

12018 SENATE RESOURCES

**SB**

**305**

**(FILE 14)**

**Final**

| Governor  | Senate Resources  |
|---|---|
|   |   |
| 20/20 tax/credit                                  | 25/20 tax/credit  |
| No progressivity                                  | 0.20 progressivity, begin at \$40.00 barrel, in \$10.00 increments.<br><br><b>Expected to change.</b>   |
| Transition or Claw-back<br>6 years, 100% of capex | Maximum 4 years; 75% for 2005- 06; 50% in 2004-05; 25% for 2003-04  |
| \$73 million standard deduction                   | <ul style="list-style-type: none"> <li>• New language that replaces the \$73 million deduction, offering instead a tax credit of 20% for development or production or a 30% credit for exploration</li> <li>• Revised old exploration credits to now allow testing, stimulation, or completion costs</li> </ul> <p><b>Expected to change.</b></p> |
| Abandonment issues – allowed as an expense.       | Clarify is not eligible for a credit, but as an expense. Expenses for past production not allowed.  |
| Effective Date – July 1, 2006                     | Effective Date – April 1, 2006  |
| 470 Fund Surcharge – allowed as an expense        | Will not be allowed as an expense, is increased by 0.01; old .03+.02=.05; now .05+.01=.06   |
| No Cook Inlet provisions.                         | Establishes existing oil production in Cook Inlet basin remains status quo – new oil and gas goes under new PPT.  |

Title: changes to reflect “net value” to “production tax value”, amending to apply to Cook Inlet, relating to surcharges, definition of “gas” in ASGDA.

“net value” requested by AOGA

Cook Inlet language for Sec. 5

Surcharges for Sec. 27-30

Gas definition for cross reference to Sec. 31

**FINAL**

1. No changes.
2. No changes, was old section 4.
3. No changes, was old section 2.
4. No changes, was old section 3.
5. New section to amend existing oil tax to accommodate the Cook Inlet basin.
6. New section “gross value at the point of production” for the Cook Inlet basin.
7. Old Sec. 5. e. New language establishing tax of 25% of production tax value of oil and gas, exception for (a) is to apply to Cook Inlet basin  
Pg. 5, line 7, (A) need to insert “gas” in front of “from the Cook Inlet basin”
  - f. (1-3) New language regarding private royalty (AOGA & ASRC)
  - (4) new language regarding royalty on ANWR and NPRA – needs correction to reflect tax on royalty, not just royalty

17. New section ... deletes "testing stimulation, or completion costs" from existing statute for production tax credits. Effect is to allow testing, stimulation, or completion costs as authorized exploration tax credit.
18. Old Sec. 13, No changes
19. Old Sec. 14, No changes
20. Old Sec. 15, No changes
21. Old Sec. 16. Slight language changes (ii) ???
22. No changes, old Sec. 17.
23. No changes, old Sec. 18.
24. Old Sec. 19. Revision to add "or" on line 26: note, this "or" may be deleted.
25. Old Sec. 20. Language changes regarding valuation, eliminating royalty settlement agreements as a method of valuation.
26. Old Sec. 21. pg. 17 line 29 adds 43.55.011(c), other slight changes in (a)  
Pg. 18, line 5, slight formatting changes in (b) "for purposes of administration"  
Pg. 18, line 2 and 18 line 20: 1/48 reflects 4 years instead of 6 years  
Pg 18, line 26 April 1, 2006  
pg. 19 line 4 "from a" ... typo?  
pg. 19, line 16-17: "including the operator or a working interest owner" - needs to read: "include a producer that is the operator"  
AOGA changes  
pg. 19, line 29 "capital assets" need better define for this  
pg. 20 line 6, need to delete "capital assets"  
pg. 20 line 7, adds "for oil and gas" AOGA changes

# CORRECTION

THE FOLLOWING DOCUMENT(S)  
HAVE BEEN REFILMED TO  
ASSURE LEGIBILITY OR PAGINATION



Central Microfilm Services  
Department of Education & Early Development  
State of Alaska

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- g. New language for progressivity, determined monthly based on WTI beginning at \$40.00 a barrel, tax rate of .20 percent for each \$10 increment.
- h. New language providing for department calculations on the rate in (g).

**NOTE: Revisions expected for this progressivity concept.**

- 8. Certain ELF provisions maintained for Cook Inlet Basin
- 9. Old Sec. 6 Change "upon" to "on" (line 31), otherwise no changes.
- 10. Old Sec. 7: Changed ... was 90% of tax due, now is 95% of tax due and now paid quarterly – "true-up".
- 11. No changes, old Sec. 8
- 12. Old Sec. 9 – AOGA changes –
- 13. No changes – old Sec. 10.
- 14. Old Sec. 11: inserted "produced but" needs to apply to both .
- 15. New language, references taxes due for Cook Inlet basin.

**NOTE: Section 16 & 17 pertain to \$73 million standard deduction and a new approach is being considered which would replace these two sections.**

- 16. Old Sec. 12. This is new language to replace the \$73 million standard deduction, offering instead a tax credit of 20 percent for development or production or 30 percent for exploration. Subsection (b) percentage needs to match the tax percent (page 10 line 11)  
Page 12, line 11, April 1, 2006 date  
Page 12, line 21, subsection (3) new  
Pg. 12, line 24 ... "or similar regulatory body" needs to be clarified that is specific to entities that have pipeline authority, etc.

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  - pg. 20 line 7, adds "for oil and gas" AOGA changes

pg. 20, line 22: (K) indemnification language requested by AOGA

pg. 20, line 25: (L) surcharges for 470 funds are not "direct costs"

pg. 20, line 26 (M) costs of abandonment are not "direct costs" under i and ii

Page 21, line 8, (N) new language for clarification on costs

Page 21, line 12 (O) new language for clarification on costs

Pg. 21, line 16 (e) drafting formatting revisions "costs" line 25

Pg. 21, line 20, new subsection (B)

Pg. 22, line 1, April 1, 2006

pg. 22, line 11 – subsection (g) – new transitional expenditures, limiting to 3 year note effective date of April 1, 2006 : look back at 25% in 2003-2004; then 50% in 2004-2005, then 75% in 2005-2006 (Jan 05 – July 06).

Pg. 22, line 27 (2) sets out in subsection formation language same as previous

Pg. 23, line 4, changes "such" to "the" other slight drafting changes in rest of section.

Deletes old subsection (i) which was the \$73 million standard

New (i) is old (k) with some drafting revisions; new (j) is old (l); new (k) is old (m);

Pg. 23, line 29: inserted new subsection (l) and (m) and (n)

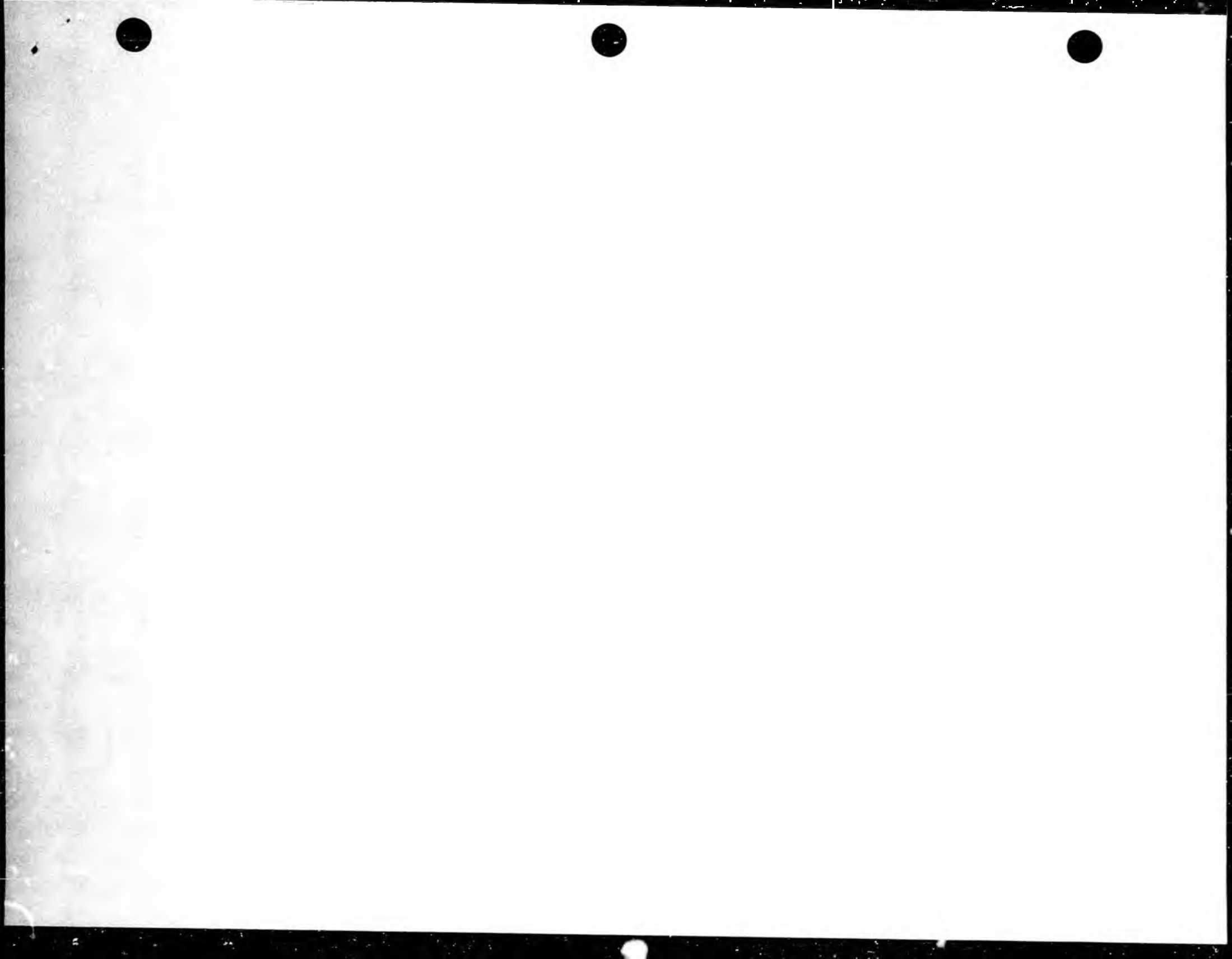
new (o) is old (n) with some AOGA revisions

27. New language establishing new surcharge rate from 0.02 to 0.01 (old Sec. 22 & 23)
28. Old Sec. 24. If not produced for purposes of production tax than not produced for purposes of surcharge tax.

29. New language establish new surcharge rate from 0.03 to 0.05. (partial old 25, 26 & 27)
30. Old Section 28 – If not produced for purposes of production tax than not produced for purposes of surcharge tax

NOTE: Old Section 29 deleted – was tax credit for surcharge

31. Old Sec. 30: no changes.
32. Old Sec. 31 no changes
33. Old. Sec. 32 no changes
34. Old. Sec. 33 no changes
35. Old Sec. 34 – repealer section: original bill eliminated AS  
43.55.011(b) for CI; 43.55.011(c) for CI; 43.55.012(b) for CI;  
43.55.013(b) (d) (j) and (k) ELF for CI; (new bill does NOT repeal  
this sections – they are referenced to Cook Inlet basin under ELF) also  
does not repeal: 43.55.900(1), 43.55.900(12) and 43.55.900(1o)
36. Old Sec. 35 applicability: Change date to April 1, 2006.
  - a. Same but references new section numbers
  - b. Same but references new section numbers.
37. Old Sec. 36 – Transitional provisions. (a)(b)(c) changes to reflect date  
April 1, 2006 and from “six months” to nine months”.  
(d) ???
38. Old. Sec. 37 – Transition : Regulations. No change.
39. Old Sec. 38 Revisions Instruction – changes to reflect revisions in  
new bill.
40. Old Sec. 39. Effective dates of specific sections.
41. General bill effective date April 1, 2006.



CS FOR SENATE BILL NO. 305(RES)  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY THE SENATE RESOURCES COMMITTEE

Offered:  
Referred:

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

A BILL

FOR AN ACT ENTITLED

1 "An Act providing for a production tax on oil and gas; amending the oil production tax  
2 to limit its application to current Cook Inlet production, repealing the gas production  
3 tax, and limiting application of the economic limit factor to oil and repealing it as to gas;  
4 relating to the relationship of the production tax on oil and gas to other taxes, to the  
5 dates those tax payments and surcharges are due, to interest on overpayments of the tax,  
6 and to the treatment of the tax in a producer's settlement with the royalty owners;  
7 relating to flared gas, and to oil and gas used in the operation of a lease or property  
8 under the production tax; relating to the prevailing value of oil or gas under the  
9 production tax; providing for tax credits against the tax for certain expenditures and  
10 losses; relating to surcharges on oil; relating to statements or other information required  
11 to be filed with or furnished to the Department of Revenue, and relating to the penalty  
12 for failure to file certain reports, for the tax; relating to the powers of the Department of

1 Revenue, and to the disclosure of certain information required to be furnished to the  
 2 Department of Revenue, as applicable to the administration of the tax; relating to  
 3 criminal penalties for violating conditions governing access to and use of confidential  
 4 information relating to the tax, and to the deposit of tax money collected by the  
 5 Department of Revenue; relating to the calculation of the gross value at the point of  
 6 production of oil or gas; relating to the determination of the production tax value of oil  
 7 and gas for purposes of a tax on the production tax value of oil and gas; relating to the  
 8 definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and  
 9 as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act;  
 10 making conforming amendments; and providing for an effective date."

11 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

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

14 INTENT OF SEC. 14 OF THIS ACT. It is the intent of the legislature through sec. 14  
15 of this Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by  
16 the Department of Revenue.

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

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

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

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

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

26 (b) A taxpayer's business income to be apportioned under this section to the  
27 state shall be the federal taxable income of the taxpayer's consolidated business for the

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1 tax period, except that

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

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

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

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

16 \* Sec. 5. AS 43.55.011(a) is amended to read:

17 (a) There is levied upon the producer of oil a tax for all oil produced in  
18 commercial quantities from each lease or property within a field or unit in the  
19 Cook Inlet sedimentary basin and that was in production and subject to tax  
20 under this section on the effective date of this amendment of this subsection [IN  
21 THE STATE], less any oil the ownership or right to which is exempt from taxation.  
22 The tax is equal to either the percentage-of-value amount calculated under (b) of this  
23 section or the cents-per-barrel amount calculated under (c) of this section, whichever  
24 is greater, multiplied by the economic limit factor determined for the oil production of  
25 the lease or property under AS 43.55.013. If the amounts calculated under (b) and (c)  
26 of this section are equal, the amount calculated under (b) of this section shall be  
27 treated as if it were the greater for purposes of this section. In this subsection, "Cook  
28 Inlet sedimentary basin" has the meaning given to "Cook Inlet" in the regulation  
29 adopted to implement AS 38.05.180(f)(4) as the regulation read on the effective  
30 date of this section.

31 \* Sec. 6. AS 43.55.011(b) is amended to read:

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LANGUAGE*

1 (b) The percentage-of-value amount equals 12.25 percent of the gross value at  
 2 the point of production of taxable oil produced on or before June 30, 1981, from the  
 3 lease or property and 15 percent of the gross value at the point of production of  
 4 taxable oil produced from the lease or property after June 30, 1981; except that for a  
 5 lease or property coming into commercial oil production after June 30, 1981, the  
 6 percentage-of-value amount equals 12.25 percent of the gross value at the point of  
 7 production of taxable oil produced from the lease or property in the first five years  
 8 after the start of commercial oil production and equals 15 percent of the gross value at  
 9 the point of production of taxable oil produced thereafter from the lease or property.  
 10 For purposes of this section, notwithstanding the definition set out in  
 11 AS 43.55.900, "gross value at the point of production" means the value of the oil  
 12 at the point where it is metered or measured (by automatic custody transfer  
 13 meter, tank gauge, or other method approved by the commissioner) in a  
 14 condition of pipeline quality on the premises of the lease or property from which  
 15 it is recovered; however, if the oil is not of pipeline quality when it is removed  
 16 from the premises of the lease or property from which it is recovered, or if the oil  
 17 recovered from a lease or property is not metered or measured (by automatic  
 18 custody transfer meter, tank gauge, or other method approved by the  
 19 commissioner) on the premises of the lease or property from which it is  
 20 recovered, then the gross value at the point of production is the value of that oil  
 21 at the off-premises location where the oil is first metered or measured (by  
 22 automatic custody transfer meter, tank gauge, or other method approved by the  
 23 commissioner) in a condition of pipeline quality.

24 \* Sec. 7. AS 43.55.011 is amended by adding new subsections to read:

25 (e) Except as to oil described in (a) of this section, there is levied on the  
 26 producer of oil or gas a tax for all oil and gas produced each month from each lease or  
 27 property in the state less any oil and gas the ownership or right to which is exempt  
 28 from taxation or constitutes a lessor's royalty interest under an oil and gas lease. The  
 29 tax is equal to 25 percent of the production tax value of the taxable oil and gas as  
 30 calculated under AS 43.55.160.

31 (f) Notwithstanding (a) and (e) of this section, there is levied on the producer

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1 of oil or gas a tax for all oil and gas produced each month from each lease or property  
 2 in the state the ownership or right to which constitutes a lessor's royalty interest under  
 3 an oil and gas lease, except for oil and gas the ownership or right to which is exempt  
 4 from taxation. The provisions of this subsection apply for a lessor's royalty interest  
 5 under an oil and gas lease as follows:

6 (1) the rate of tax levied on oil and gas produced

7 (A) <sup>GAS</sup> from the Cook Inlet basin, as that term is defined in (a) of  
 8 this section, is 1.5 percent;

9 (B) except as provided in (A) of this paragraph, is five percent;

10 (2) the rate of tax is applied to

11 (A) the amount of the royalty paid to the owner by the  
 12 producer; or

13 (B) the value, in the case of royalty oil or gas taken in kind by  
 14 the royalty owner, of that royalty oil or gas determined

15 (i) in accordance with the royalty valuation  
 16 methodology in the lease or other governing agreement between the  
 17 owner and the producer; and

18 (ii) at the point of delivery of that royalty oil or gas to  
 19 the owner;

20 (3) except as otherwise provided in (4) of this subsection, unless  
 21 otherwise expressly agreed between the producer and the royalty owner, in making  
 22 settlement with the royalty owner with respect to royalty oil or gas taxed under this  
 23 subsection, the producer may deduct the amount of the tax paid on taxable royalty oil  
 24 or gas under this subsection, or may deduct taxable royalty oil or gas equivalent in  
 25 value at the time the tax becomes due, and the provisions of AS 43.55.020(d) are not  
 26 applicable to that taxable royalty oil or gas; and

27 (4) the commissioner shall determine the amounts of royalty on all  
 28 fields developed in the Arctic National Wildlife Refuge and the National Petroleum  
 29 Reserve - Alaska on and after the effective date of this section.

30 (g) In addition to the taxes levied under (e) and (f) of this section, for each  
 31 month for which the average United States Gulf Coast price for that month of West

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1 Texas Intermediate crude oil is more than \$40 a barrel, there is levied upon the  
 2 producer of oil or gas a tax for oil or gas produced during that month from each lease  
 3 or property in the state, less any oil and gas the ownership or right to which is exempt  
 4 from taxation. The tax is equal to .20 percent for each \$10 increment or portion of the  
 5 increment that the average price of oil exceeds \$40 a barrel.

6 (h) For purposes of (g) of this section, the department may calculate the  
 7 average price or may, by regulation, specify the method by which the average price  
 8 shall be calculated with reference to one or more published sources of price  
 9 information. If, in the department's judgment, reliable published sources of price  
 10 information on West Texas Intermediate crude oil cease, or appear likely to soon  
 11 cease, to be available, or if, in the department's judgment, the price of West Texas  
 12 Intermediate crude oil ceases, or appears likely to soon cease, to be a reliable indicator  
 13 of the general price level of crude oils, the department shall, by regulation, specify a  
 14 substitute formula for computing the oil price index. The substitute formula specified  
 15 by the department under this subsection must bear, as nearly as is reasonably possible,  
 16 the same relationship to the general price level of crude oils as did the United States  
 17 Gulf Coast price of West Texas Intermediate crude oil.

18 \* Sec. 8. AS 43.55.013(j) is amended to read:

19 (j) The department may aggregate two or more leases or properties, [( ) or  
 20 portions of them ( )], for purposes of determining economic limit factors under this  
 21 section and applying them to AS 43.55.011 [OR AS 43.55.016], when economically  
 22 interdependent oil [OR GAS] production operations are not confined to a single lease  
 23 or property. The department may also segregate a lease or property into two or more  
 24 parts, for purposes of determining economic limit factors under this section and  
 25 applying them under AS 43.55.011 [OR AS 43.55.016], when two or more  
 26 economically independent oil [OR GAS] production operations are being conducted  
 27 on it, or when old crude oil is produced from the same lease or property as other oil.

28 \* Sec. 9. AS 43.55.017(a) is amended to read:

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

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- 1 (1) producing oil or gas leases;  
 2 (2) oil or gas produced or extracted in the state;  
 3 (3) the value of intangible drilling and development costs, as  
 4 described in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through  
 5 January 1, 1974 [EXPLORATION EXPENSES].

6 \* Sec. 10. AS 43.55.020(a) is repealed and reenacted to read:

7 (a) The production tax on oil and gas shall be paid as set out in this subsection.  
 8 Ninety-five percent of the tax levied under AS 43.55.011(e), net of any credits applied  
 9 under this chapter, is due on the last day of each calendar month on oil and gas  
 10 produced from each lease or property during the preceding month. The remaining  
 11 portion of the tax levied under AS 43.55.011(e), net of any credits applied under this  
 12 chapter, is due on the last day of the third month following the calendar quarter during  
 13 which the oil and gas were produced. An unpaid amount of tax that is not paid when  
 14 due in accordance with this subsection becomes delinquent. An overpayment of tax  
 15 with respect to a month may be applied against the tax due for any later month.  
 16 Notwithstanding any contrary provision of AS 43.05.280, interest on an overpayment  
 17 is allowed only from a date that is 90 days after the later of (1) the last day of the third  
 18 month following the calendar quarter of production, as described in this subsection; or  
 19 (2) the date that the statement required under AS 43.55.030(a) and 43.55.030(e) to be  
 20 filed on or before that March 31 is filed. However, interest is not allowed if the  
 21 overpayment was refunded within the 90-day period. In this subsection, "calendar  
 22 quarter" means each of the three-month periods ending March 31, June 30,  
 23 September 30, and December 31.

24 \* Sec. 11. AS 43.55.020(b) is amended to read:

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

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

28 (d) In making settlement with the royalty owner for oil or gas that is taxable  
 29 under AS 43.55.011(e), the producer may deduct the amount of the tax paid on  
 30 taxable royalty oil and [OR] gas, or may deduct taxable royalty oil or gas equivalent  
 31 in value at the time the tax becomes due to the amount of the tax paid. Unless

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otherwise agreed between the producer and the royalty owner, the amount of the tax paid under AS 43.55.011(e) on taxable royalty oil and gas for a month other than oil or gas the ownership or right to which constitutes a lessor's royalty interest under an oil or gas lease is considered to be the gross value at the point of production of the taxable royalty oil and gas produced during the month multiplied by a figure that is a quotient, in which

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

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

\* Sec. 13. AS 43.55.020(e) is repealed and reenacted to read:

(e) Gas flared, released, or allowed to escape in excess of the amount authorized by the Alaska Oil and Gas Conservation Commission is considered, for the purpose of AS 43.55.011 - 43.55.160, as gas produced from a lease or property. Oil or gas used in the operation of a lease or property in the state in drilling for or producing oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and Gas Conservation Commission to be waste, is not considered, for the purpose of AS 43.55.011 - 43.55.160, as oil or gas produced from a lease or property.

\* Sec. 14. AS 43.55.020(f) is amended to read:

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

\* Sec. 15. AS 43.55.020 is amended by adding a new subsection to read:

(g) The tax levied under AS 43.55.011(a) shall be paid monthly and is due on the last day of each calendar month on oil and gas produced from each lease or property during the preceding month, and, if not paid before the end of the month in which it becomes due, the tax becomes delinquent.

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1 \* **Sec. 16.** AS 43.55 is amended by adding a new section to read:

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

3 Notwithstanding that a qualified capital expenditure may be a deductible lease  
4 expenditure for purposes of calculating the production tax value of oil and gas under  
5 AS 43.55.160(a), unless a credit for that expenditure is taken under AS 43.55.025;

6 (1) a producer or explorer that incurs a qualified capital expenditure  
7 may also elect to take a tax credit in the amount of

8 (A) 20 percent of that expenditure, if that expenditure is for  
9 development or production, or

10 (B) 30 percent of the that expenditure, if the expenditure is for  
11 exploration, a credit under this subsection may be applied only against a tax  
12 due under AS 43.55.011 - 43.55.160;

13 (2) for a calendar year for which the producer makes an election under  
14 AS 43.55.160(f), instead of taking a tax credit at a rate authorized by (1) of this  
15 subsection as to each separate qualified capital expenditure after it has been incurred, a  
16 producer that incurs a qualified capital expenditure during that year and that wishes to  
17 apply a credit based on that expenditure against a tax due under AS 43.55.011 -  
18 43.55.160 shall calculate and apply every month an annualized tax credit in an amount  
19 equal to

20 (A) one and two-thirds percent of the total qualified capital  
21 expenditures incurred for expenditures for development or production during  
22 that year and for which the tax credit is taken for that year; or

23 (B) two and one-half percent of the total qualified capital  
24 expenditures incurred for expenditures for exploration during that year and for  
25 which the tax credit is taken for that year;

26 (3) for purposes of (1) and (2) of this subsection,

27 (A) a qualified capital expenditure is eligible for treatment as  
28 an exploration expenditure under this subsection only if the qualified capital  
29 expenditure

30 (i) was incurred on or after the effective date of this  
31 section; and

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(ii) meets the requirements of AS 43.55.025(b)(1) - (4);

(B) a capital expenditure does not qualify as an exploration expenditure if the expenditure relates to an oil and gas unit operating under a plan of development, as that term is described in regulations of the Department of Natural Resources to implement AS 38.05.180 and other provisions of AS 38.05 relating to oil and gas; and

(C) the department, after consultation with the Department of Natural Resources, may adopt regulations establishing additional standards necessary to distinguish between expenditures for exploration and expenditures for development or production.

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

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

(d) A person entitled to take a tax credit under this section that wishes to transfer the unused credit to another person may apply to the department for a transferable tax credit certificate. An application under this subsection must be on a form prescribed by the department and must include supporting information and documentation that the department reasonably requires. The department shall grant or deny an application, or grant an application as to a lesser amount than that claimed and deny it as to the excess, not later than 60 days after the latest of (1) March 31 of the year following the calendar year in which the qualified capital expenditure or carried-forward annual loss for which the credit is claimed was incurred; (2) if the applicant is required under AS 43.55.030(c) to file a statement on or before March 31 of the year following the calendar year in which the qualified capital expenditures or carried-

1 forward annual loss for which the credit was incurred, the date the statement was filed;  
2 or (3) the date the application was received by the department. If, based on the  
3 information then available to it, the department is reasonably satisfied that the  
4 applicant is entitled to a credit, the department shall issue the applicant a transferable  
5 tax credit certificate for the amount of the credit. A certificate issued under this  
6 subsection does not expire.

7 (e) A person to which a transferable tax credit certificate is issued under (d) of  
8 this section may transfer the certificate to another person, and a transferee may further  
9 transfer the certificate. Subject to the limitations set out in (a) - (c) of this section, and  
10 notwithstanding any action the department may take with respect to the applicant  
11 under (g) of this section, the owner of a certificate may apply the credit or a portion of  
12 the credit shown on the certificate only against a tax due under AS 43.55.011(e) or  
13 AS 43.20.

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

17 (1) within 24 months after the date of issuance of the tax credit  
18 certificate, the person to whom the certificate was issued or any transferee of the  
19 certificate makes a qualified capital expenditure in this state or is the successful bidder  
20 on a bid submitted for a lease on state land under AS 38.05.180(f); and

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

24 (g) The issuance of a transferable tax credit certificate under (d) of this section  
25 does not limit the department's ability to later investigate or audit a tax credit claim to  
26 which the certificate relates or to adjust or deny the claim if the department determines  
27 that the applicant was not entitled to the amount of the credit for which the certificate  
28 was issued. The tax liability of the applicant under AS 43.55.011(e) and 43.55.017 -  
29 43.55.160 is increased by the amount of the credit that exceeds that to which the  
30 applicant was entitled. That amount bears interest under AS 43.05.225 from the date  
31 the transferable tax credit certificate was issued. For purposes of this subsection, an

1 applicant that is an explorer is considered a producer subject to the tax levied under  
2 AS 43.55.011(e).

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

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

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

16 (2) for an extended period of disuse, dismantlement, removal,  
17 surrender, or abandonment of a well, facility, pipeline, platform, or other structure, or  
18 for the restoration of a lease, field, unit, area, or body of water in conjunction with an  
19 extended period of disuse, dismantlement, removal, surrender, or abandonment of a  
20 facility described in this paragraph;

21 (3) for or directly related to

22 (A) a pipeline, facility, other asset, or service regulated as to  
23 tariffs, fees, or charges by the Federal Energy Regulatory Commission,  
24 Regulatory Commission of Alaska, or similar regulatory body; or

25 (B) an asset in which the state, directly or indirectly, holds an  
26 ownership interest equal to or greater than five percent; for the purpose of  
27 making a determination of ownership interest under this subparagraph, the  
28 state's ownership of an interest in the land on which the asset is located shall be  
29 excluded.

30 (j) In this section,

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

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

(A) incurred for geological or geophysical exploration; or

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

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

(b) To qualify for the production tax credit under (a) of this section, an exploration expenditure must be incurred for work performed on or after July 1, 2003, and before July 1, 2007, except that an exploration expenditure for a Cook Inlet prospect must be incurred for work performed on or after July 1, 2005, and before July 1, 2010, and except that an exploration expenditure, in whole or in part, south of 68 degrees, 15 minutes, North latitude, and not part of a Cook Inlet prospect must be incurred for work performed on or after July 1, 2003, and before July 1, 2010, and

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

(2) if for an exploration well,

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

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

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

(3) may not be for [TESTING, STIMULATION, OR COMPLETION

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1 COSTS:] administration, supervision, engineering, or lease operating costs; geological  
 2 or management costs; community relations or environmental costs; bonuses, taxes, or  
 3 other payments to governments related to the well; or other costs that are generally  
 4 recognized as indirect costs or financing costs; and

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

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

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

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

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

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

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

23 (5) the name of the first purchaser and the price received for the oil  
 24 and for the [OR] gas; and

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

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

28 (d) Reports by or on behalf of the producer are delinquent the first day  
 29 following the day the tax is due. [EACH PRODUCER IS SUBJECT TO A PENALTY  
 30 OF \$25 A DAY FOR EACH LEASE OR PROPERTY UPON WHICH THE  
 31 REPORT IS NOT FILED. THE PENALTY FOR FAILURE TO FILE A REPORT IS

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1 IN ADDITION TO THE PENALTY FOR DELINQUENT TAXES, AND IS A LIEN  
2 AGAINST THE ASSETS OF THE PRODUCER.]

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

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

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

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

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

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

24 (B) impose appropriate conditions limiting

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

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

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

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

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

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

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

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

**Sec. 43.55.080. Collection and deposit of revenue.** Except as otherwise provided under art. IX, sec. 17, Constitution of the State of Alaska, the [THE] department shall deposit in the general fund the money collected by it under AS 43.55.011 - 43.55.160 [AS 43.55.011 - 43.55.150].

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

**Sec. 43.55.135. Measurement.** For the purposes of AS 43.55.011 - 43.55.160 [AS 43.55.011 - 43.55.150], oil is [SHALL BE] measured in terms of a "barrel of oil" and gas is [SHALL BE] measured in terms of a "cubic foot of gas."

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

(a) For the purposes of AS 43.55.011 - 43.55.160 [AS 43.55.011 - 43.55.150], the gross value at the point of production is [SHALL BE] calculated using the reasonable costs of transportation of the oil or gas. The reasonable costs of transportation are [SHALL BE] the actual costs, except when the

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

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

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

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

(d) Under regulations adopted by the department, the department may prospectively require or allow a producer, subject to limitations prescribed by the

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1 department, to calculate the gross value at the point of production of oil or gas based  
2 in whole or part on

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

5 (A) Department of Natural Resources under AS 38.05, in the  
6 case of oil and gas produced from a lease issued by the Department of Natural  
7 Resources or produced from a lease or property that is part of a unit approved  
8 by the Department of Natural Resources; or

9 (B) United States Department of the Interior under applicable  
10 federal oil and gas leasing statutes, in the case of oil and gas produced from a  
11 lease issued by the United States Department of the Interior that is not part of a  
12 unit approved by the Department of Natural Resources, or produced from a  
13 lease or property that is part of a unit approved by the United States  
14 Department of the Interior but not approved by the Department of Natural  
15 Resources; or

16 (2) another formula prescribed by the Department of Revenue that  
17 reasonably estimates a value for the oil or gas at a specific geographical location, such  
18 as the point of tender or delivery into a common carrier pipeline; the formula

19 (A) may use factors such as published price indices for oil or  
20 gas in or outside the state, quality differentials for oil or gas, transportation  
21 costs between markets, and inflation adjustments;

22 (B) may not incorporate by reference a royalty value, royalty  
23 valuation methodology, or royalty settlement agreement.

24 \* Sec. 26. AS 43.55 is amended by adding a new section to article 1 to read:

25 **Sec. 43.55.160. Determination of production tax value of oil and gas.** (a)  
26 Except as provided in (f) of this section, for purposes of AS 43.55.011(e), the  
27 production tax value of the taxable oil and gas produced during a month is the total of  
28 the gross value at the point of production of the oil and gas taxable under  
29 AS 43.55.011(e) and produced by the producer from all leases or properties in the  
30 state, (1) less the producer's lease expenditures for the month as adjusted under (c) of  
31 this section, and (2) to the extent allowed under (g) of this section and until the total

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1 amount of the producer's transitional investment expenditures has been deducted, less  
2 an amount equal to 1/48 of the producer's transitional investment expenditures.  
3 However, the production tax value calculated under this subsection may not be less  
4 than zero.

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

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

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

19 (A) may be deducted in a later month during any calendar year  
20 to the extent allowed under (g) of this section, but not more than 1/48 of a  
21 producer's transitional investment expenditures may be deducted in any month;

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

24 (c) For purposes of this section,

25 (1) a producer's lease expenditures for a period are the total costs  
26 upstream of the point of production of oil and gas that are incurred on or after April 1,  
27 2006, by the producer during the period and that are direct, ordinary, and necessary  
28 costs of exploring for, developing, or producing oil or gas from deposits located within  
29 the producer's leases or properties in the state or, in the case of land in which the  
30 producer does not own a working interest, direct, ordinary, and necessary costs of  
31 exploring for oil or gas deposits located within other land in the state; however, lease

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expenditures do not include the costs incurred to satisfy a work commitment under an exploration license under AS 38.05.132; in determining whether costs are direct, ordinary, and necessary costs of exploring for, developing, or producing an oil or gas from a deposit of oil or gas located within a lease or property or other land in the state, the department shall give substantial weight to

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

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

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

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

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

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(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;

(L) surcharges levied under AS 43.55.201 or 43.55.300;

(M) the portion of costs incurred for any extended period of disuse, dismantlement, removal, surrender, or abandonment of a well, facility, pipeline, platform, or other structure, or for the restoration of a lease, field, unit, area, body of water, or right-of-way in conjunction with an extended period of disuse, dismantlement, removal, surrender, or abandonment, that is attributable to

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(i) or proportionate to the production of oil or gas occurring before the effective date of this section; or

(ii) a pipeline, facility, or service regulated as to tariffs, fees, or charges by the Federal Energy Regulatory Commission, the Regulatory Commission of Alaska, or a similar body if the tariff, fee, or charge takes into account dismantlement, removal, abandonment, or restoration obligations;

(N) in a transaction that is not an arm's length transaction, amounts that have not been paid, to the extent that those amounts exceed fair market value; the provisions of (l) of this section apply to a determination under this subparagraph;

(O) an amount expended to purchase an interest in any corporation, partnership, limited liability company, business trust, or any other business entity; the provisions of (l) and (m) of this section apply to a determination under this subparagraph.

(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

(A) in which the producer has an ownership interest; or

(B) that is subject to a management agreement that provides for the producer to receive a management fee determined in whole or in part on the income or gross revenue earned by the production facility;

(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 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

*Handwritten marks and scribbles on the right margin, including the word "New" written vertically.*

1 April 1, 2006; the provisions of (l) and (n) of this section apply to an asset that  
2 is subject to this subparagraph; and

3 (B) oil or gas

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

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

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

11 (g) For the purposes of this section,

12 (1) a producer's transitional investment expenditures are the sum of the  
13 expenditures the producer incurred on or after January 1, 2003, and before April 1,  
14 2006, that would be qualified capital expenditures, as defined in AS 43.55.024, if they  
15 were incurred on or after April 1, 2006, less the sum of the payments or credits the  
16 producer received before April 1, 2006, for the sale or other transfer of assets,  
17 including geological, geophysical, or well data or interpretations, acquired by the  
18 producer as a result of expenditures the producer incurred on or after January 1, 2003,  
19 and before April 1, 2006, that would be qualified capital expenditures, as defined in  
20 AS 43.55.024, if they were incurred on or after April 1, 2006, multiplied by

21 (A) 25 percent for expenditures incurred on or after January 1,  
22 2003, and before January 1, 2004;

23 (B) 50 percent for expenditures incurred on or after January 1,  
24 2004, and before January 1, 2005; and

25 (C) 75 percent for expenditures incurred on or after January 1,  
26 2005, and before April 1, 2006;

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

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(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 using an appropriate consumer price index published by the United States Bureau of Labor Statistics, as prescribed by the department by regulation.

1/5/04

(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

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(1) both an oil or gas deposit located within land outside the state and an oil or gas deposit located with a 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.

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

(l) For purposes of making a determination of direct cost under (d)(2)(L) or (d)(2)(M) of this section, and for purposes of making a subtraction that may be required under (d)(2)(L) or (d)(2)(M) of this section, the standard to be applied is that

1 New

1 of a producer dealing at arm's length with an uncontrolled entity. To that end,

2 (1) the department may adopt regulations incorporating the concepts of  
3 26 U.S.C. 482 (Internal Revenue Code), as amended, and 26 U.S.C. 6662(e) (Internal  
4 Revenue Code), the related or accompanying regulations of each of those sections, and  
5 any ruling or guidance issued by the Internal Revenue Service that relates to each of  
6 those sections;

7 (2) on request of the department, a producer shall provide  
8 documentation supporting the arm's length nature of the transactions resulting in a  
9 direct cost to the producer; the department may base its consideration and  
10 determination under (d)(2)(L) of this section and this subsection only on  
11 documentation that was in existence at the time the tax return for the taxable period in  
12 question is due; a producer that fails to comply with a request under this paragraph is  
13 liable for a penalty.

14 (m) The provisions of this subsection apply to the purchase or acquisition of a  
15 business entity that is considered to be a taxable purchase of assets for purposes of the  
16 Internal Revenue Code, including, by way of example and not of limitation, the  
17 purchase of an entity that is disregarded for federal income tax purposes, or an election  
18 that is made under 26 U.S.C. 338 (Internal Revenue Code). Under this subsection,

19 (1) the purchase or allocation shall be treated, for purposes of making a  
20 determination of

21 (A) direct cost under (d)(2)(M) of this section, as a purchase of  
22 assets by the producer; and

23 (B) an adjustment by subtraction under (e) of this section, as a  
24 sale or transfer of assets by the entity that is purchased or acquired;

25 (2) if an allocation of assets is required, the principle set out in (l) of  
26 this section, as interpreted and implemented by the regulations of the department  
27 authorized by (l)(1) of this section, applies to the making of that allocation.

28 (n) For purposes of determining whether an adjustment by subtraction shall be  
29 made to a payment or credit that a producer has received under (c)(3)(A) of this  
30 section,

31 (1) if the sale or transfer of the asset is made for less than the amount

1 that would have been received in an arm's length transaction,

2 (A) the principle set out in (l) of this section, as interpreted and  
3 implemented by the regulations of the department authorized by (l)(1) of this  
4 section, applies; and

5 (B) the amount of the adjustment by subtraction shall be  
6 calculated using the fair market value of the asset;

7 (2) if the sale or transfer is of an asset that was previously included as  
8 a direct cost in the calculation of a qualified lease expenditure under this section  
9 during a prior period and the asset is subsequently removed from the state for use  
10 outside the state, the commissioner shall require the producer to adjust by subtraction  
11 the value of the asset from the producer's direct cost; and

12 (3) the producer shall adjust by subtraction from the producer's direct  
13 costs the sale of a relinquished asset; the department may adopt regulations to  
14 implement this paragraph; for purposes of this paragraph, a "relinquished asset" is an  
15 asset that was first acquired by the producer before the effective date of this section  
16 and that has been replaced by the producer's later purchase of an asset that serves a  
17 substantially similar function as the asset that was relinquished.

18 (o) For purposes of this section,

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

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

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

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

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

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

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1 imposed by AS 43.55.011 and shall be paid in the [SAME] manner described in  
 2 AS 43.55.020. The surcharge [AS THE TAX IMPOSED BY AS 43.55.011 -  
 3 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 -  
 4 43.55.310.

5 (c) A producer of oil shall make reports of production in the same manner and  
 6 under the same penalties as required under AS 43.55.011 - 43.55.160 [AS 43.55.011 -  
 7 43.55.150].

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

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

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

13 Sec. 43.55.300. Surcharge levied. (a) Every producer of oil shall pay a  
 14 surcharge of \$.05 [\$.03] per barrel of oil produced from each lease or property in the  
 15 state, less any oil the ownership or right to which is exempt from taxation.

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 (c) A producer of oil shall make reports of production in the same manner and  
 22 under the same penalties as required under AS 43.55.011 - 43.55.160 [AS 43.55.011 -  
 23 43.55.150].

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

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

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

- 29 (6) "gas" means  
 30 (A) all natural, associated, or casinghead gas;  
 31 (B) all hydrocarbons that

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SEC. 24*

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(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. 32. 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 processing and before the gas treatment, the value of the gas at the first point

OLA 31

1 where gas processing is completed or where gas treatment begins, whichever is  
2 further upstream:

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

4 (10) "oil" means

5 (A) crude petroleum oil; and

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

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

9 (17) "gas processing"

10 (A) means processing a gaseous mixture of hydrocarbons

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

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

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

19 (B) does not include gas treatment;

20 (18) "gas treatment"

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

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

26 \* Sec. 35. AS 43.55.013(c), 43.55.013(g), 43.55.013(h), 43.55.013(i), 43.55.016,  
27 43.55.900(8), and 43.55.900(11) are repealed.

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

30 APPLICABILITY. (a) Sections 5 - 8, 10 - 13, 15 - 18, 20, and 24 - 35 of this Act  
31 apply to oil and gas produced on or after April 1, 2006.

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1 (b) Section 14 of this Act applies to oil and gas produced before, on, or after the  
2 effective date of sec. 14 of this Act.

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

5 TRANSITION: AL PROVISIONS. (a) Notwithstanding any contrary provision of  
6 AS 43.55.024(a), enacted by sec. 16 of this Act, for oil and gas produced on or after April 1,  
7 2006, and before January 1, 2007,

8 (1) the phrase "every month an annualized tax credit in an amount equal to  
9 one and two-thirds percent" in AS 43.55.024(a)(1)(A), enacted by sec. 16 of this Act, shall be  
10 replaced by the phrase "every month during the period April 1, 2006, through December 31,  
11 2006, an annualized tax credit in an amount equal to 2.222 percent"; and

12 (2) the phrase "every month an annualized tax credit in an amount equal to  
13 two and one-half percent" in AS 43.55.024(a)(1)(B), enacted by sec. 16 of this Act, shall be  
14 replaced by the phrase "every month during the period April 1, 2006 through December 31,  
15 2006, an annualized tax credit in an amount equal to three and one-third percent."

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

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

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

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

31 TRANSITION: REGULATIONS. The Department of Revenue may proceed to adopt

OLD 37

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

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

6 REVISOR'S INSTRUCTION. The revisor of statutes is instructed to change the  
7 heading of

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

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

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

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

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

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

19 **CONDITIONAL RETROACTIVITY.** If the sections of this Act that, under sec. 42 of  
20 this Act, are scheduled to take effect April 1, 2006, take effect on or after April 1, 2006, those  
21 sections of this Act are retroactive to April 1, 2006.

22 \* **Sec. 41.** Sections 1 - 4, 9, 14, 19, 21 - 23, and 36 - 40 of this Act take effect immediately  
23 under AS 01.10.070(c).

24 \* **Sec. 42.** Except as provided in sec. 41 of this Act, this Act takes effect April 1, 2006.

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OLA 39

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LIBRARY

# CS for Senate Bill No 305 (RES)

Commentary

March 18, 2006

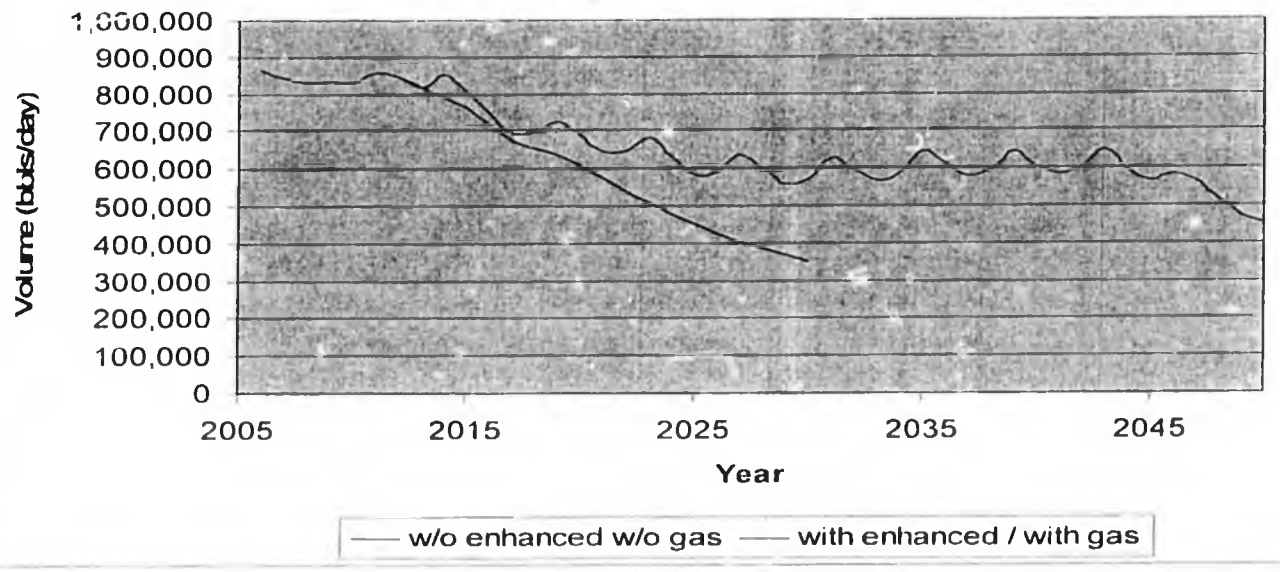
Dr. Pedro Van Meers

# TOTAL VISION

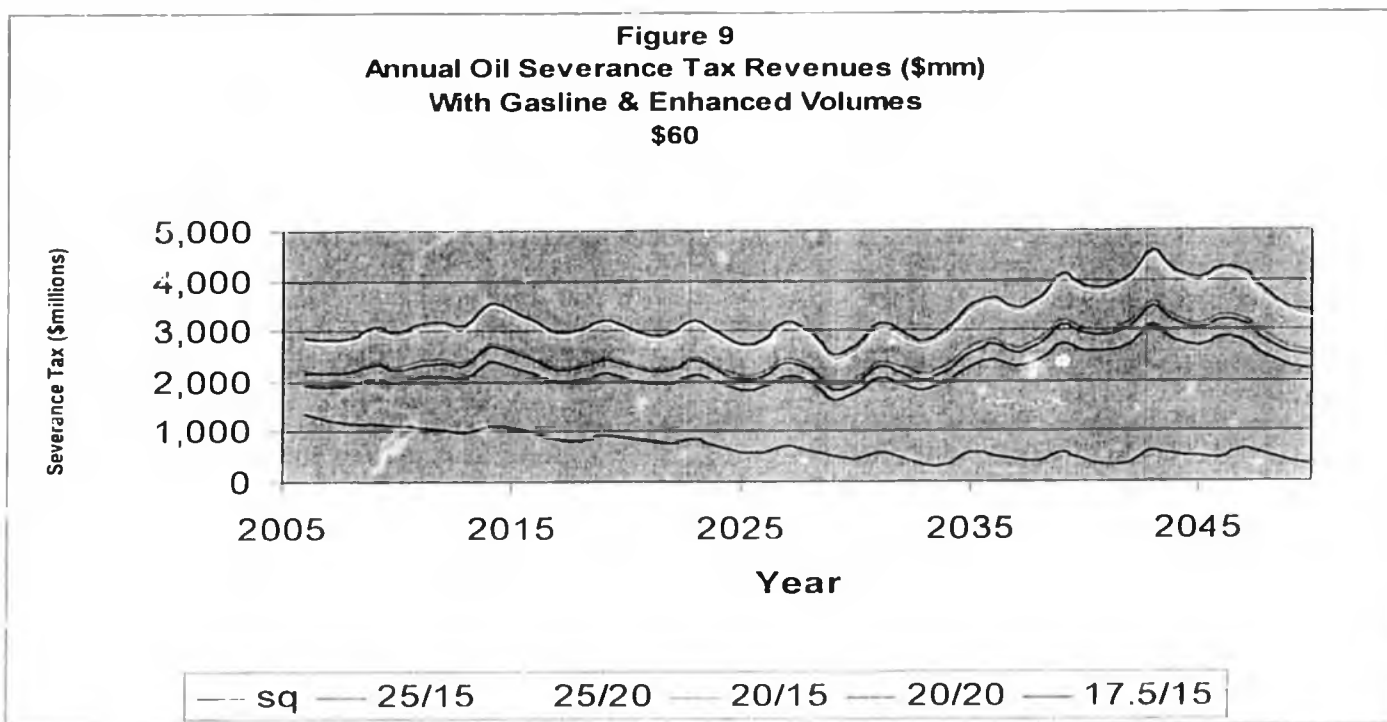
PPT bill is the first step in a process that may lead to a stranded gas contract. The gas line in turn will significantly prolong the life of the oil pipeline and lead to considerable additional oil developments.

# TOTAL VISION

Figure 1  
Volume Scenarios

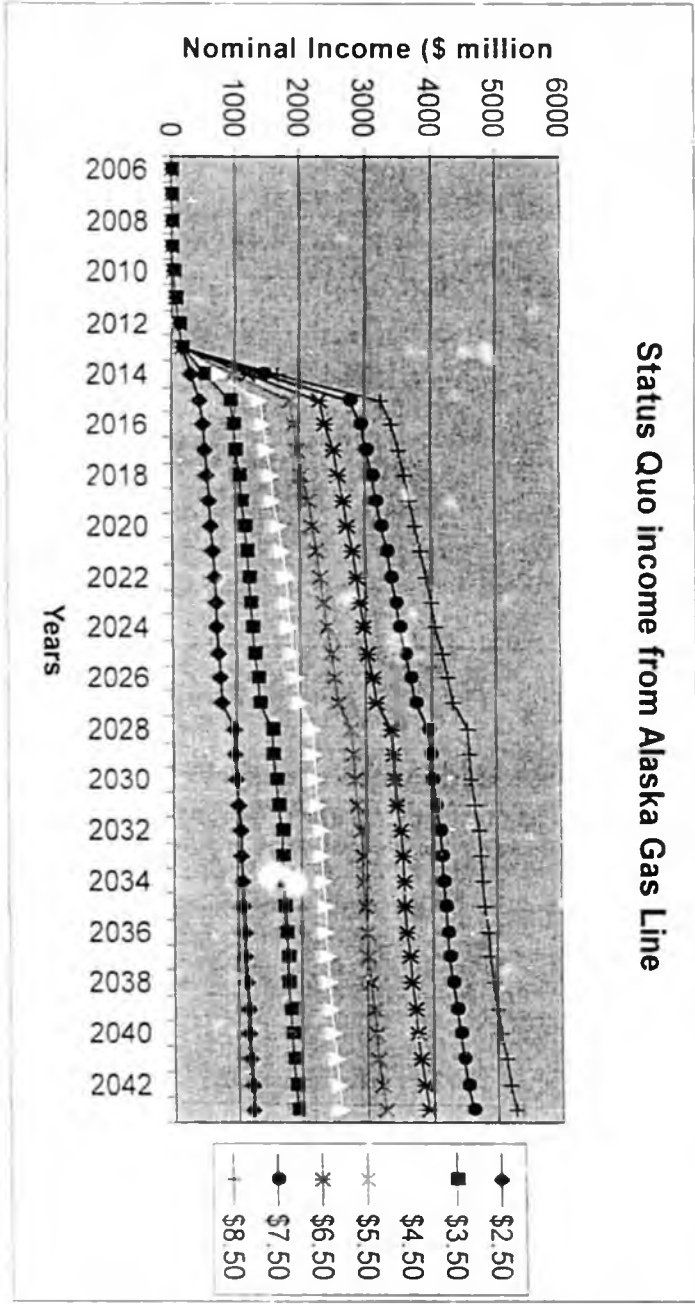


# TOTAL VISION



# TOTAL VISION

Status Quo income from Alaska Gas Line



# Tax rate and Investment

Within the range of PPT tax rates that were evaluated, there is a relationship between level of investment and tax rate.

# TAX RATE AND INVESTMENT

Large Companies

## COMPETITIVENESS RATING INDEX

| \$36              | 20-20-0 | 25-20-0 | 30-20-0 | 30-15-0 |
|-------------------|---------|---------|---------|---------|
| Alaska Current    | 161     | 158     | 157     | 156     |
| Alaska PPT        | 147     | 153     | 160     | 166     |
| Norway            | 214     | 214     | 214     | 213     |
| UK                | 63      | 63      | 63      | 63      |
| US GOM            | 25      | 25      | 25      | 25      |
| Nigeria           | 92      | 92      | 90      | 89      |
| Alberta-Oil Sands | 74      | 74      | 74      | 73      |
| Angola            | 160     | 158     | 157     | 156     |
| Russia-Sakhalin   | 226     | 226     | 224     | 224     |
| Azerbaijan        | 158     | 157     | 156     | 155     |

# TAX RATE AND INVESTMENT

## Level of Investment

|                 | 20-20 | 25-20 | 30-20 | 30-15     |
|-----------------|-------|-------|-------|-----------|
| Large Producers | more  | same  | less  | much less |
| New Investors   | more  | more  | more  | more      |

# COOK INLET

Carving out regions in Alaska from the PPT will complicate administration and creates unfair practices across Alaska.

# Promotion of Exploration

20/20 rating

| Overall           | IRR<br>Subtotal | NPV<br>Subtotal | EMV<br>Subtotal | GOV TAKE<br>Subtotal | SUM<br>TOTAL |
|-------------------|-----------------|-----------------|-----------------|----------------------|--------------|
| Alaska Current    | 100             | 97              | 88              | 78                   | 363          |
| 20-20-73          | 49              | 78              | 57              | 65                   | 249          |
| Norway            | 90              | 108             | 86              | 115                  | 399          |
| UK                | 31              | 30              | 24              | 52                   | 137          |
| US GOM            | 14              | 12              | 1               | 12                   | 53           |
| Nigeria           | 46              | 36              |                 | 45                   | 178          |
| Alberta-Oil Sands | 41              | 42              | 5               | 37                   | 163          |
| Angola            | 76              | 73              | 80              | 95                   | 324          |
| Russia-Sakhalin   | 116             | 103             | 118             | 108                  | 445          |
| Azerbaijan        | 97              | 81              | 98              | 53                   | 329          |

# Promotion of Exploration

The PPT bill as introduced already strongly promotes exploration. There is no need for special further features that would complicate the administration of the PPT

# Small Companies

There is a need to provide long term support for small companies. These companies play a special role and often contribute significantly to the local economy.

This can be achieved:

- with the \$ 73 million allowance per company or equivalent credit, or
- by making a level of production per company exempt from the PPT

## State Owned Assets

Clause 43.55.024 (i) (3) (B) is out of place and seems to prejudge a possible stranded gas contract.

**BP Presentation on Senate Bill 305 (PPT)**  
**Alaska State Legislature**  
**Senate Resources Committee**  
**18<sup>th</sup> March 2006**

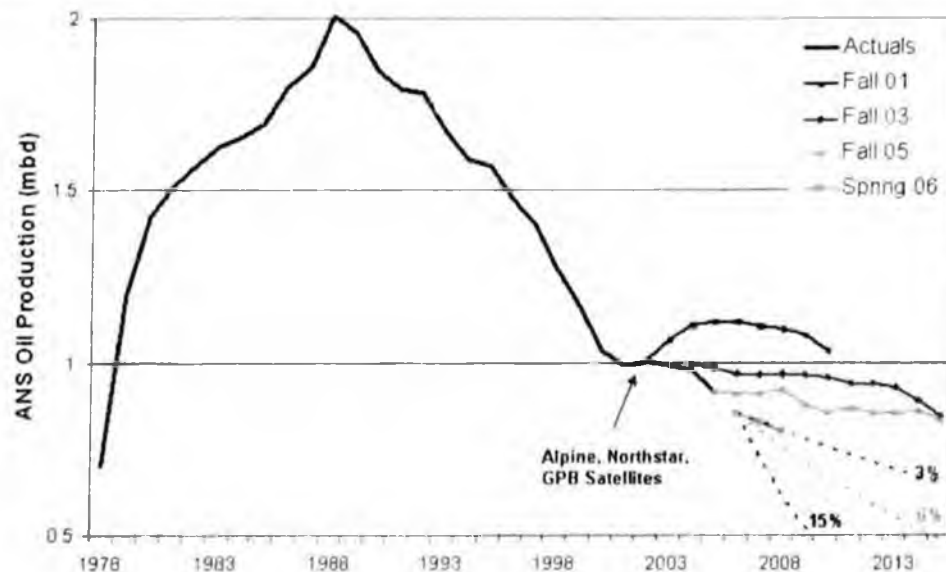
I am Angus Walker and I am the Commercial Vice President of BP Alaska.

I would like to start by thanking this Committee for the opportunity to provide further testimony on Senate Bill 305.

I will not repeat our previous testimony, but will build upon some key issues raised and provide our view of the substantive changes this Committee is considering to Senate Bill 305.

### **Investment & Decline**

Since 1999, both Industry and DOR have consistently overestimated production and have annually revised production forecasts down significantly. This is of great concern to us as it should be to you. A one hundred thousand barrel per day drop in production represents a drop in state revenue of around \$500 million per year at current prices.

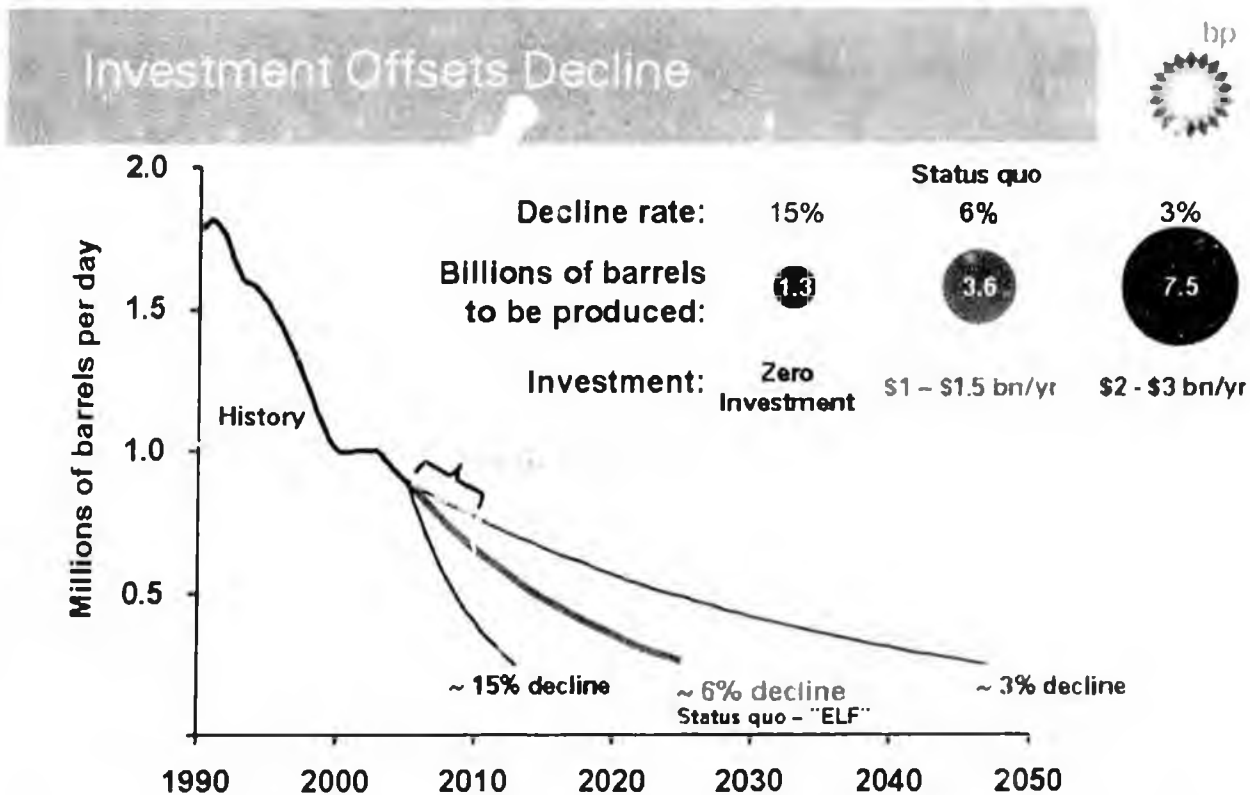


- Historical basin decline has been around 6% per year
- Flattening of production from 2002-2004 due to Alpine & Northstar
- Decline since 2004 has mirrored historical basin decline

This chart shows a subset of the DOR forecasts from 2001, 2003, 2005, along with the latest view of the Spring 2006 forecast, against actual production in red. The dashed lines describe the trajectories of a 3%, 6% and 15% decline.

Whilst development of Alpine, Northstar, and the Prudhoe Bay Satellites between 2000 and 2002 successfully flattened North Slope production for a number of years, 2005 saw decline return to the 6% rate that has characterized this basin in the past. Unfortunately for all of us, there are no more fields of Alpine or Northstar's magnitude waiting to be developed.

You will recognise the following slide from my presentation two weeks ago when I outlined the current reality of the North Slope oil business.



***DOR Spring Forecast cannot be met without significant additional investment  
The vast majority of that investment must be made in existing fields***

With no investment the natural decline of the fields would be the lower red line. At the current levels of investment (\$1-1.5 bn / year) that decline will be around six percent per year. The latest DOR 2006 Spring forecast translates into an approximate 3% decline which you can see is above the current status quo.

However, the 3% decline cannot be met without significant additional investment, in the order of 2 to 3 billion dollars per year. Unless those investments are made, history will repeat itself, decline will continue at the current rate, and the DOR will be revising its production forecast down yet again.

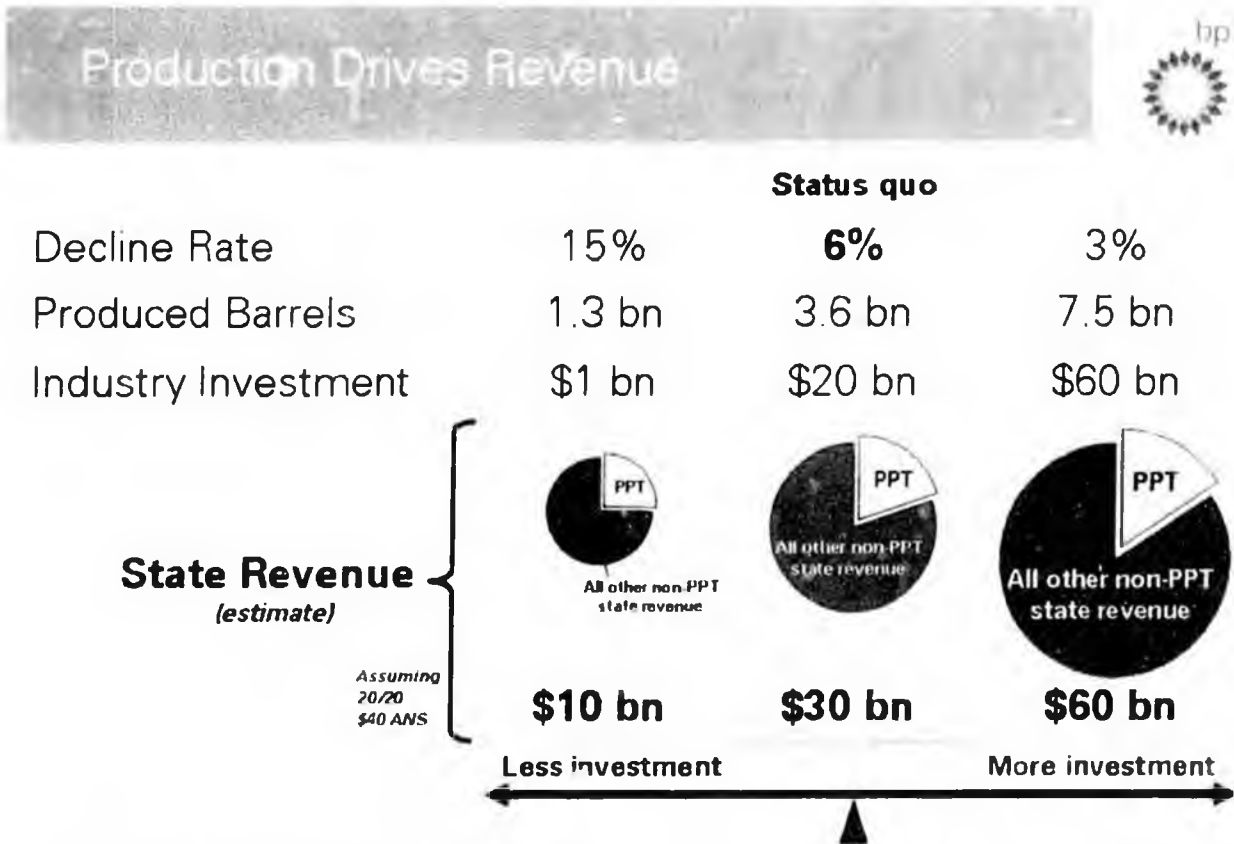
**The real question for you to be asking industry and the consultants is 'what would it take to double investment in the Alaska North Slope?'**

Encouraging new exploration is good but it is a fact, acknowledged by all who have testified, that the resources expected to be discovered through exploration will likely be significantly less than the resources we already know about. It is investment in these known resources that offers the greatest chance of stemming the decline of ANS production. As you look at incentives for exploration you must not overlook incentives for investments which are more likely to succeed.

## Decline Scenarios & State Revenues

The tax regime you approve will directly impact how attractive Alaska is for investment and that will translate into what the future decline will be. It is in the interest of all (industry and Alaska) that we focus on growing the pie rather than increasing state take from a declining pie.

The following slide is an attempt to show how growing the pie by incentivizing investment is in the best interest of the state over the long term.



**Maximizing State Revenue means maximizing Production**

I'd like to draw your attention to the capital investments necessary in each scenario and an estimate of the total state revenue. The highest state revenue is derived from the scenario which delivers the greatest production regardless of what severance tax (PPT) you collect. You could collect zero severance tax (PPT) and this would be a better outcome for the State than one where you collect a high severance tax (PPT) and have less resource development.

The size of the pie is the most important consideration. Maximizing the value of resources for Alaskans means maximizing state revenue by maximizing production. Resources left in the ground are simply a wasted opportunity.

This should be the focus of our deliberations.

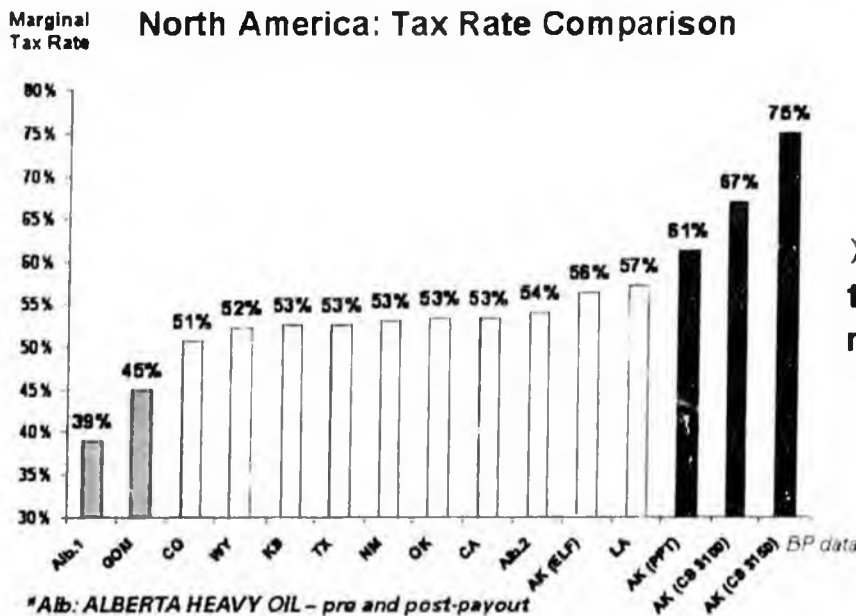
## US Marginal Rates

The good news for Alaska is that there is a huge known resource base on the North Slope.

The bad news is that it going to be technically difficult to extract that resource out of the ground. Every barrel gets more difficult.

Alaska is already one of the most expensive places in the world to produce oil and gas.

Assuming the new 20/20 PPT is put in place, Alaska would also become the area with the highest marginal tax rate in the US. Needless to say this introduces one more barrier to attracting investment. The incorporation of yet higher tax rates at higher prices is yet another take from industry and creates a bizarre fiscal regime, being regressive at low prices and progressive at high prices, thus reducing space for industry and creating yet more barriers to attracting investment. The following graph shows how Alaska compares to other North America regimes both under 20/20 PPT and the scenario outlined in the House CS. A similar graph including the rates outlined in the Senate CS is included in the addendum.



➤ Alaska is already the highest cost region to operate

**Alaska will have the highest marginal tax rate**

To maximize the value of the resources in the ground, the legislature should be focussed on maximizing North Slope production by attracting investment. The priority for the state of Alaska should be to encourage investments to help industry develop those known resources, not to make it more difficult and risky than it already is.

UK - a role model for attracting investment



"Ordinary measures of Government take throughout the 1990's made the United Kingdom government appear rather crazy and irresponsible **The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure** Furthermore, the activity in the UK started in the late 1980's and early 1990's when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom. Activity and employment in the British petroleum sector is healthy and robust.**"

***Daniel Johnston***

*23 Oct 2002, Washington DC  
Petroleum Tax Design*

You have heard much over the recent weeks about the impacts of reducing taxes in the UK. The UKCS has been our backyard for many years and we couldn't agree more with Daniel Johnston that reducing taxes firstly created and subsequently sustained an economic boom. The UK's decision to reduce Government Take led to a significant increase in activity in the North Sea, more production, higher revenues for the Government and a ripple effect throughout the whole economy.

**The actions of the UK during the 1980's and 1990's provide an excellent role model for any Government hoping to attract investment.**

Let us please not forget the urgent need to stem decline and attract significantly more capital (about twice what is being spent today) to the North Slope.

**In order to maximise the value of Alaska's resources we believe you should be adopting tax rates lower than those proposed by the Governor. In so doing you would maximize investment, maximize production and maximize jobs for Alaskans. You would also take an important step towards creating a healthy oil business which will be the foundation for gas.**

We recognize the burden on your shoulders in making these decisions. There are many people advising you to increase taxes, which will indeed increase state revenue, but for how long? One year? Two years? .....but at what cost to future production?

At the time of going to press, we are awaiting details of the substantive changes you are considering making to Senate Bill 305. Our view of these changes and key messages from this testimony are contained in the addendum.

On behalf of BP I would like to thank you for this opportunity to testify.

## **ADDENDUM: BP Presentation on Senate Bill 305 (PPT)**

Alaska State Legislature  
Senate Resources Committee  
18<sup>th</sup> March 2006

**BP has not yet had opportunity to review the details of the CS, but from the summary provided I have the following comments. The substantive changes you are considering making to Senate Bill 305 are yet more takes from industry over and above the Governor's bill and we cannot support them:**

Our key objections to the proposed changes are:-

1. The base rate of 25% is too high.
2. This level of tax is harmful given Alaska's urgent need to attract very large amounts of capital to stem decline.
3. Reality is:
  - a. challenged resource base
  - b. high cost environment
  - c. distance to marketIn order to attract investment, Alaska needs an appropriate and competitive fiscal regime.
4. The cumulative effect of these proposed changes is to further increase tax and decrease the incentives in the previous 20/20 structure.
5. The change in the effective date means this tax will be implemented before it is enacted by the Legislature.
6. The transition provisions have been significantly reduced making the implementation unfair on historic investors.

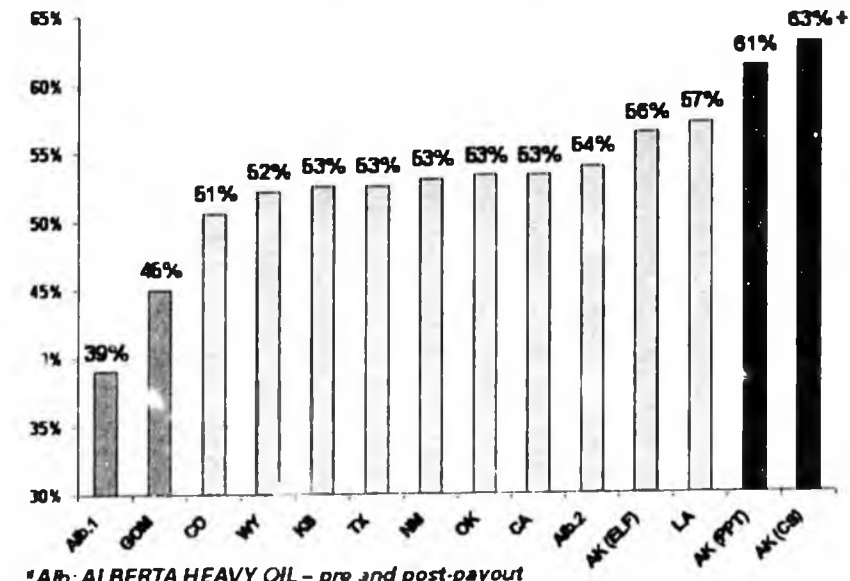
The following chart shows how the changes proposed in the CS raise Alaska's marginal tax rate even higher above the other areas in the US.

# US Marginal Tax Rates



Marginal Tax Rate

## North America: Tax Rate Comparison



➤ Alaska is already the highest cost region to operate

\*AB: ALBERTA HEAVY OIL - pre and post-payout

BP data

**Alaska will have the highest marginal tax rate**

I would like to leave you with the key messages from this testimony.

## Key Messages



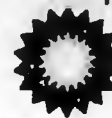
- Production is declining
- To maximize State revenue we must increase investment to reduce decline
- Alaska will have the highest tax rate and the highest cost structure in the US
- The proposed amendments to SB 305 will not maximize the benefits to Alaskans from the State's resources (oil or gas)
- The UK is a great role model for reducing taxes to increase investment, production and revenue

We believe the proposed amendments to SB 305, if enacted, would be a serious mistake for Alaska and we urge you not to adopt them.

In any event, we will continue to participate fully in the legislative process and will be urging the legislature not to enact the substantive changes being considered by this Committee, but to enact instead a bill close in structure to the original Bill, but with tax levels lower than the 20% first proposed.

On behalf of BP I would like to thank you for this opportunity to testify.

bp



**Angus J. Walker**  
Commercial Vice President

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Date: 15/03/2006

**To:**

Senator Thomas Wagoner, Chair Senate Resources Committee  
Representative Ralph Samuels, Co-Chair House Resources Committee  
Representative Jay Ramras, Co-Chair House Resources Committee

**Re: Testimony of Mr Daniel Johnston on SB 305/HB 488 Production Profit Tax (PPT)**

Dear Senator Wagoner and Representatives Samuels and Ramras:

In his testimony of 6th March 2006 to the House & Senate Resource Committees, Mr Johnston raised a number of issues related to BP's prior testimony to which I am compelled to respond. As well as setting the record straight I believe this response will be helpful to you and your committee's deliberations.

Our response relates to two issues raised by Mr Johnston:

- 1) The impact of 1993 tax cuts on investment in the UK North Sea.
- 2) The Marginal rate of taxation in the UKCS.

**1) The impact of 1993 tax cuts on investment in the UK North Sea.**

In BP's February 28<sup>th</sup> testimony, my colleague Ray Hall presented data from the UK North Sea, Gulf of Mexico and Alberta that illustrates the cause-and-effect relationship between fiscal policy and investment. With regard to the UK example, Mr Johnston contended that the data BP presented "is not a fair representation of what the result of lowering the tax rate in 1993 was". Clearly it is difficult to unequivocally attribute any outcome to the events that preceded it, and there will be many views of what might have happened without the tax change. However:-

**For BP, the position is clear**

- We increased capital investment in response to the 1993 changes
- We sanctioned 5 large projects in the matter of a few years (Andrew, Harding, Foinaven, Schiehallion and ETAP). These projects committed circa \$8 billion in capital and 2 billion boe in reserves.

**For the UK Government the position is clear**

- UKCS Exploration & Appraisal spend was the largest of any basin in the world between 1994-1999
- The number of development wells increased one and a half fold between 1993 and 1995
- Basin production rose following the reform
- Tax revenues increased following the reform

Mr Johnston himself is on record as saying:-

"Ordinary measures of Government take throughout the 1990's made the United Kingdom government appear rather crazy and irresponsible. .... The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. **The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure.** Furthermore, the activity in the UK started in the late 1980's and early 1990's when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced. **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom.** Activity and employment in the British petroleum sector is healthy and robust.." (Source: *Petroleum Tax Design page 6 by Daniel Johnston 23 Oct 2002, Washington DC*)

It is our sincere belief that there is a close relationship between fiscal policy and investment, a relationship acknowledged by Mr Johnston in earlier publications, and that the UK offers one of several notable examples where reducing taxes has stimulated investment. The attached slide pack provides additional detail.

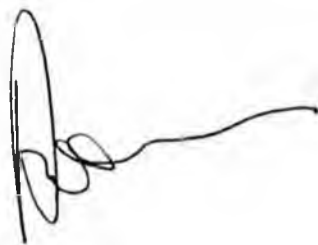
## 2) The marginal rate of taxation in the UKCS

In BP's testimony, Ray Hall compared the marginal government take under PPT 20/20 (61%) to that of the UK (50%). Mr Johnston challenged this figure, asking "why has nobody mentioned the 75% Government Take in the UK?" The 75% Government Take to which Mr Johnston is referring is that paid by the small number of the fields in the UK that are subject to Petroleum Revenue Tax (PRT). PRT is currently levied at 50% on fields given development consent prior to March 1993. Out of a total 208 fields in the UKCS, only 94 fields are liable to, and only 29 actually pay PRT (the rest are protected by volume and other allowances). These 29 fields contributed approximately 29% of the UK oil and gas production in 2005. In any event, the 50% marginal tax rate described by Mr Hall applies to all fields developed after 1993 and as such is a more appropriate comparator to future investments in Alaska.

I trust this letter is clear and would be happy to discuss any issues raised with you and your committees.

BP appreciates the opportunity to testify on this very important issue and intend to remain fully and constructively engaged in the process.

Sincerely yours,



Angus Walker

Commercial Vice President, BP Alaska

Attachments: 6 slides providing further context to the outcome of the UK 1983 and 1993 tax cuts

bp

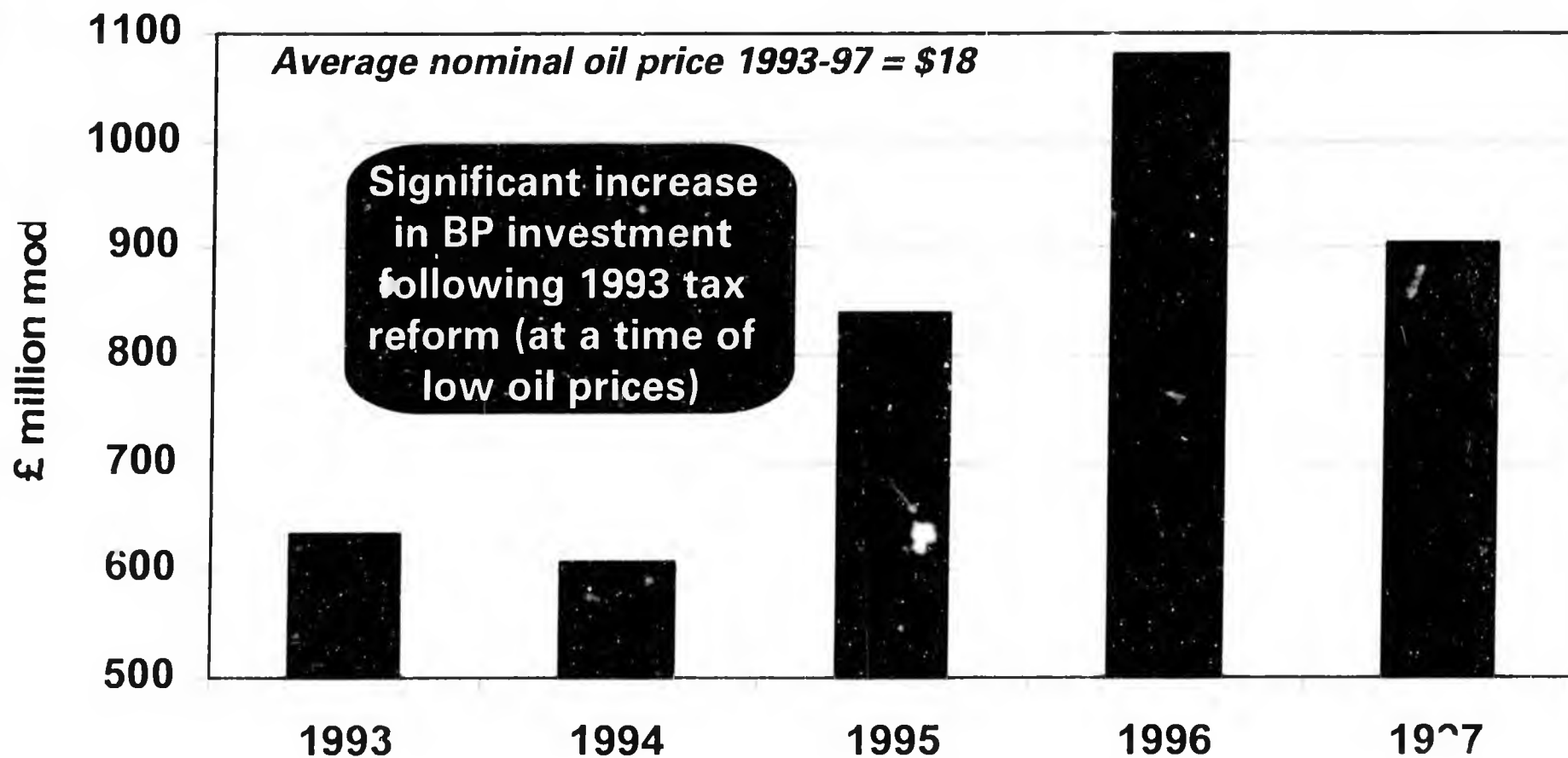


## BP response to recent testimony

Attachment to letter to Senator Wagoner, Representative Samuels & Representative Ramras

**15<sup>th</sup> March 2006**

# BP annual investment in UKCS

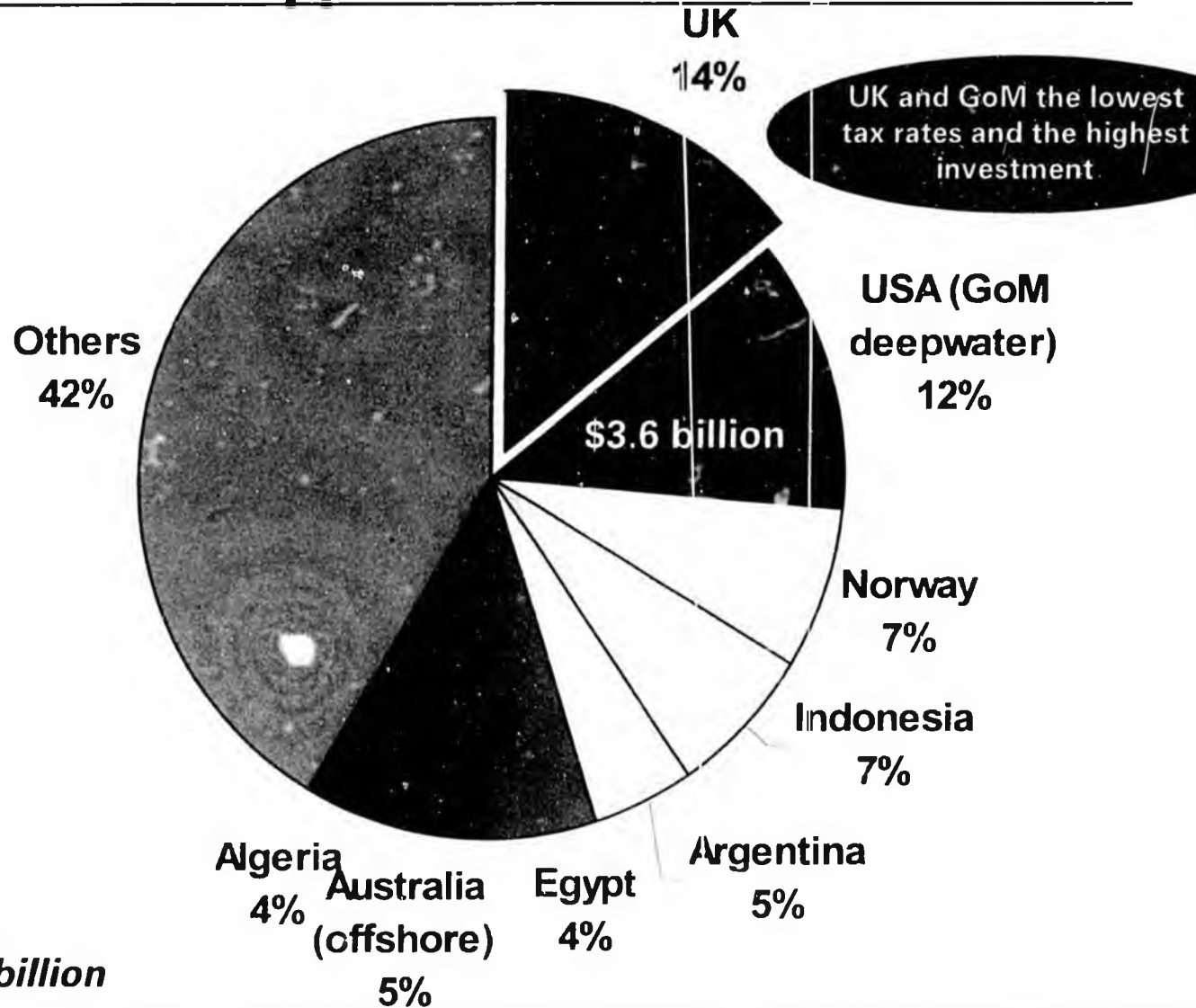


Source : BP Financial and Operating information

UK the leading basin 1994-99 for E & A spend

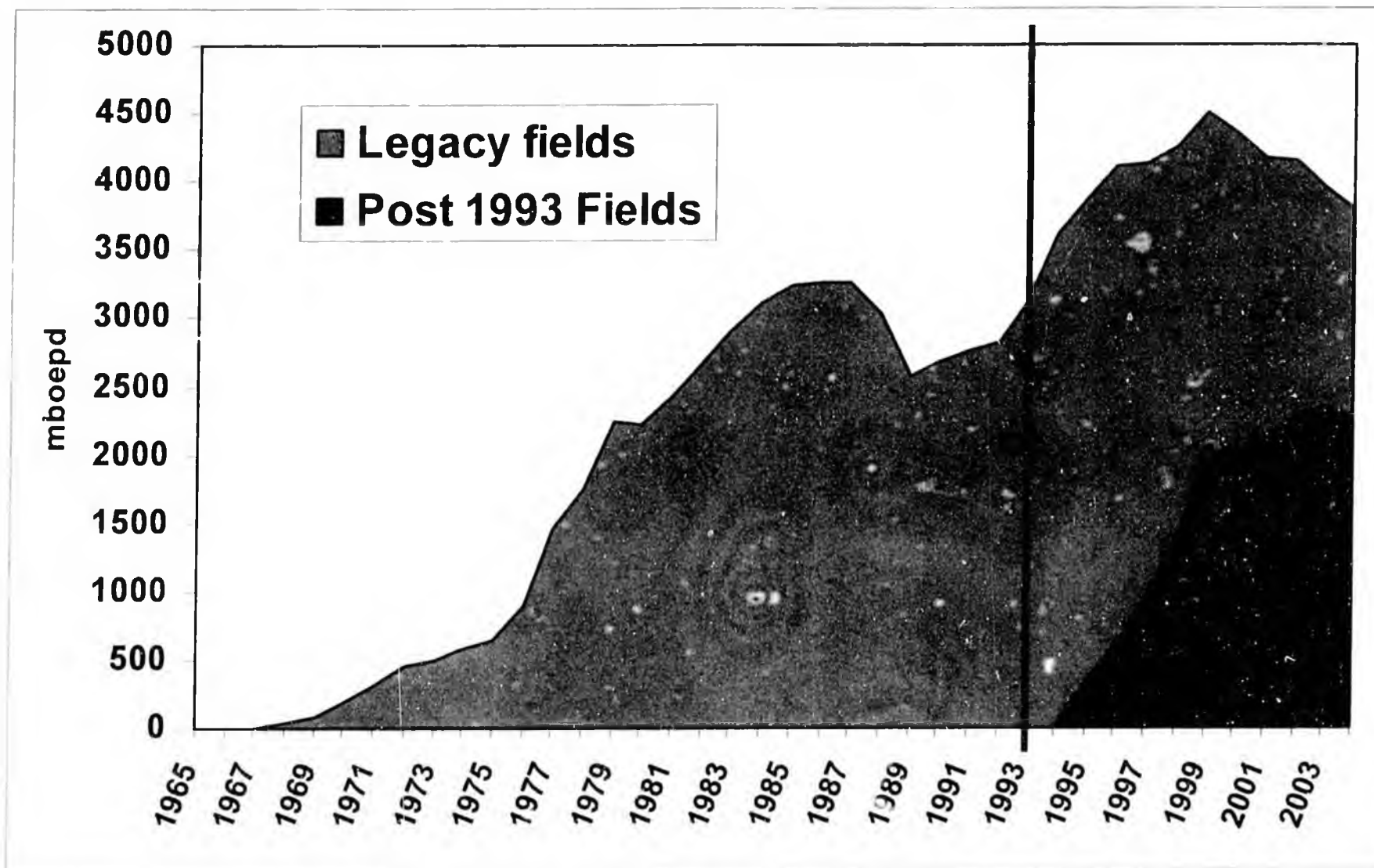


### Exploration and appraisal investment: 1994-1999



Source : Wood MacKenzie ' Global oil & gas risks and rewards study'

# Impact on basin production is clear



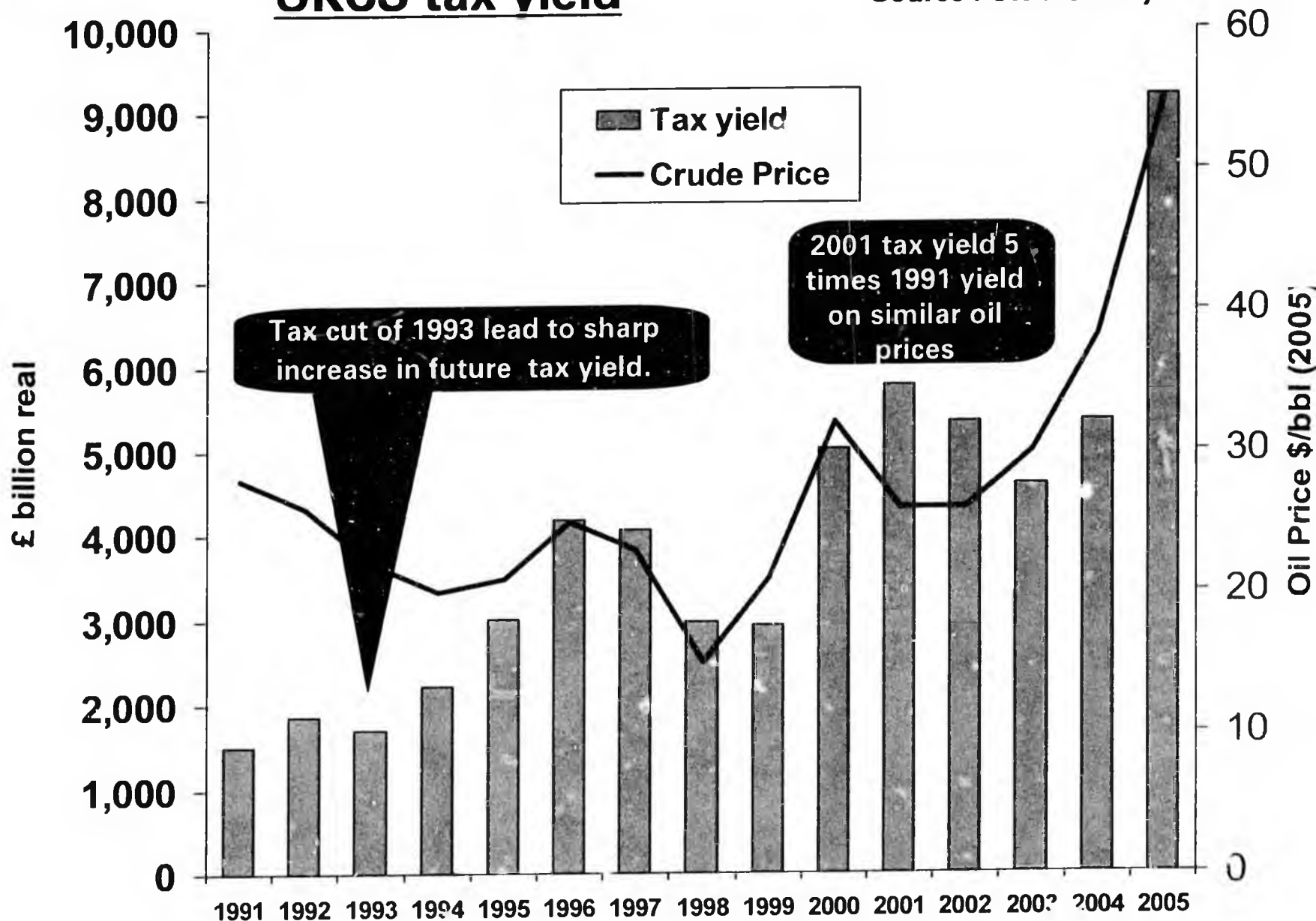
Source: Wood Mackenzie

# Dramatic tax yield increase in response to 1993 reform

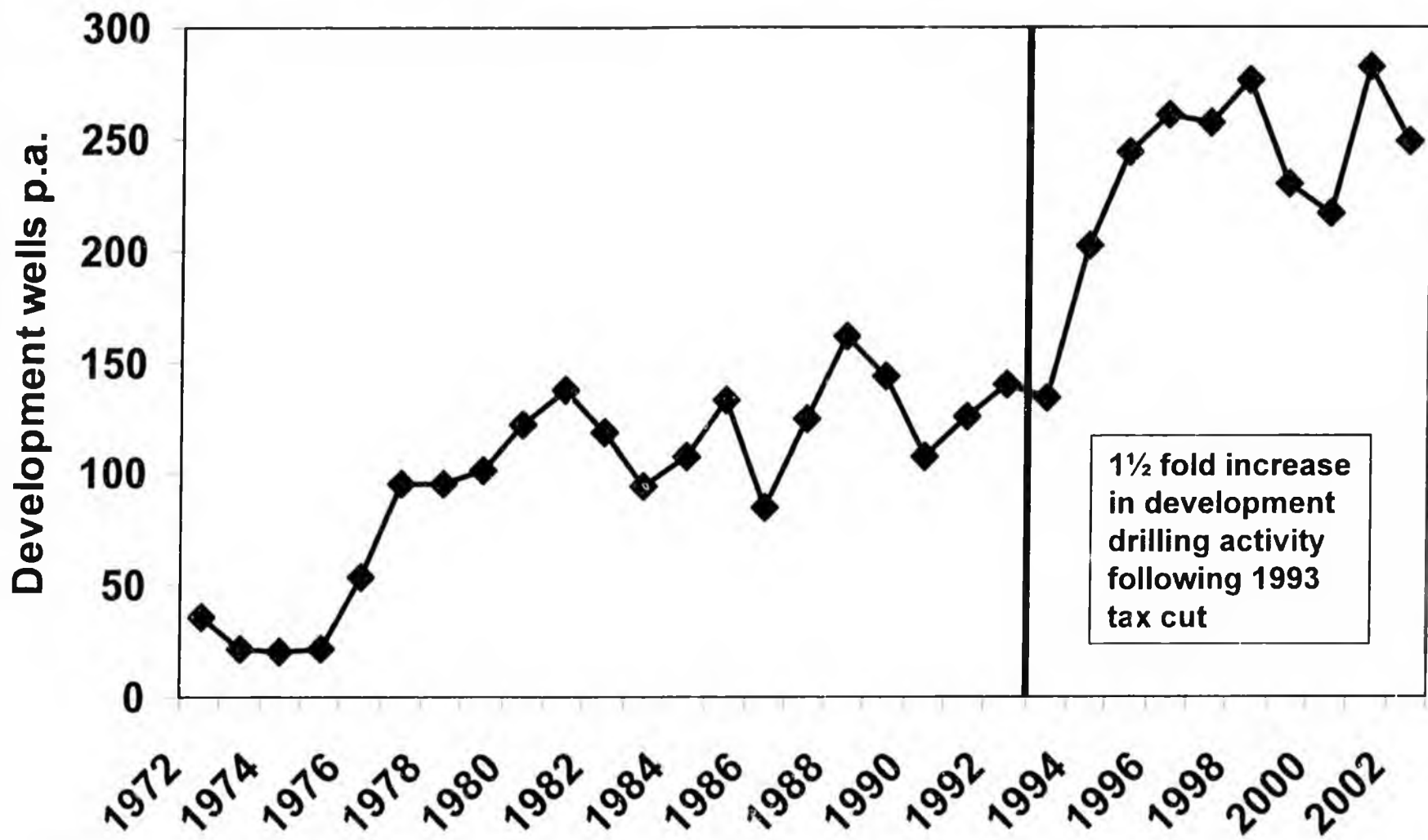


## UKCS tax yield

Source : UK Treasury



# UK Development Drilling Activity



Source of data: UK Department of Trade & Industry



“Ordinary measures of Government take throughout the 1990’s made the United Kingdom government appear rather crazy and irresponsible. .... The “gross benefits” to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. **The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the “lenient” terms of the 1990’s, is difficult to measure.** Furthermore, the activity in the UK started in the late 1980’s and early 1990’s when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced. **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom.** Activity and employment in the British petroleum sector is healthy and robust..”

***Daniel Johnston***

***23 Oct 2002, Washington DC  
Petroleum Tax Design***

## Satellite Fields Developed in Past 10 Years

| Year Discovered | Satellite    | First Production | Maximum Rate (mbd) | Recoverable Reserves (mmbbl) | Operator |
|-----------------|--------------|------------------|--------------------|------------------------------|----------|
| 1999            | Aurora       | 2000             | 11.5               | 44                           | BP       |
| 1969            | Borealis     | 2001             | 35.0               | 100                          | BP       |
| 1998            | Eider        | 1998             | 2.5                | 4                            | BP       |
| 1992            | Fiord        | 2006             | 25.0               | 50                           | CPAI     |
| 2000            | Meltwater    | 2001             | 8.0                | 26                           | CPAI     |
| 1997            | Midnight Sun | 1998             | 8.7                | 21                           | BP       |
| 2000            | Nanuq        | 2006             | 20.0               | 40                           | CPAI     |
| 1998            | Orion        | 2003             | 40.0               | 200                          | BP       |
| 2001            | Palm         | 2002             | 18.0               | 30                           | CPAI     |
| 1969            | Polaris      | 1999             | 13.9               | 40                           | BP       |
| 1986            | Tabasco      | 1998             | 7.0                | 25                           | CPAI     |
| 1991            | Tarn         | 1998             | 35.1               | 110                          | CPAI     |
| 1969            | West Sak     | 1997             | 8.0                | 35                           | CPAI     |
| 2002 (est)      | Oooguruk     | 2008             | 18-20              | 75                           | Pioneer  |