HCS CSSB 305(FIN)
Major Provisions

A production tax is a tax levied when natural resources are severed from the soil or water of a state; the revenues are intended to compensate a state and its citizens for depletion of their natural resource wealth.

House Finance Highlights.:

- Tax is still on the net profits
- Gas is still included
- 20% tax rate
- 20% tax credit
- Tax credits are refundable for producers of less than 50,000 taxable barrels/day
- Progressivity starts when oil prices are $35 net profit per barrel with an escalator of .25%, no cap
- Only one-third of gas is taxable
- April 1, 2006 effective date
- Taxpayers can still take a 20% deduction and a 20% credit for the same cost
- Cook Inlet has a different tax rate (still no distinction between new and legacy fields)
- Still no revenue floor
- Deductible costs can be off-site (including out of the country)
- Abandonment costs incurred after tax is enacted are deductible
- No additional audit authority or penalties
- 95% of the production tax is due monthly; with annual true-up
- Transitional investment expenditures "2 for 1;" producer has seven years from the first time the credits are applied for to take the credits
- Provides $12,000,000 annual tax credit for qualified capital expenditures for small producers; producer has ten years from the first time the credits are applied for to take the credits (up to $120,000,000)
- Use of Royalty Settlement agreements removed
- Tax rate for private land is 5% of the gross value
- Conservation surcharge set at $.01 for the mitigation account; $.04 for prevention
- Point of production for gas is still confusing

And now for the details…

NET PROFITS TAX STRUCTURE: The production tax is levied on the net profits (gross value minus costs). A tax on the gross value is simpler to administer, more transparent and more appropriate for a production tax. Alaska will be the first state to have its production tax based on net profits. Amendment by Rep. Crawford to entirely delete the net profit tax and replace it with a fix to the current gross production tax system failed.

Senate: Same.

TAX ON OIL AND GAS: The same tax system and rates apply to both oil and gas. The effect is that costs associated with development of major gas fields (like Exxon's Point Thompson Unit) will be deducted and credited against oil taxes (because gas will not yet be produced; or because the state will take taxable gas in-kind under the pipeline contract). Amendment by Rep. Kerttula to put the tax on oil only and providing methods for apportioning the costs of oil and gas production failed.

Senate: Same.

TAX RATE: Tax rate is 20%. When combined with other provisions in the legislation, an Econ One analysis and the fiscal note shows that when oil prices are less than $40, revenues to the state will be less than the administration's proposal. Amendment by Rep. Weyhrauch to raise tax rate to 30% failed. Amendment by Rep. Kelly to raise rate to 22.5 failed.

Senate: 22.5%

TAX CREDITS: Tax credits are available for 20% of a producer or explorer's qualified capital expenditures. Tax credits are also available for 20% of a carried-forward annual loss (deductions that cannot be used in a month). Credits can be used or transferred indefinitely.

Senate: 25%

TAX CREDIT REFUND: A producer of not more than 50,000 barrels of taxable oil and gas per day may apply to the state for a cash refund of their tax credits up to $25,000,000 per year.

Senate: No credit refund.

PROGRESSIVITY: Provides for an additional tax that kicks in when the price of oil is $35 net profit per barrel. That means eligible costs are deducted before getting to the trigger. The tax rate is .25% of the net value per dollar in excess of $35. No cap.

Senate: Trigger is $50 ANS West Coast, .02 percent rate on the gross value.

ONE-THIRD TAX ON GAS: Only one-third of produced gas will be taxed. However, the costs associated with gas production are still deductible at the full 20% rate and allowed to get the 20% tax credit. Costs to the state are unknown, but according to Econ One, they could be huge. (Administration says North Slope gas will be covered by the contract and this provision will not apply, but who knows what that means since we do not have the contract). Amendment by Rep. Kerttula to remove the provision failed.

Senate: Same.

EFFECTIVE DATE: April 1, 2006 effective date.

Senate: Same.

DOUBLE-DIPPING: Taxpayers can claim both a 20% deduction and a 20% credit for the same expenditure. Amendment by Rep. Kerttula to eliminate the double-dipping failed.

Senate: Same.

COOK INLET: An amendment passed that sets a tax rate of five percent for Cook Inlet oil and establishes a formula for Cook Inlet gas but not sure of the result.

Senate: Different provision but not sure how it compares.

REVENUE FLOOR: No provision for a revenue floor. If the price of oil falls to the $20 range, the state could find itself with no production tax revenue or less than what the state would receive under current law. By establishing a floor, the state can protect itself from the production tax falling to zero. Amendment by Rep. Kerttula to set a tax rate floor of 6% of the gross value failed.

Senate: Same.

DEDUCTIBLE LEASE EXPENDITURES: Deductible lease expenditures are the total costs upstream of the point of production (a point before the product enters a transportation pipeline). The costs that can be deducted will be determined through regulations. A new provision states that an activity need not be physically located on or near a lease in order for the cost of the activity to be a deductible expenditure (administration says this was always the intent – and yes, it means costs of constructing a drilling rig in China could be eligible for a deduction and credit). Amendment by Rep. Kerttula to tightly define deductible lease expenditures (including disallowing abandonment and overhead costs) failed; amendment by Rep. Kerttula to delete off-site provision failed.

Senate: No provision providing that offsite costs are deductible lease expenditures.

ABANDONMENT COSTS: Abandonment costs may be deducted for costs incurred after the effective date of the Act. Costs could exceed $100 million on some leases. With the costs deductible under the oil and gas tax, the state will take on a share of the costs through reduced tax revenue.

Senate: Same.

AUDIT AUTHORITY: No provision for additional audit authority or penalties; the department of revenue will rely on the producers to audit their own billable costs under joint unit operating agreements and rely on existing penalties to act as a deterrent to misbehavior. Amendment by Rep. Kerttula to require taxpayers to prove internal transactions do not exceed fair market value prior to getting a deduction failed; amendment by Rep. Kerttula to strengthen penalties for understatement of taxes failed.

Senate: Same.

PAYMENT OF TAX ("safe harbor"): 95% of the production tax is due monthly with an annual true-up. Interest is due on any amount under 95% that is delinquent. The purpose is to give taxpayers time to adjust their taxes for deductions and credits (but it may match corporate bookkeeping to have the true up quarterly).

Senate: Same.

TRANSITIONAL INVESTMENT EXPENDITURES: 20% of capital expenditures from July 1, 2001 to June 30, 2006 are eligible for credits. Maintains the "2 for 1" provision introduced in Senate Resources requiring that producers invest new capital expenditures in order to qualify for credits. Producers have until either 2013 or seven years from the first time credits are applied for to apply for credits.

Senate: Sunset 2013.

STANDARD DEDUCTION: This was once the $73 million standard deduction. It is now a $12 million annual tax credit in addition to other tax credits. Producers of 50,000 barrels per day of oil equivalent are eligible for the entire credit; for production of 50,000 to 100,000 barrels, a formula phases the credit out. The credit is non-transferable and cannot be carried forward. A producer has until 2016 or ten years from the first time the credits are applied for to take advantage of the credits.

Senate: Credit of 22.5% when the average production per day is not more than 5,000 barrels; over 5,000 barrels, a formula provides the percentage for deduction; capped at $14 million per year. Sunset 2016.

ROYALTY SETTLEMENTS & GROSS VALUE: The provision to allow the commissioner of revenue to use royalty settlement agreements (rather than current statutes) to determine the gross value of oil and gas was deleted.

Senate: Same.

TAX RATE FOR PRIVATE LAND: Sets the private royalty rate at 5% of the gross value for oil and 1.667 rate for gas. Alternative rate set at 20% for oil and 6.67% for gas (if the producer has received offset payments from royalty owners).

Senate: Same except alternative rate is 22.5% for oil and 7.5% for gas.

CONSERVATION SURCHARGES: The mitigation account surcharge is $.01 and the prevention surcharge is $.04 with intent language that DEC reduce program costs and request appropriations for exceptional program needs. Neither surcharges are deductible.

Senate: $.01 for mitigation account; $.05 for mitigation.

POINT OF PRODUCTION FOR GAS: The point of production for gas (the point where the gross value is determined) still has four possible points depending on whether or how the gas is processed. A change was made to the definition, but am not sure what it does.

Senate: Different language but not sure how it compares.