ALASKA STATE LEGISLATURE
SENATE RULES COMMITTEE
SENATOR BILL WIELECHOWSKI, CHAIR

Senate Bill 114
Sponsor Statement

SB 114 addresses three existing deficiencies with Alaska's oil tax laws through three reasonable reforms.

Closing the S-Corp Tax Loophole

In 1958 Congress established the S Corporation (S-Corp) tax classification of the IRS tax code to benefit small businesses and help them stay viable. The S-Corp tax category bypasses income taxes on the entity, enabling tax liability to "pass through" to apply only against the earnings of the individual shareholders. Alaska tax law incorporates the IRS tax code by reference, including taxation of companies. But in 1980 Alaska repealed its personal income tax. This results in an anomaly where the state generates tax revenue from the profits of a traditional C Corporation (C-Corp), while an S-Corp that is just as profitable doing business in Alaska gets to avoid paying the state any corporate income tax.

The legislative record of the personal income tax repeal demonstrates no deliberation regarding effects on pass-through taxation. The policy rationale and alternate taxing arrangement that led Congress to create the IRS S-Corp classification cannot be met in Alaska. The consequence can only be viewed as an inadvertent loophole of our tax structure that must be closed.

Under SB 114, non C-Corp entities making significant profits from Alaska's oil and gas resources will pay the same tax rate as C-Corps. The new 9.4% tax would apply only to entities making over $4 million in profits from oil and gas production or pipeline transportation, and only to their profits above $4 million.

Reducing the Sliding-Scale Per-Barrel Credits & Requiring Investment Match

The sliding-scale per-barrel credit was established in law in 2013 under SB 21, the "More Alaska Production Act" (MAPA). The deductible credit provides the major North Slope oil producers a discount on their production taxes for each barrel of oil produced based on a sliding scale, depending on the price of oil. The credit ranges from $8/barrel when the gross value of oil is less than or equal to $80/barrel, to $1/barrel when oil is valued at less than $150/barrel. The program similarly allows producers receiving a "new field" reduction on their tax liability to take a flat credit of $5/barrel.

SB 21 was introduced with no per-barrel credits. The Senate added a flat $5 per-barrel credit for all producers. When SB 21 passed the Senate on March 21, 2013, the Governor, industry, and others supported just a $5 credit. The House made the $5 credit apply to the new fields and added the $8 to $1 sliding-scale per-barrel credits for existing fields. In the final hours before adjournment, the Senate relied on the House vetting process and voted to concur with the changes to SB 21.

Through fiscal year 2023 Alaska will have lost $7.2 billion in revenue to the per-barrel credits. This fiscal year alone, the credits will cost the state $1.1 billion, and it's estimated that Alaska will lose out on another $8.7 billion in the next nine years.

SB 114 reduces these credits to a $5 to $1 sliding scale, then ties the credits to investment; producers earn the credit only up to the amount matching their qualified capital expenditures from the same tax year. The new investment qualifier encourages investment spending on projects in Alaska that will maintain production, create jobs for Alaskans, and promote industry growth.

Ringfencing North Slope Fields

Producers on the North Slope are permitted to deduct amounts spent on capital projects from their taxable profits. Currently in law the major producing legacy fields of Alaska's North Slope are considered a single entity for taxing purposes. This means that while operations are being developed in one area of the North Slope, a producer can deduct the costs for that construction from its production profits in other areas of the North Slope, reducing tax liability to the state by about 35%.

The Willow Project in the NPR-A, unanimously supported by the 33rd Alaska Legislature by resolution and recently approved by the federal government for development, highlighted this flaw in our production tax system. It has been estimated that due to lack of constraints on capital expenditure deductions, Alaska could lose $300 to $700 million in production tax revenue over the next six years.

SB 114 would establish a "ringfence" of the deductions for capital expenditures, which would mean that the deductions could only be taken for the field in which the expenses were made. The deductions would therefore not occur until the field goes into production.

Ringfencing is a common-sense fix to the defect existing in our current tax structure and was standard practice through various means in Alaska through 2005. A producer with no North Slope production will not lose the benefit of the deduction, it will just be applied when the field comes online—providing a stabilizing effect to the state's revenue stream over time.