ALASKA OIL & GAS ASSOCIATION
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TO: Senate Finance Committee

FROM: Kara Moriarty, AOGA President/CEO

RE: SB 122 – Committee Substitute (version H)

DATE: May 8, 2023

The Alaska Oil & Gas Association represents the majority of oil and gas producers, explorers, refiners and transporters of oil and gas in Alaska. Our mission is to advocate for the long-term viability of the oil and gas industry.

We would like to offer the following comments concerning the Senate Finance Committee substitute (version H) of Senate Bill 122 and hope that they are useful to you as you consider the potential ramifications of this legislation. These comments are limited to the provisions concerning the new income tax on "oil or gas entities" that have been added to the bill through the committee substitute.

SB 122 expands the oil and gas corporate income tax to non-corporate entities, increasing costs for those entities. As drafted, the proposed changes create confusion with the existing statutory structure which we set forth below by Section.

Section 2

Section 2 introduces "taxable income" without a definition and as currently drafted, proposes a use that differs from the existing statutory structure thereby leaving a new or existing taxpayer unable to discern where to begin.

For Alaska's oil and gas corporate income taxpayers, "taxable income" is defined as or in terms of "federal taxable income"[1] with adjustments, including adjustments for depletion, depreciation, and intangible drilling and development costs.[2] Unlike oil and gas corporations, the oil and gas entities that SB 122 proposes to tax do not have federal taxable income, and the adjustments to federal taxable income listed in current law likewise do not apply to partnerships or subchapter S corporations.

Absent a definition of "taxable income" SB 122 leaves the proposed taxpayers without a starting point to determine whether the $4 million threshold is applicable.

Nothing in SB 122 specifies taxable income must specifically be from oil and gas production or transportation, or that it must only be income of the taxable entity or that taxable entities direct activities. Thus, it could be income from non-oil and gas activities, including from affiliates or subsidiaries of the entity that are not actually oil and gas producers or pipeline transporters. For instance, if an oil and gas producing entity has a

[1] AS 43.20.145(h)(3); 15 AAC 20.900(5).
[2] AS 43.20.144.

subsidiary or affiliate that provides painting services to a number of different industries and individuals, would the income from that subsidiary or affiliate be taxed under SB 122?

At AS 43.20.019(b) the exclusion for corporations "paying tax under AS 43.20.011" is unclear when a corporation is not actually paying tax. For instance, if an oil and gas corporation is in a loss position or uses a net operating loss and does not pay tax, then is the exclusion no longer applicable? And, if the exclusion is no longer applicable, then does that mean an oil and gas corporation that files a consolidated federal income tax return, including pass through entities or what SB 122 defines as "entity" or "oil or gas entity," now must determine for each "oil and gas entity" the applicability of the tax proposed in SB 122? The lack of clarity whether an oil and gas entity would still be taxed seems inconsistent with the notions of consolidation and combined accounting in Sections 4 and 9.

Section 3 imposes a filing requirement on oil and gas entities. The current statute requires corporations or partnerships with corporate partners that file tax returns under the Internal Revenue Code to file state income tax returns within 30 days of filing the federal return. SB 122 simply adds references to oil and gas entities to the current statute. Existing law makes sense given that the tax on corporations starts with federal taxable income, however, SB 122's amendment is problematic given that partnerships file informational returns. There is not a calculation of taxable income or tax at the partnership level, and income from sole proprietorships is included in the sole proprietor's individual income tax return, along with other sources of income.

Section 4 brings in oil and gas entities for combined accounting and **Section 9** appears to add oil and gas entities to the consolidated business. Both sections do so by simply adding references to oil and gas entities.

- In both sections, it is unclear if these provisions are intended to combine/consolidate corporations with oil and gas entities, to combine/consolidate oil and gas entities with other oil and gas entities, or both.

- The lack of clarity creates double taxation concern. For instance, if a corporation has an oil and gas entity subsidiary or affiliate, would the tax on the income of the oil and gas entity be levied on the corporation under the current rate and bracket structure in AS 43.20.011? Or would the tax on the subsidiary be in addition to the tax on the corporation? And if so, would the tax attributes of the oil and gas entity (income and deductions) still flow through to the corporation for purposes of its corporate income taxes?

- The proposed tax is 9.4% on "taxable income" over $4 million. This is different than rates under AS 43.20.011, the current tax on corporations. This creates an apparent inconsistency, as an oil and gas entity subsidiary in the consolidated business could be taxed at a different rate than the corporation. It also affirms the concern with double taxation, given the possibility of taxation at both the corporate and subsidiary levels, but potentially with different tax rates and brackets.

Section 12 and **Section 13** add definitions for “entity” and “oil and gas entity,” respectively.

- Defining both “entity” and “oil and gas entity” is at least partially redundant.

- The definition of “oil and gas entity” is overly broad. “Engaged” in production “from a lease or property” or pipeline transportation may be read to include entities that are not actually producers or transporters. For instance, this could bring in affiliates that are neither, as well as oil and gas service industry companies, etc. Further, “lease or property” is undefined in the bill. It is, however, defined in current regulations at 15 AAC 20.900(c)(3):

  (3) “lease or property” means any economic interest (as defined in (2) of this subsection) in any right, title, or interest in or right to extract oil or gas including

  (A) a mineral interest;

  (B) a leasehold interest;

  (C) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, carried interest or any other interest in a lease, sublease, concession, joint venture, sharing arrangement, or other agreement for oil and gas exploration, development, or production;

  (D) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, carried interest or any other interest in an agreement for unitization or pooling under the provisions of Internal Revenue Code section 614(b)(3) (26 U.S.C. 614(b)(3)) as that section read on April 14, 1982;

  Like the reference to “taxable income” in Section 2 of the bill, this highlights the peril of tacking a new tax system onto the law governing an existing one. Does the legislature intend to tax income from overriding royalties and all other manner of interests included in the definition of “lease or property?”

- Without further context and definition of “partnership” as an “entity” and subsumed as an “oil or gas entity” it is difficult to determine whether certain “tax partnerships” are included or excluded in SB 122.

- For instance, oil and gas joint ventures include operating agreements that are tax partnerships for federal tax purposes only and are not organized under the laws of any state. Such tax partnerships provide the working interest owners share their proportionate costs but do not jointly market the product being produced, therefore the federal partnership return reflects only costs. Whether such tax partnerships are included as oil and gas entities under SB 122 is unclear.

We would be happy to discuss this further upon request.