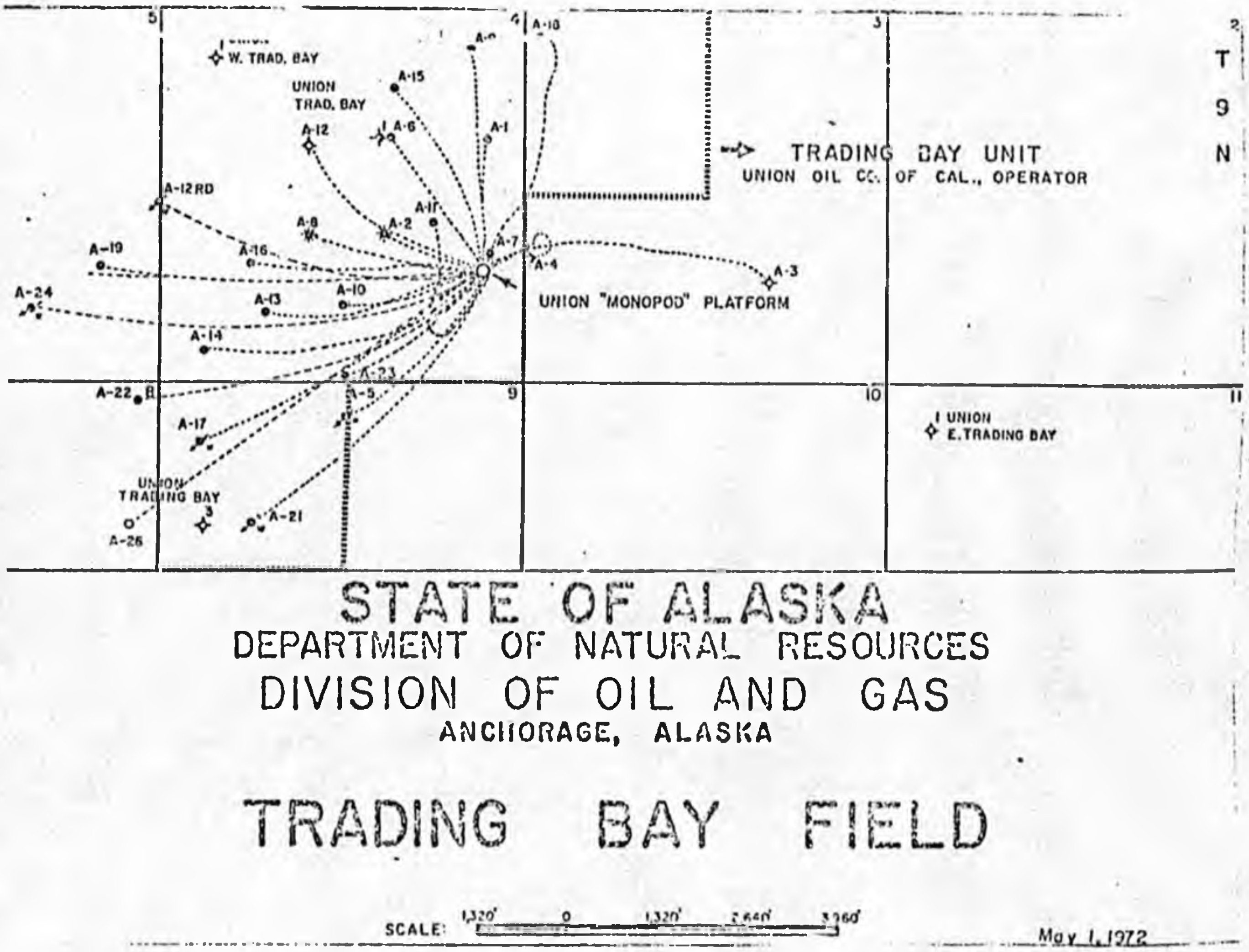
When the definition of wellhead value for royalty and tax purposes is legally determined:

A. The State should assess all deficiencies due;
B. Specific guidelines for any deductible items should be established by regulation (if such guidelines are not established by the court) and added to the oil lease form; and
C. Periodic audits of oil company records should be conducted to determine that deductions being taken are proper.

6. <u>There is a need for more definitive and complete "per well" production figures for off-shore facilities</u>.

Production tax calculations are based on average daily production for each well. However, it is standard practice in the oil industry not to meter the production of each well at offshore facilities. Instead, the production of each well is tested periodically to determine what portion of total production of the facility is represented by that well. Actual daily production of the facility for the month is allocated to each well based on the results of the periodic tests.

There are several of these offshore facilities in the Cook Inlet from which more than one well was drilled. A typical example is the Trading Bay Unit as illustrated in the below drawing taken from a statistical report issued by the Division of Oil and Gas.



FINDINGS AND RECOMMENDATIONS CONT.

The Division of Oil and Gas determines whether production on a "per well" basis appears reasonable by comparing current production to past history. In addition to the reasonableness test, periodic well tests conducted by oil producers are occasionally observed by Oil and Gas personnel. The well tests, however, are affected by many variable factors and average daily per well production cannot be certified by the Division of Oil and Gas as a result of observation of the tests.

The problem of pinpointing individual well production is a technical one. We have not addressed ourselves to this problem because of its technical nature. The Division of Oil and Gas should be encouraged to develop ideas regarding more effective observation and auditing tests or changing reporting requirements to obtain more definitive "per well" production figures.

7. Documents received in support of Production Tax and Royalty returns should be improved.

Oil is transported from offshore platforms in the Cook Inlet to onshore treating facilities and storage tanks by the producers. Pipeline companies such as Cook Inlet Pipeline Company and Kenai Pipeline Company receive the oil after it runs through a custody meter which measures the quantity. The only source document that the State receives in support of tax and royalty returns are meter tickets which report the amount of oil that passed through the custody meters during the month.

The meter tickets are supposed to be prepared and witnessed by a representative of the pipeline company and a representative of the oil producer. Employees of the State Division of Oil and Gas sign the meter ticket as a third witness when they are present to observe preparation of the ticket.

Out of 400 meter run tickets received in support of 1972 royalty returns, approximately 70 were printed by an automatic printing device at the meter station. The printing on about half of the above mentioned 70 tickets was illegible and hand written over. All other tickets were hand written. Only six of the 400 meter tickets were witnessed by a State employee.

2d SSHB 803 –
Smith Moved that the bill be passed out of Committee – Motion failed on Voice Vote.

(HB 346)

pg 1 Line 18½ old language

Tom Williams - Dir of Petroleum Revenue, Dept of Rev.
Question of where the valuation pt. of oil + gas should be. After removal of water globules and dissolved gasses oil is metered Now - In other states production tax has been derived from the oil after clensing.
Bill attemps to place value of oil at the metering pt.
State doesn't believe it should absorb the gathering costs – Cleaning + dehydration (Heater Treater) costs.

pg 1 line 18
CS SB 295: Average daily per well production. X out for each well for the calendar Month in barrels,

pg 2 line 2 daily per well production - delete [" for each well for the calendar Month"]

pg 4 (15) "Average daily per well production" Means arithmetic average of all wells Contributing to a Meter point or ADP $\frac{Pr}{W \times D}$ when Pr = total production in barrels at the production point for a Calender month. W = Number of wells feeding the production point, and D = Number of days each well produces in a Calender Month.

present rates This bill would lower states income somewhat.

AGO 513816