HB 111 Conference Committee Version X

Summary Statement

The proposed compromise bill, Version X, has a narrow focus. It is intended to end cash credits for net operating losses this year without replacing those credits with any future tax deduction, while acknowledging that the legislature must continue to work on the tax structure as a whole. It also addresses some related areas of compromise including an interest rate for delinquent taxes and alternative opportunities for companies to recover the value of their already issued credits. The draft does not directly address the area of most contention between the House and Senate drafts of HB 111, namely what system of deductions will replace the net operating loss credits. Instead a legislative working group is tasked with reviewing the tax system and identifying an appropriate replacement.

The proposed bill ends cash credits and net operating loss credits in general in three ways.

- First, the state will not pay cash for any production tax credits earned after July 1, 2017.
- Second, the net operating loss (NOL) credit created in AS 43.55.023(b) is repealed on January 1, 2018. The net operating loss credit creates a credit for qualifying expenses that companies were not able to deduct from their taxes in the current year. Small companies can get cash payments for these credits, and larger companies that do not qualify for cash earn a credit they can take against future taxes. The credit is currently equal to 35% of any lease expenditures they have not already deducted from their taxes. Repealing this NOL credit entirely levels the playing field between small companies who are eligible for cash credits and the large companies that use the credits against future taxes. This NOL credit is not replaced by any form of future deduction, but a legislative working group created by the bill is tasked with examining that issue. The working group was included in the House version of HB 111 but was not in the Senate version. Because cash payments end on July 1, 2017, but the NOL credit itself is not repealed until January 1, 2018, there will be six months of credits which are not eligible for cash payments but can be used against production taxes or transferred to another company.
- Third, the bill repeals the oil and gas credit fund (AS 43.55.028) on January 1, 2022 or when all outstanding credits are paid. Even though the state will not pay cash for any expenditures *earned* after July 1, 2017, it is prudent to leave this fund in place until all of the currently existing credits are settled.

The proposed conference committee draft additionally includes opportunities for companies to recover the value of any currently existing credits that have not been cashed. These options were originally proposed in the Senate draft of HB 111 as a way to lower the existing credit backlog. Options include using Middle Earth Exploration credits against state corporate taxes and using any production tax credits to pay any taxes, interest, or fees stemming from a prior year tax audit. Furthermore, the proposed draft ends a specific Middle Earth credit that was for 40% of seismic exploration costs in certain areas.

Finally, the proposed conference committee draft includes a revised interest rate for delinquent taxes of 5.25% above the Federal Reserve rate. This reaches a middle ground between the House interest rate of 7% and the Senate interest rate of 3%. It is important to address the interest rate this year because under current law the interest rate is 7% but interest stops accruing on delinquent oil and gas taxes after three years, which means that after three years companies have no incentive to settle audit disputes with the state. Both House and Senate versions would end this three year limit.

The proposed conference committee draft accomplishes the goal of ending cash payments for credits today without creating a future state liability of tax deductions of equal value. Creating a legislative working group to review the oil and gas tax structure provides the legislature with the time necessary to develop a replacement system which allows companies to recover their expenditures while protecting the state.