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M E M O R A N D U M February 22, 2010

SUBJECT: Gas production tax limitation in AS 43.90.320
(Work Order No. 26-LS1526)

TO: Senator Tom Wagoner

FROM: Donald M. Bullock Jr.
Legislative Counsel

You asked to what extent is the state bound by the tax exemption in AS 43.90.320.[1] The exemption in that section is offered to producers that commit to acquire firm transportation capacity in the first binding open season of the gas pipeline project license under AS 43.90 (Alaska Gasline Inducement Act, "AGIA").

The exemption in AS 43.90.320 is statutory and not contractual. Under article IX, sec. 1 of the Alaska constitution, the state may not contract away its taxing authority except as otherwise provided in article IX. Article IX, sec. 4 authorizes the legislature to grant exemptions from tax "by law." The tax exemption in AS 43.90.320 is granted by law, but as a law, is subject to amendment or repeal by the legislature.[2]

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[1] The amount of the exemption is described in AS 43.90.320(a), which reads as follows:

> (a) If a person qualified for a resource inducement under AS 43.90.300 agrees under (c) of this section, the person is entitled to *an annual exemption from the state's gas production tax in an amount equal to the difference between the amount of the person's gas production tax obligation calculated under the gas production tax in effect during that tax year and the amount of the person's gas production tax obligation calculated under the gas production tax in effect at the start of the first binding open season held under this chapter. If the difference is less than zero, the gas production tax exemption is zero.*

(Emphasis added.)

[2] As you are aware, the legislature has faced the issue of whether a contractual limitation on oil and gas production taxes is permissible under the state constitution. If such a contract were allowed under article IX, the legislature could not pass a law that impaired the obligations of that contract because of the prohibition in article 1, sec. 15. In

While a person offered the exemption may reasonably expect that the legislature would allow the exemption to continue during the specific 10-year period described in AS 43.90.320(b), the continuation of the exemption is subject to legislative discretion. A similar statutory tax incentive was offered in AS 43.55.011(b) (repealed, sec. 34, ch. 2, TSSLA 2006), in which new oil production was taxed at the rate of 12.25 percent of the gross value at the point of production for the first five years, and 15 percent thereafter. That tax incentive was in place from its enactment in 1981 until its repeal in 2006.

Although the exemption in AS 43.90.320 is offered to producers, a change in the law that reduces the value of the inducement may affect the license agreement with the AGIA licensee. The state and the AGIA licensee have a contract under which, in return for commitments and costs incurred by the licensee to develop the pipeline project, the state shares the costs and offers the services of the Alaska Gasline Inducement Act coordinator.[3] The royalty and tax exemption inducements are offered as incentives to commit to acquire firm transportation capacity in the pipeline project. If the legislature removes or reduces the inducements and the first binding open season fails to produce sufficient commitments for the project to move forward, the licensee may claim the state reduced the value of its exclusive license, contrary to article I, sec. 15 of the state constitution.

As a practical matter, the licensee's open season is expected to begin May 1, 2010, and the inducements are only offered during this first open season. If no firm commitments are received, the inducements expire. If firm commitments are received, the inducements take effect for the 10-year period described in AS 43.90.320(b), unless amended by law.

If I may be of further assistance, please advise.

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AS 43.90.320, the state offers an exemption in the amount of any increase in gas production tax liability during the designated period.

[3] AS 43.90.110(a).