

Governor's Proposed Production Tax Legislation

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Sectional Analysis

Authors: Dan Dickinson & Steve Porter

Section 1 Uncodified Laws (Legislative Intent)

Legislative Intent – refers to changes made in Section 50, page 31. It suggests that the changes are only clarifying a long-standing interpretation of AS 43.05.260 by the Department of Revenue (DOR). Details will be discussed in Section 50.

Section 2 AS 38.05.035(a)

This section allows the DOR access to the Department of Natural Resources (DNR) confidential information for

- 1) its use in forecasting state revenue under AS 43.55 or
- 2) administering AS 43.55, the production tax

In an apparent stylistic change this draft deletes previously repealed portions of AS 38.05.035(a) requiring subsections references to change as indicated in bill sections 3-9 below.

Section 3 AS 38.05.036(b)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 4 AS 38.05.036(f)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 5 AS 38.05.036(g)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 6 AS 38.05.123(f)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 7 AS 38.05.133(e)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 8 AS 38.05.180(j)(6)(B)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 9 AS 38.05.275(c)

Conforming references in Title 38 required by renumbering in sec. 2 of the proposed legislation.

Section 10 AS 39.25.110(42)

Section 39.25.110 is exempt service. This section adds oil and gas auditors performing production tax auditors and their immediate supervisors to the exempt service. This leaves oil and gas income tax auditors in the classified service.

Section 11 AS 41.09.010(d)

Conforming references in Title 41 required by renumbering in sec. 2 of the proposed legislation.

Section 12 AS 43.05.230(a)

Section 43.05.230 covers disclosure of tax returns and reports. Section 43.05.230(a) (5) adds a reference to AS 43.55.890. The reference to AS 43.55.890 (new section discussed in Section 61) in the proposed legislation would create an exclusion for certain information if aggregated

among three or more producers or explorers. This type of information would be allowed under AS 43.05.230(e) if the publication of the statistics was so classified as to prevent the identification of a particular tax payer's return or report. The new section would seem to lower the standard. This proposal would permit information which was "aggregated among three or more producers or explorers" to be divulged to the public even if, for example, a very large taxpayer's information was aggregated with two very small taxpayers so that the large taxpayer's individual taxpayer information could easily be extracted from the information disclosed.

Section 13 AS 43.05.023(h)

The Department of Revenue currently has the authority to share copies of returns, reports, and documents filed under AS 43.65 (Mining License Tax) with DNR. This language broadens the authority of DOR to also share returns, reports and documents filed under AS 43.55 (Oil and Gas Production Tax and Oil Surcharge) with DNR.

Section 14 AS 43.05.260(a)

This section adds AS 43.55.075 (Section 50 of this legislation) to the exceptions to the requirement to have taxes imposed within three years after a return is filed. Details will be discussed in Section 50.

Section 15 AS 43.55.011(e)

The current production tax is calculated on a monthly basis. In the proposal tax would be calculated based on a calendar year. This structure of the law is also changed. Currently AS 43.55.011(e) establishes the base tax rate (22.5%), and progressivity was dealt with elsewhere. However now this section refers to the percentage determined in AS 43.55.011(g) where both the base and progressivity rates would be established. This simplifies the comparison with the floor in AS 43.55.011 (f) - which is compared with a combined base and progressivity tax.

Section 16 AS 43.55.011(f)

This section makes changes to the minimum tax.

The current minimum tax is applied is 4% of gross value at the point of production over \$25, 3% of gross over \$20, 2% of gross over \$17.50 and 1% of gross over \$15 and 0% for \$15 and under. The new minimum tax is 10% of gross value at the point of production.

The current minimum tax is applied to all oil and gas produced north of 68 degrees North latitude, i.e. the entire North Slope. The proposed minimum tax would apply only to oil and gas produced from leases or properties within a unit or non-unitized reservoir that have cumulatively produced one billion BTU equivalent barrels of oil or gas and from which the average daily oil and gas production during the most recent calendar year exceed 100,000 BTU equivalent barrels. Based on this limitation, the new minimum tax would only apply to oil and gas produced at Prudhoe Bay and Kuparuk.

The current floor compares net values to gross values, and then allows certain credits to be applied against the result – even against the floor. The proposed floor test compares 25% of net plus any progressivity less any credits with 10% of gross. If 10% of gross is higher, that is the tax and a taxpayer may not apply tax credits to reduce its tax liability to below 10 percent of total gross value at the point of production.

Section 17 AS 43.55.011(g)

This section proposes a tax of 25 percent plus 0.2 percent times the progressivity price index, defined in .011(h), however the sum is not to exceed 50 percent. The current law is 22.5 percent

plus 0.25 percent times the progressivity price index, however the sum is not to exceed 47.5 percent.

Section 18 AS 43.55.011(h)

This section amends the price index from a monthly calculation to a calendar year calculation.

This section also changes the starting net value of progressivity from \$40 to \$30 a barrel.

Section 19 AS 43.55.011(j)

Conforming changes recognize that both the base and progressivity taxes would be levied in section .011(e) in the proposed legislation.

Section 20 AS 43.55.011(k)

Conforming changes recognize that both the base and progressivity taxes would be levied in section .011(e) in the proposed legislation.

Section 21 AS 43.55.011(m)

This section clarifies what a producer could claim in excess credits from Cook Inlet against taxes on leases or properties elsewhere in the state.

If the amount of excess adjusted lease expenditures multiplied by 25 percent is greater than or equal to the total of the reductions for all leases calculated under the Cook Inlet ceilings in AS 43.55.011(j) or (k) , the total calculated under this paragraph would be zero.

Otherwise the remainder calculated by subtracting the excess adjusted lease expenditures multiplied by 25 percent from the total of the reductions for all leases calculated under AS 43.55.011(j) or (k) would be the total calculated under this paragraph.

This language is currently found in regulation at 15 AAC 55.360 (d)

Section 22 AS 43.55.020(a)

This section would reconcile the monthly installment payments of tax to be consistent with other proposed changes, and incorporates some regulatory solutions to some of the ambiguities in the existing legislation concerning Cook Inlet ceilings and credits that could only be applied on an annual basis.

Section 23 AS 43.55.020(d)

Conforming changes recognize that both the base and progressivity taxes would be levied in section .011(e) in the proposed legislation.

Section 24 AS 43.55.020(g)

Reference changes and clarifies annual due date.

Section 25 AS 43.55.020(h)

Reference changes and clarifies annual due date.

Section 26 AS 43.55.023(a)

This section stipulates that no more than half of a capital expenditure tax credit may be applied in a single year.

Section AS 43.55.011(f) states that a tax credit may not be applied to reduce a producer's tax liability below 10 percent of the total gross value at the point of production. This section deals with the excess tax credit left over after a producer reduces their tax to 10% of gross. This section stipulates that the excess tax credit left over may not be used to reduce the producer's taxes outside that unit.

A significant portion of the language -which had originally been copied from section .025 -would now be invoked by referencing AS 43.55.025(f).

Section 27 AS 43.55.023(b)

This section changes the amount of carried-forward annual loss that may be taken as a tax credit from 20 percent to 25 percent. (In current law the loss carry-forward at 20% does not equal the base tax rate at 22.5% percent.)

This section also prevents lease expenditures subject to AS 43.55.011(f) i.e., Prudhoe and Kuparuk, from contributing to a carried-forward annual loss.

Section 28 AS 43.55.023(d)

This section would end the ability to transfer or obtain a cash payment for an unused tax credit under AS 43.55.028 (new section) if that unused tax credit is described in the floor sections (i.e. Prudhoe Bay or Kuparuk.)

This section changes the time period that the department has to grant or deny the application from 60 days to 120 days and amends the language that designates the start of the 120 day period.

This section also splits the certificate into two transferrable tax credit certificates, one that is available to use any time and the other that is not available until the next calendar year.

Section 29 AS 43.55.023(e)

Conforming changes to changes made in the proposed legislation.

Section 30 AS 43.55.023(g)

Conforming changes to changes made in the proposed legislation.

Section 31 AS 43.55.023(l)

This new section clarifies that an entity which is exempt from tax under the chapter cannot apply for a transferable tax certificate (for example the Alaska Natural Gas Development Authority or the Alaska Gasline Port Authority.) See section 40

Section 32 AS 43.55.024(a)

Proposal changes law so .024 credits cannot be applied against the tax floor in .011 (f).

Section 33 AS 43.55.024(c)

Proposal changes law so .024 credits cannot be applied against the tax floor in .011 (f).

Section 34 AS 43.55.024(e)

Proposal changes law so .024 credits cannot be applied against the tax floor in .011 (f).

Section 35 AS 43.55.024(g)

Proposal changes law so .024 credits cannot be applied against the tax floor in .011 (f).

Section 36 AS 43.55.025(a)

Proposal changes law so .024 credits cannot be applied against the tax floor in .011 (f).

Section 37 AS 43.55.025(b)

This section changes the date for expenditures for work performed to be eligible for a production tax exploration credit from July 1, 2003 to December 31, 2007. (That is, even if this bill becomes law, the old rules will apply through December 31, 2007.)

This section adds the obligation that a well must be "completed or abandoned" at the time the explorer claims the exploration credit. Application would not be allowed prior to finishing the well.

This section would exempt costs arising from gross negligence or violations of Health Safety & Environmental statutes or regulations from expenditures that qualify for the exploration credit.

Section 38 AS 43.55.025(c)

The current law requires a well to be drilled 3 miles away from a preexisting well to be eligible for a credit, except in CI, where DNR can certify that the well tests a "distinct exploration target".

The proposed law would require

- (1) That the well be drilled to a structural or stratigraphic trap that is distinctly separate from any trap that has been tested by a preexisting well, with this determination made by the commissioner of DNR before the well is spudded;
- (2) The existing three mile requirement for all wells not in the CI, and
- (3) The commissioner of DNR to determine, after the well is completed or abandoned that the well adequately achieved the explorer's stated objective.

Section 39 AS 43.55.025(f)

This section defines what data would be necessary to be submitted to claim an exploration credit. The new language clarifies the obligation of the explorer to provide the DNR with all seismic data, on state lands and off state lands, within and outside unit boundaries.

In the case of well data the proposed legislation reduces the time period the data is required to be kept confidential from 10 years to 2 years. In addition AS 31.05.035(c) allowed an explorer to request the DNR to extend the time of confidentiality from 2 years for as long as necessary. The proposed legislation in (D) prohibits the explorer from requesting an extension if they want the credit.

This section also explains that the certificate issued will be two certificates, each for half the credit, one to be used whenever the explorer wants and one not to be used before the next calendar year. All certificates will have the date on which the information required to be submitted will be released.

Section 40 AS 43.55.025(g)

This new section clarifies that an entity which is exempt from tax under the chapter cannot transfer a transferable tax certificate (for example the Alaska Natural Gas Development Authority or the Alaska Gasline Port Authority.) See section 31

Section 41 AS 43.55.025(h)

Proposal changes law so .025 credits cannot be applied against the tax floor in .011 (f).

Section 42 AS 43.55.025(i)

Proposal changes law so .025 credits cannot be applied against the tax floor in .011 (f), and recognizes the proposed change from a monthly to an annual tax.

Section 43 AS 43.55.025(k)

This section changes the definition of preexisting well from a well spudded more than the 150 days to 540 days in the proposed legislation. In other words, it expands the window to qualify as an exploration well from one season of work to two seasons, and thus may include delineation wells.

Section 44 AS 43.55.025(l)

This new section would allow the DNR approve a credit for seismic shot prior to July 1, 2003 if the Commissioner of DNR finds it in the best interest of the state to acquire the seismic for public distribution. The credit would be 5% of the old investment expenditure.

Section 45 AS 43.55.028

This section would create an oil and gas tax credit fund to purchase certain transferrable credit certificates issued under AS 43.55.023. The amount of revenue deposited into the fund would be based on the average price value forecast by the DOR of ANS oil sold on the West Coast. For \$60 or higher the percentage is 10%; for less than \$60 the percentage is 15%. For example,

the current forecast by the DOR for 2008 is \$51.25; so 15% of all revenues production tax received during 2008 would go to the fund after deposits to the CBR. Production tax revenues for 2008 are forecast to be \$995.4 million; so, the deposit to the fund would be approximately \$150 million. If the DOR projections are wrong or the tax is increased, the amount going into the fund would be different.

The department would be able to use the fund to purchase tax certificate but the purchase could not exceed the amount incurred by the applicant for qualified capital expenditures or lease bonuses in the 24 months subsequent to the application. The applicant's total production cannot exceed 50,000 BTU equivalent barrels per day, thus excluding the 3 largest taxpayers. All the qualifications currently found in AS 43.55.023 (f) (which is repealed under this proposal) have been retained, except the maximum of \$25 million a year to each taxpayer

Section 46 AS 43.55.030(a)

This section would amend what a tax payer is required to file by March 31st of the following year. It makes explicit the requirement to submit the costs for transportation of the oil and gas, qualified capital expenditures, and lease expenditures under AS 43.55.165 and 170, the production tax value of the oil and gas, and any claims for credits.

Section 47 AS 43.55.030(d)

This section defines the penalties of up to \$1,000 a day for not filing the required reports.

Section 48 AS 43.55.030(e-f)

Section (e) would add a reporting obligation to explorers that do not produce oil or gas.

Section (f) details what the department could require of a producer, explorer, or operator on a monthly basis.

Section 49 AS 43.55.040

This section would add a clause to the powers of DOR giving them the right to require a producer, explorer or operator to file reports that are "considered necessary" to forecast state revenue under AS 43.55. To the degree that this lines up with statutory authority (37.07.060 (b) (4), the forecast is for the current and next fiscal year; however the limitation is not explicit.

The section also provides for penalties of up to \$1,000 a day for a person that does not file the reports "considered necessary" by the department.

Section 50 AS 43.55.075

This section was referred to in the legislative intent language of the proposed legislation – which recognizes that historically most production tax audits took longer than 3 years and relied on AS 43.05.260(c) (3) which permits a longer audit if the "taxpayer ... consented in writing". The proposal requires the amount of tax imposed by this chapter to be assessed within 6 years after the latest return is filed. The section also details various filing time period obligations.

Section 51 AS 43.55.110(e-f)

Section (e) allows the department to require electronic filing

Section (f) allows the department to require electronic payments

Section 52 AS 43.55.160(a)

This section is a simplified rewrite of existing law, a consequence of no long having to do monthly calculations for progressivity.

Section 53 AS 43.55.160(b)

Continues the simplification from the prior section

Section 54 AS 43.55.160(e)

The proposal would expand section (e) to include among the costs that may be used to generate loss carry forwards those costs associated with leases of a producer that are not producing oil and gas or are on lands where the producer does not own an operating or working interest.

Section 55 AS 43.55.160(f-i)

This section deals with allocations of costs that a taxpayer incurs in one lease or property against revenues from another lease or property. Proposed North Slope rules are in (f), New Area Development rules are in (g) and Cook Inlet rules are in (h) and (i). This section would import regulatory language into the statute:

Section (f) clarifies that costs subject to the floor in AS 43.55.011(f) could not be allocated to other leases or properties. Otherwise costs must be allocated to producing properties

Section (g) applies to leases outside the North Slope and outside Cook Inlet, in other words costs that qualify for the .024 new area development credit. Those expenditures must be applied to leases outside the North Slope and outside Cook Inlet.

Section (h) deals with CI allocations and which costs (defined as "Cook Inlet excess adjusted lease expenditures") can be used in calculating carried-forward annual loss These rules are currently found in regulations in 15 AAC 55.235.

Section (i) sets forth the calculations for determining the carried-forward annual loss in (h), using rules currently found in regulations in 15 AAC 55.223.

Section 56 AS 43.55.165(a)

Section (a) is rewritten and would delete the "typical industry practices and standards" language in the current legislation. The language that is deleted from (a) is inserted in (b).

Section 57 AS 43.55.165(b)

Section (b) was modified by deleting reasonable allowance language that was inserted in 165(a).

Section 58 AS 43.55.165(e)

The current law allows for the costs for dismantlement, removal, and surrender or abandonment (DR&R) to qualify as lease expenditures if they are incurred after April 1, 2006. The proposed legislation would disallow all dismantlement, removal and surrender or abandonment costs to qualify as lease expenditures.

Section (19) was added to (e). It would disallow costs incurred for repair, replacement, or deferred maintenance that is undertaken in response to a failure or problem that results in an unscheduled interruption or reduction in the rate of oil or gas production.

Section (20) was added to (e). It would disallow costs of refineries or crude oil topping, plants, including those on the North Slope that produce fuel for North Slope production operations. Instead a taxpayer will be allowed a deduction for what it (and the State's auditors) reckons is the "fair market value" for refinery products less the underlying value of the oil used in the refinery.

Section 59 AS 43.55.165(h)

The original language of this section directed the department to write regulations where (as in CI under .011(j) and .011(k)) lease costs need to be allocated between oil production and gas production. The proposed change would expand that directive to include any required allocation of costs.

Section 60 AS 43.55.170(a)

This section would delete qualifying language regarding payment or credit that has already been subtracted in calculating billable or billed costs under AS 43.55.165(c) or (d).

Section 61 AS 43.55.890

This is a new section regarding the disclosure of tax information. It would allow the department to publish certain information if the information is aggregated from three or more producers or explorers. The potential impact of this change was previously discussed in Section 12.

Section 62 AS 43.55.900

This section adds the definitions of "non-unitized reservoir", "pool", "producer", and "unit"

Section 63 Repeals

This section would repeal the following:

AS 43.55.023(f), (State purchase of certain credits),

AS 43.55.165(c), (Use of operating agreements)

AS 43.55.165(d), (Use of audits under operating agreements)

AS 43.55.011(l), (Ordering of CI taxes against credits)

AS 43.55.023(i), (Transitional Investment expenditure credits),

and AS 43.55.160(c), (Monthly allocation of annual costs).

Section 64 Uncodified Laws

This section stipulates the applicability dates for each of the sections. In general, the new rules would become effective January 1, 2008, except for the deferred maintenance/corrosion provisions of .165 (e) (19) which would be retroactive to April 1, 2006.

Section 65 Auditors

This section would assign oil and gas auditors to exempt service.

Section 66 Retroactivity of Regulations

This section stipulates the dates on which the regulations implementing this statute could apply.

Section 67 Pending Applications

This section stipulates how to handle credit applications that are currently pending before the Department and have not been approved.

Section 68 Regulations

This section would grant DOR and DNR the authority to adopt regulations necessary to implement this legislation.

Section 69 Retroactivity

This provision explicitly provides that certain provisions of the act are retroactive to specific dates.