



State of Alaska Department of Revenue

Tax Division- Audit Status Update

Oil and Gas Production Tax

Presentation to Senate Finance Subcommittee for Department of Revenue

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Four Major Oil and Gas Revenue Sources

Property Tax

Pipeline, Equipment, Facilities. About 80% of property tax collections are credited back to local governments

Royalty

Landowner's share, usually 12.5%. Most North Slope production is on State land. At least $\frac{1}{4}$ of royalties go to the Permanent Fund. Administered by Department of Natural Resources

Production Tax

Based on net profits; most of the conflict in recent years is over this tax. North Slope tax is 35% less a variable "per-taxable-barrel" credit, with a gross minimum tax "floor"

Corp. Income Tax

Taxes the remaining profit after production tax, based on global asset apportionment. Rate is 9.4%, but effectively closer to 7%

Timing of Recent Production Tax Audits

Pre-2007, three-year statute of limitations

- The years 2006-2008 were spent completing the audits for tax years 2003-2005
- 2006 Audits were completed in March, 2010 (three years after 3/31/07 tax filing deadline)
- The 2006 audits were for a split year:
 - January – March, ELF was still in effect
 - PPT bill (HB 3001, CH2 TSSLA 06) passed in August, 2006 with a retroactive effective date to April 1, 2006

Timing of Recent Production Tax Audits

ACES bill (HB2001, CH1 SSSLA 07) passed Nov. 2007 with a retroactive effective date to July 1, 2007

- ACES extended the statute of limitations to six years
 - Rationale was the increased complexity of a net profits-based tax system
- Although individual audits were performed, no audit years were completed during 2011-2013
 - Extensive multi-phase regulations projects to implement the changes of PPT and ACES
 - Rapid increase in tax credit applications, most of which had a 120 day statutory deadline
 - FY2012 capital budget, passed May 2011, provided \$34.7 million for tax revenue management system
 - Although built for the entire tax division, the primary rationale was the increased needs for production tax

Timing of Recent Production Tax Audits

First ACES audits, for 2007, were completed in March, 2014 just before the deadline

- 2007 was also a split tax year, with PPT in effect Jan-June and ACES in effect July-Dec
- Differences were not just tax rates: treatment of lease expenditures, arms-length tariffs, cleanup costs, etc.

Special Legislative Audit report on Oil and Gas Tax Audit Process, June 2014

- Audit identified longer time need for audits, determined tax audit staff was qualified to do their jobs
- “Best Practices” recommendation has been largely met with rollout of Tax Management software

Assessments in Profits-Tax Era Audits

Average (ELF) Audit Assessments for the years 2000-2005 were \$15.1 million per year

2006: \$78 million

2007: \$410 million

(Total noted in Leg. Audit = \$488 million)

2008 (3/15): \$264 million

2009 (3/16): \$132 million

2010 (3/17): \$194 million

These figures include interest as of assessment date

Note: Most deductible North Slope Operating Expenses for 2007-2009 were capped at 3% above previous year due to the “standard deduction” provision of ACES (AS 43.55.165(j-k))

Pending Audits

- Some but not all of the 2011 audits are completed, we will have all done by the 3/31/18 deadline
 - Hoped to be done last fall; staff has been very involved in testing software changes due to HB247 and HB111, plus several retirements
- ❖ **The 2011s have been worked in parallel with the 2012s and 2013s**
- The 2012s will be completed this summer, with the goal of completing the 2013s by the end of 2018
- That will move us more than one full year off the statute of limitations

Important: many companies refile their taxes multiple times before an audit is complete, which makes a very time consuming process to incorporate changes. Four of five major taxpayers refiled 2011 within the past year

Post-Audit Process

After receiving an assessment, known as a “notice and demand letter,” a company has basically three choices:

1. Pay the assessment, without appeal
2. Pay the assessment, under appeal
(main reason to do this is to stop accrual of interest)
3. Appeal the assessment without payment

Post-Audit Process

If an assessment is appealed

1. Initial review is from the Tax Division's internal Appeals group
 - Report is an "Informal Conference Decision," and often makes adjustments to what the auditors did
2. After internal conference, further appeal is the Office of Administrative Hearings in Dept. of Admin
3. Then to Superior Court and then to Supreme Court

Settlement negotiations can and do go on during every stage of this, and many audits are settled

Rarely do we get to the courts; Supreme Court in 12/16 decided the 2005 ELF aggregation case in the state's favor

2018 Status Report Request

- Leg Audit and LB&A Committee requested a status update to the 2014 report
- Provided a series of tables to detail what has resulted from recent audits and what is still pending
- Reported submitted this Monday, 2/26

Five Metrics in 2018 Status Report

1. Total tax audit assessments, including principal and interest, with summary data on how much is collected, appealed, and still in process
2. Total amount appealed, and amount resolved and pending at each stage of the process
3. Number of tax returns filed, audited, and appealed
4. Number and dollar value of audit assessments on credits issued under AS 43.55.023 and 025
Note: “023” credits are issued based on a more limited due diligence review, which is summarized in #5. “025” credits are all audited before initial issuance.
5. Number and dollar value of review adjustments made prior to issuing credits under AS 43.55.023

The actual report submitted to LB&A includes extensive footnotes describing the assumptions and definitions within each column of the five tables

1. In the table below, please provide the dollar amount of tax return audit assessments. The assessments should be presented by tax year and should be categorized by account (columns C-F) and by payment type (columns G-J). The total assessments in columns F and J should equal. If additional categories that comprise the total (accounts or payment status) exist, please add them as extra columns.

| Table 1 Tax Return Revenues and Audit Assessments for Tax Years 2006 through 2017 | | | | | | | | | | | | | |
|--|---|---------------------------------------|---|---|----------------|-----------------|----------------|---------------------------------------|---------------------------|--|-------------------------|---|--|
| Amount of Taxes Assessed by Account | | | | | | | | | | Amount of Taxes Assessed by Payment Status | | | |
| (A) Tax Year | (B) Tax Revenue Filed by All Taxpayers | (Added by DOR) Tax Revenue Audited | (Added by DOR) Additional Tax Assessed | (Added by DOR) Installment Interest Increase | (C) Tax Due | (D) Interest | (E) Penalty | (F) Total Equals to (J) [C+D+E] | (G) Paid under protest | (H) Paid final (after settlement or not appealed) | (I) Not yet resolved | (J) Total All Payment Status [G+H+I] | |
| 2006 | \$ 2,001,815,419 | \$ 1,896,292,691 | \$ 60,270,499 | \$0 | \$60,270,499 | \$31,123,893 | \$ - | \$ 91,394,392 | \$ 35,922,401 | \$ 27,730,473 | \$0 | \$ 63,652,874 | |
| 2007 | 3,476,535,942 | 3,476,535,942 | 200,329,234 | 0 | 200,329,234 | 187,161,624 | \$ - | 387,490,858 | 75,391,076 | 167,376,312 | 9,153,545 | 251,920,933 | |
| 2008 | 7,132,582,848 | 7,132,582,848 | 145,491,245 | 0 | 145,491,245 | 112,884,120 | \$ - | 258,375,365 | \$ - | 84,511,964 | 170,085,453 | 254,597,417 | |
| 2009 | 2,034,600,383 | 2,020,134,580 | 78,478,727 | 3,838,197 | 82,316,924 | 48,259,887 | \$ - | 130,576,811 | \$ - | 38,549,642 | 44,572,555 | 83,122,197 | |
| 2010 | 3,105,939,796 | 3,078,326,487 | 122,777,652 | 5,791,760 | 128,569,412 | 60,677,441 | \$ - | 189,246,853 | \$ - | 28,688,931 | 165,675,554 | 194,364,485 | |
| 2011 | 6,115,571,666 | 6,114,627,023 | 165,013,470 | 6,195,130 | 171,208,600 | 72,677,102 | \$ - | 243,885,702 | \$ - | \$ - | \$ - | \$ - | |
| 2012 | 5,311,152,662 | 5,261,161,108 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |
| 2013 | 3,419,300,268 | 3,388,137,380 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |
| 2014 | 1,434,224,635 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |
| 2015 | 230,674,669 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |
| 2016 | 166,949,412 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |
| 2017 | 257,333,324 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | |

The actual report submitted to LB&A includes extensive footnotes describing the assumptions and definitions within each column of the five tables

2. In the table below, please provide the dollar amount of tax assessments contested at each level of appeal as of December 15, 2017 (columns B-E), and the portion of that amount paid or not paid by taxpayers (columns F-H). The amounts in the column F should match to the column G in the table 1.

Table 2 *
Tax Return Appeals for Tax Years 2006 through 2017

| Contested Amounts At Each Appeal Level | | | | | | | Contested Amounts Paid | | |
|--|---------------------|---|--|--|----------------------------------|---|------------------------|----------------------|-------------------------------------|
| (A) Tax Year | (B) Tax Assessed | (C) TaxAppealed to Informal Conference | (D) Tax Upheld at Informal Conference | (E) Tax Currently Pending at Informal Conference | (F) Tax Appealed to OAH | (G) Tax Currently Pending at OAH | (H) Tax Paid | (I) Interest Paid | (J) Total Tax & Interest Paid |
| 2006 | \$ 60,270,499 | \$ 25,600,152 | \$ 20,417,720 | \$0 | \$11,158,363 | \$0 | \$46,819,134 | \$16,833,740 | \$63,652,874 |
| 2007 | 200,329,234 | 174,204,717 | 52,186,445 | 0 | 38,491,888 | 38,491,888 | 129,010,990 | 113,756,398 | 242,767,388 |
| 2008 | 145,491,245 | 134,401,975 | 32,908,651 | 88,315,595 | 10,674,670 | 10,674,670 | 46,002,370 | 38,509,594 | 84,511,964 |
| 2009 | 82,316,924 | 78,484,917 | 10,891,636 | 43,367,794 | - | - | 10,891,636 | 6,908,364 | 17,800,000 |
| 2010 | 128,569,412 | 120,885,096 | - | 120,885,096 | - | - | 1,974,538 | 1,261,684 | 3,236,222 |
| 2011 | 171,208,600 | - | - | - | - | - | - | - | - |

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3. In the table below, please provide the number of tax returns filed, audits completed, and assessments appealed at each level of appeal.

Table 3
Number of Tax Returns Audited andAppealed

| Number of Tax Returns Filed by Audit Status | | | | | | | | Number of Appeals by Level | | | |
|---|---|---|--|--|---|-------------------------------|--|----------------------------------|--|-------------------------|--|
| (A) Tax Year | (Added by DOR) Number of Tax Returns Filed | (Added by DOR) Number of Producers Filing Returns | (Added by DOR) Number of Producers Who Qualified for 024(c) credit | (B) Tax Returns with Completed Audits | (C) Tax Returns Not Yet Audited | (D) Awaiting Assessment | (E) Tax Returns Filed by Producers [B+C+D] | (F) DOR Appeals Section | (G) Office of Administrative Hearings | (H) Alaska Courts | (I) Total Number of Appeals [F+G+H] |
| 2006 | 14 | 14 | 11 | 8 | 6 | 0 | 14 | 4 | 2 | 0 | 6 |
| 2007 | 17 | 15 | 12 | 12 | 3 | 0 | 15 | 4 | 2 | 0 | 6 |
| 2008 | 17 | 17 | 14 | 7 | 10 | 0 | 17 | 4 | 1 | 0 | 5 |
| 2009 | 17 | 17 | 14 | 10 | 7 | 0 | 17 | 5 | 0 | 0 | 5 |
| 2010 | 55 | 19 | 16 | 8 | 11 | 0 | 19 | 4 | 0 | 0 | 4 |
| 2011 | 58 | 21 | 18 | 10 | 11 | 0 | 21 | 0 | 0 | 0 | 0 |
| 2012 | 60 | 24 | 21 | 0 | 15 | 9 | 24 | 0 | 0 | 0 | 0 |
| 2013 | 60 | 25 | 22 | 0 | 18 | 7 | 25 | 0 | 0 | 0 | 0 |
| 2014 | 63 | 22 | 19 | 0 | 17 | 5 | 22 | 0 | 0 | 0 | 0 |
| 2015 | 58 | 24 | 21 | 0 | 20 | 4 | 24 | 0 | 0 | 0 | 0 |
| 2016 | 58 | 40 | 37 | 0 | 36 | 4 | 40 | 0 | 0 | 0 | 0 |
| 2017 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

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4. In the table below, please provide the dollar amount and number of 023 and 025 credit audit assessments for tax years 2006 – 2013 (PPT/ACES) and 2014 – 2017 (SB21).

| Table 4 023 and 025 credit audit assessments for tax years 2006 – 2013 (PPT/ACES) and 2014 – 2017 (SB21) | | | | | | | | | | |
|---|---------------------------------|-----------------|-----------------------|--|--------------------------------------|--|-------------------------------|---|---|--|
| (A) Tax Years | Amount of Credit Assessments | | | | Number of Credit Assessments | | | | | |
| | (B) Tax Credit Disallowed | (C) Interest | (D) Total [B+C] | (E) Amount of Total Credit Allowed in Appeal | (F) Credit Audits Completed | (G) Credit Audits Still to Be Completed and Issued | (H) Credits Not Audited | (I) Total Credits Filed [F+G+H] | (J) Number of Credit Audits Appealed | |
| 2006 | \$11,713,939 | * | \$11,713,939 | \$0 | 8 | 0 | - | 8 | * | |
| 2007 | 28,993,346 | * | 28,993,346 | 4,889,934 | 18 | 0 | - | 18 | 6 | |
| 2008 | 25,388,367 | * | 25,388,367 | 632,198 | 23 | 0 | - | 23 | 3 | |
| 2009 | 45,023,915 | * | 45,023,915 | 5,891,454 | 15 | 0 | - | 15 | 7 | |
| 2010 | 2,880,337 | * | 2,880,337 | 8,406 | 7 | 0 | - | 7 | * | |
| 2011 | 9,773,044 | * | 9,773,044 | (383,084) | 10 | 0 | - | 10 | * | |
| 2012 | 52,724,565 | * | 52,724,565 | 2,728,906 | 14 | 4 | - | 18 | 3 | |
| 2013 | 7,766,777 | * | 7,766,777 | 862,673 | 14 | 4 | - | 18 | * | |
| 2014 | 3,192,672 | * | 3,192,672 | 336,314 | 14 | 5 | - | 19 | * | |
| 2015 | 8,057,553 | * | 8,057,553 | - | 15 | * | - | * | 0 | |
| 2016 | 35,466,110 | * | 35,466,110 | - | 12 | 5 | - | 17 | 0 | |
| 2017 | - | * | - | - | - | - | - | - | - | |

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5. In the table below, please provide the dollar amount and number of 023 credit review assessments for tax years 2006 – 2013 (PPT/ACES) and 2014 – 2017 (SB21). Note that *reviews* are being distinguished from *audits* which are summarized in Table 4. Reviews that must be completed within 120 days may also result in assessments. A portion of these credits may later be audited.

| Table 5 023 Credit Review Assessments for Tax Years 2006-2013 and 2014-2017 | | | | | | | | | |
|--|------------------------------|-------------------------------|---------------------------------|---------------------------------------|--|--------------------------------|----------------------------------|---|--|
| (A) Tax years | Amount of Credit Assessments | | | Number of Credit Assessments | | | | | |
| | (Added by DOR) | (B) Tax Credit Requests | (C) Tax Credit Disallowed | (F) Credit Reviews Completed | (G) Credit Reviews Still to Be Completed and Issued | (H) Credits Not Reviewed | (I) Total Credits Filed | (J) Number of Credit Reviews Appealed | |
| 2006 | \$85,490,257 | \$ 7,520,378 | \$6,266,855 | 14 | 0 | 0 | 14 | 3 | |
| 2007 | 299,412,427 | 29,665,978 | * | 59 | 0 | 0 | 59 | * | |
| 2008 | 334,494,453 | 45,725,797 | 4,211,742 | 67 | 0 | 0 | 67 | 7 | |
| 2009 | 268,078,710 | 15,039,467 | 9,248,828 | 74 | 0 | 0 | 74 | 10 | |
| 2010 | 444,535,610 | 6,609,401 | 1,362,869 | 73 | 0 | 0 | 73 | 5 | |
| 2011 | 393,576,565 | 28,217,239 | 5,058,680 | 65 | 0 | 0 | 65 | 7 | |
| 2012 | 610,144,269 | 111,099,520 | 9,880,179 | 81 | 0 | 0 | 81 | 8 | |
| 2013 | 724,710,171 | 148,446,444 | 5,906,854 | 89 | 0 | 0 | 89 | 4 | |
| 2014 | 623,979,795 | 29,262,225 | 6,852,859 | 109 | 0 | 0 | 109 | 7 | |
| 2015 | 568,746,758 | 70,391,549 | 7,131,776 | 82 | 0 | 0 | 82 | 6 | |
| 2016 | 209,333,160 | 29,743,889 | - | 50 | * | 0 | * | 3 | |
| 2017 | - | - | - | - | - | - | - | - | |

THANK YOU

Please find our contact information below:

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