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other than the operator, has substantial incentive and ability to effectively audit billings under the agreement.

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

(1) includes

~~(A) outlays for capital assets;~~

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

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

(2) does not include

(A) depreciation or amortization of capital assets;

(B) royalty payments for oil and gas;

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

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

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

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

(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;

(wait)  
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"or in lieu of"

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(L) surcharges levied under AS 43.55.201 or 43.55.300.

(e) A producer's lease expenditures must be adjusted by subtracting any payment or credit the producer receives for

(1) the use by another person of a production facility in which the producer has an ownership interest;

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

(3) the sale or other transfer of

(A) an asset, including geological, geophysical, or well data or interpretations, acquired by the producer as a result of a lease expenditure or an expenditure that would be a lease expenditure if it were incurred on or after April 1, 2006; and

(B) oil or gas

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

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

(f) In place of the adjusted lease expenditures for a month under (e) of this section, a producer may, at any time, elect to substitute, for every month of a calendar year, one-twelfth of the producer's adjusted lease expenditures for the calendar year.

(g) For the purposes of this section,

(1) a producer's transitional investment expenditures are the sum of the expenditures the producer incurred on or after January 1, 2003, and before April 1, 2006, that would be qualified capital expenditures, as defined in AS 43.55.024, if they were incurred on or after April 1, 2006, less the sum of the payments or credits the producer received before April 1, 2006, for the sale or other transfer of assets, including geological, geophysical, or well data or interpretations, acquired by the producer as a result of expenditures the producer incurred ~~on or after January 1, 2003.~~

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~~and~~ before April 1, 2006, that would be qualified capital expenditures, as defined in AS 43.55.024, if they were incurred on or after April 1, 2006, multiplied by

(A) 25 percent for expenditures incurred on or after January 1, 2003, and before January 1, 2004;

(B) 50 percent for expenditures incurred on or after January 1, 2004, and before January 1, 2005; and

(C) 75 percent for expenditures incurred on or after January 1, 2005, and before April 1, 2006;

(2) notwithstanding (1) of this subsection, an amount of transitional investment expenditures may not be deducted under (a) of this section for a month for which the average price of Alaska North Slope oil delivered on the United States West Coast, as determined under (h) of this section, is equal to or less than \$40 a barrel, as adjusted for inflation under (h) of this section.

(h) The average price described in (g) of this section shall be an average, as calculated using a formula prescribed by the department by regulation, of published daily spot price assessments during the month for Alaska North Slope oil delivered on the United States West Coast. However, if the department determines that the daily assessments cease to be published throughout the calendar year or appear likely to soon cease to be published throughout the calendar year or that they cease to be reliable evidence of market conditions or appear likely to soon cease to be reliable evidence of market conditions, the department shall by regulation provide that the average price described in (g) of this section is the prevailing value of Alaska North Slope oil delivered on the United States West Coast as determined under regulations of the department implementing AS 43.55.020(f). For each year after 2006, the department shall adjust the reference price of \$40 a barrel set out in (g) of this section for inflation. The dollar amount in (g) of this section changes according to and to the extent of changes in the Consumer Price Index for all urban consumers for the Anchorage Metropolitan Area compiled by the Bureau of Labor Statistics, United States Department of Labor (the index). The index for January of 2006 is the reference base index. If the index is revised, the percentage of change is calculated based on the revised index. If a revision of the index changes the reference base index, a revised

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reference base index is determined by multiplying the reference base index applicable by the rebasing factor furnished by the United States Bureau of Labor Statistics. If the index is superseded, the index referred to in this section is the one represented by the United States Bureau of Labor Statistics as reflecting most accurately changes in the purchasing power of the dollar for Alaska consumers.

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

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

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

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

(k) For purposes of AS 43.55.024(a) and (b) and only as to expenditures incurred to explore for an oil or gas deposit located within land in which an explorer, ~~as defined in AS 43.55.025,~~ does not own a working interest, the term "producer" in

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(b), (c) and (e) of this section includes "explorer."

(l) For purposes of this section,

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

(2) "ordinary and necessary" has the meaning given "ordinary and necessary" in 26 U.S.C. 162 (Internal Revenue Code) and regulations adopted under that section;

(3) "stratigraphic test well" means a well drilled for the sole purpose of obtaining geological information to aid in exploring for an oil or gas deposit and the target zones of which are located in the state, ~~as defined in AS 43.55.025.~~

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~~Sec. 43.55.170. Additional nontransferable credit. (a) For a month for which the net value of the taxable oil and gas produced during the month calculated under AS 43.55.160 exceeds zero, a producer that is qualified under (b) of this section may~~

Need def of explorer if not in AS 43.55.900

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~~reduce the net value by applying a tax credit for a qualified capital expenditure, as that term is defined in AS 43.55.024, if the qualified capital expenditure involved a payment made in this state and the claim of the credit is not taken under AS 43.55.024 or 43.55.025. The credit authorized by this subsection may be calculated and applied so that~~

- ~~(1) the net value for the month is not reduced below zero; and~~
- ~~(2) the total of the credits applied during the calendar year does not exceed \$10,000,000.~~

~~(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 <sup>production tax liability</sup> ~~not value of taxable oil and gas, as determined under AS 43.55.10(a)~~, that would be reasonably expected to be attributed to a single producer entity if the <sup>tax credit</sup> ~~allowance~~ provision of (a) of this section did not exist.~~

~~(c) An unused allowance or portion of an allowance under this section is not transferable under AS 43.55.024(d), may not be carried forward to a later calendar year, and may not be used to establish a carried-forward annual loss under AS 43.55.024(b).~~

~~(d) A producer may not claim a credit under this section for a qualified capital expenditure incurred after March 31, 2016.~~

\* Sec. 25. AS 43.55.201(a) is amended to read:

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

\* Sec. 26. AS 43.55.201(b) is amended to read:

~~(b) The surcharge imposed by (a) of this section is in addition to the tax imposed by AS 43.55.011 and shall be paid in the [SAME] manner described in AS 43.55.020. The surcharge [AS THE TAX IMPOSED BY AS 43.55.011 -~~

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~~43.55.150; AND] is in addition to the surcharge imposed AS 43.55.300 - 43.55.310.~~

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

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

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

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

\* Sec. 29. AS 43.55.300(a) is amended to read:

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

\* Sec. 30. AS 43.55.300(b) is amended to read:

~~(b) The surcharge imposed by (a) of this section is in addition to the tax imposed by AS 43.55.011 and shall be paid in the [SAME] manner described in AS 43.55.020. The surcharge [AS THE TAX IMPOSED BY AS 43.55.011 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 - 43.55.231.~~

Insert 13

\* Sec. 31. AS 43.55.300(c) is amended to read:

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

\* Sec. 32. AS 43.55.300 is amended by adding a new subsection to read:

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

\* Sec. 33. AS 43.55.900(6) is repealed and reenacted to read:

(6) "gas" means

(A) all natural, associated, or casinghead gas;

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- (B) all hydrocarbons that
  - (i) are recovered by mechanical separation of well fluids or by gas processing; and
  - (ii) exist in a gaseous phase at the completion of mechanical separation and any gas processing; and
- (C) all other hydrocarbons produced from a well not defined as oil;

\* Sec. 34. AS 43.55.900(7) is repealed and reenacted to read:

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

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

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

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

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

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

(C) for gas run through an integrated gas processing and gas treatment facility that does not accurately meter the gas after the gas

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1 processing and before the gas treatment, the value of the gas at the first point  
2 where gas processing is completed or where gas treatment begins, whichever is  
3 further upstream;

4 \* Sec. 35. AS 43.55.900(10) is repealed and reenacted to read:

5 (10) "oil" means

6 (A) crude petroleum oil; and

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

9 \* Sec. 36. AS 43.55.900 is amended by adding new paragraphs to read:

10 (17) "gas processing"

11 (A) means processing a gaseous mixture of hydrocarbons

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

16 (ii) for the purpose of extracting and recovering liquid  
17 hydrocarbons; and

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

20 (B) does not include gas treatment;

21 (18) "gas treatment"

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

25 (B) includes incidentally removing liquid hydrocarbons from  
26 the gas.

27 \* Sec. 37. AS 43.55.011(b), 43.55.011(c), 43.55.012(b), 43.55.013, 43.55.016,  
28 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12), and 43.55.900(16) are repealed.

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

31 APPLICABILITY. (a) Sections 5, 6, 8 - 11, 13, 14, 16, 18, and 20 - 37 of this Act

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1 apply to oil and gas produced on or after April 1, 2006.

2 (b) Section 12 of this Act applies to oil and gas produced before, on, or after the  
3 effective date of sec. 12 of this Act.

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

6 TRANSITIONAL PROVISIONS. (a) Notwithstanding any contrary provision of  
7 AS 43.55.024(a), enacted by sec. 14 of this Act, for oil and gas produced on or after April 1,  
8 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an  
9 amount equal to one and two-thirds percent" in AS 43.55.024(a), enacted by sec. 14 of this  
10 Act, shall be replaced by the phrase "every month during the period April 1, 2006, through  
11 December 31, 2006, an annualized tax credit in an amount equal to 2.222 percent."

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

✓ 16 (c) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 24 of  
17 this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the  
18 phrase "for every month of a calendar year, one-twelfth of the producer's adjusted lease  
19 expenditures for the calendar year" in AS 43.55.160(f), enacted by sec. 24 of this Act, shall be  
20 replaced by the phrase "for each of the last nine months of 2005, <sup>ONE NINTH</sup> ~~2.222 percent~~ of the  
21 producer's adjusted lease expenditures for that nine-month period."

✓ 22 <sup>eg</sup> For oil and gas produced before April 1, 2006, the provisions of AS 43.55, and  
23 regulations adopted under AS 43.55, that were in effect before April 1, 2006, and that were  
24 applicable to the oil and gas continue to apply to that oil and gas.

Insert 14

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

27 TRANSITION: REGULATIONS. The Department of Revenue may proceed to adopt  
28 regulations to implement the changes made by this Act. The regulations take effect under  
29 AS 44.62 (Administrative Procedure Act), but not before the effective date of the law  
30 implemented by the regulation.

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

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1 read:

2 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the  
3 heading of

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

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

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

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

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

13 \* Sec. 42. The uncodified law of the State of Alaska is amended by adding a new section to  
14 read:

15 **CONDITIONAL RETROACTIVITY.** If the sections of this Act that, under sec. 44 of  
16 this Act, are scheduled to take effect April 1, 2006, take effect on or after April 1, 2006, those  
17 sections of this Act are retroactive to April 1, 2006.

18 \* Sec. 43. Sections 1 - 4, 7, 12, 15, <sup>17</sup>19, <sup>20</sup>22 and 38 <sup>40</sup>42 of this Act take effect immediately  
19 under AS 01.10.070(c).

20 \* Sec. 44. Except as provided in sec. 43 of this Act, this Act takes effect April 1, 2006.

# LEGAL SERVICES

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

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State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 4<sup>th</sup> St., Rm. 329

## MEMORANDUM

March 14, 2006

**SUBJECT:** Draft CSHB 488(RES) (Work Order No. 24-GH205)

**TO:** Representative Jay Ramras  
Representative Ralph Samuels  
Co-Chairs of the House Resources Committee

**FROM:** Jack Chenoweth  
Assistant Revisor

The changes set out in the accompanying draft are made to the bill as introduced. Please note --

The changes generally follow from the red line material prepared by Assistant Attorney General Rob Mintz, with the change made to the price index (proposed AS 43.55.011(g)), added as part of bill section 6, to follow your instruction to substitute a single .25 percent provision for the split index set out in the red-line.

In addition, the draft contains:

-- provisions eliminating the ninety percent payment/ten percent square up, substitution of language requiring payment in full; and, for failure to file or tender payment in full without justification, inclusion of language calling for a penalty comparable to tax penalties otherwise imposed under AS 43; you subsequently directed inclusion of a provision imposing a penalty for failure to pay or remit at least 90 percent of the tax due, a provision that is included as proposed AS 43.55.020(h), added as part of bill section 13;

-- inclusion of a five percent rate for private royalties on leases in effect on that provision's effective date (proposed AS 43.55.011(e)(1)), with the rate to be set at the commissioner of revenue's discretion (proposed AS 43.55.011(e)(2)); the latter provision, as set out, amounts to a standardless delegation of authority to an executive agency (a constitutional problem), and you should revisit it and provide necessary guidance as to how that rate should be calculated;

-- deletion of the surcharge credit provision, bill sections 25 and 29 of the administration's original bill;

Representative Jay Ramras  
Representative Ralph Samuels  
March 14, 2006  
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-- inclusion of Representative Seaton's amendment A.2 adjusting the split of the nickel-per-barrel surcharge;

-- targeted amendments as submitted by the Alaska Oil & Gas Association that you have specifically approved for inclusion;

-- substitution of language referring to a specific consumer price index referencing changes occurring in the Anchorage CPI for all urban consumers.

From an earlier draft, the following have been incorporated into this "F" draft:

-- a progressive tax rate, with an index when prices exceed \$50/barrel WTI; please be sure that the index limits, proposed AS 43.55.011(g), conform to your expectations [just so you understand my drafting of the provision, at \$150/bbl, the index is calculated  $\$150 - \$50 = \$100$ , or an index of 100;  $100 \times .30 = 30$  that, when added to the base 20 percent of gross value, recovers at an effective rate of 50 percent];

-- transitional allowance adjustment: see proposed AS 43.55.160(g), added as part of bill section 14; the reference index is set in AS 43.55.160(h); adjustment of the transitional investment expenditures from six to seven years is addressed by amending the "1/72" fraction to substitute "1/84" in AS 43.55.160(a) and (b)(2)(A);

-- exploration enhancement, extending the authorized credits statewide to July 2010 -- see bill section 15;

-- disallowance of abandonment costs: see AS 43.55.024(i)(2), added by bill section 14;

-- private royalties set at five percent as to current (i.e. April 1, 2006) leases: see treatment of lessor's royalty interest, AS 43.55.011(e)(1);

-- effective date for provisions set to April 1, 2006: bill sections 42 and 44 address this change;

-- revision of the \$73,000,000 allowance: language of the original version was deleted and proposed AS 43.55.170 substituted;

-- tax credit repurchase: see AS 43.55.024(f), added as part of bill section 14.

\*

In addition, I've made other edits and modifications to conform the measure to the Legislative Drafting Manual. Look particularly at the handling of the exceptions to the definition of "qualified capital expenditure" with the additional material responsive to

Representative Jay Ramras  
Representative Ralph Samuels  
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your request to disallow "abandonment costs" for the credit allowed against the production tax value of the oil and gas.

JBC:ljw  
06-126.ljw

Enclosure

24-GH205  
Chenoweth  
3/14/06

**CS FOR HOUSE BILL NO. 488(RES)**  
**IN THE LEGISLATURE OF THE STATE OF ALASKA**  
**TWENTY-FOURTH LEGISLATURE - SECOND SESSION**

**BY THE HOUSE RESOURCES COMMITTEE**

**Offered:**  
**Referred:**

**Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act repealing the oil production tax and gas production tax and providing for a  
2 production tax on oil and gas; relating to the relationship of that tax to other taxes, to  
3 the dates those tax payments and surcharges are due, to interest on overpayments of the  
4 tax, and to the treatment of the tax in a producer's settlement with the royalty owners;  
5 relating to flared gas, and to oil and gas used in the operation of a lease or property  
6 under the production tax; relating to the prevailing value of oil or gas under the  
7 production tax; providing for tax credits against the tax for certain expenditures, losses,  
8 and surcharges; amending the rates applicable to each of the two tax surcharges  
9 imposed on oil under the production tax that are used to support the oil and hazardous  
10 substance release prevention and response fund and relating to those surcharges;  
11 relating to statements or other information required to be filed with or furnished to the  
12 Department of Revenue, and relating to the penalty for failure to file certain reports, for

1 the tax; relating to the powers of the Department of Revenue, and to the disclosure of  
2 certain information required to be furnished to the Department of Revenue, as  
3 applicable to the administration of the tax; relating to criminal penalties for violating  
4 conditions governing access to and use of confidential information relating to the tax,  
5 and to the deposit of tax money collected by the Department of Revenue; relating to the  
6 calculation of the gross value at the point of production of oil or gas; relating to the  
7 determination of the production tax value of oil and gas for purposes of a tax on the  
8 production tax value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain  
9 other terms for purposes of the production tax, and as the definition of the term 'gas'  
10 applies in the Alaska Stranded Gas Development Act; making conforming amendments;  
11 making uniform throughout the state the deadline for certain exploration expenditures  
12 used as credits against the production tax on oil and gas produced from a lease or  
13 property in the state by extending to July 1, 2010, the deadline for those expenditures on  
14 leases or properties located north of 68 degrees, 15 minutes, North latitude; and  
15 providing for an effective date."

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

17 \* **Section 1.** The uncodified law of the State of Alaska is amended by adding a new section  
18 to read:

19 INTENT OF SEC. 12 OF THIS ACT. It is the intent of the legislature through sec. 12  
20 of this Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by  
21 the Department of Revenue.

22 \* **Sec. 2.** AS 43.05.230(f) is amended to read:

23 (f) A wilful violation of the provisions of this section or of a condition  
24 imposed under AS 43.55.040(1)(B) is punishable by a fine of not more than \$5,000,  
25 or by imprisonment for not more than two years, or by both.

26 \* **Sec. 3.** AS 43.20.031(c) is amended to read:

1 (c) In computing the tax under this chapter, the taxpayer is not entitled to  
2 deduct any taxes based on or measured by net income. The taxpayer may deduct the  
3 tax levied and paid under AS 43.55.

4 \* Sec. 4. AS 43.20.072(b) is amended to read:

5 (b) A taxpayer's business income to be apportioned under this section to the  
6 state shall be the federal taxable income of the taxpayer's consolidated business for the  
7 tax period, except that

8 (1) taxes based on or measured by net income that are deducted in the  
9 determination of the federal taxable income shall be added back; the tax levied and  
10 paid under AS 43.55 may not be added back;

11 (2) intangible drilling and development costs that are deducted as  
12 expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the  
13 federal taxable income shall be capitalized and depreciated as if the option to treat  
14 them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been  
15 exercised;

16 (3) depletion deducted on the percentage depletion basis under 26  
17 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income  
18 shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612  
19 (Internal Revenue Code); and

20 (4) depreciation shall be computed on the basis of 26 U.S.C. 167  
21 (Internal Revenue Code) as that section read on June 30, 1981.

22 \* Sec. 5. AS 43.55.011(a) is repealed and reenacted to read:

23 (a) There is levied on the producer of oil or gas a tax for all oil and gas  
24 produced each month from each lease or property in the state less any oil and gas the  
25 ownership or right to which is exempt from taxation or constitutes a lessor's royalty  
26 interest under an oil and gas lease. The tax is equal to 20 percent of the production tax  
27 value of the taxable oil and gas as calculated under AS 43.55.160.

28 \* Sec. 6. AS 43.55.011 is amended by adding new subsections to read:

29 (e) There is levied on the producer of oil or gas a tax for all oil and gas  
30 produced each month from each lease or property in the state the ownership or right to  
31 which constitutes a lessor's royalty interest under an oil and gas lease, except for oil

1 and gas the ownership or right to which is exempt from taxation. For purposes of this  
2 subsection, for a lessor's royalty interest under an oil and gas lease

3 (1) that is in effect on the effective date of this section, the tax levied  
4 on the oil and gas is equal to five percent of the gross value at the point of production  
5 of the oil and gas; however, if the department determines that, for purposes of  
6 reducing the producer's tax liability under this paragraph, the producer has received or  
7 will receive consideration from the lessor offsetting all or a part of the producer's  
8 royalty obligation, the tax under this subsection is equal to 20 percent of the gross  
9 value at the point of production of the oil and gas; and

10 (2) other than an interest described in (1) of this subsection, the tax  
11 levied on the oil and gas is equal to a rate to be determined by the commissioner based  
12 on the gross value at the point of production.

13 (f) In addition to the taxes levied under (a) and (e) of this section, for each  
14 month for which the oil price index determined under (g) of this section is greater than  
15 zero, there is levied upon the producer of oil or gas a tax for oil and gas produced  
16 during that month from each lease or property in the state, less any oil and gas the  
17 ownership or right to which is exempt from taxation. The tax is equal to .30 percent  
18 multiplied by the oil price index as determined under (g) of this section.

19 (g) The oil price index for a month is the average United States Gulf Coast  
20 price for that month of West Texas Intermediate crude oil in dollars per barrel, less  
21 \$50, except that, if the average price determined under this subsection is

22 (1) not more than \$50 per barrel, the oil price index is zero; and

23 (2) more than \$150 per barrel, the oil price index is 100.

24 (h) For purposes of (f) and (g) of this section, the department may calculate  
25 the average price or may, by regulation, specify the method by which the average  
26 price shall be calculated with reference to one or more published sources of price  
27 information. If, in the department's judgment, reliable published sources of price  
28 information on West Texas Intermediate crude oil cease, or appear likely to soon  
29 cease, to be available, or if, in the department's judgment, the price of West Texas  
30 Intermediate crude oil ceases, or appears likely to soon cease, to be a reliable indicator  
31 of the general price level of crude oils, the department shall, by regulation, specify a

1 substitute formula for computing the oil price index. The substitute formula specified  
2 by the department under this subsection must bear, as nearly as is reasonably possible,  
3 the same relationship to the general price level of crude oils as did the United States  
4 Gulf Coast price of West Texas Intermediate crude oil.

5 \* Sec. 7. AS 43.55.017(a) is amended to read:

6 (a) Except as provided in this chapter, the taxes imposed by this chapter are in  
7 place of all taxes now imposed by the state or any of its municipalities, and neither the  
8 state nor a municipality may impose a tax on [UPON]

9 (1) producing oil or gas leases;

10 (2) oil or gas produced or extracted in the state;

11 (3) the value of intangible drilling and development costs, as  
12 described in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through  
13 January 1, 1974 [EXPLORATION EXPENSES].

14 \* Sec. 8. AS 43.55.020(a) is repealed and reenacted to read:

15 (a) The tax levied under AS 43.55.011(a) shall be paid as set out in this  
16 subsection. The tax, net of any credits applied under this chapter, is due on the last day  
17 of each calendar month on oil and gas produced from each lease or property during the  
18 preceding month. An unpaid amount of tax that is not paid when due in accordance  
19 with this subsection becomes delinquent. An overpayment of tax for a month may be  
20 applied against the tax due for a later month. Notwithstanding any contrary provision  
21 of AS 43.05.280, interest on an overpayment is allowed only from a date that is 90  
22 days after the statement required under AS 43.55.030(e) to be filed on or before  
23 March 31 of the year following the calendar year during which the oil and gas were  
24 produced is filed. However, interest is not allowed if the overpayment was refunded  
25 within the 90-day period.

26 \* Sec. 9. AS 43.55.020(b) is amended to read:

27 (b) The production tax on oil and [OR] gas shall be paid by or on behalf of the  
28 producer.

29 \* Sec. 10. AS 43.55.020(d) is amended to read:

30 (d) In making settlement with the royalty owner for oil or gas that is taxable  
31 under AS 43.55.011, the producer may deduct the amount of the tax paid on taxable

1 royalty oil and [CR] gas, or may deduct taxable royalty oil or gas equivalent in value  
2 at the time the tax becomes due to the amount of the tax paid. Unless otherwise  
3 agreed between the producer and the royalty owner, the amount of the tax paid  
4 under AS 43.55.011 on taxable royalty oil and gas for a month other than oil or  
5 gas the ownership or right to which constitutes a lessor's royalty interest under  
6 an oil or gas lease is considered to be the gross value at the point of production of  
7 the taxable royalty oil and gas produced during the month multiplied by a figure  
8 that is a quotient, in which

9 (1) the numerator is the producer's total tax liability under  
10 AS 43.55.011(a) for the month of production; and

11 (2) the denominator is the total gross value at the point of  
12 production of the oil and gas taxable under AS 43.55.011(e) produced by the  
13 producer from all leases and properties in the state during the month.

14 \* Sec. 11. AS 43.55.020(e) is repealed and reenacted to read:

15 (e) Gas flared, released, or allowed to escape in excess of the amount  
16 authorized by the Alaska Oil and Gas Conservation Commission is considered, for the  
17 purpose of AS 43.55.011 - 43.55.170, as gas produced from a lease or property. Oil or  
18 gas used in the operation of a lease or property in the state in drilling for or producing  
19 oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and  
20 Gas Conservation Commission to be waste, is not considered, for the purpose of  
21 AS 43.55.011 - 43.55.170, as oil or gas produced from a lease or property.

22 \* Sec. 12. AS 43.55.020(f) is amended to read:

23 (f) If oil or gas is not sold, or if oil or gas is sold under circumstances where  
24 the sale price does not represent the prevailing value for oil or gas of like kind,  
25 character, or quality in the field or area from which the product is produced, the  
26 department may require the tax to be paid upon the basis of the value of oil or gas of  
27 the same kind, quality, and character prevailing during the calendar month of  
28 production for that field or area.

29 \* Sec. 13. AS 43.55.020 is amended by adding new subsections to read:

30 (g) The tax levied under AS 43.55.011(e) and (f) shall be paid monthly and is  
31 due on the last day of each calendar month on oil and gas produced from each lease or

1 property during the preceding month, and, if not paid before the end of the month in  
2 which it becomes due, the tax becomes delinquent.

3 (h) The penalty provisions of AS 43.05.220 apply to a producer who fails to  
4 pay at least 90 percent of the tax when due under (a) or (g) of this section.

5 \* Sec. 14. AS 43.55 is amended by adding a new section to read:

6 **Sec. 43.55.024. Tax credits for certain losses and expenditures.** (a)

7 Notwithstanding that a qualified capital expenditure may be a deductible lease  
8 expenditure for purposes of calculating the production tax value of oil and gas under  
9 AS 43.55.160(a), a producer or explorer that incurs a qualified capital expenditure  
10 may also elect to take a tax credit in the amount of 20 percent of that expenditure,  
11 unless a credit for that expenditure is taken under AS 43.55.025. A credit under this  
12 subsection may be applied only against a tax due under AS 43.55.011(a). For a  
13 calendar year for which the producer makes an election under AS 43.55.160(f), instead  
14 of taking a tax credit of 20 percent of each separate qualified capital expenditure after  
15 it has been incurred, a producer that incurs a qualified capital expenditure during that  
16 year and that wishes to apply a credit based on that expenditure against a tax due  
17 under AS 43.55.011(a) shall calculate and apply every month an annualized tax credit  
18 in an amount equal to one and two-thirds percent of the total qualified capital  
19 expenditures incurred during that year and for which the tax credit is taken for that  
20 year.

21 (b) A producer may elect to take a tax credit in the amount of 20 percent of a  
22 carried-forward annual loss. A credit under this subsection may be applied only  
23 against a tax due under AS 43.55.011(a). For purposes of this subsection, a carried-  
24 forward annual loss is the amount of a producer's adjusted lease expenditures under  
25 AS 43.55.160 for a previous calendar year that was not deductible in any month under  
26 AS 43.55.160(a) and (b).

27 (c) A credit or portion of a credit under this section may not be used to reduce  
28 a person's tax liability under AS 43.55.011(a) for any month below zero, and any  
29 unused credit or portion of a credit not used under this subsection may be applied in a  
30 later month.

31 (d) A person entitled to take a tax credit under this section that wishes to

1 transfer the unused credit to another person may apply to the department for a  
2 transferable tax credit certificate. An application under this subsection must be on a  
3 form prescribed by the department and must include supporting information and  
4 documentation that the department reasonably requires. The department shall grant or  
5 deny an application, or grant an application as to a lesser amount than that claimed and  
6 deny it as to the excess, not later than 60 days after the latest of (1) March 31 of the  
7 year following the calendar year in which the qualified capital expenditure or carried-  
8 forward annual loss for which the credit is claimed was incurred; (2) if the applicant is  
9 required under AS 43.55.030(a) and (e) to file a statement on or before March 31 of  
10 the year following the calendar year in which the qualified capital expenditures or  
11 carried-forward annual loss for which the credit was incurred, the date the statement  
12 was filed; or (3) the date the application was received by the department. If, based on  
13 the information then available to it, the department is reasonably satisfied that the  
14 applicant is entitled to a credit, the department shall issue the applicant a transferable  
15 tax credit certificate for the amount of the credit. A certificate issued under this  
16 subsection does not expire.

17 (e) A person to which a transferable tax credit certificate is issued under (d) of  
18 this section may transfer the certificate to another person, and a transferee may further  
19 transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and  
20 notwithstanding any action the department may take with respect to the applicant  
21 under (g) of this section, the owner of a certificate may apply the credit or a portion of  
22 the credit shown on the certificate only against a tax due under AS 43.55.011(a).  
23 However, a credit shown on a transferable tax credit certificate may not be applied to  
24 reduce a producer's total tax due under AS 43.55.011(a) on oil and gas produced  
25 during a calendar year to less than 80 percent of the tax that would otherwise be due  
26 without applying that credit, and any portion of a credit not used under this subsection  
27 may be applied in a later period.

28 (f) Under standards established in regulations adopted by the department, the  
29 commissioner may repurchase a transferable tax credit certificate issued under (d) of  
30 this section if

31 (1) within 24 months after the date of issuance of the tax credit

1 certificate, the person to whom the certificate was issued or any transferee of the  
2 certificate makes a qualified capital expenditure in this state or is the successful bidder  
3 on a bid submitted for a lease on state land under AS 38.05.180(f); and

4 (2) the expenditure made or bid submitted under (1) of this subsection  
5 is not less than the amount of the transferable tax credit certificate issued under (d) of  
6 this section.

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

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

20 (i) A producer or explorer may not elect to take a tax credit under this section  
21 for a lease expenditure under AS 43.55.160 that is an expenditure incurred

22 (1) to acquire an asset (A) the cost of previously acquiring which was a  
23 lease expenditure under AS 43.55.160(c) or would have been a lease expenditure  
24 under AS 43.55.160(c) if it had been incurred on or after April 1, 2006; or (B) that has  
25 previously been placed in service in the state; an expenditure to acquire an asset is not  
26 excluded under this paragraph if not more than an immaterial portion of the asset  
27 meets a description under (A) or (B) of this paragraph; for purposes of this paragraph,  
28 "asset" includes geological, geophysical, and well data and interpretations; or

29 (2) for an extended period of disuse, dismantlement, removal,  
30 surrender, or abandonment of a well, facility, pipeline, platform, or other structure, or  
31 for the restoration of a lease, field, unit, area, or body of water in conjunction with an

1 extended period of disuse, dismantlement, removal, surrender, or abandonment of a  
2 facility described in this paragraph.

3 (j) In this section,

4 (1) "explorer" has the meaning given in AS 43.55.025;

5 (2) "qualified capital expenditure" means, except as otherwise  
6 provided in (i) of this section, an expenditure that is a lease expenditure under  
7 AS 43.55.160 and is

8 (A) incurred for geological or geophysical exploration; or

9 (B) treated as a capitalized expenditure under 26 U.S.C.  
10 (Internal Revenue Code), as amended, regardless of elections made under 26  
11 U.S.C. 263(c) (Internal Revenue Code), as amended, and either is treated as a  
12 capitalized expenditure by the person incurring the expenditure or is eligible to  
13 be deducted as an expense under 26 U.S.C. 263(c) (Internal Revenue Code), as  
14 amended.

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

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

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

27 (2) if for an exploration well,

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

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

31 and

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

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

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

14 \* Sec. 16. AS 43.55.03<sup>(1)</sup> is amended to read:

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

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

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

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

26 (4) the gross [TOTAL] value at the point of production of the oil  
27 and of the [OR] gas produced from each [THE] lease or property owned by each  
28 producer for whom the tax is paid; [AND]

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

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

3 \* Sec. 17. AS 43.55.030(d) is amended to read:

4                   (d) Reports by or on behalf of the producer are delinquent the first day  
5 following the day the tax is due. **The provisions of AS 43.05.230 apply to reports**  
6 **that are not timely filed under this section.** [EACH PRODUCER IS SUBJECT TO  
7 A PENALTY OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH  
8 THE REPORT IS NOT FILED.] The penalty for failure to file a report is in addition  
9 to the penalty for delinquent taxes, and is a lien against the assets of the producer.

10 \* Sec. 18. AS 43.55.030 is amended by adding a new subsection to read:

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

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

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

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

28                                   **(A) provide the person that furnished the information a**  
29 **reasonable opportunity to be heard regarding the proposed disclosure and**  
30 **the conditions to be imposed under (B) of this paragraph; and**

31                                   **(B) impose appropriate conditions limiting**

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

5 (ii) the use of the information to use for the purpose  
 6 of determining or contesting the producer's tax obligation;

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

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

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

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

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

15 \* Sec. 20. AS 43.55.080 is amended to read:

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

20 \* Sec. 21. AS 43.55.135 is amended to read:

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

24 \* Sec. 22. AS 43.55.150(a) is amended to read:

25 (a) For the purposes of AS 43.55.011 - 43.55.170 [AS 43.55.011 - 43.55.150],  
 26 the gross value at the point of production is [SHALL BE] calculated using the  
 27 reasonable costs of transportation of the oil or gas. The reasonable costs of  
 28 transportation are [SHALL BE] the actual costs, except when the

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

31 (2) [WHEN THE] contract for the transportation of oil or gas is not an

1 arm's length transaction or is not representative of the market value of that  
2 transportation:

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

5 \* Sec. 23. AS 43.55.150 is amended by adding a new subsection to read:

6 (d) Under regulations adopted by the department, the department may allow a  
7 producer, subject to limitations prescribed by the department as to the frequency of  
8 making elections, to elect prospectively to calculate the gross value at the point of  
9 production of oil or gas based in whole or part on

10 (1) a royalty value determined under a royalty settlement agreement  
11 between the producer and the state, with adjustments if appropriate;

12 (2) a formula prescribed by the department that uses, with adjustments  
13 if appropriate, a royalty value or valuation methodology accepted by the

14 (A) Department of Natural Resources under AS 38.05, in the  
15 case of oil and gas produced from a lease issued by the Department of Natural  
16 Resources or produced from a lease or property that is part of a unit approved  
17 by the Department of Natural Resources; or

18 (B) United States Department of the Interior under applicable  
19 federal oil and gas leasing statutes, in the case of oil and gas produced from a  
20 lease issued by the United States Department of the Interior that is not part of a  
21 unit approved by the Department of Natural Resources, or produced from a  
22 lease or property that is part of a unit approved by the United States  
23 Department of the Interior but not approved by the Department of Natural  
24 Resources; or

25 (3) a. Other formula prescribed by the Department of Revenue that  
26 reasonably estimates a value for the oil or gas at a specific geographical location, such  
27 as the point of tender or delivery into a common carrier pipeline; the formula may use  
28 factors such as published price indices for oil or gas in or outside the state, quality  
29 differentials for oil or gas, transportation costs between markets, and inflation  
30 adjustments.

31 \* Sec. 24. AS 43.55 is amended by adding new sections to article 1 to read:

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

2       Except as provided in (f) of this section, for purposes of AS 43.55.011(a), the  
3       production tax value of the taxable oil and gas produced during a month is the total of  
4       the gross value at the point of production of the oil and gas taxable under  
5       AS 43.55.011(a) and produced by the producer from all leases or properties in the  
6       state, (1) less the producer's tax paid for the month under AS 43.55.011(f); (2) less the  
7       producer's lease expenditures for the month as adjusted under (e) of this section, and  
8       (3) to the extent allowed under (g) of this section and until the total amount of the  
9       producer's transitional investment expenditures has been deducted, less an amount  
10      equal to 1/84 of the producer's transitional investment expenditures. However, the  
11      production tax value calculated under this subsection may not be less than zero.

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

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

22                   (2) an amount of transitional investment expenditures that would  
23      otherwise be deductible in a month but whose deduction would cause the production  
24      tax value calculated under (a) of this section of the taxable oil and gas produced during  
25      the month to be less than zero

26                           (A) may be deducted in a later month during any calendar year  
27      to the extent allowed under (g) of this section, but not more than 1/84 of a  
28      producer's transitional investment expenditures may be deducted in any month;

29                           (B) may not be used to establish a carried-forward annual loss  
30      under AS 43.55.024(b).

31           (c) For purposes of this section,

1 (1) a producer's lease expenditures for a period are the total costs  
2 upstream of the point of production of oil and gas that are incurred on or after April 1,  
3 2006, by the producer during the period and that are direct, ordinary, and necessary  
4 costs of exploring for, developing, or producing oil or gas from deposits located within  
5 the producer's leases or properties in the state or, in the case of land in which the  
6 producer does not own a working interest, direct, ordinary, and necessary costs of  
7 exploring for oil or gas deposits located within other land in the state; however, lease  
8 expenditures do not include the costs incurred to satisfy a work commitment under an  
9 exploration license under AS 38.05.132; in determining whether costs are direct,  
10 ordinary, and necessary costs of exploring for, developing, or producing an oil or gas  
11 from a deposit of oil or gas located within a lease or property or other land in the state,  
12 the department shall give substantial weight to

13 (A) the typical industry practices and standards in the state and  
14 in the United States as to costs that an operator is allowed to bill a working  
15 interest owner that is not the operator, under unit operating agreements or  
16 similar operating agreements that were in effect on or before December 1,  
17 2005, and were subject to negotiation with working interest owners, not the  
18 operator, with substantial bargaining power; and

19 (B) the standards adopted by the Department of Natural  
20 Resources as to the costs, other than interest, that a lessee is allowed to deduct  
21 from revenue in calculating net profits under a lease issued under  
22 AS 38.05.180(f)(3)(B), (D), or (E);

23 (2) the Department of Revenue may authorize a producer, including  
24 the operator or a working interest owner, to treat as its lease expenditures under this  
25 section the costs paid by the producer that are billed to the producer by an operator in  
26 accordance with the terms of a unit operating agreement or similar operating  
27 agreement if the Department of Revenue finds that

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

31 (B) at least one working interest owner party to the agreement,

1 other than the operator, has substantial incentive and ability to effectively audit  
2 billings under the agreement.

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

4 (1) includes

5 (A) outlays for capital assets;

6 (B) payments of property taxes, sales and use taxes, motor fuel  
7 taxes, and excise taxes;

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

12 (2) does not include

13 (A) depreciation or amortization of capital assets;

14 (B) royalty payments for oil and gas;

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

16 (D) interest or other financing charges or costs of raising equity  
17 or debt capital;

18 (E) acquisition costs for a lease or property or exploration  
19 license;

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

21 (G) fines or penalties imposed by law;

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

26 (I) donations;

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

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

1 (L) surcharges levied under AS 43.55.201 or 43.55.300.

2 (e) A producer's lease expenditures must be adjusted by subtracting any  
3 payment or credit the producer receives for

4 (1) the use by another person of a production facility in which the  
5 producer has an ownership interest;

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 April 1, 2006; and

16 (B) oil or gas

17 (i) that is not considered produced from a lease or  
18 property under AS 43.55.020(e); and

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

21 (f) In place of the adjusted lease expenditures for a month under (a) of this  
22 section, a producer may, at any time, elect to substitute, for every month of a calendar  
23 year, one-twelfth of the producer's adjusted lease expenditures for the calendar year.

24 (g) For the purposes of this section,

25 (1) a producer's transitional investment expenditures are the sum of the  
26 expenditures the producer incurred on or after January 1, 2003, and before April 1,  
27 2006, that would be qualified capital expenditures, as defined in AS 43.55.024, if they  
28 were incurred on or after April 1, 2006, less the sum of the payments or credits the  
29 producer received before April 1, 2006, for the sale or other transfer of assets,  
30 including geological, geophysical, or well data or interpretations, acquired by the  
31 producer as a result of expenditures the producer incurred on or after January 1, 2003,

1 and before April 1, 2006, that would be qualified capital expenditures, as defined in  
2 AS 43.55.024, if they were incurred on or after April 1, 2006, multiplied by

3 (A) 25 percent for expenditures incurred on or after January 1,  
4 2003, and before January 1, 2004;

5 (B) 50 percent for expenditures incurred on or after January 1,  
6 2004, and before January 1, 2005; and

7 (C) 75 percent for expenditures incurred on or after January 1,  
8 2005, and before April 1, 2006;

9 (2) notwithstanding (1) of this subsection, an amount of transitional  
10 investment expenditures may not be deducted under (a) of this section for a month for  
11 which the average price of Alaska North Slope oil delivered on the United States West  
12 Coast, as determined under (h) of this section, is equal to or less than \$40 a barrel, as  
13 adjusted for inflation under (h) of this section.

14 (h) The average price described in (g) of this section shall be an average, as  
15 calculated using a formula prescribed by the department by regulation, of published  
16 daily spot price assessments during the month for Alaska North Slope oil delivered on  
17 the United States West Coast. However, if the department determines that the daily  
18 assessments cease to be published throughout the calendar year or appear likely to  
19 soon cease to be published throughout the calendar year or that they cease to be  
20 reliable evidence of market conditions or appear likely to soon cease to be reliable  
21 evidence of market conditions, the department shall by regulation provide that the  
22 average price described in (g) of this section is the prevailing value of Alaska North  
23 Slope oil delivered on the United States West Coast as determined under regulations  
24 of the department implementing AS 43.55.020(f). For each year after 2006, the  
25 department shall adjust the reference price of \$40 a barrel set out in (g) of this section  
26 for inflation. The dollar amount in (g) of this section changes according to and to the  
27 extent of changes in the Consumer Price Index for all urban consumers for the  
28 Anchorage Metropolitan Area compiled by the Bureau of Labor Statistics, United  
29 States Department of Labor (the index). The index for January of 2006 is the reference  
30 base index. If the index is revised, the percentage of change is calculated based on the  
31 revised index. If a revision of the index changes the reference base index, a revised

1 reference base index is determined by multiplying the reference base index applicable  
2 by the rebasing factor furnished by the United States Bureau of Labor Statistics. If the  
3 index is superseded, the index referred to in this section is the one represented by the  
4 United States Bureau of Labor Statistics as reflecting most accurately changes in the  
5 purchasing power of the dollar for Alaska consumers.

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

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

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

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

16 (k) For purposes of AS 43.55.024(a) and (b) and only as to expenditures  
17 incurred to explore for an oil or gas deposit located within land in which an explorer,  
18 as defined in AS 43.55.025, does not own a working interest, the term "producer" in  
19 (c) and (e) of this section includes "explorer."

20 (l) For purposes of this section,

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

23 (2) "ordinary and necessary" has the meaning given "ordinary and  
24 necessary" in 26 U.S.C. 162 (Internal Revenue Code) and regulations adopted under  
25 that section;

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

29 **Sec. 43.55.170. Additional nontransferable credit.** (a) For a month for which  
30 the net value of the taxable oil and gas produced during the month calculated under  
31 AS 43.55.160 exceeds zero, a producer that is qualified under (b) of this section may

1 reduce the net value by applying a tax credit for a qualified capital expenditure, as that  
2 term is defined in AS 43.55.024, if the qualified capital expenditure involved a  
3 payment made in this state and the claim of the credit is not taken under AS 43.55.024  
4 or 43.55.025. The credit authorized by this subsection may be calculated and applied  
5 so that

6 (1) the net value for the month is not reduced below zero; and

7 (2) the total of the credits applied during the calendar year does not  
8 exceed \$10,000,000.

9 (b) On written application by a producer, including any information the  
10 department may require, the department shall determine whether the producer  
11 qualifies under this section for a calendar year. To qualify under this section, a  
12 producer must demonstrate that its operation in the state or its ownership of an interest  
13 in a lease or property in the state as a distinct producer entity would not result in the  
14 division among multiple producer entities of any net value of taxable oil and gas, as  
15 determined under AS 43.55.160(a), that would be reasonably expected to be attributed  
16 to a single producer entity if the allowance provision of (a) of this section did not  
17 exist.

18 (c) An unused allowance or portion of an allowance under this section is not  
19 transferable under AS 43.55.024(d), may not be carried forward to a later calendar  
20 year, and may not be used to establish a carried-forward annual loss under  
21 AS 43.55.024(b).

22 (d) A producer may not claim a credit under this section for a qualified capital  
23 expenditure incurred after March 31, 2016.

24 \* Sec. 25. AS 43.55.201(a) is amended to read:

25 (a) Every producer of oil shall pay a surcharge of \$.01 [\$.02] per barrel of oil  
26 produced from each lease or property in the state, less any oil the ownership or right to  
27 which is exempt from taxation.

28 \* Sec. 26. AS 43.55.201(b) is amended to read:

29 (b) The surcharge imposed by (a) of this section is in addition to the tax  
30 imposed by AS 43.55.011 and shall be paid in the [SAME] manner described in  
31 AS 43.55.020. The surcharge [AS THE TAX IMPOSED BY AS 43.55.011 -

1 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -  
2 43.55.310.

3 \* Sec. 27. AS 43.55.201(c) is amended to read:

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

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

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

11 \* Sec. 29. AS 43.55.300(a) is amended to read:

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

15 \* Sec. 30. AS 43.55.300(b) is amended to read:

16 (b) The surcharge imposed by (a) of this section is in addition to the tax  
17 imposed by AS 43.55.011 and shall be paid in the [SAME] manner described in  
18 AS 43.55.020. The surcharge [AS THE TAX IMPOSED BY AS 43.55.011 -  
19 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 -  
20 43.55.231.

21 \* Sec. 31. AS 43.55.300(c) is amended to read:

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

25 \* Sec. 32. AS 43.55.300 is amended by adding a new subsection to read:

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

29 \* Sec. 33. AS 43.55.900(6) is repealed and reenacted to read:

30 (6) "gas" means

31 (A) all natural, associated, or casinghead gas;

1 (B) all hydrocarbons that

2 (i) are recovered by mechanical separation of well  
3 fluids or by gas processing; and

4 (ii) exist in a gaseous phase at the completion of  
5 mechanical separation and any gas processing; and

6 (C) all other hydrocarbons produced from a well not defined as  
7 oil;

8 \* Sec. 34. AS 43.55.900(7) is repealed and reenacted to read:

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

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

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

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

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

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

30 (C) for gas run through an integrated gas processing and gas  
31 treatment facility that does not accurately meter the gas after the gas

1 processing and before the gas treatment, the value of the gas at the first point  
2 where gas processing is completed or where gas treatment begins, whichever is  
3 further upstream;

4 \* Sec. 35. AS 43.55.900(10) is repealed and reenacted to read:

5 (10) "oil" means

6 (A) crude petroleum oil; and

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

9 \* Sec. 36. AS 43.55.900 is amended by adding new paragraphs to read:

10 (17) "gas processing"

11 (A) means processing a gaseous mixture of hydrocarbons

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

16 (ii) for the purpose of extracting and recovering liquid  
17 hydrocarbons; and

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

20 (B) does not include gas treatment;

21 (18) "gas treatment"

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

25 (B) includes incidentally removing liquid hydrocarbons from  
26 the gas.

27 \* Sec. 37. AS 43.55.011(b), 43.55.011(c), 43.55.012(b), 43.55.013, 43.55.016,  
28 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12), and 43.55.900(16) are repealed.

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

31 APPLICABILITY. (a) Sections 5, 6, 8 - 11, 13, 14, 16 - 18, and 22 - 37 of this Act

1 apply to oil and gas produced on or after April 1, 2006.

2 (b) Section 12 of this Act applies to oil and gas produced before, on, or after the  
3 effective date of sec. 12 of this Act.

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

6 **TRANSITIONAL PROVISIONS.** (a) Notwithstanding any contrary provision of  
7 AS 43.55.024(a), enacted by sec. 14 of this Act, for oil and gas produced on or after April 1,  
8 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an  
9 amount equal to one and two-thirds percent" in AS 43.55.024(a), enacted by sec. 14 of this  
10 Act, shall be replaced by the phrase "every month during the period April 1, 2006, through  
11 December 31, 2006, an annualized tax credit in an amount equal to 2.222 percent."

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

16 (c) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 24 of  
17 this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the  
18 phrase "for every month of a calendar year, one-twelfth of the producer's adjusted lease  
19 expenditures for the calendar year" in AS 43.55.160(f), enacted by sec. 24 of this Act, shall be  
20 replaced by the phrase "for each of the last nine months of 2006, 2.222 percent of the  
21 producer's adjusted lease expenditures for that nine-month period."

22 (d) For oil and gas produced before April 1, 2006, the provisions of AS 43.55, and  
23 regulations adopted under AS 43.55, that were in effect before April 1, 2006, and that were  
24 applicable to the oil and gas continue to apply to that oil and gas.

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

27 **TRANSITION: REGULATIONS.** The Department of Revenue may proceed to adopt  
28 regulations to implement the changes made by this Act. The regulations take effect under  
29 AS 44.62 (Administrative Procedure Act), but not before the effective date of the law  
30 implemented by the regulation.

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

1 read:

2 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the  
3 heading of

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

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

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

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

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

13 \* Sec. 42. The uncodified law of the State of Alaska is amended by adding a new section to  
14 read:

15 CONDITIONAL RETROACTIVITY. If the sections of this Act that, under sec. 44 of  
16 this Act, are scheduled to take effect April 1, 2006, take effect on or after April 1, 2006, those  
17 sections of this Act are retroactive to April 1, 2006.

18 \* Sec. 43. Sections 1 - 4, 7, 12, 15, 19 - 21, and 38 - 42 of this Act take effect immediately  
19 under AS 01.10.070(c).

20 \* Sec. 44. Except as provided in sec. 43 of this Act, this Act takes effect April 1, 2006.

# LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES  
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STATE OF ALASKA

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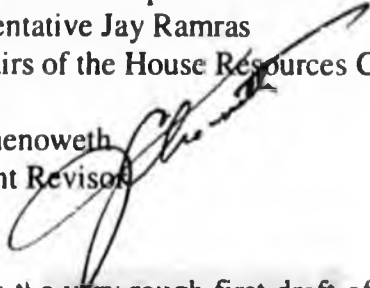
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Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

March 9, 2006

**SUBJECT:** Initial draft CSHB 488(RES): notes to accompany the bill draft  
(Work Order No. 24-GH2052\G)

**TO:** Representative Ralph Samuels  
Representative Jay Ramras  
Co-Chairs of the House Resources Committee

**FROM:** Jack Chenoweth  
Assistant Revisioner 

Transmitted with this memo is the very rough first draft of a committee substitute for the petroleum production tax bill. The draft is based on the notes you provided during our Tuesday morning meeting.

The draft does not address items identified as 2 (tax rate) and 9 (manner of determining gas valuation). My understanding is that details of each of these, including, particularly, the substitution of varying tax rates, remain under active consideration among committee members.

**1. REDUCE "CLAWBACK" PROVISIONS: SUBSTITUTE RATES OF 75 PERCENT FOR 2005, 50 PERCENT FOR 2004, AND 25 PERCENT FOR 2003; SPREAD THE PAYBACK OVER 7 YEARS:**

The transitional investment expenditures provision, AS 43.55.160(g) of the bill in the form as introduced, has been reworked and appears as AS 43.55.160(g)(1), at page 15 of the accompanying draft. The extended payback spread is addressed as replacement fractions "1/84" (instead of "1/72") [page 12, lines 5 and 23].

**3. PER CONVERSATION AT OUR TUESDAY MORNING MEETING, REDUCE THE TAX CREDIT RATE TO 15 PERCENT:**

Done: see amendments made in AS 43.55.024(a) and (b), added by bill section 13.

**4. SUBSTITUTE AN APRIL 1, 2006, EFFECTIVE DATE:**

Done: see in this draft bill section 40. A conditional retroactivity provision is provided against the likelihood that enactment will not occur before the date. When a final form of the House Resources Committee Substitute is agreed to, I will restate the conditional

Representative Ralph Samuels  
Representative Jay Ramras  
March 9, 2006  
Page 2

retroactivity provision to identify specific bill sections. Additionally, within the text of the permanent and temporary law sections, references to "July 1, 2006" have been replaced by references to "April 1, 2006", and the temporary law provisions that base a calculation on a six-month adjustment have been recalculated to a nine-month adjustment.

**5. ELIMINATE THE SPILL CONTINGENCY SURCHARGE AMENDMENTS:**

Bill sections 25 and 29 of the original bill have been dropped from the committee substitute.

**6. PROVIDE FOR "FULLY REFUNDABLE" TAX CREDITS THAT ARE IN ADDITION TO THE TRANSFERABLE FEATURE: WE AGREED IN CONVERSATION THAT THESE SHOULD BE DISCRETIONARY ("MAY REPURCHASE") RATHER THAN MANDATORY ("SHALL REPURCHASE"):**

See proposed AS 43.55.160(f), a new subsection, beginning at the bottom of page 6 of the draft.

**7. REWORK THE \$73,000,000 EXEMPTION AS AN ADDITIONAL INVESTMENT TAX CREDIT FEATURE, WITH DIFFERENT CONSTRAINTS, TO OPERATE FOR 10 YEARS:**

The material formerly set out in AS 43.55.160(i) and (j) has been dropped from that section, revised, and set out as a new section, AS 43.55.170. See if the material meets your expectations. A corresponding interim adjustment provision, bill section 36(d) of the original bill, has been deleted.

The treatment of this material as a credit (rather than as a reduction to the net value of oil) necessitated deletion of references to the material in former AS 43.55.160(i) and (j) as bearing on an authorized adjustment to the net value of oil. Please make sure that this is handled consistently with your expectations.

**8. THE GAS TAX RATE:**

No change in the material as introduced, per instruction.

**10. THE PRIVATE ROYALTY ISSUE:**

The first part of the Arctic Slope Regional Corporation's suggested amendment was used for the text of material to be found, in this draft, as AS 43.55.011(e), added as a new bill section 6, as related to the oil tax rate. Since the other portion of the ASRC amendment addressed settlement, a matter also addressed in AS 43.55.020(d), in the amendment of AS 43.55.020(d) made by bill section 10, assuming that the provisions would otherwise cover these so-called private royalties, I added the phrase "Except as to oil and gas for

Representative Ralph Samuels  
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Page 3

which tax is payable under AS 43.55.011(e)," at the beginning of the principal amending language in that subsection. Again, please verify that this handling is responsive to the suggestion. Out of caution, in the material set out as AS 43.55.011(e), I inserted reference to "the owner of the land or interest in the land [that] is not the state" so that this provision would leave no argument that the reduced rate authorized in this subsection somehow might apply to a state-issued lease. You should review that as well.

For purposes of this draft, I used the ASRC's initial submission. Sara Gill has provided different language that I will incorporate into a subsequent draft.

\*

In addition to the foregoing, I have made substantial edits to the text as submitted to conform to the drafting manual.

Someone should independently verify that the references to "2.222 percent" [page 21, lines 13 and 22] are accurate monthly adjustments to reflect the adjustment of the effective date from "July 1, 2006" (six months of the current calendar year) back to "April 1, 2006" (nine months of the current calendar year).

Finally, the bill title is a short form title intended only as working title for purposes of treating with any drafts. Again, when the committee has substantially settled on the content of the committee substitute, I will rewrite the title to more fully describe the measure's contents.

JBC:lmb  
06-095.lmb

Enclosure

24-GH205213  
Chenoweth  
3/8/06

**CS FOR HOUSE BILL NO. 488(RES)**

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

**TWENTY-FOURTH LEGISLATURE - SECOND SESSION**

**BY THE HOUSE RESOURCES COMMITTEE**

**Offered:**

**Referred:**

**Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR**

**A BILL**

**FOR AN ACT ENTITLED**

1 **"An Act repealing the oil production tax and gas production tax and providing for a**  
2 **production tax on the net value of oil and gas, and making conforming amendments;**  
3 **amending the definition of 'gas' as it applies to the taxes described in this Act and as**  
4 **used in the Alaska Stranded Gas Development Act; and providing for an effective date."**

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

6 **\* Section 1.** The uncodified law of the State of Alaska is amended by adding a new section  
7 to read:

8 **INTENT OF SEC. 12 OF THIS ACT.** It is the intent of the legislature through sec. 12  
9 of this Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by  
10 the Department of Revenue.

11 **\* Sec. 2.** AS 43.05.230(f) is amended to read:

12 (f) A wilful violation of the provisions of this section or of a condition  
13 imposed under AS 43.55.040(1)(B) is punishable by a fine of not more than \$5,000,  
14 or by imprisonment for not more than two years, or by both.

1 \* **Sec. 3.** AS 43.20.031(c) is amended to read:

2 (c) In computing the tax under this chapter, the taxpayer is not entitled to  
3 deduct any taxes based on or measured by net income. The taxpayer may deduct the  
4 tax levied and paid under AS 43.55.

5 \* **Sec. 4.** AS 43.20.072(b) is amended to read:

6 (b) A taxpayer's business income to be apportioned under this section to the  
7 state shall be the federal taxable income of the taxpayer's consolidated business for the  
8 tax period, except that

9 (1) taxes based on or measured by net income that are deducted in the  
10 determination of the federal taxable income shall be added back; the tax levied and  
11 paid under AS 43.55 may not be added back;

12 (2) intangible drilling and development costs that are deducted as  
13 expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the  
14 federal taxable income shall be capitalized and depreciated as if the option to treat  
15 them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been  
16 exercised;

17 (3) depletion deducted on the percentage depletion basis under 26  
18 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income  
19 shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612  
20 (Internal Revenue Code); and

21 (4) depreciation shall be computed on the basis of 26 U.S.C. 167  
22 (Internal Revenue Code) as that section read on June 30, 1981.

23 \* **Sec. 5.** AS 43.55.011(a) is repealed and reenacted to read:

24 (a) There is levied on the producer of oil or gas a tax for all oil and gas  
25 produced each month from each lease or property in the state, less any oil and gas the  
26 ownership or right to which is exempt from taxation. The tax is equal to 20 percent of  
27 the net value of the taxable oil and gas as calculated under AS 43.55.160.

28 \* **Sec. 6.** AS 43.55.011 is amended by adding a new subsection to read:

29 (e) Notwithstanding (a) of this section, the tax due by a producer under  
30 AS 43.55.011 - 43.55.170 on taxable oil or gas that is royalty due to the fee owner of  
31 the land, or of an estate in the land that is less than fee simple, from which the oil or

1 gas is produced, if the owner of the land or interest in the land is not the state, is five  
2 percent of the amount of the royalty paid to the owner by the producer, or five percent  
3 of the gross value of the royalty oil or gas at the point of delivery to the owner if the  
4 owner takes the royalty oil or gas in kind. The producer shall exclude from calculation  
5 of the tax due under (a) of this section the value of the oil and gas for which tax has  
6 been paid under this subsection.

7 \* Sec. 7. AS 43.55.017(a) is amended to read:

8 (a) Except as provided in this chapter, the taxes imposed by this chapter are in  
9 place of all taxes now imposed by the state or any of its municipalities, and neither the  
10 state nor a municipality may impose a tax on [UPON]

11 (1) producing oil or gas leases;

12 (2) oil or gas produced or extracted in the state;

13 (3) the value of intangible drilling and development costs, as  
14 described in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through  
15 January 1, 1974 [EXPLORATION EXPENSES].

16 \* Sec. 8. AS 43.55.020(a) is repealed and reenacted to read:

17 (a) The production tax on oil and gas shall be paid as set out in this subsection.  
18 Ninety percent of the tax levied under AS 43.55.011, net of any credits applied under  
19 this chapter, is due on the last day of each calendar month on oil and gas produced  
20 from each lease or property during the preceding month. The remaining portion of the  
21 tax levied under AS 43.55.011, net of any credits applied under this chapter, is due on  
22 March 31 of the year following the calendar year during which the oil and gas were  
23 produced. An unpaid amount of tax that is not paid when due in accordance with this  
24 subsection becomes delinquent. An overpayment of tax for a month may be applied  
25 against the tax due for a later month. Notwithstanding any contrary provision of  
26 AS 43.05.280, interest on an overpayment is allowed only from a date that is 90 days  
27 after the later of (1) March 31 of the year following the calendar year during which the  
28 oil and gas were produced; or (2) the date that the statement required under  
29 AS 43.55.030(a) and (e) to be filed on or before March 31 of the year following the  
30 calendar year during which the oil and gas were produced is filed. However, interest is  
31 not allowed if the overpayment was refunded within the 90-day period.

1 \* Sec. 9. AS 43.55.020(b) is amended to read:

2 (b) The production tax on oil and [OR] gas shall be paid by or on behalf of the  
3 producer.

4 \* Sec. 10. AS 43.55.020(d) is amended to read:

5 (d) In making settlement with the royalty owner for oil or gas that is taxable  
6 under AS 43.55.011, the producer may deduct the amount of the tax paid on taxable  
7 royalty oil and [OR] gas, or may deduct taxable royalty oil or gas equivalent in value  
8 at the time the tax becomes due to the amount of the tax paid. Except as to oil and  
9 gas for which tax is payable under AS 43.55.011(e), unless otherwise agreed  
10 between the producer and the royalty owner, the amount of the tax paid on  
11 taxable royalty oil and gas for a month is considered to be the quantity of that  
12 taxable royalty oil and gas produced during the month multiplied by the quotient  
13 of the producer's total tax liability for the month of production under  
14 AS 43.55.011 divided by the producer's total quantity of taxable oil and gas, other  
15 than royalty oil and gas, produced from all leases and properties in the state  
16 during the month. For purposes of the product calculated under this subsection,  
17 6,000 cubic feet of gas is considered to be equivalent in amount to one barrel of  
18 oil.

19 \* Sec. 11. AS 43.55.020(e) is repealed and reenacted to read:

20 (e) Gas flared, released, or allowed to escape in excess of the amount  
21 authorized by the Alaska Oil and Gas Conservation Commission is considered, for the  
22 purpose of AS 43.55.011 - 43.55.170, as gas produced from a lease or property. Oil or  
23 gas used in the operation of a lease or property in the state in drilling for or producing  
24 oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and  
25 Gas Conservation Commission to be waste, is not considered, for the purpose of  
26 AS 43.55.011 - 43.55.170, as oil or gas produced from a lease or property.

27 \* Sec. 12. AS 43.55.020(f) is amended to read:

28 (f) If oil or gas is not sold, or if oil or gas is sold under circumstances where  
29 the sale price does not represent the prevailing value for oil or gas of like kind,  
30 character, or quality in the field or area from which the product is produced, the  
31 department may require the tax to be paid upon the basis of the value of oil or gas of

1 the same kind, quality, and character prevailing during the calendar month of  
2 production for that field or area.

3 \* **Sec. 13.** AS 43.55 is amended by adding a new section to read:

4 **Sec. 43.55.024. Tax credits for certain losses and expenditures.** (a)

5 Notwithstanding that a qualified capital expenditure may be a deductible lease  
6 expenditure for purposes of calculating the net value of oil and gas under  
7 AS 43.55.160(a), a producer or explorer that incurs a qualified capital expenditure  
8 may also elect to take a tax credit in the amount of 15 percent of that expenditure,  
9 unless a credit for that expenditure is taken under AS 43.55.025. A credit under this  
10 subsection may be applied only against a tax due under AS 43.55.011 - 43.55.170. For  
11 a calendar year for which the producer makes an election under AS 43.55.160(f),  
12 instead of taking a tax credit of 15 percent of each separate qualified capital  
13 expenditure after it has been incurred, a producer that incurs a qualified capital  
14 expenditure during that year and that wishes to apply a credit based on that  
15 expenditure against a tax due under AS 43.55.011 - 43.55.170 shall calculate and  
16 apply every month an annualized tax credit in an amount equal to one and one-fourth  
17 percent of the total qualified capital expenditures incurred during that year and for  
18 which the tax credit is taken for that year.

19 (b) A producer may elect to take a tax credit in the amount of 15 percent of a  
20 carried-forward annual loss. A credit under this subsection may be applied only  
21 against a tax due under AS 43.55.011 - 43.55.170. For purposes of this subsection, a  
22 carried-forward annual loss is the amount of a producer's adjusted lease expenditures  
23 under AS 43.55.160 for a previous calendar year that was not deductible in any month  
24 under AS 43.55.160(a) and (b).

25 (c) A credit or portion of a credit under this section may not be used to reduce  
26 a person's tax liability under AS 43.55.011- 43.55.170 for any month below zero, and  
27 any unused credit or portion of a credit not used under this subsection may be applied  
28 in a later month.

29 (d) A person entitled to take a tax credit under this section that wishes to  
30 transfer the unused credit to another person may apply to the department for a  
31 transferable tax credit certificate. An application under this subsection must be on a

1 form prescribed by the department and must include supporting information and  
2 documentation that the department reasonably requires. The department shall grant or  
3 deny an application, or grant an application as to a lesser amount than that claimed and  
4 deny it as to the excess, not later than 60 days after the latest of (1) March 31 of the  
5 year following the calendar year in which the qualified capital expenditure or carried-  
6 forward annual loss for which the credit is claimed was incurred; (2) if the applicant is  
7 required under AS 43.55.030(a) and (e) to file a statement on or before March 31 of  
8 the year following the calendar year in which the qualified capital expenditures or  
9 carried-forward annual loss for which the credit was incurred, the date the statement  
10 was filed; or (3) the date the application was received by the department. If, based on  
11 the information then available to it, the department is reasonably satisfied that the  
12 applicant is entitled to a tax credit, the department shall issue the applicant a  
13 transferable tax credit certificate for the amount of the credit. A certificate issued  
14 under this subsection does not expire.

15 (e) A person to which a transferable tax credit certificate is issued under (d) of  
16 this section may transfer the certificate to another person, and a transferee may further  
17 transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and  
18 notwithstanding any action the department may take with respect to the applicant  
19 under (g) of this section, the owner of a certificate may apply the credit or a portion of  
20 the credit shown on the certificate only against a tax due under AS 43.55.011 -  
21 43.55.170. However, a credit shown on a transferable tax credit certificate may not be  
22 applied to reduce a producer's total tax due under AS 43.55.011 - 43.55.170 on oil and  
23 gas produced during a calendar year to less than 80 percent of the tax that would  
24 otherwise be due without applying that credit, and any portion of a credit not used  
25 under this subsection may be applied in a later period.

26 (f) Under standards established in regulations adopted by the department, the  
27 commissioner may repurchase a transferable tax credit certificate issued under (d) of  
28 this section if

29 (i) within 24 months after the date of issuance of the tax credit  
30 certificate, the person to whom the certificate was issued or any transferee of the  
31 certificate makes a qualified capital expenditure in this state or is the successful bidder

1 on a bid submitted for a lease on state land under AS 38.05.180(f); and

2 (2) the expenditure made or bid submitted under (1) of this subsection  
3 is not less than the amount of the transferable tax credit certificate issued under (d) of  
4 this section.

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

14 (h) 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 (i) In this section,

19 (1) "explorer" has the meaning given in AS 43.55.025;

20 (2) "qualified capital expenditure"

21 (A) means, except as otherwise provided under (B) of this  
22 paragraph, an expenditure that is a lease expenditure under AS 43.55.160 and  
23 is

24 (i) incurred for geological or geophysical exploration;

25 or

26 (ii) treated as a capitalized expenditure under 26 U.S.C.  
27 (Internal Revenue Code), as amended, regardless of elections made  
28 under 26 U.S.C. 263(c) (Internal Revenue Code), as amended, and  
29 either is treated as a capitalized expenditure by the person incurring the  
30 expenditure or is eligible to be deducted as an expense under 26 U.S.C.  
31 263(c) (Internal Revenue Code), as amended;

1 (B) does not include an expenditure to acquire an asset (i) the  
2 cost of previously acquiring which was a lease expenditure under  
3 AS 43.55.160(c) or would have been a lease expenditure under  
4 AS 43.55.160(c) if it had been incurred on or after April 1, 2006; or (ii) that  
5 has previously been placed in service in the state; an expenditure to acquire an  
6 asset is not excluded under this subparagraph if not more than an immaterial  
7 portion of the asset meets a description under (i) or (ii) of this subparagraph;  
8 for purposes of this subparagraph, "asset" includes geological, geophysical,  
9 and well data and interpretations.

10 \* Sec. 14. AS 43.55.030(a) is amended to read:

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

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

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

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

22 (4) the gross [TOTAL] value at the point of production of the oil  
23 and of the [OR] gas produced from each [THE] lease or property owned by each  
24 producer for whom the tax is paid; [AND]

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

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

30 \* Sec. 15. AS 43.55.030(d) is amended to read:

31 (d) Reports by or on behalf of the producer are delinquent the first day

1 following the day the tax is due. [EACH PRODUCER IS SUBJECT TO A PENALTY  
2 OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH THE  
3 REPORT IS NOT FILED. THE PENALTY FOR FAILURE TO FILE A REPORT IS  
4 IN ADDITION TO THE PENALTY FOR DELINQUENT TAXES, AND IS A LIEN  
5 AGAINST THE ASSETS OF THE PRODUCER.]

6 \* Sec. 16. AS 43.55.030 is amended by adding a new subsection to read:

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

11 \* Sec. 17. AS 43.55.040 is amended to read:

12 Sec. 43.55.040. Powers of Department of Revenue. Except as provided in  
13 AS 43.05.405 - 43.05.499, the department may

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

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

27 (B) impose appropriate conditions limiting  
28 (i) access to the information to those legal counsel,  
29 consultants, employees, officers, and agents of the producer who  
30 have a need to know that information for the purpose of  
31 determining or contesting the producer's tax obligation; and

1 (ii) the use of the information to use for the purpose  
2 of determining or contesting the producer's tax obligation:

3 (2) examine the books, records, and files of [SUCH] a person  
4 described in (1) of this section:

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

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

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

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

12 \* Sec. 18. AS 43.55.080 is amended to read:

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

17 \* Sec. 19. AS 43.55.135 is amended to read:

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

21 \* Sec. 20. AS 43.55.150(a) is amended to read:

22 (a) For the purposes of AS 43.55.011 - 43.55.170 [AS 43.55.011 - 43.55.150],  
23 the gross value at the point of production is [SHALL BE] calculated using the  
24 reasonable costs of transportation of the oil or gas. The reasonable costs of  
25 transportation are [SHALL BE] the actual costs, except when the

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

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

31 (3) [WHEN THE] method of transportation of oil or gas is not

1 reasonable in view of existing alternative methods of transportation.

2 \* **Sec. 21.** AS 43.55.150 is amended by adding a new subsection to read:

3 (d) Under regulations adopted by the department, the department may allow a  
4 producer, subject to limitations prescribed by the department as to the frequency of  
5 making elections, to elect prospectively to calculate the gross value at the point of  
6 production of oil or gas based in whole or part on

7 (1) a royalty value determined under a royalty settlement agreement  
8 between the producer and the state, with adjustments if appropriate;

9 (2) a formula prescribed by the department that uses, with adjustments  
10 if appropriate, a royalty value or valuation methodology accepted by the

11 (A) Department of Natural Resources under AS 38.05, in the  
12 case of oil and gas produced from a lease issued by the Department of Natural  
13 Resources or produced from a lease or property that is part of a unit approved  
14 by the Department of Natural Resources; or

15 (B) United States Department of the Interior under applicable  
16 federal oil and gas leasing statutes, in the case of oil and gas produced from a  
17 lease issued by the United States Department of the Interior that is not part of a  
18 unit approved by the Department of Natural Resources, or produced from a  
19 lease or property that is part of a unit approved by the United States  
20 Department of the Interior but not approved by the Department of Natural  
21 Resources; or

22 (3) another formula prescribed by the Department of Revenue that  
23 reasonably estimates a value for the oil or gas at a specific geographical location, such  
24 as the point of tender or delivery into a common carrier pipeline; the formula may use  
25 factors such as published price indices for oil or gas in or outside the state, quality  
26 differentials for oil or gas, transportation costs between markets, and inflation  
27 adjustments.

28 \* **Sec. 22.** AS 43.55 is amended by adding new sections to article 1 to read:

29 **Sec. 43.55.160. Determination of net value of oil and gas.** (a) Except as  
30 provided in (f) of this section, for purposes of AS 43.55.011, the net value of the  
31 taxable oil and gas produced during a month is the total of the gross value at the point

1 of production of the oil and gas taxable under AS 43.55.011 and produced by the  
2 producer from all leases or properties in the state, (1) less the producer's lease  
3 expenditures for the month as adjusted under (e) of this section, and (2) to the extent  
4 allowed under (g) of this section and until the total amount of the producer's  
5 transitional investment expenditures has been deducted, less an amount equal to 1/84  
6 of the producer's transitional investment expenditures. However, the net value  
7 calculated under this subsection may not be less than zero.

8 (b) In making the determination required by this section,

9 (1) any adjusted lease expenditures that would otherwise be deductible  
10 in a month but whose deduction would cause the net value calculated under (a) of this  
11 section of the taxable oil and gas produced during the month to be less than zero may  
12 be added to the producer's adjusted lease expenditures for one or more other months in  
13 the same calendar year; the total of any adjusted lease expenditures that are not  
14 deductible in any month during a calendar year because their deduction would cause  
15 the net value calculated under (a) of this section of the taxable oil and gas produced  
16 during one or more months to be less than zero may be used to establish a carried-  
17 forward annual loss under AS 43.55.024(b); and

18 (2) an amount of transitional investment expenditures that would  
19 otherwise be deductible in a month but whose deduction would cause the net value  
20 calculated under (a) of this section of the taxable oil and gas produced during the  
21 month to be less than zero

22 (A) may be deducted in a later month during any calendar year  
23 to the extent allowed under (g) of this section, but not more than 1/84 of a  
24 producer's transitional investment expenditures may be deducted in any month;

25 (B) may not be used to establish a carried-forward annual loss  
26 under AS 43.55.024(b).

27 (c) For purposes of this section,

28 (1) a producer's lease expenditures for a period are the total costs  
29 upstream of the point of production of oil and gas that are incurred on or after April 1,  
30 2006, by the producer during the period and that are direct, ordinary, and necessary  
31 costs of exploring for, developing, or producing oil or gas from deposits of oil or gas

1 located within the producer's leases or properties in the state or, in the case of land in  
2 which the producer does not own a working interest, direct, ordinary, and necessary  
3 costs of exploring for deposits of oil or gas located within other land in the state;  
4 however, lease expenditures do not include the costs incurred to satisfy a work  
5 commitment under an exploration license under AS 38.05.132; in determining whether  
6 costs are direct, ordinary, and necessary costs of exploring for, developing, or  
7 producing oil or gas from a deposit of oil or gas located within a lease or property or  
8 other land in the state, the department shall give substantial weight to

9 (A) the typical industry practices and standards in the state and  
10 in the United States as to costs that an operator is allowed to bill a working  
11 interest owner that is not the operator, under unit operating agreements or  
12 similar operating agreements that were in effect on or before December 1,  
13 2005, and were subject to negotiation with working interest owners, not the  
14 operator, with substantial bargaining power; and

15 (B) the standards adopted by the Department of Natural  
16 Resources as to the costs, other than interest, that a lessee is allowed to deduct  
17 from revenue in calculating net profits under a lease issued under  
18 AS 38.05.180(f)(3)(B), (D), or (E);

19 (2) the Department of Revenue may authorize a producer to treat as its  
20 lease expenditures under this section the costs paid by the producer that are billed to  
21 the producer by an operator in accordance with the terms of a unit operating  
22 agreement or similar operating agreement if the Department of Revenue finds that

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

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

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

30 (1) includes

31 (A) outlays for capital assets;

1 (B) payments in lieu of property taxes;  
2 (C) a reasonable allowance, as determined under regulations  
3 adopted by the department, for overhead expenses directly related to exploring  
4 for, developing, and producing oil or gas deposits located within leases or  
5 properties, or other land in the state;

6 (2) does not include

7 (A) depreciation or amortization of capital assets;

8 (B) royalty payments;

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

10 (D) interest or other financing charges or costs of raising equity  
11 or debt capital;

12 (E) acquisition costs for a lease or property or exploration  
13 license;

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

15 (G) fines or penalties imposed by law;

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

20 (I) donations;

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

23 (K) amounts paid for purposes of indemnification.

24 (e) A producer's lease expenditures must be adjusted by subtracting any  
25 payment or credit the producer receives for

26 (1) the use by another person of a production facility in which the  
27 producer has an ownership interest;

28 (2) a reimbursement or similar payment that offsets the producer's  
29 lease expenditures, including any payment from the state or federal government for  
30 reimbursement of the producer's upstream costs, including costs for gathering,  
31 separating, cleaning, dehydration, compressing, or other field handling associated with

1 the production of oil or gas upstream of the point of production;

2 (3) the sale or other transfer of

3 (A) an asset, including geological, geophysical, or well data or  
4 interpretations, acquired by the producer as a result of a lease expenditure or an  
5 expenditure that would be a lease expenditure if it were incurred on or after  
6 April 1, 2006; and

7 (B) oil or gas

8 (i) that is not considered produced from a lease or  
9 property under AS 43.55.020(e); and

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

12 (f) In place of the adjusted lease expenditures for a month under (a) of this  
13 section, a producer may, at any time, elect to substitute, for every month of a calendar  
14 year, one-twelfth of the producer's adjusted lease expenditures for the calendar year.

15 (g) For the purposes of this section,

16 (1) a producer's transitional investment expenditures are the sum of the  
17 expenditures the producer incurred on or after January 1, 2003, and before April 1,  
18 2006, that would be qualified capital expenditures, as defined in AS 43.55.024, if they  
19 were incurred on or after April 1, 2006, less the sum of the payments or credits the  
20 producer received before April 1, 2006, for the sale or other transfer of assets,  
21 including geological, geophysical, or well data or interpretations, acquired by the  
22 producer as a result of expenditures the producer incurred on or after January 1, 2003,  
23 and before April 1, 2006, that would be qualified capital expenditures, as defined in  
24 AS 43.55.024, if they were incurred on or after April 1, 2006, multiplied by

25 (A) 25 percent for expenditures incurred on or after January 1,  
26 2003, and before January 1, 2004;

27 (B) 50 percent for expenditures incurred on or after January 1,  
28 2004, and before January 1, 2005; and

29 (C) 75 percent for expenditures incurred on or after January 1,  
30 2005, and before April 1, 2006;

31 (2) notwithstanding (1) of this subsection, an amount of transitional

1 investment expenditures may not be deducted under (a) of this section for a month for  
2 which the average price of Alaska North Slope oil delivered on the United States West  
3 Coast, as determined under (h) of this section, is equal to or less than \$40 a barrel, as  
4 adjusted for inflation under (h) of this section.

5 (h) The average price described in (g)(2) of this section shall be an average, as  
6 calculated using a formula prescribed by the department by regulation, of published  
7 daily spot price assessments during the month for Alaska North Slope oil delivered on  
8 the United States West Coast. However, if the department determines that the daily  
9 assessments cease to be published throughout the calendar year or appear likely to  
10 soon cease to be published throughout the calendar year or that they cease to be  
11 reliable evidence of market conditions or appear likely to soon cease to be reliable  
12 evidence of market conditions, the department shall by regulation provide that the  
13 average price described in (g)(2) of this section is the prevailing value of Alaska North  
14 Slope oil delivered on the United States West Coast as determined under regulations  
15 of the department implementing AS 43.55.020(f). For each year after 2006, the  
16 reference price of \$40 a barrel set out in (g)(2) of this section shall be adjusted for  
17 inflation using an appropriate consumer price index published by the United States  
18 Bureau of Labor Statistics, as prescribed by the department by regulation.

19 (i) The department shall specify or approve a reasonable allocation method for  
20 determining the portion of a cost that is appropriately treated as a lease expenditure  
21 under (c) of this section if a cost that would otherwise constitute a lease expenditure  
22 under (c) of this section is incurred to explore for, develop, or produce

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

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

27 (j) The department may adopt regulations that establish additional standards  
28 necessary to carrying out the purposes of this section.

29 (k) For purposes of AS 43.55.024(a) and (b) and only as to expenditures  
30 incurred to explore for an oil or gas deposit located within land in which an explorer,  
31 as defined in AS 43.55.025, does not own a working interest, the term "producer" in

1 (c) and (e) of this section includes "explorer."

2 (l) For purposes of this section,

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

5 (2) "stratigraphic test well" means a well drilled for the sole purpose of  
6 obtaining geological information to aid in exploring for an oil or gas deposit, the target  
7 zones of which are located in the state.

8 **Sec. 43.55.170. Additional nontransferable credit.** (a) For a month for which  
9 the net value of the taxable oil and gas produced during the month calculated under  
10 AS 43.55.160 exceeds zero, a producer that is qualified under (b) of this section may  
11 reduce the net value by applying a tax credit for a qualified capital expenditure, as that  
12 term is defined in AS 43.55.024, if the qualified capital expenditure involved a  
13 payment made in this state and the claim of the credit is not taken under AS 43.55.024  
14 or 43.55.025. The credit authorized by this subsection may be calculated and applied  
15 so that

16 (1) the net value for the month is not reduced below zero; and

17 (2) the total of the credits applied during the calendar year does not  
18 exceed \$10,000,000.

19 (b) On written application by a producer, including any information the  
20 department may require, the department shall determine whether the producer  
21 qualifies under this section for a calendar year. To qualify under this section, a  
22 producer must demonstrate that its operation in the state or its ownership of an interest  
23 in a lease or property in the state as a distinct producer entity would not result in the  
24 division among multiple producer entities of any net value of taxable oil and gas, as  
25 determined under AS 43.55.160(a), that would be reasonably expected to be attributed  
26 to a single producer entity if the allowance provision of (a) of this section did not  
27 exist.

28 (c) An unused allowance or portion of an allowance under this section is not  
29 transferable under AS 43.55.024(d), may not be carried forward to a later calendar  
30 year, and may not be used to establish a carried-forward annual loss under  
31 AS 43.55.024(b).

1 (d) A producer may not claim a credit under this section for a qualified capital  
2 expenditure incurred after March 31, 2016.

3 \* Sec. 23. AS 43.55.201(b) is amended to read:

4 (b) The surcharge imposed by (a) of this section is in addition to and shall be  
5 paid in the same manner as the tax imposed by AS 43.55.011, **except that,**  
6 **notwithstanding any contrary provisions of AS 43.55.020(a), the full amount of**  
7 **the surcharge is due on the last day of each calendar month on oil produced from**  
8 **each lease or property during the preceding month. The surcharge** [AS 43.55.011  
9 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -  
10 43.55.310).

11 \* Sec. 24. AS 43.55.201(c) is amended to read:

12 (c) A producer of oil shall make reports of production in the same manner and  
13 under the same penalties as required under AS 43.55.011 - 43.55.170 [AS 43.55.011 -  
14 43.55.150].

15 \* Sec. 25. AS 43.55.201 is amended by adding a new subsection to read:

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

19 \* Sec. 26. AS 43.55.300(b) is amended to read:

20 (b) The surcharge imposed by (a) of this section is in addition to and shall be  
21 paid in the same manner as the tax imposed by AS 43.55.011, **except that,**  
22 **notwithstanding any contrary provisions of AS 43.55.020(a), the full amount of**  
23 **the surcharge is due on the last day of each calendar month on oil produced from**  
24 **each lease or property during the preceding month. The surcharge** [AS 43.55.011  
25 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 -  
26 43.55.231.

27 \* Sec. 27. AS 43.55.300(c) is amended to read:

28 (c) A producer of oil shall make reports of production in the same manner and  
29 under the same penalties as required under AS 43.55.011 - 43.55.170 [AS 43.55.011 -  
30 43.55.150].

31 \* Sec. 28. AS 43.55.300 is amended by adding a new subsection to read:

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

4 \* Sec. 29. AS 43.55.900(6) is repealed and reenacted to read:

5 (6) "gas" means

6 (A) all natural, associated, or casinghead gas;

7 (B) all hydrocarbons that

8 (i) are recovered by mechanical separation of well fluids or by gas processing;

9 and

10 (ii) exist in a gaseous phase at the completion of mechanical separation and  
11 any gas processing; and

12 (C) all other hydrocarbons produced from a well not defined as

13 oil;

14 \* Sec. 30. AS 43.55.900(7) is repealed and reenacted to read:

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

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

25 (B) for gas, other than gas described in (C) of this paragraph,

26 that is

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

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

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

3 (C) for gas run through an integrated gas processing and gas  
4 treatment facility that does not accurately meter the gas after the gas  
5 processing and before the gas treatment, the value of the gas at the first point  
6 where gas processing is completed or where gas treatment begins, whichever is  
7 further upstream;

8 \* **Sec. 31.** AS 43.55.900(10) is repealed and reenacted to read:

9 (10) "oil" means

10 (A) crude petroleum oil; and

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

13 \* **Sec. 32.** AS 43.55.900 is amended by adding new paragraphs to read:

14 (17) "gas processing"

15 (A) means processing a gaseous mixture of hydrocarbons

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

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

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

22 (B) does not include gas treatment;

23 (18) "gas treatment"

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

27 (B) includes incidentally removing liquid hydrocarbons from  
28 the gas.

29 \* **Sec. 33.** AS 43.55.011(b), 43.55.011(c), 43.55.012(b), 43.55.013, 43.55.016,  
30 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12), and 43.55.900(16) are repealed.

31 \* **Sec. 34.** The uncodified law of the State of Alaska is amended by adding a new section to

1 read:

2 APPLICABILITY. (a) Sections 5, 8 - 11, 13, 14, 16, and 20 - 33 of this Act apply to  
3 oil and gas produced on or after April 1, 2006.

4 (b) Section 12 of this Act applies to oil and gas produced before, on, or after the  
5 effective date of sec. 12 of this Act.

6 \* Sec. 35. The uncodified law of the State of Alaska is amended by adding a new section to  
7 read:

8 TRANSITIONAL PROVISIONS. (a) Notwithstanding any contrary provision of  
9 AS 43.55.024(a), enacted by sec. 13 of this Act, for oil and gas produced on or after April 1,  
10 2006, and before January 1, 2007, the phrase "every month an annualized tax credit in an  
11 amount equal to one and two-thirds percent" in AS 43.55.024(a), enacted by sec. 13 of this  
12 Act, shall be replaced by the phrase "every month during the period April 1, 2006, through  
13 December 31, 2006, an annualized tax credit in an amount equal to 2.222 percent."

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

18 (c) Notwithstanding any contrary provision of AS 43.55.160(f), enacted by sec. 22 of  
19 this Act, for oil and gas produced on or after April 1, 2006, and before January 1, 2007, the  
20 phrase "for every month of a calendar year, one-twelfth of the producer's adjusted lease  
21 expenditures for the calendar year" in AS 43.55.160(f), enacted by sec. 22 of this Act, shall be  
22 replaced by the phrase "for each of the last nine months of 2006, 2.222 percent of the  
23 producer's adjusted lease expenditures for that nine-month period."

24 (d) For oil and gas produced before April 1, 2006, the provisions of AS 43.55, and  
25 regulations adopted under AS 43.55, that were in effect before April 1, 2006, and that were  
26 applicable to the oil and gas continue to apply to that oil and gas.

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

29 TRANSITION: REGULATIONS. The Department of Revenue may proceed to adopt  
30 regulations to implement the changes made by this Act. The regulations take effect under  
31 AS 44.62 (Administrative Procedure Act), but not before the effective date of the law

1 implemented by the regulation.

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

4 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the  
5 heading of

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

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

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

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

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

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

17 CONDITIONAL RETROACTIVITY. If the sections of this Act that, under sec. 40 of  
18 this Act, are scheduled to take effect April 1, 2006, take effect on or after April 1, 2006, those  
19 sections of this Act are retroactive to April 1, 2006.

20 \* Sec. 39. Sections 1 - 4, 7, 12, 15, 17, and 36 - 38 of this Act take effect immediately under  
21 AS 01.10.070(c).

22 \* Sec. 40. Except as provided in sec. 39 of this Act, this Act takes effect April 1, 2006.

# FISCAL NOTE

**STATE OF ALASKA**  
**2006 LEGISLATIVE SESSION**

Fiscal Note Number: \_\_\_\_\_  
 Bill Version: LL06-0052-DNR-O&G-02  
 ( ) Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Natural Resources  
 Title Repealing the oil production tax and gas RDU Resource Development  
production tax etc. Component Oil & Gas Development  
 Sponsor Rules by Request of Governor  
 Requester Governor Component No. 459

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

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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

<b>CHANGE IN REVENUES ( )</b>						
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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)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2006) cost: 0.0  
 Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

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

There is no anticipated fiscal impact for DNR associated with implementation of this legislation.

Prepared by: Bill VanDyke, Acting Director  
 Division: Oil & Gas  
 Approved by: Michael Menge, Commissioner  
 Agency: Natural Resources

Phone: 907-269-8800  
 Date/Time: 2/15/2006  
 Date: 2/15/2006

# FISCAL NOTE

**STATE OF ALASKA**  
**2006 LEGISLATIVE SESSION**

Fiscal Note Number: \_\_\_\_\_  
 Bill Version: 773060052  
 ( ) Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: \_\_\_\_\_ Revenue \_\_\_\_\_  
 Title An Act Relating to the Production Tax on RDU Tax and Treasury  
Oil and Gas Component Tax  
 Sponsor Rules Committee  
 Requester Governor Component No. 2476

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

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	359.2	366.4	373.7	381.2	388.8	396.6
Travel						
Contractual	1,200.0	520.0				
Supplies	24.0					
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous [OH office, etc]	18.0	18.0	18.0	18.0	18.0	18.0
<b>TOTAL OPERATING</b>	<b>1,601.2</b>	<b>904.4</b>	<b>391.7</b>	<b>399.2</b>	<b>406.8</b>	<b>414.6</b>

<b>CAPITAL EXPENDITURES</b>						
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**CHANGE IN REVENUES ( )** See analysis section

**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	1,601.2	904.4	391.7	399.2	406.8	414.6
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>1,601.2</b>	<b>904.4</b>	<b>391.7</b>	<b>399.2</b>	<b>406.8</b>	<b>414.6</b>

Estimate of any current year (FY2006) cost: 275.0  
 Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

**POSITIONS**

Full-time	4	4	4	4	4	4
Part-time						
Temporary						

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

This bill would amend the oil and gas production tax by basing the tax on the net value of the oil and gas. The net value is the wellhead value (net of royalty) less all qualified lease expenditures, including capital and operating costs, property taxes, and an additional \$73 million per year allowance for each producer. (The allowance can be no greater than the net value before the allowance.) The net income would be subject to a 20% tax, less a credit of 20% which applies to capital costs upstream of the point of production. In addition, there would be a deduction for capital costs incurred over the previous five years, which can be realized over the next six years, but only in years where the ANS price is over \$40. It is estimated this would reduce revenues about \$170 million in years when it was realized. In years where the ANS price is under \$40 the deduction can be carried forward.

Prepared by: Robynn Wilson, Michael Williams, and Roger Marks  
 Division: Tax Division  
 Approved by: Jerry Burnett  
 Agency: Department of Revenue

Phone 269-1019  
 Date/Time 2/21/06 12:00 AM  
 Date 2/21/2006

**ANALYSIS CONTINUATION**

The figures in the table below reflect the revenues that would be received from the bill relative to the status quo under various prices. They are predicated on the oil volumes in the Department of Revenue Fall 2005 Revenue Sources Book. The figures reflect North Slope activity; the impact on Cook Inlet is expected to be modest. They assume that seven producers utilize the full allowance. The status quo assumes the January 2005 ELF aggregation decision by the Department of Revenue for Prudhoe Bay continues.

The cost assumptions are as follows:

- \$100 mm/yr exploration
- \$1/bbl on-going capital on all barrels
- \$3.50/bbl developmental capital on 1/3 of existing conventional oil
- \$8/bbl developmental capital on 2/3 of existing heavy oil
- \$3.50/bbl developmental capital on new conventional oil
- \$8/bbl developmental capital on new heavy oil
- \$3/bbl operating cost on conventional oil
- \$5/bbl operating cost on heavy oil

The following table shows the 2007-2012 receipts from the bill, sensitive to different oil prices. These include the Department of Revenue forecast, a \$40 price, and a \$60 price. (Note that the status quo numbers are slightly different from what is reflected in the Fall 2005 Revenue Sources Book because of some minor changes in assumptions introduced since Fall 2005, and because of some differences between what some taxpayers actually remit and what is ultimately expected to be collected.)

Operating expenditures include costs for 3 additional positions for auditors: 1 O & G Specialist (Range 23), 1 O & G Revenue Auditor IV (Range 22), and 1 O & G Revenue Auditor III (Range 20). These positions would be used to fulfill additional audit responsibilities inherent in a net profits tax. In addition, we request 1 additional position for a Tax Tech III (Range 14) to process additional information and tax returns that will be required, and additional credit applications anticipated. Personal Services reflect a 2% yearly increase.

Contractual expenses include \$100,000 and \$70,000 for programming in FY 07 and FY 08, respectively, \$250,000 in each of FY 07 and FY 08 for help in writing regulations, and \$850,000 and \$200,000 in FY 07 and FY 08, respectively, for auditing costs related to the new transition rules. Supplies include computers and other supplies necessary for new positions.

**FISCAL NOTE**

**ANALYSIS CONTINUATION (MILLIONS OF 2005 DOLLARS)**

Fiscal Year	DOR Forecast	Status Quo Tax	Tax from Bill	Gain from Bill
2007	49.20	934	1,363	429
2008	40.95	697	915	217
2009	25.50	404	349	-55
2010	25.50	387	339	-48
2011	25.50	362	351	-11
2012	25.50	343	332	-10

Year	Price	Tax	Bill	Bill
2007	40.00	737	1,038	301
2008	40.00	679	1,031	353
2009	40.00	673	1,118	445
2010	40.00	646	1,106	460
2011	40.00	606	1,138	532
2012	40.00	576	1,112	536

.....

Fiscal Year	High Price	Status Quo Tax	Tax from Bill	Gain from Bill
2007	60.00	1,165	1,938	773
2008	60.00	1,069	1,917	848
2009	60.00	1,042	2,007	965
2010	60.00	1,003	1,992	989
2011	60.00	941	2,051	1,110
2012	60.00	896	2,014	1,117

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# Proposed Petroleum Production Tax (PPT)

## Questions and Answers

### What is the new petroleum production tax?

The new petroleum production tax will change the existing oil taxation system in Alaska. The current production tax on oil is based on a percentage of the gross value of production. A new petroleum production tax would be based on a percentage of the net profit. The current production tax rate is driven by the Economic Limit Factor (ELF). This ELF-based system is no longer working for Alaska. The second largest oil field in the nation (Kuparuk) will no longer pay a production tax in the next year and Prudhoe Bay will pay a near zero production tax in 12 - 14 years.

### Why is a new petroleum production tax a good idea?

The ELF-based oil production tax no longer works effectively for Alaska for three reasons:

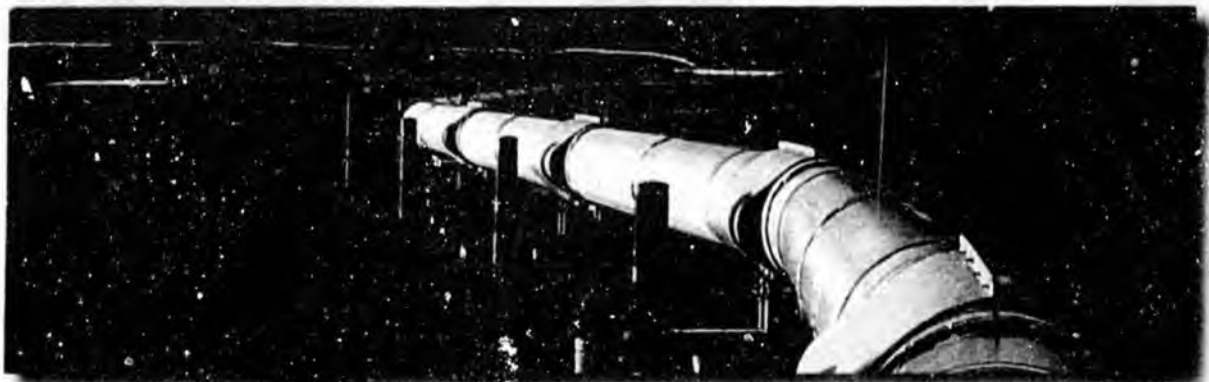
1. Alaska is not getting its fair share of oil revenue under the ELF system compared to what the producers are paying in similar oil regimes around the world.
2. The current production tax provides few incentives for exploration, development and investment. The new oil production tax being proposed will provide significant new oil and gas exploration and investment incentives.
3. ELF will drop to near zero in 12 -14 years, meaning that Alaskans will receive no production tax revenue.

### How would this new tax work?

The new tax system would be net cash flow driven. That is, it would be based on the difference between capital and operating expenditures and revenues as they occur annually. As a result, tax revenue would be lower when the initial large new capital outlays are made and higher as production responds to that investment and net cash flow becomes positive.

### What are the tax rates?

The producers will pay a 20% tax rate with a 20% tradable capital investment tax credit. The bill also provides for a \$73 million annual allowance to be used as an additional deduction as long as the allowance is not greater than the net value before the allowance. 20% of any carry-forward loss may also be taken as a tax credit.



*Continued.-->*

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### **Is this tax designed to make the state more money?**

Yes, when oil prices are above approximately \$25 per barrel. Under the current system, when profits are high, they are being expatriated outside of Alaska because there is no tax incentive to invest in Alaska. However, when producers reinvest their profits here, or when prices are low because of low oil prices or high costs, it is possible that the state could see lower production tax revenue. More investment will lead to more barrels, more barrels will lead to more profits and more profits will lead to more taxes.

### **Why should the State change the oil tax?**

Alaska should receive a fair share of the revenue generated from our natural resources. The current oil production tax does not provide Alaska the same level of revenue (also considering federal tax) that the producers are paying in similarly situated oil provinces around the world.



The new petroleum production tax would be a component of the fiscal stability offered to the producers who are proposing to build the gas pipeline. It is only fair that in exchange for fiscal stability on oil taxes that the state gets a fair share, similar to what the producers are paying elsewhere in the world, especially since fiscal stability increases the value of the leases that the producers hold.

### **What are the benefits of this tax?**

A new petroleum production tax would ensure that Alaska gets a fair share of oil revenues compared to what the producers are paying in similar areas around the world. The structural tax change puts in place development incentives that encourages new and existing producers to invest their oil profits in finding and developing Alaska's oil and gas resources.



### **What about incentives for development?**

The bill creates new incentives for investment, exploration and development - a 20% tradable capital investment tax credit and a \$73 million "standard deduction". The new incentives were included in the legislation because Prudhoe Bay is an aging field and other than ANWR, we are unlikely to find major new oil fields on state land on the North Slope. Explorers are more likely to find new fields in the 50 to 150 million barrel range. These explorers will need incentives to find and develop these expensive and smaller fields.

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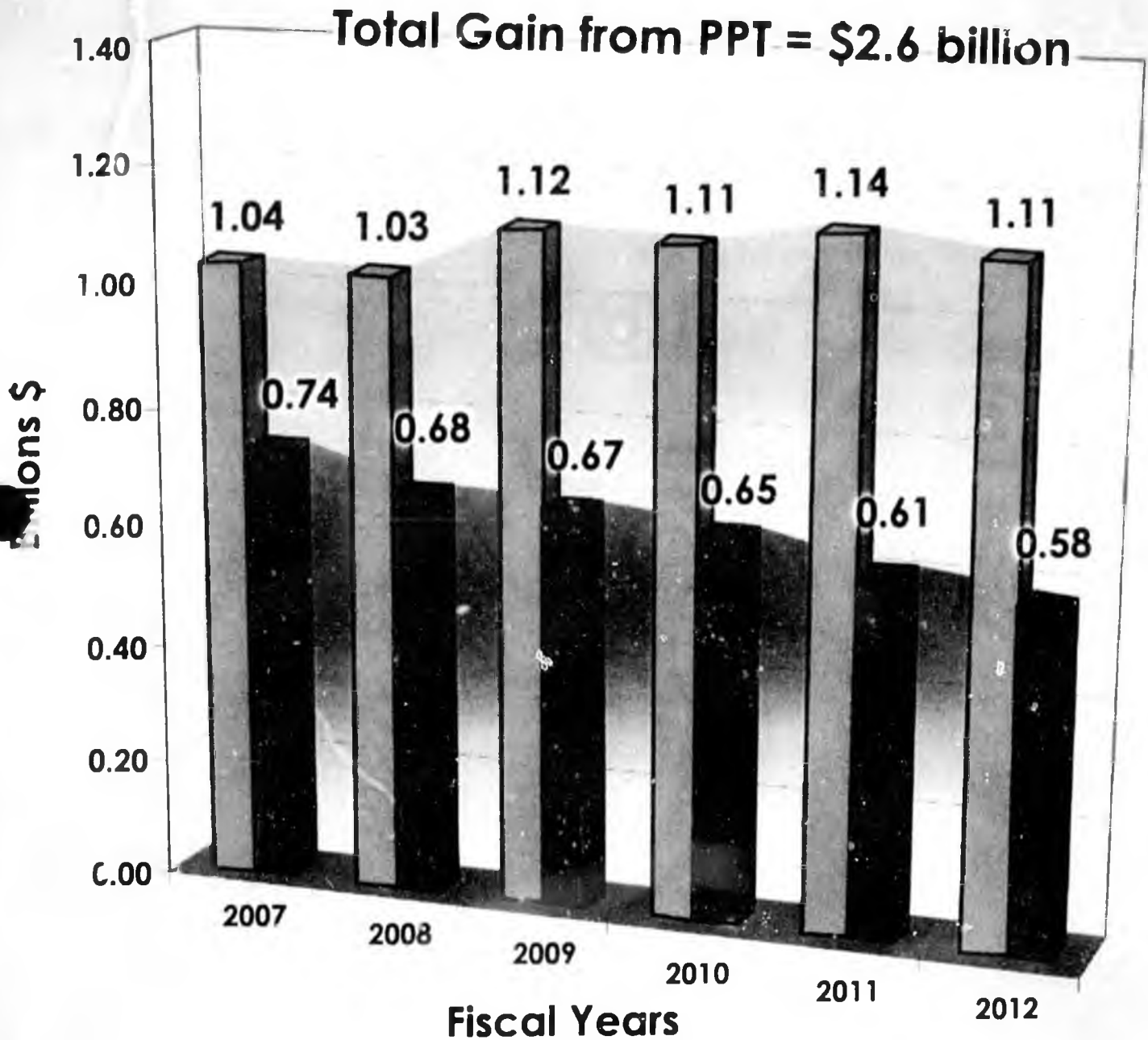
### **For Questions and Comments:**

**Chuck Logsdon**  
*Gas Pipeline Negotiations Spokesman*  
907.269.7450

**Becky Hultberg**  
*Governor's Spokeswoman*  
907.465.3500

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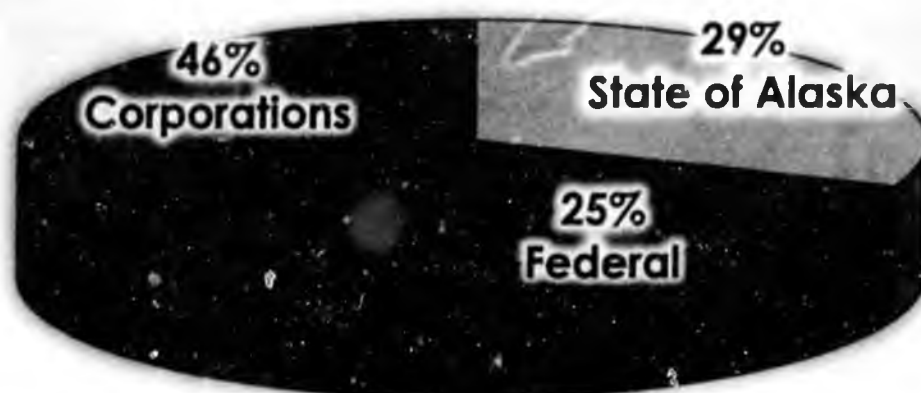
# Oil Production Revenue Comparison Current vs. Proposed (Billions \$)



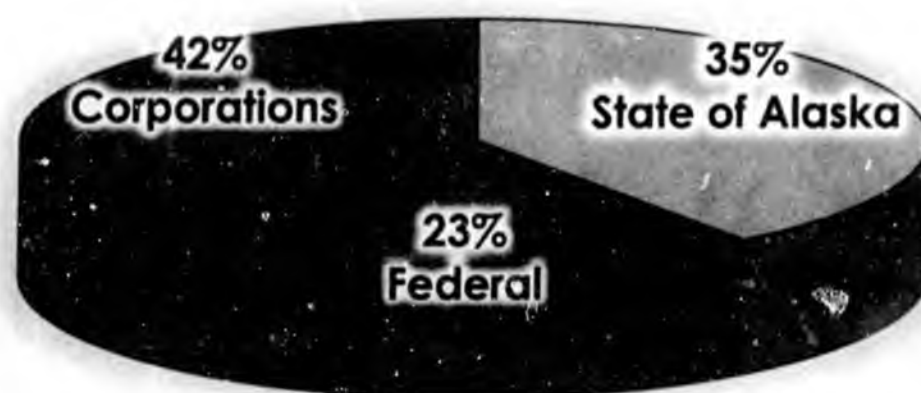
- Proposed Petroleum Production Tax
- Current Oil Production Tax

Based on Fiscal Note at \$40 per Barrel

# Oil Resource Value Shares Over Long Term (2006-2050)



**Current System**



**PPT System**

Production Tax, Royalties, Corporate Income Tax, Property Tax

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February 21, 2006

The Honorable John Harris  
Speaker of the House  
Alaska State Legislature  
State Capitol, Room 208  
Juneau, AK 99801-1182

Dear Speaker Harris:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the oil and gas production tax.

This bill would eliminate the economic limit factor (ELF) from the determination of production tax, and would replace it with a more progressive and investment-friendly tax system.

Under current law, the tax imposed on oil or gas production generally is determined by multiplying the gross value at the point of production times the appropriate tax rate times the economic limit factor for that production.

The economic limit factor was intended to provide a proxy for costs. It is determined by a complex formula that uses as input the total production from, and productivity of, the wells in a field. The theory behind the economic limit is that a producer would not be taxed for production below the economic limit while still recovering costs. However, this has not worked well in recent practice. On the one hand, under current conditions, producers are allowed proxy costs several times their actual costs. On the other hand, a producer reinvesting its profits from Alaska production in exploration, production, or development in the state may receive little or no tax benefit compared to a producer who exports its profits and makes those same investments in another state or country.

As explained in more detail below, this bill introduces two important investment-friendly tax concepts in place of the economic limit factor.

- The tax proposed in the bill is based essentially on the cash flow from a lease, or the profit net of all qualified costs. Thus, a deduction is allowed for all upstream costs, including expenses and capital investment. In other words, the tax base is not gross value at the point of production but the net value. In addition, every producer is allowed an annual allowance of up to \$73 million, so if a producer's cash flow is \$73 million or less in a year, there would be no tax.
- A 20 percent tax credit is allowed for all the upstream capital investment, even if a deduction was taken for that investment as described above. Another credit is allowed for operating losses.

Because of this proposed switch from a gross to net basis, a higher tax rate is appropriate and this bill would raise the rate (before applying ELF) from the current 15 percent (or 12.25 percent for new production) to 20 percent. In addition, the minimum tax is repealed. Thus, as mentioned above, a company would incur a production tax liability only if it has positive cash flow from its Alaska production properties greater than \$73 million a year.

#### Upstream Cost Deduction

The calculation of the net value of a producer's oil and gas starts with gross value, which is essentially unchanged from current law, with some streamlining. Direct lease costs, including both capital investment and operating costs are deducted from that gross value. If in any month the total cash flow is reduced to zero by those costs, remaining costs are carried forward to future months (or, if unused by the end of a calendar year, are translated into a credit applicable in future years). In addition, each producer is granted an allowance of up to \$200,000 a day or \$73 million a year. That is, if after calculating its net profit a producer still showed positive cash flows of \$73 million or less, this allowance may be used to reduce that cash flow to zero (though again, not any lower). If the producer showed a positive cash flow of more than \$73 million, the allowance would be used to reduce the taxable cash flow by \$73 million. Finally, as a transition measure, for the first 72 months in which the Alaska North Slope oil spot price is above \$40 a barrel, a producer is allowed to include in its upstream deduction a pro rata amount of capital costs incurred in the five years before the new production tax takes effect.

In the interests of streamlining and simplicity, the Department of Revenue is directed to take into account the kind of costs that an operator typically bills a working interest owner (and a working interest owner typically audits) and the Department of Natural Resources' net profit share lease regulations.

A number of indirect costs that may not be included in the calculation of direct lease costs are specified in the bill. Finally, the bill specifies that any deduction for lease expenses must be reduced by any reimbursements that a taxpayer receives from other taxpayers, say, for example, for use of facilities, or from the government where such payments are in the nature of field costs.

#### New Investment Credits

Two major new credits are provided for in the bill.

(1) A credit would be allowed against the production tax for 20 percent of any qualified investment, even though that same outlay may also be deductible in calculating taxable net value of the oil and gas. This credit and the exploration credits under AS 43.55.025 may not both be taken for the same expenditures. Qualified capital expenditures include outlays for new (or new-to-Alaska) assets that are treated as capital under the federal tax code, as well as geological and geophysical exploration costs and drilling costs that would be expensed under the federal tax code.

(2) A credit also would be allowed for 20 percent of any annual loss. Because the tax due can only be reduced to zero (and not below zero), mechanically this is the same as allowing unclaimed expense to be carried forward year to year, but for tax administration purposes it is preferable for carryforwards to be in the form of credits.

These credits would be non-refundable; that is, they could not be used to reduce a taxpayer's liability below zero. However, any credit not used in a given period could either be carried forward or sold to another taxpayer who might better be able to use it. Taxpayers who purchase credits may not use the credits to reduce their production taxes by more than 20 percent in any year.

In addition to the two major new credits, producers would be allowed to credit their oil conservation surcharge payments under AS 43.55 against the production tax.

Other Provisions

In providing for taxation of the net value of oil and gas, the bill also would preserve most of the current provisions on calculating gross value at the point of production, since this calculation is an intermediate step in calculating taxable net value. This approach has the benefit of conserving the body of regulations, interpretations, and case law that has developed over several decades. In the interest of fostering simplicity and efficiency, however, the bill would make a significant addition to the current provisions, authorizing the Department of Revenue to allow taxpayers, if appropriate, to rely on royalty settlement agreements with the Department of Natural Resources (DNR), or other royalty values or methodologies accepted by the DNR, or the United States Department of the Interior (in the case of some federal leases or units) or to use a simplifying formula approved by the Department of Revenue.

The bill would make several changes in current law to facilitate administration of the new production tax approach. The subjects addressed include tax returns and tax payment due dates, definitions of oil and gas and other terms, and treatment of private royalty oil and gas for production tax purposes. The bill clarifies how the Department of Revenue may disclose certain otherwise confidential information to taxpayers when the information affects their tax liabilities. Persons who violate the conditions of such disclosure would be subject to the same criminal penalties that currently apply to state employees who violate taxpayer confidentiality. The bill also simplifies the tax treatment of flared gas and extends to oil the current tax exemption for gas that is used on the lease.

The bill would make needed updates and clarifications to certain provisions of the production tax statute: confirming the Department of Revenue's long-standing application of the prevailing value concept to internal transfers of oil or gas, incorporating a necessary reference to the constitutional budget reserve fund regarding the department's disposition of revenue, and repealing a specific failure-to-file penalty that is superfluous in the light of the general penalty provisions of the revenue laws.

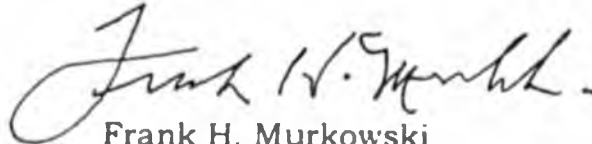
The proposed new production tax on net value, and related provisions of the bill, would apply prospectively, as of July 1, 2006. The bill has an immediate effective date for other purposes.

This bill will greatly improve Alaska's oil and gas tax system, encouraging investment in the state, making tax administration more predictable, better reflecting the variable economics of oil and gas development,

The Honorable John Harris  
February 21, 2006  
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and providing Alaskans with a fairer share of the value of the oil and gas taken out of the ground in our state. I urge your prompt and favorable action on this legislation.

Sincerely yours,

A handwritten signature in cursive script, reading "Frank H. Murkowski".

Frank H. Murkowski  
Governor

Enclosure

**HB 488**  
**"OIL AND GAS PRODUCTION TAX"**  
**SECTIONAL ANALYSIS**

**Section 1:** This section addresses the legislative intent of sec. 11 of the bill, which amends AS 43.55.020(f), a provision of the production tax statute. Section 1 explains that the intent is not to change the meaning or effect of that law but rather to confirm the meaning as it has long been interpreted by the Department of Revenue.

**Sections 2 and 3:** These sections amend provisions of the corporate income tax statute, AS 43.20, to ensure that the oil and gas production tax, as amended by this bill, is not treated the way an income tax is treated under that statute. Specifically, the amendments ensure that the production tax may be deducted, and that the production tax will not be added back to federal taxable income, for purposes of computing the corporate income tax.

**Section 4:** This section deals with criminal penalties for unauthorized disclosure of confidential tax records. Currently, AS 43.05.230(f) subjects current or former state officers, employees, and agents to fine or imprisonment for such disclosure. Section 4 would extend the criminal penalties to private persons who violate conditions imposed by the Department of Revenue limiting access to and use of certain confidential information related to the production tax.

**Section 5:** This section is one of the core provisions of the bill. It (together with the repealer provision, sec. 34) replaces the current production taxes on oil and gas with a single production tax on both oil and gas. The current taxes are generally based on a percentage of the *gross* value of oil or gas at the point of production. As amended by sec. 5, the production tax is equal to 20 percent of the *net* value of oil and gas. Section 21 of the bill addresses how net value is determined.

**Section 6:** This section conforms certain existing statutory terminology to that used in the Internal Revenue Code and incorporates a definition that no longer needs to be located in a separate definitions section of the statute.

**Section 7:** This section deals with production tax payment due dates and interest. As under existing law, the production tax remains a monthly tax, but because a taxpayer's exact liability may be subject to adjustment in light of later information or events (such as capital investments), only 90 percent of the tax is initially due each month. The remainder is due when a "true-up" return is filed by March 31 of the next calendar year.

**Sections 8, 18, 19, 22, 23, 26, 27, and 38:** These sections are simply conforming amendments or updates to reflect current legislative language usage.

**Section 9:** This section deals with a producer's right to charge a private royalty owner for the share of production taxes attributable to royalty oil and gas. That right is recognized in existing law; what the section adds is a method of determining the royalty share of the taxes in the absence of an agreement between the producer and royalty owner to use a different method.

**Section 10:** This section expands the current production tax exemption for gas that is used in lease operations, to include oil that is used in lease operations. The section also simplifies the treatment of flared gas, which currently may be tax exempt, taxable, or both taxable and subject to a penalty, depending on why it is flared. Under this bill, gas whose flaring is authorized by the Alaska Oil and Gas Conservation Commission would be tax exempt; and otherwise it would be taxable.

**Section 11:** This section amends a provision of the production tax statute allowing the Department of Revenue to require production tax to be paid on the basis of the prevailing value of oil or gas. The section clarifies that the provision applies, not only where the sale price of oil or gas is sold differs from the prevailing value, but also where the oil or gas is not sold at all – for example, where it is refined by the company that produced it.

**Section 12:** This core section of the bill provides for two new types of tax credits that may be applied against the production tax. One is in the amount of 20 percent of capital expenditures for oil or gas exploration, development, or production. The other is in the amount of 20 percent of net losses from oil or gas exploration, development, or production that are carried forward from previous years. An unused credit may be sold to other producers by applying to the Department of Revenue for a transferable tax credit certificate. If the Department of Revenue later finds that the original producer's credit claim was invalid, it may assess a tax deficiency against that producer, but the purchaser of the certificate would still be able to rely on and use the certificate in full.

**Sections 13 - 15:** These sections update the statutory provisions that govern production tax returns, including requiring those returns to report on the costs that will be deductible under this bill for purposes of calculating taxable net value of oil and gas. The annual return that "trues up" prior year monthly returns must show any adjustments or corrections to those monthly returns. Section 13 repeals a \$25 per day penalty for failure to file a production tax return, in light of the fact that there is a generally applicable late-filing penalty in the tax administration provisions of AS 43.

**Section 16:** This section clarifies that the Department of Revenue's power to obtain information relevant to determining taxes includes the power to require the filing of regular reports. The section also clarifies the statutory confidentiality restrictions on tax information, recognizing that the Department of Revenue may disclose such information to a taxpayer when it is necessary to compute that taxpayer's liability. In such

circumstances, the Department is required to impose appropriate limitations on which individuals may have access to the information and how the information may be used.

**Section 17:** This section amends the current requirement that production taxes be deposited in the general fund, to incorporate exceptions imposed under the constitutional budget reserve fund amendment.

**Section 20:** This section amends AS 43.55.150, which deals with determining the gross value at the point of production of oil and gas. The section authorizes the Department of Revenue to allow producers to calculate the gross value with a formula that uses a producer's royalty settlement agreement with the state, or a royalty value or valuation methodology accepted by the Department of Natural Resources or the United States Department of the Interior in certain cases, or another formula using such factors as published price indices.

**Section 21:** This section, a core provision of the bill, provides for the calculation of a producer's net value of taxable oil and gas. This calculation may include five steps. First, the gross value at the point of production of all of the producer's taxable oil and gas statewide is computed. Second, the producer's deductible costs of oil and gas exploration, development, and production – called adjusted lease expenditures -- in the state are totaled. Third, those costs are deducted from gross value. Fourth, a specified fraction of the producer's oil and gas capital investments during the five years before the new tax law takes effect may be deducted. Fifth, an allowance of up to \$73 million, spread over a calendar year, may be deducted. In no case, however, may the net value calculation for oil and gas drop below zero; the section establishes rules for the treatment of unused deductions.

The section directs the Department of Revenue to give substantial weight, in determining deductible costs, to typical industry practices and standards as reflected in billable types of costs under joint operating agreements, and allows the Department of Revenue to authorize producers in appropriate circumstances to rely on billings under such agreements for production tax purposes. The section also provides examples of costs that are potentially deductible as "direct" costs and examples of costs that are not deductible because they are not "direct." Costs are required to be adjusted to account for reimbursements, asset sales, and other relevant producer receipts.

The section establishes limits on the deduction of previous capital investments, including a requirement that the West Coast price of Alaska North Slope oil must exceed \$40 per barrel for the month. This figure is subject to future adjustment for inflation.

To benefit from an annual allowance of up to \$73 million, a producer must qualify with the Department of Revenue. The qualification requirement is designed to prevent the proliferation of producer entities for tax avoidance purposes.