

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 7, 2016

6:02 p.m.

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Bob Herron
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr

MEMBERS ABSENT

Representative Mike Hawker, Vice Chair

COMMITTEE CALENDAR

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."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 247

SHORT TITLE: TAX; CREDITS; INTEREST; REFUNDS; O & G

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/03/16	(H)	RES AT 1:00 PM BARNES 124
02/03/16	(H)	Heard & Held
02/03/16	(H)	MINUTE(RES)
02/05/16	(H)	RES AT 1:00 PM BARNES 124
02/05/16	(H)	-- MEETING CANCELED --
02/10/16	(H)	RES AT 1:00 PM BARNES 124
02/10/16	(H)	Heard & Held
02/10/16	(H)	MINUTE(RES)
02/12/16	(H)	RES AT 1:00 PM BARNES 124
02/12/16	(H)	Heard & Held
02/12/16	(H)	MINUTE(RES)
02/13/16	(H)	RES AT 1:00 PM BARNES 124
02/13/16	(H)	-- MEETING CANCELED --
02/22/16	(H)	RES AT 1:00 PM BARNES 124
02/22/16	(H)	Heard & Held
02/22/16	(H)	MINUTE(RES)
02/24/16	(H)	RES AT 1:00 PM BARNES 124
02/24/16	(H)	Heard & Held
02/24/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 8:30 AM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 1:00 PM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/26/16	(H)	RES AT 1:00 PM BARNES 124
02/26/16	(H)	Heard & Held
02/26/16	(H)	MINUTE(RES)

02/27/16	(H)	RES AT 10:00 AM BARNES 124
02/27/16	(H)	Heard & Held
02/27/16	(H)	MINUTE(RES)
02/29/16	(H)	RES AT 1:00 PM BARNES 124
02/29/16	(H)	Heard & Held
02/29/16	(H)	MINUTE(RES)
02/29/16	(H)	RES AT 6:00 PM BARNES 124
02/29/16	(H)	Heard & Held
02/29/16	(H)	MINUTE(RES)
03/01/16	(H)	RES AT 1:00 PM BARNES 124
03/01/16	(H)	Heard & Held
03/01/16	(H)	MINUTE(RES)
03/02/16	(H)	RES AT 1:00 PM BARNES 124
03/02/16	(H)	Heard & Held
03/02/16	(H)	MINUTE(RES)
03/02/16	(H)	RES AT 6:00 PM BARNES 124
03/02/16	(H)	Heard & Held
03/02/16	(H)	MINUTE(RES)
03/07/16	(H)	RES AT 1:00 PM BARNES 124
03/07/16	(H)	RES AT 6:00 PM BARNES 124

WITNESS REGISTER

KEN ALPER, Director
Tax Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 247, continued his PowerPoint presentation on behalf of the governor entitled, "Oil and Gas Tax Credit Reform- HB247, Additional Modeling and Scenario Analysis - Part 2a."

CHERIE NIENHUIS, Commercial Analyst
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 247, answered questions on behalf of the governor.

DAN STICKEL, Assistant Chief Economist
Tax Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 247, answered questions on behalf of the governor.

ACTION NARRATIVE

[6:02:11 PM](#)

CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 6:02 p.m. Representatives Olson, Johnson, Seaton, Josephson, Tarr, Herron, Talerico, and Nageak were present at the call to order.

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

[6:03:13 PM](#)

CO-CHAIR NAGEAK announced that the only order of business is 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."

6:04:36 PM

KEN ALPER, Director, Tax Division, Department of Revenue (DOR), continued his PowerPoint presentation on behalf of the governor entitled, "Oil and Gas Tax Credit Reform- HB247, Additional Modeling and Scenario Analysis - Part 2a," which he had begun at the committee's 1:00 p.m. meeting today. He noted that slides 47-50 in many ways parallel slides 40-46, all of them being modeling of the status quo looking at the assumptions of a new oil field [of 50 million barrels of oil (MMbo)] being developed in Cook Inlet. The only difference between the two sets of slides is what happens in the year 2022 when the current tax caps are scheduled to sunset under existing law. The modeling on slides 40-46 show the answers for the taxes that would be paid under the underlying tax regime of 35 percent net profits tax. The modeling on slides 47-50 show the answers for what would happen if the Cook Inlet caps were extended indefinitely.

MR. ALPER turned to slide 48, "Cook Inlet Life Cycle Modeling, 50 mmo Status Quo, Tax Caps extended, \$60/bbl." He pointed out that at an oil price of \$60 per barrel (bbl), the amount of production tax paid would be zero because the current statutory production tax on oil in Cook Inlet is zero. This is based upon the conditions that were in place in 2006 when the production profits tax (PPT) was passed [Twenty-Fourth Alaska State Legislature, House Bill 488]; those are the old Economic Limit Factor (ELF) multipliers. In a zero tax scenario at a price of \$60, this field would be quite robust for the producer, but the state's net present value (NPV) would be negative \$37 million. The state would receive money from royalty and eventually would have a positive cash flow, but not enough to compensate the state for credit cost up front, especially without any backend production tax revenue.

6:06:27 PM

REPRESENTATIVE SEATON understood that a minimum of 25 percent of the royalty is required to go to the permanent fund and so unavailable for the general fund, and that the property tax is split about 50:50 in Cook Inlet. Referring to the bottom right chart on slide 48, he requested an explanation of what is included in the figures on lines 6-9.

MR. ALPER offered his belief that these numbers include the non-permanent fund share of the royalty, meaning the general fund portion of the royalty which is 75 percent. He said he is fairly certain that the numbers include only the state's portion

of property taxes, meaning the portion that is shared with municipalities is not included in this analysis. So, this is the state's unrestricted general fund cash flow as an isolated dataset. He requested Ms. Cherie Nienhuis to confirm whether he is correct in his answer.

CHERIE NIENHUIS, Commercial Analyst, Tax Division, Department of Revenue (DOR), offered her belief that the state revenue in this case does include the amount that would go to the permanent fund. If only the revenue that goes to the general fund was represented it would be called general fund unrestricted revenue (GFUR). She further offered her understanding that this is state revenues only and does not include the amount that would go to the municipalities for the property tax, but it does include the amount that would go to the permanent fund.

REPRESENTATIVE SEATON requested that the department get back to the committee with a verification of the answer so committee members can understand exactly what is included.

MR. ALPER thanked Ms. Nienhuis for correcting him and explained that part of the confusion is that DOR did the analysis both ways for Representative Seaton's request. The request had asked for a broader set of analysis with different cash flows and he was not sure which one survived to the version that is now before the committee.

[6:09:00 PM](#)

MR. ALPER addressed slide 49, "Cook Inlet Life Cycle Modeling, 50 mmbbl Status Quo, Tax Caps extended, \$80/bbl." He specified that once again no production tax is paid, but when the royalty is included the state has a positive NPV of \$63 million. However, he qualified, if this is looking at general fund only, then that might go back to being a negative number and so that needs to be found out. The producer's discounted cash flow is relatively robust at \$612 million. Generally speaking, there is not a lot of difference in the shapes of the curves on slides 47-49, it is just a matter of the magnitude that is tied to the different prices of oil.

REPRESENTATIVE JOSEPHSON said that when looking at these slides his eyes continually focus on the comparison with opportunity lost. He asked whether this is what DOR is trying to reflect in the state NPV 6.15 percent.

MR. ALPER responded that when it is said "state NPV 6.15 [percent]," yes. It is the value of what is called a discounted cash flow. A dollar received next year is 6.15 percent less valuable than a dollar received this year. A dollar received two years from now would be 6.15 percent times 6.15 percent less valuable. So, the deeper into the future the less the money is worth to the state.

REPRESENTATIVE JOSEPHSON, regarding slide 49, inquired whether the state's \$337 million is the comparison to [the producer's] \$1.385 billion.

MR. ALPER answered that the [net] cash flow, the money in/money out, without worrying about time, is \$337 million for the state as compared to the producer's [net] cash flow of \$1.385 billion. In terms of the time value of money, the state's \$36 million compares to the producer's \$612 million.

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MR. ALPER moved to slide 50, "Cook Inlet Life Cycle Modeling, 50 mmo Status Quo, Tax Caps extended, Fall 2015 FC Price," and specified that in all of these models the forecast price falls somewhere in between \$60 and \$80. In this scenario, the state's NPV number of \$14 million is almost exactly zero because with a dataset this large \$14 million is essentially a rounding error. The producer's cash NPV is \$481 million. This slide is a relatively unlikely scenario of the status quo in that it presumes that the legislature chooses to indefinitely extend the existing caps on Cook Inlet taxes without making any other changes to the tax and credit regime in Cook Inlet.

REPRESENTATIVE JOSEPHSON recalled that when asked about this at the committee's 1:00 p.m. meeting today, Mr. Alper responded that it was unlikely the legislature would extend the caps beyond 2022. Representative Josephson posited that the arguments heard before would be the same arguments [in 2022], short of having a gasline coming from the North Slope to the city gate and in which case the legislature might logically ask what it is doing with Cook Inlet at that point. He asked Mr. Alper to address why the arguments would be any different.

MR. ALPER replied that to his knowledge no one is actively asking for extension of the Cook Inlet tax caps right now. As heard in last week's invited testimony before the committee, he continued, there are certainly many proponents to keeping the tax credit regime in place the way that it is. The caps were

left in place for 15 years, a very long time. A production tax of zero is hard to justify over the long term unless the state simply did not have a production tax and that would be a very different thing. The state does have a production tax on the books that pays out a lot of credits. As shown by the red bars [in the upper left graph], at the forecasted price the state is spending \$347 million on tax credits of various sorts to the owners of that field without any production tax. As a diligent sovereign, as an entity desiring to balance a budget and do all the many things that the Alaska state government needs to do, it is hard to imagine a justification for that over the indefinite long term.

[6:13:53 PM](#)

MR. ALPER looked at the first of several slides dealing with the impact of HB 247. Turning to slide 51, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, 2022 Tax Caps expire, \$40/bbl," he explained that the bill's proposed cap of \$25 million per company is clearly apparent in the red bars on the upper left graph. He noted the reimbursements are at \$25 million for several years before they reduce and the state gets positive cash flow from the production tax. Even with that, at a price of \$40 it is not really making a lot of money for anybody. But the production tax is enough to provide positive cash flow to the state of \$159 million, with a discounted cash flow of negative \$19 million. The state's total cash flow, including apparently permanent fund royalties, creates a positive net present value of \$108 million. Although he argued earlier that a scenario of maintaining the tax caps forever is too low, this tax regime for Cook Inlet is almost certainly too high. This is a 35 percent net profits tax without any sort of comparable benefit like the Per-Barrel Credit that exists on the North Slope and without any sort of Gross Value Reduction (GVR) benefit for new oil that exists on the North Slope. At just the 35 percent net tax the state has a positive net present value, and once the royalty is included the producer is losing money at an oil price of \$40.

[6:15:33 PM](#)

MR. ALPER discussed slide 52, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, 2022 Tax Caps expire, \$60/bbl." He pointed out that at a price of \$60 this is a money-making field to the producer at a positive net present value of \$80 million, despite the onerous production tax regime and the cutting off of the credits at \$25 million. The state would have a discounted net

present value of \$121 million on the production tax. The state's total revenue would provide a net present value of \$331 million. In this scenario the tax credits themselves would be cut off at \$25 million per year. Mr. Alper outlined the state's numbers shown in the bottom right chart: state's production tax NPV - \$121 million; state's NPV - \$331 million; producer's cash NPV - \$80 million. He then brought attention to slide 44 [depicting the status quo at \$60 a barrel with the tax caps expiring: state's production tax NPV - negative \$50 million; state's NPV - \$167 million; producer's cash NPV - \$202 million]. Comparing the numbers for both scenarios, he said that under HB 247 the state would gain about \$170 million on the production tax NPV and the producer's cash NPV would lose about \$120 million. This gain for the state would primarily be from moving the cash flow around of the \$25 million per year cap on the refunded tax credits.

MR. ALPER moved to slide 53, "Cook Inlet Life Cycle Modeling, 50 mmbbl HB 247, 2022 Tax Caps expire, \$80/bbl." He noted that in this scenario the state would get a robust cash flow from the production tax [\$263 million], an excellent cash flow from total state take [\$557 million], and the producer would see a cash NPV/discounted value of \$278 million. He clarified that in these various scenarios the cost profiles and all other assumptions have stayed the same as the price of oil was moved around, thus the changes are purely the impact of the changes in the price of oil.

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REPRESENTATIVE JOSEPHSON inquired whether Mr. Alper is saying that a future legislature would need to revisit this tax before 2022 or in 2022. He further inquired whether the passage of HB 247 along with the expiration of the tax caps would result in a scenario that is too favorable to the state.

MR. ALPER responded that the expiration of tax caps in 2022 is a pending issue before the legislature with or without the passage of tax credit reform this year. In his opinion, that production tax is likely too generous and, frankly, unstable for Cook Inlet given the inlet's constraints. That tax system would also be the same tax system for gas - 35 percent of net profits without any offsets or Per-Barrel Credits. He explained that it was not so much left there to be the tax system, but was left there because a previous legislature, when looking to reform North Slope taxes, did not need to worry about the Cook Inlet yet since it was enough years off in the future. It is a problem

that might not need to be addressed until the Thirty-Second Alaska State Legislature in the 2021 session. He recounted that the legislature's consultant, Mr. Janak Meyer of enalytica, and whose testimony he is inclined to agree with, testified that industry finds instability in Alaska's system in a couple of different places. First, the State of Alaska has giant deficits and therefore industry does not know what the state's government is going to look like in a year or two. Second, and more importantly in the context here, industry sees the state's extensive negative cash flow from the tax credit system. The state is spending hundreds of millions of dollars that are more than the amount of production tax revenue coming in and industry is presuming, on a certain level at least, that some sort of reform is going to be made and industry is building that instability into its assumptions. Third is the sunset of the tax caps. Industry does not know what the fiscal system is going to be for the majority of the life cycle of any decision that industry might make now. Any investment decision made now or soon is a multi-year decision and industry does not know what the tax is going to be for the tail end of it. He said he would be happy to work with the committee, if it is so inclined, to create a new Cook Inlet oil and gas tax system.

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MR. ALPER resumed his presentation and addressed slide 54, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, 2022 Tax Caps expire, Fall 2015 FC Price." In this scenario, he said, the forecast price is going up from \$50 now to \$56 next year and stabilizing into the \$70s. Without considering inflation, DOR sees the state with positives on the production tax [\$197 million], higher positives on the overall take [\$451 million], and the producer with a positive value of \$183 million. He pointed out that the cash flow on such a field drops off quite rapidly after peak production, which is the nature of any large oil field. Fields of 50 MMbo, he continued, peak at 17,000 barrels a day of production, but production declines rapidly after that peak.

[6:22:36 PM](#)

MR. ALPER brought attention to slide 55, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, Tax Caps extended, \$40 bbl," explaining that this scenario is the tax caps extended with the impact of HB 247 [at a price of \$40 a barrel]. The credits are capped at \$25 million per year with a sum total payout in tax credits of negative \$142 million. Passage of HB 247 would also result in the repeal of the Cook Inlet Well Lease Expenditure (WLE) Credit

and the Qualified Capital Expenditure (QCE) Credit. In this scenario the state would only be paying 25 percent of costs through the development phase via the Net Operating Loss Credit, as opposed to the 50-60 percent that the state is currently paying. The state's cash obligations would be cut by more than half, which tremendously helps the state's bottom line. Even with that, at a price of \$40 a barrel the state would be losing money on production tax because there is no production tax and would barely be making money on the total state take [\$29 million in state NPV]. The producer would lose money [negative \$76 million in cash NPV], as is also the case in the status quo. The difference in these numbers is about the same between the no tax system and the underlying tax system, as there is between the before and the after with the passage of HB 247. The order of magnitude is about the same.

MR. ALPER discussed slide 56, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, Tax Caps extended, \$60/bbl," noting that a price of \$60 is closer to a breakeven price for everyone. At this price the state would pay \$134 million in credits, with a discounted value of negative \$97 million. The total state take would be decent at \$126 million. The producer does better at this price [with a cash NPV] of \$214 million.

[6:24:52 PM](#)

MR. ALPER turned to slide 57, "Cook Inlet Life Cycle Modeling, 50 mmbo HB247, Tax Caps extended, \$80/bbl." Drawing attention to the top right graph he pointed out that while it looks like the numbers are smaller, it is only because the scale of the graph is at \$100 million while the scale for this same graph on slide 56 is at \$50 million. Total state take in the \$80 scenario is close to \$80 million a year in the peak years of the project, with a total state take discounted value of \$225 million. [The production tax NPV is negative \$92 million.] If the tax caps are extended, the production tax is never going to be a positive number, he noted. If the state spends any money on credits in any one year it becomes a negative money for the entirety of the calculation because there is never a positive number to offset against. The producer would be at a cash NPV of \$[494] million.

MR. ALPER displayed slide 58, Cook Inlet Life Cycle Modeling, 50 mmbo HB247, Tax Caps extended, Fall 2015 FC Price," and said the state does pretty well at an oil price of \$80 and the producers do better. A regime of the tax caps extended, he added, would be a very generous regime to industry.

[6:26:15 PM](#)

MR. ALPER drew attention to the summary tables on slides 60 and 61. He explained that slide 60, "Summary Table- North Slope," includes on one page all 20 of the North Slope modeling scenarios that he presented. The first eight scenarios were based on a smaller field of 50 MMbo, four of the scenarios depicting the status quo at four different prices and four of the scenarios depicting what would happen under the proposals of HB 247 at four different prices. Each scenario includes a summary column for the total credits paid by the state, the state's net of production tax credits minus eventual taxation, the state's discounted value of that cash flow, net state gain, state net present value (NPV), the producer's cash flow, and the producer's NPV/discounted value. Across the board, all of the \$40 scenarios are losers for the producer. All of the \$60 scenarios for the smaller field are winners for the producer under both the status quo and the proposed changes of HB 247. The changes made by HB 247 do turn the large field from a small gain to a loss, with the main reason for that being the cap of \$25 million a year on how much credits the state is prepared to purchase; this is a much bigger deal for a much bigger field. The 12 scenarios for the 750 MMbo field include two different "after" scenarios - one where a company gets the \$25 million and one where a very large company of more than \$10 billion in revenue is completely excluded from being able to get state cash rebates. He drew attention to the last column for producer NPV at a price of \$80 for a 750 MMbo field at the status quo, noting it would be \$2.216 billion. This amount drops to \$1.415 billion if the producer gets \$25 million a year from the state, and when the company gets no credits the producer NPV drops by only \$60 million [to \$1.355 billion]. So, there is far more impact done from the reduction in credits to \$25 million than the further reduction to zero in credits.

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MR. ALPER reviewed slide 61, "Summary Table- Cook Inlet," which includes on one page all 16 scenarios that he presented for the Cook Inlet. He reminded committee members that DOR only looked at the smaller field of 50 MMbo because the department does not anticipate elephant fields in Cook Inlet. Two tax regimes were looked at [for the status quo and proposed changes under HB 247] with the question being asked of whether the tax caps sunset (third column). At an oil price of \$80 in the status quo and a sunset of the tax caps, the producer's NPV drops from \$396

million to \$278 million, a loss of about \$118 million in net present value. If the tax caps are extended, the producer loses about \$120 million. So, similar numbers but the increment between a sunset of the tax cap and not a sunset within the status quo is actually bigger; it is over \$200 million benefit to the company of extending the tax caps within the status quo and over \$200 million benefit from the company from extending the tax caps within the HB 247 scenario. He said the argument he is making is that the credit changes, while material, are smaller in magnitude than any other decisions that a future legislature would make about the tax regime itself that impacts production in Cook Inlet.

MR. ALPER further mentioned that DOR would like to put together some gas field life cycle modeling and that this could be done in fairly short order. Slides will be provided to the committee so DOR does not need to be scheduled again before the committee. He noted that Representative Olson after today's earlier hearing asked whether DOR had other scenarios. Something DOR has done on the North Slope side is to look at a field of 750 MMbo and what the impact would be if it were in a high royalty location, a part of the state where the producer is paying the one-sixth rather than the one-eighth royalty. Although the state gains money on the royalty side with that higher royalty, the state loses money on the production tax side because of the way Senate Bill 21 [passed in 2013, Twenty-Eighth Alaska State Legislature] is constructed so that the Gross Value Reduction (GVR) for new oil increases from a 20 percent benefit to a 30 percent benefit if the entirety of a field is at the high royalty level. The bottom line numbers are about the same and DOR will be providing these slides to the committee, but it is more royalty and less production tax.

[6:32:40 PM](#)

REPRESENTATIVE OLSON asked whether this same type of summary table could be done for the Interior, Middle Earth, and everything that is going on in Fairbanks.

MR. ALPER answered he is pretty sure it can be done but he will check with his staff. He offered his belief that Middle Earth has its own statutory tax caps of 4 percent of gross value that are good until 2027, thus providing a bit more certainty for the short and medium term as to what the tax is going to be. He noted that something could be done along the lines of the kind of development that Doyon, Limited, is talking about for the Nenana area.

REPRESENTATIVE OLSON inquired whether there are tax credits for the Fairbanks liquefied natural gas (LNG) storage facility and suggested that those be included. He also inquired about including the in-state refinery up north.

MR. ALPER replied that these are hard credits to build into project-level modeling. The Fairbanks utility, the Fairbanks regional project, is going to benefit from the storage tank credit, which is a comparable credit to what was received by the Cook Inlet Natural Gas Storage Alaska (CINGSA) facility. He said he does not know where the refinery credits can be built into that as he does not know enough about the local utilities and needs as to where that might play into the project itself. He offered for Representative Olson to talk to him after the hearing for directions on how to run this modeling request.

REPRESENTATIVE OLSON said he thinks he and Mr. Alper are on the same page, which is why he asked the question. He acknowledged that his request will be a lot of work but said it will help the committee.

MR. ALPER noted that DOR provided three presentations to the Senate Working Group last fall - one dedicated to Cook Inlet, one to North Slope, and one to Middle Earth credits. He said he will provide the committee co-chairs with the links to those presentations so committee members can read those presentations which provide a good overview of how the credits are structured and used, what the benefits are, and what the sunsets are. The presentations will serve as a good background document and DOR will do some modeling on a theoretical future project.

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REPRESENTATIVE SEATON asked whether DOR can also make sure that the committee receives some modeling on private royalty/private land and what the state is providing in that type of scenario. He said it would be helpful to know what the state's cash flow is for projects where the state does not receive any royalty.

MR. ALPER responded that DOR earlier provided the committee with an analysis that was done for a member of the other body showing the royalty breakdowns for federal lands such as the National Petroleum Reserve-Alaska and Arctic National Wildlife Refuge, as well as for private royalty that will be shared with the committee soon. The department would like to run some scenarios. The first project by Doyon, Limited, works out great

because it is on state land, but Doyon's second project is on its own private land and would have a very different cash flow to the state. He said DOR may not get into the multiple variations and different price scenarios, but maybe a few less options for each possible scenario so as not to inundate the committee with 50 more slides.

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REPRESENTATIVE TARR commented that in regard to evaluating these different tax structures it is frequently heard that there not be winners and losers, or that one company size not be favored over another, or development opportunity. She said HB 247 moves away from some of the other credits to net operating loss structurally, but keeps 35 percent for North Slope and 25 percent for Cook Inlet. She asked what the reasoning was for that and whether DOR has considered doing the same for both areas and why that would be good or bad.

MR. ALPER answered that the 35 percent Net Operating Loss Credit on the North Slope came along for the ride with the 35 percent base tax rate in Senate Bill 21. That change was only applied to the North Slope. However, the portion of the tax code that talks about the base rate did not parse it out, it actually put that 35 number in statute. That is why Alaska has this 35 percent tax rate in Cook Inlet. It would certainly be possible to put in a 35 percent operating loss credit without a terribly complicated amendment. That would increase the state's cost, the state's liability. A part of the rationale for the higher operating loss credit on the North Slope is that the companies actually are paying those taxes. So, there is some measure of a playing field leveler in play here. For example, if a major producer spends one more dollar on some new field, the producer reduces its taxable income and therefore saves 35 cents on its taxes. Regardless of the Per-Taxable-Barrel Credit, the tax savings is at the marginal rate of 35 percent, so the state offers a 35 percent operating loss credit to the new company that does not have profits. Up until such time as the incumbent producers in Cook Inlet are actually paying taxes, there is not really a playing field to level; the state does not need to give a higher benefit to the company on its loss credits to make them equitable with the taxpayer if the taxpayer's effective rate is zero for the next five years. At such time as there is a new Cook Inlet tax regime, it seems to him that a new Cook Inlet operating loss credit would be an important component of that.

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REPRESENTATIVE JOSEPHSON, following up on Representative Tarr's question, said the other factor is the whole issue of the need for natural gas in Southcentral Alaska. [indisc. - technical sound difficulty] ... more parity with the North Slope.

MR. ALPER replied that that is an excellent point. Although not as overwhelming or as imminent as it might have been a few years ago, there remains some sense of gas supply anxiety for the Cook Inlet utilities. If the state needs to provide a higher level of benefit to keep that gas being produced, especially in a world where the proposal is to eliminate the drilling credits, it is a reasonable argument to say that 35 percent as a sort of a compromise number going forward might be viable. [The administration] is not proposing that and he is not in a position to offer that, but while going from 50, 60, to 25, going to 35 might certainly blunt the impact.

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REPRESENTATIVE OLSON inquired whether DOR has done any models on the Agrium bill [HB 100] and the potential impact of the credit that is proposed by that bill.

MR. ALPER responded that he is familiar with the provisions and the economics embedded in [HB 100] because he wrote DOR's fiscal note for the bill and the bill analysis for the governor. He said it is an interesting concept and has a lot of upside for the state without that much downside simply because there is no upfront cash expended. It is very different as envisioned to any of the credits that the administration is looking to reform here in that it would require the producer, Agrium, to do all the work and make the commitment to redevelop its facility and then begin purchasing large amounts of gas and then earn a profit and start having a corporate income tax obligation. Then, any credit that Agrium earned through HB 100 would be an offset against Agrium's corporate income tax liability. What that bill could do potentially is provide the security for gas suppliers to drill and develop new fields. For example, Furie Operating Alaska, LLC, ("Furie") may have made a large discovery and has signed some relatively small sales contracts. But if Furie is in fact sitting on a large resource, Furie would like to be able to develop it but cannot do that unless it has a way to sell it. Something like a rebuilt Agrium facility might go a long way towards giving Furie the security it needs to do that, and in that case it would make it easier to modify some of the

Cook Inlet tax credits because there would be a lot less supply anxiety going forward.

REPRESENTATIVE OLSON asked whether there is something that the administration might support.

MR. ALPER answered he is not in position to speak for the administration and does not know if the governor has taken a position on HB 100. He added that he did his best to analyze HB 100 and model it as dispassionately as he could and talk about the potential benefits. It is a hard year to have a tax credit bill, given there is negative cash flow to the state, the state is losing money, and the state has big deficits. He is before the committee with a bill to reduce the state's spending on tax credits by several hundred million dollars, so it is hard to add another credit. However, there is a lot of argument to be made for targeted, smaller, focused credits which have a really good multiplier for the state's economics.

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REPRESENTATIVE SEATON, regarding the Cook Inlet, recalled the legislature's consultants stating that \$5-\$7/Mcf is sufficient gas price to develop even the most expensive gas around the world. So, he surmised, those credits are not needed for gas production in almost every scenario. If the state continues to pay the credits in Cook Inlet and getting the multiple of 8,000 or more barrels a day, the state will be paying annual credits in the range of \$200-\$400 million. The state is effectively subsidizing \$68-\$136 per barrel, even if some of the companies are drilling for gas but the credits were not needed to get that drilling. He inquired whether there is a mechanism that could be applied to separate oil from gas, given the combined drilling costs and combined capital costs equation.

MR. ALPER replied that the figure of \$136 comes from an analysis done by Representative Seaton in which the 8,000 barrels a day of increased oil production seen in Cook Inlet in the last few years is divided among the \$400 million that the state spent on credits last year. Obviously, he noted, that does not provide the benefit with the gas. As large as this number is, it is not outrageous because the numbers are real - the state did spend \$400 million. As far as dividing costs between oil and gas, that is always complicated. In 2010 a decoupling bill spent a lot of time before this committee and one issue was how to adequately separate costs between oil and gas. The BlueCrest Energy, Inc., ("BlueCrest") project might be easier than most

just because BlueCrest has a very different and distinct drilling location for its oil project versus its gas project - the resources themselves are in the same part of the earth but are vertically above each other; however, that is more the exception than the rule. He deferred to Mr. Dan Stickel to speak to DOR's ability to separate oil and gas expenditures.

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DAN STICKEL, Assistant Chief Economist, Tax Division, Department of Revenue (DOR), offered his understanding that currently if a unit within Cook Inlet produced both oil and gas, those commingled costs would be separated based on the gross value at the point of production of the oil versus the gas. If 60 percent of the value came from oil, then 60 percent of the costs would be attributed to the oil. Before calculating the tax, the zero tax ceiling for oil would be applied along with the 17.7 cents per Mcf ceiling for gas.

REPRESENTATIVE SEATON posed a scenario of a new field with all the investments and earned credits up front, and with production coming later that varies in how much gas and how much oil. He asked whether DOR, if working on that kind of a scheme, would go back and recover some credits from the company if it had more gas than oil if credits were not being given for gas since the price is adequate to support gas development. He said he cannot recall the conversation from when decoupling was discussed.

MR. ALPER offered his belief that the decoupling bill ended up with a formula tied to gross value at the point of production. He said it is in-artful and in-exact, but it would be possible to a certain extent to do a more comprehensive separation although it would be a workload within the department. He said he thinks the question that Representative Seaton is really asking is, "Could we establish a different level of credit support for oil versus gas?" He said he thinks that could be done but he needs to check with a few people about what the hurdles and pitfalls might be because the ultimate desire of the Cook Inlet Recovery Act was to get a big benefit to make sure people found enough gas to keep the lights on. However, he reported, an analysis done by DOR found that about one-third of that money got spent on oil that might not have been necessary to get the oil developed because the oil had a more stable market and was not as much of a life or death situation. If it is wanted to do two different things for oil versus gas, he said DOR would have to look at how to implement it but he believes it could be done.

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REPRESENTATIVE OLSON remarked that he thinks oil is an issue in parts of Cook Inlet, particularly to Tesoro who used to get all its oil in Cook Inlet but is now bringing it around from Valdez or elsewhere because there is not an adequate supply.

[HB 247 was held over.]

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 6:51 p.m.