

HOUSE FINANCE COMMITTEE  
April 6, 2016  
3:05 p.m.

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CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 3:05 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair  
Representative Steve Thompson, Co-Chair  
Representative Dan Saddler, Vice-Chair  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lynn Gattis  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Jane Pierson, Staff, Representative Steve Thompson; Don Bullock, Staff, House Majority; Ken Alper, Director, Tax Division, Department of Revenue; Randall Hoffbeck, Commissioner, Department of Revenue; Representative Liz Vasquez; Representative Adam Wool.

SUMMARY

HB 247 TAX;CREDITS;INTEREST;REFUNDS;O & G

HB 247 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson discussed the meeting agenda.

#hb247

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

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Co-Chair Neuman MOVED to ADOPT the proposed committee substitute for HB 247, Work Draft 29-GH2609\F

(Nauman/Shutts, 4/6/16). There being NO OBJECTION, it was so ordered.

Co-Chair Thompson addressed the Committee Substitute (CS) and summarized some of the changes. He noted that changes were made to the House Resources Committee version of the bill. He relayed that the interest on delinquent taxes would be 5 percent above the Twelfth Federal Reserve District rate compounded quarterly for the first 4 years and then straight interest at 5 percent above the Twelfth Federal Reserve District rate for the next two years. The oil tax floor was hardened to 2 percent of the gross value of the point of production. He outlined adjustments to the Cook Inlet credits in the CS. The net operating losses in the House Resources version of the bill was 25 percent, 10 percent, and 10 percent and were unchanged in the CS. The "Qualified Capital Expenditure" (QCE) credits were 20 percent, 20 percent, 20 percent in the Resources version and were changed to 20 percent and in January 2017 and 2018 to 10 percent. The "Well Lease Expenditure" (WLE) credit remained unchanged at 40 percent reduced to 30 percent [in 2017[, and 20 percent [in 2018]. He added that the CS amended the Frontier Basin Credits for expenditures to complete an exploration well that was "spudded" but not completed before July 1, 2016. The CS extended Cook Inlet credits to Middle Earth to hold the region harmless and reduced the cap on credits that the Department of Natural Resources (DNR) may purchase from \$200 million to \$100 million "per person, per year." He detailed that the "new definition" for new oil was 5 years. The Committee Substitute removed the Cook Inlet tax cap on oil January 1, 2017.

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JANE PIERSON, STAFF, REPRESENTATIVE STEVE THOMPSON, presented the changes in the bill. She provided an explanation of changes (copy on file) to the Committee Substitute:

Title Changes to conform with changes in the bill.

Sec. 6. (Page 3, Lines 18-28) AS 43.05.225 - Interest Rate on delinquent taxes. Will now be compounded quarterly at 5% above the 12th Federal Reserve District for the first 4 years after the tax becomes

delinquent and 5% annually, no compounding after the first 4 years.

Sec. 10 (Page 5, Lines 5-26) AS 43.55.011(e) Deletes reference to the Cook Inlet tax cap. Repealed in Sec. 42.

Sec. 11 (Page 5, Lines 6-26) AS 43.55.011(f) - Hardens the floor so that no credits can reduce the floor below 2% of the gross value at the point of production.

Sec. 12 (Page 8, Lines 6-7) AS 43.55.011(m) Takes out reference to old credits that are not being used and deletes a reference to the Cook Inlet tax cap.

Sec. 13. (Page 8, Line 13-18) AS 43.55.019(e) - Makes sure that the Education Tax Credit cannot take the floor.

Sec.14. (Page 15-16, Lines 1-3) AS 43.55.020(a) - Installment Payments - Conforming language regarding payment of taxes and the new floor. Addresses the Cook Inlet tax cap.

Sec. 15 (Page 16, Line 12) AS 43.55.023(a) - Qualified Capital Expenditures. Reduces the qualified capital expenditure credits from 20% to 10% starting on January 1, 2017.

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Ms. Pierson continued with the explanation of changes:

Sec. 16 (Page 17, Lines 6-16) AS 43.55.023(b) - Net Operating Loss Credits. Keeps the Middle Earth carried-forward annual loss credits at 25%. Reduces the Cook Inlet Net Operating loss credits from 25% to 10% starting January 1, 2017, if the producer or explorer has not taken a credit prior to January 1, 2017 they are not eligible. The amount Cook Inlet NOLs are consistent with the House Resources version of the bill. Continues a 25% credit for Middle Earth after 2016.

Sec. 17 (Page 17, Lines 27-30) AS 43.55.023(c) - Conforming language to the floor.

Sec. 20 (Page 19 Lines 11-20) AS 43.55.023(1) - Well Lease Expenditure Credits. Reduces the Cook Inlet Well Lease Expenditure Credits from 40% to 30% on January 1, 2017, and to 20% on January 1, 2018. Middle Earth credits will reduce from 40% to 30% on January 1, 2017

Sec. 21-23 (Pages 19, Lines 31-17) AS 43.55.024(f) (g) (i) - Small Producer Credits. Conforms to the floor.

Sec. 24 (Page 20, Lines 26-28) AS 43.55.025(m) - Middle Earth Drilling Credits. States that the middle earth drilling credits are extended to complete an exploration well that has spudded but not completed before July 1, 2016.

Sec.25. (Page 21, Lines 26-29) AS 43.55.025 - Alternative Tax Credits for Oil and Gas Exploration. - Conforming language to the floor.

Sec. 26. (Page 22, Lines 5 and 13) AS 43.55.028(e) - Oil and Gas Tax Credit Fund Established; Cash Purchase of Tax Credit Certificates. States that the Department may not purchase more than \$100,000,000 in tax credits from a person in a calendar year. This is reduced from \$200,000,000 in the House Resources version of the bill.

Sec. 31. (Page 15, Lines 11, 17, and 20) AS 43.55.160(e) Conforming amendment regarding Cook Inlet Tax Cap on oil.

Secs. 32 and 33. (Pages 25-27, Lines 24 - 6) AS 43.55.160(f) (g) New Oil, Gross Value Reduction - For oil and gas first produced after December 31, 2016, the new oil reduction shall apply for the first five years after the commencement of production in commercial quantities. For oil and gas first produced prior to January 1, 2017, the reduction shall expire January 1, 2021.

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Ms. Pierson noted that any other changes were conforming amendments.

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RECONVENED

DON BULLOCK, STAFF, HOUSE MAJORITY, emphasized that the removal of the Cook Inlet gas cap only applied to oil.

Representative Gara had questions about the changes in the CS compared to the governor's bill. He understood that the governor eliminated the Cook Inlet QCE and WLE credits and wondered whether changes were made to the credits in the CS. Mr. Bullock replied that based on testimony from Enalytica, the credits were stepped down rather than eliminated. Representative Gara noted that the governor had proposed to eliminate the 20 percent QCE and the 40 percent WLE credits. He asked what the CS did in relation to the items. Mr. Bullock referenced page 16, line 11 of the legislation and pointed out the language reduced the QCE from 20 percent to 10 percent. He reported that the Net Operating Loss (NOL) credit found on page 17 was "scaled down" to 10 percent inside the Cook Inlet sedimentary basin.

Co-Chair Thompson noted that the Department of Revenue (DOR) would answer questions later in the evening.

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Representative Gara noted that the governor's bill did not allow the tax floor to go below 4 percent. He understood that in the CS the tax floor was established at 2 percent. Mr. Bullock answered that the reduction of the tax floor was a 2 step process; first a calculation determined whether the minimum tax on the gross applied and if so, AS 43.55.011(f) applied. If the allowable credits were below 4 percent the floor hardened at 2 percent. Representative Gara surmised that the tax floor was now 2 percent. Mr. Bullock believed the governor had wanted a higher percentage than 4 percent. Representative Gara asked for the changes to the Cook Inlet oil tax in the CS. He responded that on January 1, 2017 the tax cap on Cook Inlet Oil was eliminated. Representative Gara wondered what the oil tax reverted to. Mr. Bullock replied that the tax rate would be the same as the statewide rate of 35 percent.

Representative Gara asked whether the 35 percent rate was structured the same as in SB 21 (Oil And Gas Production Tax)[Chapter 10 SLA 13 - 05/21/2013]. Mr. Bullock remarked that 35 percent was the rate established in SB 21. Representative Gara asserted that the 35 percent tax kicked in at \$155 per barrel of oil but was much lower below the threshold. Representative Gara voiced that the governor's bill removed the exemption for "Gross Value Reduction" (GVR) fields (post 2002 fields) and subjected the oil to the tax floor. He surmised that the CS subjected GVR field's oil to the tax floor after 5 years and the "higher prices to the older oil tax rate." Mr. Bullock answered that there were two different effects related to the GVR. He explained that one was added back in order to determine the NOL credit and the second change limited the period in which the GVR would apply. Representative Gara asked whether the statewide tax rate would apply after the five period. Mr. Bullock responded that "they would not be subject to the GVR." Representative Gara asked "how it was not the same thing."

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Mr. Bullock replied that "after the oil no longer qualified for the GVR and the clocks ran out there was no special distinction for the oil."

Representative Wilson asked which sections of the CS had to do with SB 21 and the North Slope. Mr. Bullock answered that SB 21 addressed the GRV, therefore the provisions in the CS related to the hard floor applied, in addition the NOL changes, the QCE reduction, and the interest rates were changes from SB 21. Representative Wilson referenced the changes to the interest rate for delinquent taxes. She surmised that the taxes were not really delinquent; the companies paid its taxes and that the state was delinquent due to audits. She did not want it to appear like the companies were not filing appropriately. She asked how the interest rate changes were developed. Mr. Bullock responded that there had been significant discussion on the necessary length of time to complete audits. He explained that the reduced interest rate "after the first period of time" was established in consideration of the time it took to complete audits. He informed the committee that "delinquency" referred to the amount of tax that was due at the time and maybe higher subsequent to the audit than initially calculated. Similarly, if a company was entitled

to a refund the rate would apply the interest rate from the date of the overpayment.

Co-Chair Thompson surmised that it was essentially an underpayment. Mr. Bullock replied that delinquency was an underpayment based on the tax amount determined by the audit. He detailed that the interest only applied to the unpaid amount as determined by the audit.

Representative Wilson asked whether all of the oil companies were audited. She remarked that the Internal Revenue Service (IRS) did not audit all taxes.

Co-Chair Thompson deferred the question to the Department of Revenue (DOR).

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Representative Munoz asked about the updated fiscal notes.

Co-Chair Thompson replied that DOR was in a meeting currently and would have the updated fiscal notes later in the evening.

Representative Gara spoke to the governor's effort to "cap tax credits at \$25 million per owner." He understood that the CS capped credits at \$100 million. He understood that companies never claimed more than \$100 million in credits. He asked if the cap was real. Mr. Bullock stated that the amount was a cap and anticipated that enough funding was maintained in the oil and gas tax credit fund to pay the amount. Representative Gara stated that the governor's bill estimated a savings of \$785 million and the Resources version only saved the state \$20 million in FY 17. He asked for concurrence.

Co-Chair Thompson deferred the question to DOR. He relayed that the meeting would recess until 6:30 p.m.

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Co-Chair Thompson asked the department to address the committee.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, stated that he was present to answer questions about the Committee Substitute. He referred to a draft fiscal impact document from the department dated April 6, 2016, (copy on file) which included a table that depicted the estimated fiscal impact [revenue and budget] of the provisions in the CS.

Representative Kawasaki referred to the DOR fiscal note dated March 29, 2016 that projected a \$770 million to \$805 million fiscal impact [in FY 2017]. He asked why the total fiscal impact for the CS in FY 17 was \$10 million to \$50 million. Mr. Alper answered that FY 17 was not the "wrong data point to use as the comparative." He elaborated that there were anomalies in FY 17 and that the most "substantial" change between the previous fiscal note was the effective date. The governor's bill had an effective date of July 1, 2016 and most of the changes in the Committee Substitute included an effective date of January 1, 2017. He suggested that referring to the out years, when the provisions were fully implemented provided a better comparison. Representative Kawasaki cited the difference between the governor's bill total fiscal impact in FY 2018 totaling \$420 million to \$455 million and the CS version fiscal impact of \$105 million to \$195 million, which amounted to roughly half the fiscal impact of the governor's bill. Mr. Alper replied in the affirmative. He detailed that the largest difference in the totals were related to the "minimum tax." The governor's hard floor was 5 percent; all of the various credits were "tightened up" and would not reduce the tax burden below the 5 percent floor. The Committee Substitute included a 2 percent hard floor for credits that represented the largest portion of the changes.

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Representative Guttenberg referred to the NOL credits and wondered how the Committee Substitute differed from the House Resources Committee and governor's versions of the bill. Mr. Alper answered that companies experiencing net operating losses was a new phenomenon in "modern Alaska history" due to the low oil prices. He elaborated that the companies were losing money at a time the state offered a net profits tax and were earning NOL credits. A company was prohibited from receiving a cash payment from the state if a company produced more than 50,000 bbl. per day therefore,

the credit balance against taxes was carried forward to future years. He elucidated that DOR predicted that \$750 million in carried forward "non-cashable" NOL credits would be due to the major producers in FY 2018 or FY 2019. The floor was partially hardened against the majors using the NOL credits at 4 percent in the CS. The \$750 million amount represented the amount that was left over after the floor was completely wiped out by stacked credits while accumulating more NOLs to carry forward. The CS made the stacked credits "higher;" only some of the minimum tax could be offset (2 percent). Therefore, only some of the operating loss credits were not being used to offset the floor and were remaining in the company's pile of NOL credits. He guessed that based on the original governor's bill fiscal note another \$400 to \$500 million in NOLs would be carried forward amounting to over \$1 billion in credit liabilities that will be offset to taxes once the price increased. Representative Guttenberg wondered what happened if the state remained in a long-term low price environment and how long the NOL credits were able to "roll out." Mr. Alper answered that the breakeven average price based on the current estimates was \$46.00 for all oil companies. He noted that 180 million bbl. per year were produced and every dollar price drop below \$46.00 represented a loss of \$180 million in operating budget losses times 35 percent totaled \$75 million in NOL credits. He reported that if there were multiple years of operating losses for the major producers "the NOLs were a wave that would build and roll forward." In the future, if the price of oil spiked to \$120 per barrel the carried forward NOL credits would first be used to offset the production tax but not from the royalties.

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Co-Chair Thompson noted that Representative Liz Vasquez and Representative Adam Wool were present in the committee room.

Representative Gara asked whether North Slope producers could either deduct or charge the state 35 percent of a company's losses depending on the size of the producer. Mr. Alper responded that the credit applied to revenue minus expenditures if amounted to a negative number which represented a loss times the 35 percent of the rate and would amount to the credit earned. He reiterated that a company producing less than 50 thousand bbl. per day was

eligible for a refundable cash credit that was subject to appropriation and larger producers received NOL carried forward credits. Representative Gara spoke to the cash credits and asked whether the state was paying 35 percent of all of a company's operating and capital costs. Mr. Alper answered in the affirmative. Representative Gara referred to North Slope companies that were producing 50,000 bbl. or less and asked how much the state would pay in credits to the small producers in FY 17, FY 18 and paid in the current year. Mr. Alper replied that the total in FY 15 was \$203 million and in FY 16 was estimated similarly and in FY 17 was roughly \$325 million and in FY 18 was approximately \$250 million. Representative Gara asked whether years after that time relied on "guesswork." Mr. Alper answered that the estimates were a little more than guesswork but tended to increase the closer to the present day because more variables were known. Representative Gara surmised that for small North Slope producers the state was estimated to pay \$200 million to \$325 million within four years and only receive \$15 million to \$60 million in production taxes. Mr. Alper responded in the affirmative but the CS would change the estimates due to hardening the floor to 2 percent in FY 18 when \$70 to \$100 million was projected in production tax revenues.

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Representative Gara asked that considering the increased revenues the state was still expected to pay more in cashable NOLs in the future years than it would receive in production tax revenues. Mr. Alper replied in the affirmative and stated that "at best" the production tax was predicted to just breakeven. Representative Gara spoke to the NOLs paid to the major producers. He wondered what was forecasted for the current and next year NOLs. Mr. Alper responded that in the calendar year 2015 one major producer had enough credits to offset a large amount of production tax. The department predicted approximately \$23 million in carry forward NOLs in FY 16 and \$95 million in FY 17 and by 2018 the number increased to at least \$150 million, which completely offset North Slope production taxes. Representative Gara asked about FY 17 and FY 18. He asked for the total value of the NOL credits for both years combined. Mr. Alper clarified that any of the credits earned in FY 15 were at the 45 percent level due to a temporary NOL increase over two years granted in SB 21. The

forecasted amount of NOLs earned by the major producers by the end of FY 16 was \$385 million.

Representative Gara asked about the estimate for FY 17 and FY 18. Mr. Alper clarified that the \$385 million figure included the NOL's from the prior year since the credits carried forward and accumulated. He offered that by the end of FY 17 the total was \$635 million (approximately \$250 million more than in FY 16) and by the end of FY 18 the total was \$766 million (about \$135 million more than in the end of FY 17).

Representative Wilson spoke to the money owed in credits in the current year. She asked for verification that there was a difference in the credits owed and what the state was required to pay. Mr. Alper answered in the affirmative. He spoke to how much the state had to repay and pointed to statute that only required "a relatively small number at low oil prices" but historically the legislature funded the amount requested. He remarked that ultimately the amount paid was subject to appropriation.

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Representative Wilson noted her frustration at the tenor of the conversation about the credits. She characterized the state's return on the investment as "pretty good." She asked whether Mr. Alper agreed. Mr. Alper responded that he had included a few slides in a past presentation that had calculated new barrels associated with refundable tax credits and believed it was a more fair way to frame the discussion on return on investment. He commented that when the price of oil had risen the state received a windfall from the legacy oil fields. Representative Wilson contended that she saw the windfall as an investment from previous tax credits that incentivized production. She recalled a chart related to SB 21 that depicted the highest years of tax credits were forthcoming due to other tax credits from previous tax systems. She asked whether the refundable tax credits were only related to SB 21 or included credits from previous systems. She asked for a distinction between North Slope and Cook Inlet refundable tax credits. Mr. Alper responded that SB 21 did not impact Cook Inlet taxes in any way. The credits related to Cook Inlet were the 25 percent "Operating Loss Credit" that was part of Alaska's Clear and Equitable Share (ACES), the 20 percent "Capital Expenditure Credit" from the Petroleum Production Tax (PPT) in 2006,

the 40 percent credit WLE part of the Cook Inlet Recovery Act in 2010, and the Exploration Credits from 2003 from the Economic Limit Factor (ELF) era. He explained that related to the North Slope part of the charts included transitioning from the refundable capital credits from PPT and extended through ACES were being accelerated to 1.5 years and eliminated. The chart also included the small amount of exploration credits from 2003 and the NOLs. He added that the NOL concept dated back to the PPT system but establishing the credits at 35 percent and 45 percent was unique to SB 21. He voiced that the bill as proposed or amended did not change the NOL credit on the North Slope.

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Representative Wilson asked what cash tax credits were currently eligible for payment under SB 21. Mr. Alper answered that if exclusively tax credits under SB 21 existed for Cook Inlet the NOL credits would apply. Representative Wilson interjected and rephrased her question. She wondered what the cashable tax credits solely for the North Slope based exclusively on SB 21 would total. Mr. Alper replied that roughly \$67 million in exploration credits were anticipated. He detailed that the credits were high because the 40 percent exploration credits were about to sunset and were stacked with 45 percent NOL credits. Representative Wilson asked whether the number included the NOL credits that were credits against taxes owed. Mr. Alper clarified that the majors did not receive cash for anything, but the smaller producers could receive cash for NOLs. Representative Wilson spoke to the 2 percent floor in the Committee Substitute. She asked whether the credits would carry forward to the following year or would be lost due to the 2 percent floor. Mr. Alper responded that the NOLs would carry forward to the next year; however the SB 21 per barrel credit was not carried forward. He mentioned that the small producer and per barrel credits were "use them or lose them" credits. Representative Wilson surmised that the issue could have a negative impact on activity. Mr. Alper remarked that the per barrel credit and the small producer credits had been established in law and were never cashable. The CS only impacted the \$5 per barrel credit for new fields or "GVR eligible" fields earned by new producers currently, which could be used to reduce taxes to zero and would subject them to the 2 percent hard floor. He characterized the change as an unrecoverable tax increase.

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Representative Pruitt referred to Representative Wilson's question regarding the benefits of the credits. He recalled that Mr. Alper had referred to a slide and relayed that most of the production came from legacy fields. He had heard that there had been a recent increase in oil production. He wondered how his answer "meshed." Mr. Alper referred to the DOR forecast documents (Revenue Source Book) that included the types of oil production that stacked such as currently producing oil, the oil under development and the amounts of oil that were under evaluation by the department. He elucidated that the currently producing oil was in a natural decline rate. New wells were drilled in legacy fields to increase efficiency but were not considered new oil and specifically did not qualify for the Gross value Reduction (GVR). He agreed that production increased last year by 1 percent or 15 thousand barrels per day in the new CD5 field which decreased North Slope decline by 5,000 barrels per day to offset the decline to 10,000 barrels per day. Representative Pruitt surmised that the NOLs came into play to help offset decline. He surmised that NOL's were responsible for the oil from CD5 and also the new oil from new wells in the legacy fields. He believed that without the state's investments more oil would not have been produced. Mr. Alper agreed. He stated that there was a substantial amount of new oil and one could argue what was the total share of new oil versus legacy oil. He informed the committee that 9 percent of the current production was eligible for the GVR and some of the oil could possibly be new oil. In the specific case of CD5 (ConocoPhillips field) the spending did not show up on the credit side of the ledger, but as a reduction in tax liability due to an offset in profits because field development began in profitable years. He maintained that switching to a net profits tax in 2006 was "a more fundamental decision" to encourage reinvestment of profits in Alaska by investing in new fields by not taxing the share of revenue that was reinvested in something new. He opined that "there were efficiencies and inefficiencies" in the system, but the incentive had been successful in the case of CD5

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Representative Pruitt spoke to the uncertainty caused by changing from gross to "a high level" of net in order to

offset the high level on net credits. He believed the state had created the haphazard system of credits that was currently in place for its own benefit. He spoke to the limit of \$100 million per company in the CS. He asked whether the administration intended to pay the credits to the statutory number of \$73.5 million maximum pay out. Mr. Alper remarked that he could not read the governor's mind. He stated that the governor's bill intended to reduce the annual size of the credit program to something more affordable for the state. The Committee Substitute was "somewhere in between" the governor's bill and the House Resources Committee version and he was uncertain how the governor was going to respond. Representative Pruitt stated there had been a previous version of the bill that included a \$200 million limit. He remarked that Mr. Alper was present to "speak for the governor" and wanted to know whether the administration was going to pay the credits to the statutory limit in the future.

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, answered that the question was two-fold. First, it depended on how much the legislature would appropriate for payment of the credits. Second, the decision concerning how much the governor appropriated depended on what budget package was passed by the legislature.

Representative Pruitt spoke to the \$100 million cap. He asked what happened if a producer had \$110 million in "liability" and wondered whether the \$10 million would roll over as credits for the next year. Mr. Alper responded in the affirmative. He discussed "repurchasing credits" known as "certificates." He explained that only small producers were eligible to have its certificates repurchased by the state and that the refundable credits were not use it or lose it credits. He reiterated that only credits that could be applied against a liability could not be carried forward; NOLs and other credits were "not lost."

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Representative Munoz referred to testimony from producers urging that the credits should be maintained in the current year. She noted that producers operated on a different fiscal year and asked what portion of the FY 17 credit for Cook Inlet was committed in the state's current fiscal year. Mr. Alper replied that the Committee Substitute included an effective date of January 1, 2017 and all of the credits earned for the rest of 2016 were unchanged. He detailed that some of the credits earned from January through June, 2017 (included in fiscal year 2017) would impact the FY 17 calculations. Whatever the fiscal impact, the numbers were much smaller in FY 17 largely because it was only half a year. The bulk of the impact was not seen until all of the provisions were fully implemented in FY 18. Representative Munoz observed that the largest impact in the CS was on the North Slope and thought the goal was to place a greater impact on Cook Inlet. She referred to DOR's spring revenue forecast document and cited the Cook Inlet revenue for FY 17 of \$414 million, \$162 million in FY 18 decreasing to \$100 million in FY 20. She asked for the estimated amount based on the CS that the state would be paying in credits for Cook Inlet. Mr. Alper explained that the CS fiscal impact document was divided into revenue increases and reduced spending. In FY 18, spending on credits for Cook Inlet would be reduced by the credits average of \$35 million, which would be subtracted from \$162 million.

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Representative Munoz surmised that changes in the CS generated more revenue in relation to the North Slope. Mr. Alper answered that the CS only impacted 3 areas of revenue. One change, the reintroduced tax on Cook Inlet oil generated a minimal dollar amount and was estimated at \$10 million to \$15 million per year until 2021 when they slightly increased. Second, most of the oil and value was from the North Slope; therefore, the impact from the hardened floor would be felt on the North Slope. He offered that the third piece related to the GRV reductions impact on the NOL credits was limited to the North Slope because the GVR provision in SB 21. He stated that the money and value were in the North Slope production.

Co-Chair Neuman referred to \$15 million in the value of oil in Cook Inlet. He asked about the current production and price of the oil. Mr. Alper answered that Cook Inlet

produced 15 to 18 thousand bbl. per day which resulted in 5 million taxable bbls. of oil per year (the number included a reduction of roughly one-eighth total barrels for royalties). He mentioned that the department's forecasted price was "bleak" and the state would receive about \$10 million per year in production tax.

Representative Munoz referred to conclusions from the legislature's consultant [Janak Mayer, Chairman and Chief Technologist, analytical] that the issues lied in Cook Inlet credits that had worked but were now too generous. She thought the Cook Inlet changes in the CS were not sufficient and warranted further reduction. She would continue to work on the issue.

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Representative Pruitt asked how much of the 15,000 bbl. to 18,000 bbls. of oil production from Cook Inlet was consumed in-state. Mr. Alper replied that all of the oil was refined in Alaska and was mostly consumed in state.

Commissioner Hoffbeck interjected that 100 percent of Cook Inlet production was used in Alaska.

Representative Pruitt asked how the \$10 million in taxes would impact investment in Cook Inlet, for refiners like Tesoro, and also consumers. Mr. Alper deduced that the tax was roughly \$0.05 per gallon. He was uncertain what amount a company would absorb and how much would be passed on to customers. Representative Pruitt mentioned the bill that would increase motor fuel tax by \$0.08, jet fuel tax by \$0.07, etc. Fuel taxes paid by the consumer could increase to \$0.13 per gallon. He asked whether his calculations were accurate if both measures passed.

Commissioner Hoffbeck answered that Cook Inlet oil was a waterborne commodity that could be sold anywhere and that the market would determine the price of the oil. Cook Inlet producers "would not cut Tesoro a deal" due to credits.

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Representative Pruitt was concerned that the committee had not seen any modelling on how the CS would impact Cook Inlet investment.

Representative Gara discussed the development of CD5 under ACES and the "conscious decision" had been made by the legislature that the taxes were high and at high prices the state would reinvest in credits. He voiced that oil taxes were lower and hoped that would be considered when decisions were made about credits. He pointed to the FY 17 credits and deduced that roughly \$325 million in cashable credits and \$250 million in large producer credits accrued for the North Slope, and \$130 million in credits accumulated for Cook Inlet. He asked whether his math was accurate. Mr. Alper responded that the CS reduced the credit spend in FY 17 by \$20 million because of the later effective dates. He reported that DOR recently revised the credit spend and estimated the credits would total \$775 million in FY 17 which would total roughly \$750 million if the CS was passed. Additionally, another \$150 million in credits against liability and approximately \$300 million in carried forward credits that were not cashable were applicable and brought the FY 17 total to \$1.1 billion. Representative Gara spoke to the accrued credits for FY 18. He asked whether the CS maintained over \$500 million in credits. Mr. Alper answered that the revised FY 18 credit estimate in the final spring forecast was \$500 million and the bill would reduce the amount by approximately \$60 million for a total number of \$440 million. In addition, \$150 million in non-cashable credits and \$205 million in credits against liability applied to total \$800 million in FY 18. He remembered that the CS gained \$100 million in taxes due to the hardening of the floor, which detracted from the \$800 million total.

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Representative Gara asked about the additional \$200 million. Mr. Alper replied that the \$200 million related to the credits against a tax liability that were the minimum tax, the small producer credit, and the per barrel credit.

Representative Gara asked whether the small producer credit was eliminated in all versions of the legislation. Mr. Alper responded that the small producer credit would slowly phase out over the next 9 years. He delineated that that the credit was established in the PPT system 10 years earlier and must be earned by May 1, 2016 in order to use it. If a new company qualified by May 1, 2016, the company collected the credit for the next nine years. The small producer credits would end in 2024. Representative Gara

spoke to the \$100 million credit limit per company. He wondered whether the limit was real since most producers already fell within the \$100 million cap. Mr. Alper reiterated that there had been 6 instances in the state's history when a company had received credits over \$100 million in a single year. He elaborated that DOR was not aware of any large credits over the \$100 million threshold in the next two or three years.

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Representative Gara believed that the state should collect \$800 million in tax revenue in order to afford \$800 million in credits. He ascertained that the CS instituted a 4 percent gross tax with some exceptions and was maintained until roughly \$76.00 per barrel. Mr. Alper clarified that based on current cost estimates the crossover point at which the gross tax inflected and paid the normal 35 percent tax with the per barrel credit was \$76.00 per barrel for legacy oil. Representative asserted that the state could not afford the tax structure in the CS.

Representative Wilson referred to taxing oil in Cook Inlet and thought that it was "different" than North Slope oil. She referred to Flint Hills being forced to compete with royalty oil and could import refined oil rather than refine Alaskan oil. She asked when the "scale would be tipped" in favor of importing refined oil due to the proposed tax on Cook Inlet oil. Mr. Alper answered that he did not know the answer. Representative Wilson stated that the answer was necessary to keep the instate refineries "strong." She asked if the governor's bill taxed gas in Cook Inlet. Mr. Alper replied that the ELF tax caps part of the PPT tax were not changed in the governor's bill because the legislation eliminated many of the credits and would revisit the issue in 5 years. He continued that the House Resources version created a working group to determine how to tax Cook Inlet gas and oil in 2022 and the CS repealed the tax cap for oil and repealed the \$0.17 tax cap on gas in 2022.

In response to a question by Representative Wilson, Mr. Alper replied that there was no gas tax in the Committee Substitute. Representative Wilson wondered why. She spoke about fairness and stated that nothing related to energy issues was fair. Mr. Alper ascertained that the gas tax caps were put in place in 2006 for the same reason that a

lot of the credits were put in place, because of a fear of a gas shortage in Cook Inlet. He stated that the \$0.17 gas tax cap in Cook Inlet was zero because of the small producer credit but the credit was starting to phase out and some Cook Inlet gas would be subject to the \$0.17 tax within 2 years.

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Representative Wilson voiced that "the committee did not receive all of the information." The committee did not know how much the state was making per year and that one highly profitable year made the investment in credits worth it. She stated that field development took time and the development years made the states credit investments look unfavorable. She was concerned that she did not know when taxes "tipped the scale" unfavorably and wondered whether a "better way" to understand how the state's investments were working existed and believed they were "pretty darn good." Commissioner Hoffbeck answered that there was no doubt that the change in Regulatory Commission of Alaska (RCA) regulations regarding price and credits "turned things around" in Cook Inlet. He believed that the Department of Natural Resources' (DNR) testimony on ample gas reserves and availability of gas in Cook Inlet prompted the governor's decision to "pull back" on the exploration and development credits in Cook Inlet. The administration believed taking a hiatus from incentivizing oil and gas in Cook Inlet was warranted due to sufficient supply. Representative Wilson spoke to the North Slope. She wondered whether currently the administration would propose changing oil taxes if oil prices were higher; around \$70 per barrel. Commissioner Hoffbeck answered that the bill did not make significant changes to credits on North Slope oil. The issue related to hardening of the oil tax floor. He stated that the discussion would not be occurring if oil prices were higher. He affirmed that the Cook Inlet discussion was prompted by the low price environment and the state's ability to pay the credits.

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Representative Kawasaki asked whether Middle Earth was included in the CS. Mr. Alper responded that there "were simply too few transactions in Middle Earth" and the transactions could not be reported due to confidentiality laws so Middle Earth was included with Cook Inlet as "non-

North Slope. The transactions made up a very slight percentage of fiscal impacts. Representative Kawasaki asked for the percentage of Middle Earth activity. Mr. Alper related a story from personal experience and repeated information shared publicly by a representative from the Doyon Corporation in relation to Middle Earth. The representative reported that the corporation received \$60 million in credits earned to date and he noted that Doyon was the largest user of exploration services in the area. Representative Kawasaki pointed to a very small tax change for wells being spudded in the CS by the end of FY 16. He asked whether wells currently qualified and if the provision had a fiscal impact. Mr. Alper answered that he was referring to "Frontier Areas Credit" or the "super credit" (80 percent credit) for "high probability area." He referred to testimony from the Ahtna Corporation that had a promising well that could supply oil to the Glenallen area and the provision in the CS ensured the well qualified for the super credit. He added that without the change Ahtna's well would still have earned a roughly 55 percent credit.

Co-Chair Thompson thanked the presenters.

HB 247 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson discussed the schedule for the following meeting.

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ADJOURNMENT

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The meeting was adjourned at 7:56 p.m.