

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 8, 2016

1:03 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)	Heard & Held
03/07/16	(H)	MINUTE(RES)
03/07/16	(H)	RES AT 6:00 PM BARNES 124
03/07/16	(H)	Heard & Held
03/07/16	(H)	MINUTE(RES)
03/08/16	(H)	RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

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

**POSITION STATEMENT:** On behalf of the governor, provided a sectional analysis of HB 247.

CORRI FEIGE, Director  
Central Office  
Division of Oil & Gas  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** On behalf of the governor, provided information and answered questions regarding HB 247.

MARY HUNTER GRAMLING, Assistant Attorney General  
Natural Resources Section  
Civil Division (Juneau)  
Department of Law (DOL)

Juneau, Alaska

**POSITION STATEMENT:** On behalf of the governor, answered questions regarding HB 247.

**ACTION NARRATIVE**

[1:03:51 PM](#)

**CO-CHAIR BENJAMIN NAGEAK** called the House Resources Standing Committee meeting to order at 1:03 p.m. Representatives Seaton, Olson, Josephson, Tarr, Talerico, and Nageak were present at the call to order. Representatives Johnson and Herron arrived as the meeting was in progress.

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

[1:04:41 PM](#)

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

[1:04:49 PM](#)

KEN ALPER, Director, Tax Division, Department of Revenue (DOR), on behalf of the governor, continued the sectional analysis of HB 247 that he had begun on 2/12/16 entitled, "Sectional Analysis, HB 247, Governor's Oil and Gas Tax Credit Reform Bill, January 22, 2016." [In that presentation Mr. Alper reviewed Sections 1-18.]

MR. ALPER brought attention to Section 18, explaining that it relates to the concern where a producer is in production and enjoys a Gross value reduction (GVR), but is in an operating loss and can use that GVR to increase the size of the producer's Net operating loss credit. He recalled that DOR, as well as the legislature's consultant, Janak Mayer of analytica, previously provided slides showing how that calculation could lead to an operating loss credit significantly higher than 35 percent and possibly in certain circumstances in excess of 100 percent. He further recalled that Mr. Foley of Caelus Energy Alaska, LLC, testified that this would impact his company. Caelus, he continued, is the sort of company that one could imagine getting this sort of condition - a smaller producer that might be operating at a loss because of a low price environment, but because it is producing new oil that production would use the gross value reduction, which could be used to increase the size of an operating loss. He drew attention to the language in Section 18 of the bill that would handle the problem: "For the purpose of a credit under this subsection, any reduction under AS 43.55.160(f) or (g) [the GVR] is added back to the calculation of production tax values for that calendar year under AS 43.55.160 for the determination of a carried-forward annual loss." In other words, Mr. Alper explained, the GVR is a benefit if it is about reducing a company's taxes, but in a circumstance of an operating loss the GVR effectively gets added back and the tax is calculated as if the GVR did not exist. The intent of this provision is to resolve what DOR and Mr. Mayer believe is an unanticipated consequence of how the GVR interfaces with an operating loss at low prices.

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CO-CHAIR TALERICO inquired as to how significant of an impact this would be to [a company].

MR. ALPER replied that the smaller producers with the smaller volumes are the producers who would generally benefit from this, so it is not a \$100 million line item because there is not that much tax in play. For example, a company with an operating loss of \$10 million under normal circumstances might enjoy an operating loss credit of \$3.5 million. With the interplay of the GVR that could be turned into a loss of \$30 million and an operating loss credit of \$11 million; so, in that circumstance, the GVR increases the size of the credit by \$7-\$8 million. The high end of the dollar value attached to this provision could be two or three times that.

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REPRESENTATIVE SEATON asked whether this would also be the case for developing a field of 750 million barrels as modeled by DOR.

MR. ALPER responded that plausibly, yes, there could be a much larger number. What would have to happen is that the large field would get developed and then be operated at loss. While that would be an awkward circumstance it certainly could happen, especially in an individual year. A company making an investment that size is not going to be anticipating losses, but that size field would be 100,000 barrels a day or roughly 35 million barrels year. Those 35 million barrels with a 20 percent gross value reduction, or a 30 percent GVR in the case of a high royalty field, could be a fairly substantial increase. He therefore concluded that he might need to revise what he said to Representative Talerico in the context of a big field operating at a loss.

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REPRESENTATIVE TARR, given that a 750 million barrel field would take several years to get to production, questioned whether a single year isolated in that multi-year project would be that dramatically different. Although, she continued, that has been seen when looking at the last few years. She requested Mr. Alper to speak to how a company might adjust its activity to reflect a scenario like today where there was a very rapid decline in price in a very short amount of time, but the company still decided to go forward with that sizeable development.

MR. ALPER answered that he thinks the more likely circumstance is that the price happens after the field is done and in production. So, the investment would have been made, the company is in production, and suddenly there is a major price collapse. He did a quick calculation: 35 million barrels a year at a gross value of \$40 per barrel would equal a total gross value of \$1.5 billion; 20 percent of \$1.5 billion is \$300 million. If that \$300 million is used to increase the size of an operating loss it could increase the operating loss credit by 35 percent of that, or about another \$105 million. He said he will provide the committee with a written calculation of this scenario since this calculation was off the top of his head.

REPRESENTATIVE SEATON requested Mr. Alper to also provide the committee with a calculation on the 16 percent royalty, which would be the 30 percent GVR.

MR. ALPER agreed to do so and said he will provide the analysis in the same format as was previously presented to the committee that describes the calculation in Section 18.

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REPRESENTATIVE JOSEPHSON noted Point Thomson was constructed rapidly, going from tundra to fully developed field in a two or three years, and is entitled to the GVR. He inquired whether that would be a situation that might be problematic.

MR. ALPER responded yes, in theory. The owners of Point Thomson for the most part have other business operations on the North Slope, he said, so they have other production. Any losses from Point Thomson would be offset potentially by profits from other parts of the field. Their other production is legacy production that does not enjoy the gross value reduction, so the amount of GVR they would be receiving is relatively minor in the context of their overall production profile, which is different from a company like Caelus that has all of its production in the GVR category.

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MR. ALPER returned to his sectional analysis. He explained that Section 19 would harden the floor - the credits in AS 43.55.023 could not reduce tax liability below the minimum tax. It is primarily the operating loss credit that is being talked about here, because other provisions in the bill look at repeal of the capital credit and the well lease expenditure credit. This is

the circumstance that would primarily refer to a major producer that is not eligible to get cash for its operating loss credits and so that credit is carried forward into the next year. In a scenario of two consecutive years of low prices where there is a loss after one year, like what is happening now, then beginning in January of the second year a company would typically be paying 4 percent of its gross value as a monthly tax payment, but that could be offset by an operating loss credit. The change proposed by Section 19 would force that company to continue to carry forward its operating loss credit into some future month or some future year where the prices had sufficiently recovered to where the company could use the credit to offset taxes but not go below the minimum tax. For as long as things stayed at the floor level the company would have to continue to carry forward that credit. Section 19 also proposes to put an expiration on certain operating loss credits, such that if this were to happen and then a company cannot use up its credits within 10 years, the credits would be truly foregone. The net operating loss credits would go away after 10 years if the company was not able to use them.

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REPRESENTATIVE TARR, regarding the proposed 10-year sunset, asked what would happen if during that time period other changes were made to taxes that affected that company's operations. She further asked whether those would be separated and "in the bank" for the company regardless of other tax changes.

MR. ALPER answered that it is important to go back to the issue of what is a credit. When a company earns a credit, applies for the credit, and gets awarded the credit by the Department of Revenue, it shows up in the form of a credit certificate. The credit certificate is an asset, a thing that the company has physical possession of that it will use to either turn in for cash or use against its taxes. So, the answer to the question is no, the subsequent changes would not affect the existence of the company's certificate, the company would hold it until such time as it had a tax liability and use it. The other option that any company has is to sell the certificate. If the company does not owe any taxes it can sell that certificate to a company that does owe taxes. While a company selling a certificate generally gets less than 100 cents on the dollar, it is able to get value for its credit certificate.

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MR. ALPER resumed his sectional analysis. He said Section 20 works with Section 19 and would create the statutory language to establish that there is a 10-year sunset on the existence of certain credits.

REPRESENTATIVE JOHNSON posed a scenario in which a company sells its credit certificate in year nine and eleven months. He inquired whether the person purchasing the certificate would have one month to cash the certificate, or would have ten years from that point to cash it.

MR. ALPER replied that 10 years is the life span of the certificate itself. So, if the certificate is sold after nine-plus years the buyer would only have a limited period of time. Ideally at that point the person buying the certificate is someone who has an active tax liability at that moment.

REPRESENTATIVE JOHNSON said he wants to be clear that the certificate expirations could not be stacked.

MR. ALPER responded that the intent of the proposed change is to have that flow with the life of the certificate itself.

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MR. ALPER continued his sectional analysis. He specified that Section 21 is conforming language related to Section 40 which would repeal the qualified capital expenditure (QCE) credit in AS 43.55.023(a). Due to that proposed change, lots of conforming language is needed where other parts of existing law refer to different sections in .023, especially (a). Section 21 itself does not really matter; this section of the bill has to do with conditions under which credits can be transferred. [The language in AS 43.55.023(e)] states, "Subject to the limitations set out in (a) - (d) of this section ...." He said "(a) - (d)" would be changed to read "(b) - (d)" because (a) is no longer going to exist. Thus, it is a conforming change that reflects the repeal of (a) elsewhere in the bill.

MR. ALPER said Section 22 is new statute, is important, and is language that DOR developed with the Department of Natural Resources (DNR). He explained that existing exploration credit statutes require certain data to be provided to [DNR] as a condition of receiving those credits. Generally, this data can be made public after 10 years and most is seismic data, but also some downhole wellbore-type information. One of DNR's concerns with the impending sunset of the exploration credits, many of

which are going away this July regardless of HB 247, is that DNR will not be able to get that data and make it public any longer. That data is used by DNR as a marketing strategy for selling leases in Alaska's oil patch. Section 22 says that a recipient of the remaining credits that exist in law, the net operating loss credit primarily, would be required to provide its comparable geological data to DNR so that the data can then be made public 10 years later.

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REPRESENTATIVE JOSEPHSON asked whether the thought is that if the owner of the data did not use it to some benefit within a decade it might as well be made into transparent public data.

MR. ALPER answered that in general the data was bought in part with a state resource, the credit money, and therefore the thinking was that the state gets something tangible in return. The sharing of the data with DNR for DNR's internal confidential purposes is part of general statute and that is not going anywhere. What is specific here is that that data becomes public in 10 years and DNR can share it. He said he was previously concerned this might lead to too much data, such that new computers would be required to be able to deal with it. However, in a conversation with DNR a day or so ago he learned that for the most part DNR is already getting the data. What would be changed is the terms and conditions under which it could be shared and made public.

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MR. ALPER turned back to his sectional analysis, noting that changes for the hardening of the tax floor are made in various places in the bill because the floor is being hardened versus multiple credits. Section 23 would make a change to the small producer credit in AS 43.55.024(g). This credit can be received by producers that make less than a certain volume of oil or gas and this credit maxes out at \$12 million. This credit can currently be used on the North Slope to reduce tax liability below the minimum tax all the way down to zero. The proposed change in Section 23 would force small producers to pay at the 4 percent level and not be able to use that credit to go below.

MR. ALPER specified that Section 24 is another floor hardening provision that describes the \$5 per-taxable-barrel credit under AS 43.55.024(i), which is the analog to the sliding scale

credit. The sliding scale credit of \$0-\$8 is for legacy oil, the old fields that are paying the minimum tax. The so-called new oil that gets the \$5 per-taxable-barrel credit can be used by a company to go below the minimum tax. Section 24 would change that so new producers would also have to pay at the minimum tax level regardless of the price of oil.

MR. ALPER noted that Section 25 [would amend AS 43.55.025] relating to exploration credits, to the extent that these credits still remain. If on the North Slope those credits could not be used to bring the tax payments below the minimum tax of 4 percent of the gross. Sections 23, 24, and 25 are of identical structure and would just specifically change three different credits to say that the credits cannot be used to go below that 4 percent floor level.

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REPRESENTATIVE JOSEPHSON, regarding Section 24, understood it is not DOR's position that this falls under the arguably inadvertent category. In other words, it was understood by the committees in 2013 that along with the privilege of the GVR there would be yet another privilege attached to it where the tax could drop beneath the 4 percent floor.

MR. ALPER replied yes, absolutely. He said he remembers the hearings before the House Resources Standing Committee. The language evolved, but when the sliding scale credit was introduced in the final committee substitute, because AS 43.55.024(i) had also previously been a \$5 credit (i) very explicitly said it could not be used to go below zero. And (j) said it could not be used to go below the minimum tax calculation, the reference to AS 43.55.011(f) which is the minimum tax on North Slope oil. This was very much intentional.

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MR. ALPER recommenced his sectional analysis. He said Section 26 proposes several changes that talk about limitations and being able to use credit certificates. This is not about earning the credits, the credits are going to be earned, the work is going to be done, and the company is going to have these certificates. The follow up here is whether the company can use them open-endedly to get cash. For a company in the category of 50,000 barrels or more, the answer is currently yes, it is an open-ended ability. Section 26 would add several different limitations to that. [Currently], if a company owes taxes to

the state it cannot get paid the credits. First the company must use the credits to pay its taxes or DOR will pay them for the company by holding back the credits sufficient to pay the tax liability owed by the company. The intention here and elsewhere in the bill is to expand upon that to say if a company owes other obligations to the state - such as a royalty, lease payment, or a fine - the state would be able to use a tax credit payment to pay that off. The first part of Section 26 [would amend AS 43.55.028(e)(2)] to conform to that intended change. The language, "the applicant does not have an outstanding liability to the state", would be amended by deleting the words, "for unpaid delinquent taxes under this title", thus broadening it to all unpaid liabilities to the state. This change is small and conforming, but meaningful.

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The committee took a brief at-ease.

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CORRI FEIGE, Director, Central Office, Division of Oil & Gas, Department of Natural Resources (DNR), addressed Section 22 in regard to the addition of the data coming into DNR and when the existing tax credit programs expire. She said DNR did some in-house due diligence on that and determined that it would not create extra volume of data for the department. Something that DNR would like members to be aware of because it will be material, is that this would now be taking production data, development data, and making that data public, as opposed to just the exploration data. That is one key difference going forward. However, in terms of the volume of data, the division currently does receive all of the production data and development data, but it is just not made public at this time. This language proposes to change that, and that data would now become public as well as any exploration data.

[1:30:37 PM](#)

REPRESENTATIVE SEATON understood Ms. Feige to be saying it is not the same data of well or seismic exploration, but additional data for a company's current operations, as on page 18, line 9, of the bill.

MS. FEIGE clarified that currently under the tax credit programs the division receives exploration, well, and seismic data. Moving this language into the new legislation would allow DNR to

continue to receive the exploration, seismic, and well data when the tax credit programs expire, and that data will continue to go public. What will be new is that any seismic data that is acquired within an existing producing unit, any production well data acquired within a producing unit, would also now become public. Under current statute the unit data that is collected is considered development or production data, not exploration data, and that information as well as the seismic data is currently held confidential into perpetuity. The division receives that data under other statute and under the lease and permit requirements.

REPRESENTATIVE SEATON asked Mr. Alper whether the intent of Section 22 is to make it be all future production data, not just the seismic or well data that was the basis of the credits.

MR. ALPER responded that his understanding of the intent was to replicate the data that the division is currently receiving that it would not be able to receive simply because those exploration credits are sunseting. He said he is not personally aware of the net being broadened into additional data. He deferred to the Department of Law to provide clarification.

MARY HUNTER GRAMLING, Assistant Attorney General, Natural Resources Section, Civil Division (Juneau), Department of Law (DOL), drew attention to page 18 of the bill, lines [3-4], which state, "A producer or explorer shall comply with the notice and information provision requirements in AS 43.55.025(f)(2) ...." She explained that (f)(2) currently applies only to explorers seeking credit under that section. This would move those requirements to explorers or producers seeking a net operating loss credit, in effect, so it would potentially broaden that. She offered her belief that the administration would be willing to work to narrow that if that is the intent of the committee.

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REPRESENTATIVE JOHNSON understood that this is an existing unit and the state would get additional information. He asked why that would need to be made public unless the state was trying to sell a unit out from under someone.

MR. ALPER answered he is not personally familiar with what DNR has previously received in exploration credits. He offered his understanding that what Ms. Gramling said is that because the language is being moved from the exploration credits section, which is quite explicit to only being new areas at the fringes,

and attaching the requirement to the data to the operating loss credit, it is in effect putting those requirements on anything that earns the operating loss credit, which would then include the stuff inside the units. He said he does not know what the public purpose in making those things public in 10 years is and suggested that it might be an inadvertent byproduct of trying to make this change of trying to protect DNR's interest of continuing to get the exploration and seismic data for DNR's planning purposes. The expectation is those activities with the sunset of the exploration credit will still be seeking operating loss credits, so the hook to continue to get that data for those expenses has to be somehow attached to the operating loss credit. It is not the administration's desire to get that data from these other things, it sounds like it is an inadvertent byproduct of the way the bill was written.

REPRESENTATIVE JOHNSON said his concern is the part about making it public and what purpose it serves unless it is to remarket the unit to someone else. His concern is about the kind of confidence that would be instilled in people trying to buy leases from the state, so he would like to revisit this.

MR. ALPER agreed and reiterated that that is not the administration's intent. A lot of the seismic data received by DNR is not necessarily shot inside someone's unit boundaries, he continued. The department has an excellent network of data that goes all over the North Slope; DNR uses that data to market the unleased areas of the state. Obviously no one is in a position to lease something that is already leased. However, if the state has information that is inside somebody's line it might help lure someone to buy a lease on the other side of the line.

REPRESENTATIVE JOHNSON remarked that if he is feeling a little paranoid then he cannot imagine what the industry is feeling. He stated for the record that it is not the intention to do this as part of the public record, but is more than likely an oversight in the drafting of this legislation.

MR. ALPER agreed and said the intent of Section 22 is to preserve the information that DNR currently gets from explorers and find a mechanism for DNR to obtain data with the expectation the exploration credits themselves are sunseting. Anything beyond that is an inadvertent byproduct of the drafting.

[1:38:09 PM](#)

REPRESENTATIVE TARR observed that page 18, line 8, of the bill states that the Department of Natural Resources "may" publish this information. She surmised this leaves it up to DNR to describe whether that information would be made public after the 10-year period.

MR. ALPER replied that that is his understanding, but requested that Ms. Feige be able to answer the question.

MS. FEIGE responded that up to this point the department and the division have exercised the ability to make that exploration data public. Whether there is potential for commercial harm is always considered. For example, if a company has well data and there is unleased lake acreage on one side or adjacent to a block, the company can request an extended period of confidentiality on exploration well data to preserve its commercial interest. In many cases the division has granted those extensions. However, there is no ability to request extended confidentiality for seismic data acquired under the credit programs. Typically seen are very broad surveys run over very large regional areas. Also, brokers could have much older vintages of data in areas and those areas will often overlap. She said she does not know of a situation where the seismic data has been set aside and not considered for being made public, unless it is on private lands or some other aspect that removes it from the division's ability to make it public. The division is only now in the process of publishing and making available to the public the very first releases of seismic data under those credit programs. That data was collected in 2004 and 2005.

REPRESENTATIVE TARR understood that because the credits go away this provision would provide a mechanism to get the information. The division, however, would have the ability to control what information is released.

MS. FEIGE answered correct. The division would have to work with DOR in making sure that DNR could put together a list of projects that will have data that comes available. That becomes more problematic when talking about development data and the in-unit data because of the confidentiality associated with even claiming a tax credit. So, as mentioned by Mr. Alper, the division would have to work together with DOR to ensure that only the exploration data is captured and meeting the intent of the data release as it is defined in the current exploration credit programs.

[1:42:20 PM](#)

REPRESENTATIVE JOSEPHSON noted that Section 22 is an entirely new section. He understood Ms. Feige to be saying that DNR currently has some discretion, it writes the regulations and reaches some sort of agreement with the producers. He recalled Ms. Feige stating that the division works with the producers wanting an extension of confidentiality. He inquired whether this is how Ms. Feige sees this provision working as well.

MS. FEIGE replied no. She explained that presently the division would receive a request from an explorer; for example, an explorer that drilled an exploration well. Only the exploration well data qualifies for an extension of the confidentiality period. At present, well data is held confidential for a period of two years. If the explorer feels there would be potential commercial harm to itself or some other factor where the explorer would be harmed by the release of that exploration well data, the explorer can, under statute, apply to the division to have an additional 24 months of confidentiality placed on that well data. The division sees that fairly routinely, for example a lot of the Native corporations would like their well data on their lands held confidential. Where exploration seismic data is concerned, that data cannot be extended under the credit programs and it is released at the end of the 10-year period.

[1:44:12 PM](#)

REPRESENTATIVE SEATON requested that DNR, DOR, and DOL work together to develop and submit a narrowed version of Section 22 to just simply extend the current data and disclosures.

CO-CHAIR NAGEAK asked Mr. Alper whether this can be done.

MR. ALPER requested an at-ease so he could check with DOL.

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The committee took a brief at-ease.

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MR. ALPER responded that a narrowed version can be done, but confirmation with the governor's office is needed before an amendment can be proposed, which is the nature of the amendment process. He said he presumes the ability would be given.

REPRESENTATIVE TARR, in regard to what the state gets for the credits, said this changes the value in her mind and she would like to better understand that piece of it. She surmised that this information can be used for further development or leasing work, so a monetary value could be assigned to that.

MS. FEIGE answered that the division has done a "back of the envelope" estimation of what it would cost the state to acquire the seismic data that up to this point has been received through credit programs. She elaborated that it was a high level planning number and was presented during Senator Giessel's 2015 tax credit working group presentations. She agreed to provide the committee with the numbers calculated for that acquisition value for both the North Slope and the Cook Inlet.

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CO-CHAIR NAGEAK asked that members submit their requests in writing to the committee co-chairs so that the co-chairs can then share the information with every committee member.

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MR. ALPER returned to his sectional analysis and continued his review of Section 26. He specified that this section is the limitations on the state purchasing credits under AS 43.55.028(e). He drew attention to page 19, lines 15-17, of the bill which state: "(4) the applicant's average daily production of oil and gas taxable under AS 43.55.011(e) during the calendar year preceding the calendar year in which the application is made was not more than 50,000 BTU equivalent barrels". He said this is the large producer exception [in current law], under which a producer of this size cannot get cash for its credits and must instead roll its credits forward and use them against future liability.

MR. ALPER said Section 26 would add two other restrictions, the first proposed restriction being in paragraph (5) which provides that if a company's revenue from its overall oil and gas business worldwide during the previous calendar year was greater than \$10 billion, the company would not be eligible to get cash for its credits. The company would have to hold its credit certificates on its books until the future date when it has a tax liability and then use the certificates to offset its taxes. He noted that companies of this size are comparable in size to Alaska's major producers that are unable to get cash for their credits anymore and must save them until they have a tax

liability. The second proposed restriction is in paragraph (6) which establishes a limit on credit repurchases of \$25 million per company per year. That would be the cap on how much cash money the state would pay every year to each company, regardless of how much the company had in possession in tax certificates; the rest the company would either sell to a third party or carry forward and use in the next year. Mr. Alper noted that in regard to the 10-year sunset there is a first in/first out provision so that the older credits would be able to be used up first so as not to get sunset, and the new ones coming in later would keep the clock rolling further into the future.

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REPRESENTATIVE TARR recalled that discussion has occurred on the idea of additional restrictions on who is eligible for the credits and perhaps making it phased to final investment decision, or something like that. She asked whether Section 26 is the appropriate place for fitting in something like this.

MR. ALPER replied that to a certain extent it is the other half of the equation of possible restrictions on who can earn a credit tied to current status of having a plan of development or some sort of pre-approval process (which was discussed internally but did not get into the bill) that the Department of Revenue would apply for a company getting a project approved before it could earn a credit. That would be on the half of earning the certificate, he advised. The changes made by Section 26 are relatively silent on who is earning the credit; they are relevant to when the company has the credit and how the company would get cash for it. He said he thinks the two are important factors in a broader reform effort potentially, but they are opposite sides of the same coin.

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REPRESENTATIVE JOSEPHSON observed that page 19, line 11, of the bill would delete the language "for unpaid delinquent taxes under this title". He inquired whether this is a solution in search of a problem and whether this is happening a lot. He said he assumes that if royalty is due on January 1 or March 31 it gets paid, so he wonders what is being dealt with here.

MR. ALPER responded that this is not something that was an historic problem. It is being witnessed in the environment of bankruptcies in the industry, where if a company is having severe cash flow problems and potentially heading towards

bankruptcy it might not make that royalty payment or that annual lease payment, or the company might have a fine that it is not paying. But yet the company might just from the timing of things have the expectation of receiving a tax credit payment from state. Should the company receive that payment in whole it is up to the company's discretion, or if the company is in bankruptcy it is the court's discretion, as to where that money might go and it might never make it back to the company's obligations to the state. Generally there will be a secured creditor or someone in position in front of the state. Several interlinked provisions in HB 247 speak to this outstanding liability to the state. The intent is to ensure the state is made whole before the credit leaves the state system and is paid to the company. Mr. Alper recounted that there has been pushback that this could be interpreted too broadly, that it could be used to hold back a credit certificate for someone who is a legitimate protestor or in a legitimate appeals process against a tax assessment. He said DOR is prepared to talk about and consider that point, but that is not why the department wrote this. The department wrote this not for the reputable companies that are continuing to go about their business and paying everything that they owe, but for those who are more at the margins to protect the state's interest.

REPRESENTATIVE JOSEPHSON asked whether there is some quick appeasement that could be offered where there is a statutory section that talks about legitimately disputed royalty or tax.

MR. ALPER answered that the language that is amended throughout the bill takes the sections that say "outstanding liability to the state for unpaid delinquent taxes", a well understood concept, and gets rid of the words "for unpaid taxes". So, it leaves the words "outstanding liability to the state" and then Section 39 adds a new definition of "outstanding liability to the state" after the definition section inside the broader revenue statutes. What Representative Josephson is speaking to would require some sort of tightening or limitation on that definition and that is where the fix would be if there is a need for a fix or a need for some additional certainty that this provision would not be overused.

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MR. ALPER, responding to Representative Johnson, read Section 39 aloud: "'outstanding liability to the state' means an amount of tax, interest, penalty, fee, rental, royalty, or other charge for which the state has issued a demand for payment that has not

been paid when due and, if contested, has not been finally resolved against the state." He allowed that this could be interpreted to include a regular tax assessment that may be in the appeals process. He said that if the committee's intent was to not include that sort of thing, then in his opinion that is the portion of the sentence the committee would look to amend.

[1:55:26 PM](#)

REPRESENTATIVE TARR inquired whether DOR would consider something that is in an appeals process as being an unpaid liability rather than in appeals status.

MR. ALPER replied that the decision would be made by the appeals group that looks to these things. To him, a demand for payment that has not been paid and is being contested almost perfectly defines what DOR's tax assessment process looks like. At the end of an audit, DOR will say to Company X that it owes \$5 million and Company X will say it does not, and then it goes to appeals. That is a demand for payment which has not been paid and is being contested. So, as he reads this definition, that appeals process would fall under this expanded definition.

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REPRESENTATIVE HERRON asked whether this new proposed definition is only for Title 43 or is broader than that.

MR. ALPER responded that under current law any tax owed under Title 43 can already be used to offset the credit. The language proposed to be deleted, "for unpaid delinquent taxes under this title", refers to all of Title 43. Getting rid of this language would broaden it to all chapters. The main chapter is 38, which is where the royalty and DNR-type payments come in.

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MR. ALPER returned to his sectional analysis. Section 27, he said, would add another restriction on the ability to repurchase credits, so it would be AS 43.55.028(j). It would scale the buyback of a credit certificate to Alaska hire such that the percentage of the certificate purchased by the department could not exceed the percentage of the applicant's workforce in the state. The workforce would include resident workers by the company as well as its contractors. The portion not paid back would be carried forward and used against the company's tax liability. For example, a company with 70 percent Alaska hire

and a certificate of \$10 million would be given \$7 million by DOR and the other \$3 million would be carried forward and used against future taxes.

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REPRESENTATIVE TARR noted her support for the concept of Alaska hire. She posed a circumstance where the technical expertise of a skilled worker is needed, but such an individual is not available in the Alaska workforce. She asked how a company would be able to address that.

MR. ALPER answered that there is no such waiver provision in the bill as written. It would likely be technically complicated to do, but it certainly could be written. In practical terms the company being described by Representative Tarr might have 95 percent Alaska hire or less if it had to bring up a team of special project experts from Outside. That is a consideration, he allowed, but the reality is that hopefully those numbers will not get to the number where it is a severe burden on the payback. If people limited their out of state hiring to where they absolutely have to, hopefully they would be getting 90 percent or more on their money. He pointed out that it is not taking the money from anyone, that money remains in the certificate and gets rolled forward and used against tax liability. When the inevitable constitutional challenge occurs, DOR is hoping that it is not taking cash from anybody's pocket, it is just changing the way in which it is being given to them.

REPRESENTATIVE TARR commented she wanted to understand this provision better given there is concern over whether there would be a challenge.

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REPRESENTATIVE SEATON, regarding Section 27, surmised that it would still be a transferable credit that could be sold to another company for that company to apply to its tax liability.

MR. ALPER replied he expects it would be sellable and the buyer would be able to cash it in. He deferred to Ms. Gramling to further answer the question.

MS. GRAMLING offered her understanding that the credit not purchased by the state under this provision would still be a transferrable tax credit certificate. By not purchasing 100 percent of the credit, the state might be actually helping the

market for these certificates. A distinguishing factor of this provision compared to other tax credit limitations that may have tried local hire in the past is that here the repurchase of credits is not integral to the calculation of the tax, the company earns the credit amount. So, this provision is limiting how the state invests its money. An important distinction here is that the credit certificate is still available for future use if the company had a tax liability, and if the company could sell the remaining portion to another company that had a tax liability then that other company could apply it against its tax liability. Transferable tax credits if they are sold can only be used against tax liability, the person buying it cannot then ask the state to purchase it.

[2:02:21 PM](#)

REPRESENTATIVE JOSEPHSON inquired whether it is true for all transferrable credits that they must be used against liability in every instance in Alaska statutes.

MS. GRAMLING responded she is unsure about film tax credits which were purchasable by the state, but production tax credits that are transferable can either be used against tax liability by a company that buys them or by the company that earned them. If the company that earned them does not transfer them to another producer and does not have tax liability, then that is when the company is applying to the state for repurchase.

REPRESENTATIVE JOSEPHSON asked whether the purchaser of the tax credit [certificate] would be obligated to do local hiring.

MS. GRAMLING answered no, under existing law a person purchasing a credit from another producer cannot then apply to the state to repurchase that credit; it would have to be used against the person's tax liability. That would remain unchanged.

REPRESENTATIVE JOSEPHSON understood that a company could sell off part of the credit.

MS. GRAMLING replied correct.

REPRESENTATIVE JOSEPHSON surmised that this entire endeavor could be undermined by a company saying, "Well, all we can do is 85 percent, we'll just sell the other 15 and we'll collect ... 90 cents on the dollar and we don't have to do this local hire."

MS. GRAMLING responded that basically the credit still has value, it is just whether or not the state would be repurchasing it. The local hire provision would kick in when the state repurchases a credit.

[2:04:31 PM](#)

REPRESENTATIVE SEATON remarked that trying to promote local hire has always been problematic. While a little complex, he continued, it seems like this is probably the first legal way for the state to take out of the treasury and pay on the percentage of local hire but still not take away the tax credits. The credits would still be available to the company to sell to someone else that does have a tax liability. He said he is interested in hearing more comments from industry and that it could be off the record.

[2:06:13 PM](#)

CO-CHAIR TALERICO commented that the state got wrapped around axle in the 1970's when building the Trans-Alaska Pipeline System. He said he sees these tax credits being connected to just doing the business of the oil industry, which is the same thing being done when building the pipeline. He recalled the state knowing it was as "right as rain" until it got to the [U.S. Supreme Court] and the court disagreed. Therefore he has huge questions about putting any type of Alaska hire preference in the bill because of the legal challenges, and added that it is an obviously glaring issue to him.

MR. ALPER agreed with Co-Chair Talerico that it would inevitably be challenged. However, he said, the decision before the body is whether the state wants to fight that fight right now. In regard to Ms. Gramling's statements, he clarified that any company can get cash for the credits it earns, except for the three major producers or the new restrictions that would be added. A tax credit that is purchased can only be used to offset tax liability - a bought credit cannot be cashed in.

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MR. ALPER resumed his sectional analysis. He pointed out that Sections 28, 29, and 30 are all conforming. By repealing the qualified capital expenditure credit in AS 43.55.023(a), and in some places the well lease expenditure credit in AS 43.55.023(l), conforming language is needed. Other sections that refer to those credits or to those sections need to be

modified slightly to get rid of the (a) and (1) subsections so there is not stray language in statute. Section 28 refers to the provisions for being able to assign a tax credit to a third party, a power that was added to statute about three years ago that enables DOR to pay the money directly back to banks in certain circumstances. Section 29 refers to the annual statement, the tax return that everyone has to pay in March based on the previous calendar year. Clarifying language is in there to say there is no longer going to be a qualified capital expenditure credit. As is being seen in other legislation this session, attorneys do not want to embed the definition inside a substantive piece of legislation. If a term needs to be defined it should be sitting out in a definition section. Right now within AS 43.55.023(a), within the qualified capital expenditure credit section of statute, there is an existing definition for what a qualified capital expenditure is. So, when repealing .023(a), when repealing the credit, also being repealed is the definition of what is a qualified capital expenditure. However, there is value to having a definition of qualified capital expenditure, a definition is needed for other purposes, and therefore Section 38 would add a definition of qualified capital expenditure. It is not a new definition, it is the same definition syntactically as what is currently in .023(a), it is just being moved into the general definition section inside the production tax statutes. Section 29 repoints this term, "qualified capital expenditures," to the new definition rather than to the old definition that is being repealed.

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MR. ALPER noted that Section 31 is substantive and was defined and modeled in his previous presentation. Section 31 would provide that the gross value at the point of production cannot be less than zero. That is in the section that is really about tariffs and allows deductions for transportation to allude to this thing called gross value at the point of production, which is really wellhead value. It is the value of the oil or gas minus the cost of getting it to the point of sale, therefore it is the value at the point at which it was produced. The point of production for oil is defined as basically Pump Station 1, at the input to the Trans-Alaska Pipeline System in the North Slope. Mr. Alper reminded members that DOR provided a specific example of a very high tariff field, or remote field, or field that for whatever reason has a higher tariff than the value of the oil itself. The department considered the possibility that in a period of extended low prices Point Thomson could plausibly have a wellhead value of less than zero, and Section 31 would

say that it must be rounded up to zero at the field level so that negative number cannot be used to offset positive values elsewhere on the North Slope for taxation purposes.

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MR. ALPER moved to Section 32 and recalled that during the 2007 debates on Alaska's Clear and Equitable Share (ACES) [House Bill 2001, Twenty-Fifth Alaska State Legislature] there was a provision of the ACES tax called the standard deduction. The standard deduction was a limitation on lease expenditure inflation. More or less, a cap was put on how much a company could charge for operating expenditures based on what it had charged the previous year. This created a little bit of certainty because of some anxiety within a critical mass of the legislative body at the time that there would be unchecked inflation and deductible lease expenditures that might erode whatever benefits the state was getting from a switch to a net profits tax. This standard deduction provision passed by a single vote as an amendment in both bodies. As a provision of law it did create certain restrictions on deductible lease expenditures with a built-in three-year sunset. Beginning with 2010 that old law was no longer in effect and there have been no limitations on deductibility, but those sections still survive in statute. The repealer section of HB 247 repeals a bunch of old statute that is no longer needed and Section 32 conforms to that. It would get rid of a sentence that says, "Except as provided in (j) and (k) of this section," and then continues on with the rest of the substantive language. Since allowable lease expenditures are what is being talked about, this correction for the old standard deduction limitation is no longer needed and the limitation can now be ignored and safely deleted. So Section 32 is conforming to that change.

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MR. ALPER noted that Sections 33-36 are much the same as 28-30. They are conforming to the elimination of the qualified capital expenditure credit or, in most cases more precisely, conforming to the moving of the definition of qualified capital expenditure from where it used to live inside the credit itself and to the new definition section that is being added in Section 38 of the bill. Drawing attention paragraph (18) on page 24, line 11, of the bill he explained that these are the existing restrictions on deductions, things that are not considered allowable deductions for purposes of taxation. Paragraph (18) talks about what is known in the industry as the "30-cent haircut provision"

that says the first 30 cents per barrel of capital expenditures cannot be counted because it in some ways is a proxy for routine maintenance. The words "as defined in AS 43.55.023" are being deleted from paragraph (18) because the definition has been moved and is no longer in that location. This is the sort of conforming changes seen in Sections 33-36 that do not in any way change the substance of the purpose of the underlying bill and the law as it is being implemented; it just re-corrects to the idea that qualified capital expenditures themselves are being defined in a different part of law.

2:15:24 PM

MR. ALPER pointed out that Section 37 is the one he modeled when talking about the municipal utility that has its own gas and what happens if the municipal utility is selling a small portion of that gas to a third party. It in some ways is an advertent language in existing law that says if a utility sells 1 percent of its gas and has a relatively small amount of revenue from that, the utility could, as interpreted, offset all of its costs against the small amount of the revenue and create what could potentially be very large operating losses for a utility that operates as a break-even nonprofit. Section 37 would correct that. Current law [AS 43.55.895(b)] states, "A municipal entity subject to taxation because of this section is eligible for all tax credits under this chapter to the same extent as any other producer." Section 37 would change this language to make it be proportionate to the utility's production that is taxable. For example, if only 2 percent of a utility's production is taxable, the utility would get 2 percent of its credits. This would ensure that the municipal utility does not get credits that are out of scale with the amount of production that the utility is actually selling, given that only the production that the utility sells is subject to the tax. The production that is not sold and burned in the utility's turbines is not taxable.

MR. ALPER reminded members that Section 38 is the new definition of qualified capital expenditure. He explained that this lengthy definition refers back to the Internal Revenue Service (IRS) code because when talking about capital in the federal tax code it is depreciable that is being talked about. It is treated for tax purposes different than an operating expense because its cost is taken over multiple years. The State of Alaska does not use that type of tax treatment, the state does not depreciate inside the production tax. The state does however piggyback on those IRS definitions to be able to define capital expenditure, and that is what this language is. It is

not new language, it looks new because it is in a new section, but it is actually copied almost word for word from another definition that is in another portion of the law that is being repealed because of another change made by this bill.

MR. ALPER said Section 39 is a new definition of "outstanding liability to the state." This is relevant to the ability to hold back credits if the company owes a royalty or other payment to the state. Those conforming changes being made in multiple other portions of the bill are conformed with here through this new definition of what exactly is an outstanding liability to the state. As discussed earlier by the committee, there might be a desire to narrow that somewhat so that a legitimate in-process appeal would not fall within the definition.

[2:18:39 PM](#)

REPRESENTATIVE TARR, because the qualified capital expenditure (QCE) credit is going away, asked whether the definition in Section 38 would limit what a company could claim as its capital expenditures for purposes of transportation cost, capital expenses, and operating expenses. She further asked where that definition would be applied.

MR. ALPER answered that multiple other places in statute refer to qualified capital expenditures for other than credit purposes. Generally those are referenced in the conforming statute where it says operating and capital expenditures and those definitions must be referred to. Because there will be no qualified capital expenditure credit there will not be much of a substantive cash definition between the two anymore. One exception would be the "30-cent haircut" provision on page 24 of the bill that says the first 30 cents per barrel of capital expenditures is not deductible under current law; that was part of the production profits tax (PPT) negotiations in 2006.

REPRESENTATIVE TARR understood that this particular QCE goes away but this particular definition for purposes of this bill would be applied to that section and would limit what can be considered for the cost that that 30 cents is applied to.

MR. ALPER replied correct. Any place in statute where the term qualified capital expenditures is used would now be defined by this new definition in Section 38. The definition is no different, just the location. The only place it would have a dollar value impact with the repeal of the QCE credit would be

this 30-cent haircut section. There may be others, he said, but he cannot think of them off the top of his head.

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MR. ALPER continued his sectional analysis. He said Section 40 is a long repealer section, some being cleanup language. He recalled referring in his other testimony to some of the old applicability language that comes from Senate Bill 21 [passed in 2013, Twenty-Eighth Alaska State Legislature] that said "part A refers to oil produced before 2014 and part B refers to oil produced after." Since it is now after 2014 the old language referring to the before is no longer needed. He brought attention to the actual language in Section 40 that begins on page 27 of the bill: "AS 38.05.180(i); AS 41.09.010, 41.09.020, 41.09.030, 41.09.090; AS 43.20.053(j)(4); AS 43.55.011(m), 43.55.020(a)(1), 43.55.020(a)(2), 43.55.023(a), 43.55.023(l), 43.55.023(n), AS 43.55.023(o), 43.55.028(i), 43.55.075(d)(1), 43.55.165(j), and 43.55.165(k) are repealed." He explained that the statutes in Title 38 and Title 41 refer to the older DNR exploration credit that has not been used in many decades that [the administration] is looking to repeal proactively while now allowing DOR's exploration credits to sunset. They no longer have any value and are not being used.

MS. GRAMLING, at Mr. Alper's request, discussed the next two statutes that would be repealed under Section 40. She explained that AS 43.20.053(j)(4) is the definition of unpaid delinquent tax. This statute would no longer be necessary because the bill broadens that requirement to outstanding liability to the state. She offered her belief that AS 43.55.011(m) is a now-out-of-date tax treatment for Cook Inlet that has not been applicable since 2011 or 2010.

MR. ALPER stated that AS 43.55.020 in general is the monthly installment payment section for how to do that calculation prior to 2014 before the changes in Senate Bill 21 took effect. So it would be repealing language that refers to older production that is no longer relevant. He explained that AS 43.55.023(a) is the qualified capital expenditure credit and AS 43.55.023(l) is the well lease expenditure credit south of 68 degrees latitude. Since these statutes are the credits themselves, they are the most essential repealers to the bill itself.

MS. GRAMLING related that AS 43.55.023(n) is a conforming repeal to the repeal in (l) of the well lease expenditure credit. She said AS 43.55.023(o) is the actual definition of qualified

capital expenditure, but explained that the definition is still needed in existing law. Instead of leaving (o) when qualified capital expenditure is not referenced in .023 anymore, it is being moved to the definition section in the chapter generally. The actual language in that definition is unchanged; the subsections have changed a little due to drafting requirements, but the substance of the definition is unchanged. She offered her belief that the AS 43.55.028(i) repealer is a definition related to the repeal of the QCE credit. This section says the qualified capital expenditure has the meaning given in AS 43.55.023, but that definition is no longer needed since it is being taken out of .023 and moved to the general definitions section. She offered her belief that the repeal in AS 43.55.075(d)(1) is also just a definition change. She lastly noted that repeal of AS 4.55.165(j) and (k) is the standard deduction, which is language that is no longer applicable.

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MR. ALPER stated that Section [41] is the applicability section. As these changes are made, he explained, it must be ensured that regardless of the effective date the things that are already in existence can continue to be in existence. For example, the bill is only making the changes applicable to production after the effective date. So, if a company does the work before the effective date, even if the company applies for the credit after the effective date, the company still earns the credit because the work was done before the effective date. Section 41 clarifies that the effective date has to do with the work, not with the application. Also, in the event of the 10-year sunset, 10 years from what? For the purpose of determining the last calendar year that a credit can be used, it provides that existing credit certificates would start their clock at the effective date of the bill, whereas new credit certificates get 10 years from when they are issued.

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REPRESENTATIVE JOSEPHSON recalled that Senator Giessel's [2015] working group recommended there be some sort of a lag time so the rug would not be pulled out. In regard to getting credit for the work, he asked what "work" means and further asked what would happen if a company is half-way done with a project.

MR. ALPER explained by using an example of the repeal of the qualified capital expenditure credit, which HB 247 proposes to sunset on July 1, 2016. A company might be in the midst of a

project and would be able to define and say that this is the money it spent and the work it did before July 1 and it will qualify, but the other work might not. What is protected by Section 41 is that many producers do not actually apply for the credit immediately. They might keep all their paperwork and wait until their year's books are finished and come in in March 2017 to pay and claim a net operating loss credit and file their taxes in general for that year. Even though they are not applying for that credit, so long as they are showing the activities earning the capital credit were done before the effective date, they would still qualify.

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MR. ALPER recommenced his sectional analysis. He specified that Sections 42 and 43 are transition language, something that is seen in a lot of bills. These sections provide that while working toward getting the bill implemented, DOR and DNR would be empowered to draft regulations to clarify and implement the changes made by the bill. Oftentimes the regulation process on a complicated piece of legislation can take up to a year. Should those regulations come into being some months later they could be made retroactive to the effective date of the bill so that there are no gaps in coverage and no lack of clarity as to what the law is during the period of transition.

MR. ALPER said Sections 44 and 45 are the effective dates. He recalled that industry testimony brought substantial attention to Section 44, which is the retroactive applicability of Section 17 of the bill, the only retroactive section. Section 17 would limit the ability to use certain credits to go below the floor. The main change is that the companies would pay the minimum tax for all of calendar year 2016. The other change in Section 17 (c) has to do with the migrating of credits from month to month that was modeled and explained during an earlier hearing. That provision would likely not be relevant for this current calendar year because the price of oil is not expected to go above \$80 to where there would be months at the minimum tax and months above the minimum tax. Should that happen during this year then the retroactive application of Section 17 would limit the ability of those credits to be migrated. In January and February of this year some companies earned, but were unable to use, the \$8 per-taxable-barrel credit. Should the price of oil spike to \$120 this fall, those unused credits from now, per current law, would be used to offset taxes on oil produced in November and December. However, that would not be the case if Section 17 (c) is made retroactive.

2:32:13 PM

REPRESENTATIVE HERRON inquired whether it would not be just as well to have Sections 44 and 46 and January 1, 2017.

MR. ALPER answered that that is a choice of the committee. To delay the effective date of the bill would affect the dollar value; additional dollars' worth of credits would be spent by the state in the intervening period. There are pros and cons to that. A case could be made that it would provide a certain amount of certainty or at least transitional certainty for works in progress from the industry. Section 44 is a tax section; it is the calculation that is being talked about. The one push back he has received from his own staff is to avoid making tax sections effective in the middle of the year because it makes for very complicated calculations. The rest of the bill that talks about the ability to use credits and when an activity might get cut off does not matter quite so much and can take effect in the middle of the year because it is tied to a specific activity, to a receipt. Thus, if the retroactivity in Section 44 is unpalatable, [DOR] would ask that it be moved to January 1 of a different year.

2:33:49 PM

MR. ALPER returned to his sectional analysis. He said certain of the sections that are more transitional language and about doing the paperwork related to implementing the bill would be effective immediately. It is the transitional language and the one retroactive effective date that is being talked about in Section 44.

MR. ALPER concluded his sectional analysis by pointing out that Section 46 is the main effective date. The great bulk of the provisions and changes made in the bill would take effect on July 1, 2016, which is the beginning of fiscal year (FY) 2017. This way, all credits earned in the next fiscal year would be under the new regime.

2:34:30 PM

REPRESENTATIVE JOSEPHSON asked whether Mr. Alper was referring to Section 44 when he stated that if the legislature and this committee did not adopt the retroactivity, DOR would prefer a January 1 date.

MR. ALPER replied that Section 44 is the retroactivity of Section 17. Section 17 would sort of codify all of the floor hardening provisions in general. It discusses how certain things would not be able to be used below the floor, the physical mechanics of that calculation below the floor. The floor calculation, the tax calculation, is inherently annual, and therefore it would make for a very complex tax form if the changes were to be done mid-year. So, if January 1, 2016, was not desirable, he would ask that it be made January 1 of a different year.

REPRESENTATIVE JOSEPHSON commented that as cumbersome as it would be there are tens of millions of dollars at issue.

MR. ALPER responded yes, if talking about the ability to use an operating loss credit to go below the minimum tax. He said his fear is that it would take a lot of conforming language because it is currently written and described as an annual calculation. For example, if the hardening of the floor were to occur on July 1, the so-called minimum tax would have to be somehow calculated for the first six months of the year, allow it to be offset down to zero, but separate it somehow from the minimum tax obligation for the second six months of the year. While it could certainly be done, 2007 being an example of it happening before, it is a heavy lift. He agreed there probably are dollars in it, but said it would put something of a burden on the staff.

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MR. ALPER turned to the two fiscal notes for HB 247, one being identified as DOR-TAX, Department of Revenue, and the other as DOR-OGTCF, Fund Capitalization. He explained that the fiscal notes are in many ways complimentary to each other, adding up to the value of the bill as far as the state's bottom-line fiscal picture. The DOR-TAX fiscal note estimates that the bill would bring in approximately \$100 million in additional revenue for the first two years, declining to \$50 million beginning in FY 2019. The reason for that is that the bill has two different components for raising revenue. One component is the increase of the minimum tax from 4 percent to 5 percent. The other is the hardening of the floor, the restriction on being able to use credits to go below the minimum tax. The main beneficiary of that second \$50 million in the hardening of the floor really is in the operating loss credit. Certain major producers, at least one, had an operating loss in 2015 and may have operating losses in 2016. Those companies will be able to use their loss credits to reduce their payments below the minimum tax all the way to

zero in the year after they earn those credits. For the first two years DOR sees this as being a condition. After those two years, DOR projects the price of oil to be high enough, although not rosy, that the major producers will at least be breaking even or making money. Therefore DOR does not see any cash value to the state in that particular floor hardening provision. However, DOR does foresee being underneath the minimum tax paradigm for the next four or five years throughout the term of this fiscal note. That is why the \$50 million revenue goes out to the end of the fiscal note in FY 2022. The second \$50 million, the floor hardening, would only be of value for the first two years and so that is the drop-off in the value. The other important provision in the DOR-TAX fiscal note is the cost. The department is anticipating a cost to implement the changes in the bill - a relatively substantial reprogramming of a lot of different formulas in a lot of different provisions in DOR's revenue online and tax revenue management system. A firm estimate from the contractor is not yet in hand, but the number of \$1.5 million was put as something of a placeholder. The hope is that should this bill move, and before it makes it to the end of its process, DOR will be able to put a more precise number in there for the cost of implementing.

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REPRESENTATIVE HERRON observed that the first line of analysis on page 2 of the DOR-TAX fiscal note states that the legislation is an attempt to "reduce the cost of Alaska's current program of providing direct tax credit rebates and other advantages to oil and gas companies." He asked what "other advantages to oil and gas companies" means.

MR. ALPER answered that that is a broad term. It is talking about things that could be used to reduce a tax liability. The first half of the sentence is talking about tax rebates and the second half is talking about lower taxes. Because HB 247 would harden the floor and because in some cases it would increase the taxes that certain companies would pay, the advantage that the bill would cut back on is the advantage of being able to go below the minimum tax to zero. The companies would no longer receive that advantage because the floor would be hardened and the companies would be forced to pay at a higher rate.

REPRESENTATIVE HERRON observed that page 2 of the DOR-TAX fiscal note outlines several goals of the legislation, one of which is to strengthen the minimum tax and prevent abuses to the system. He requested Mr. Alper to identify those abuses.

MR. ALPER replied that the term was used to refer to what DOR perceives as inadvertent mechanisms where operating losses can be larger than the actual loss to where a credit can be claimed for a very high percentage of a loss because of the interplay of the gross value reduction (GVR) and the net operating loss credit. Another inadvertent loophole in statute is the municipal utility section where a company is selling a small amount of gas and getting a very large credit based on all of the utility's expenditures. There is no pejorative intended in abuse, it is simply that people are able to use the system in a way beyond which was originally intended.

REPRESENTATIVE HERRON asked whether the last word "loopholes" on page 2 of the DOR-TAX fiscal note is the loopholes that Mr. Alper is referring to.

MR. ALPER responded, "Yes, absolutely."

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REPRESENTATIVE JOSEPHSON said it strikes him that there is one enormous carrot in HB 247, which is that the governor under law is within his right to pay 10 percent per year indefinitely, albeit at some point retiring the credits. The administration is signaling that it wants to capitalize these credits at almost \$1 billion, thereby providing stability and predictability for both sides. In effect it signals a weighing of this right to veto any more than, for example, \$73 million this year. He asked whether he is reading this right.

MR. ALPER answered that Representative Josephson is right. He pointed out that the fiscal note for the \$900 million in capitalization is labeled DOR-OGTCF, Fund Capitalization. He explained that the statutory obligation, which is 10 or 15 percent at very low prices, is actually 15 percent of the revenue collected under the production tax system, which per DOR's current forecast is about \$73 million. This is the number the governor put in his operating budget and is what the state is more or less obligated to buy. Although the tax credit system is somewhat open-ended, people could earn \$1-\$10 billion worth of credits potentially. Last year DOR showed a scenario where one project could earn \$3 billion in credits in a relatively short period of time. The actual limitation on buying them is tied to this language in AS 43.55.028(b) and (c) that says 15 percent of the revenue collected - \$73 million. The governor's intent is to reduce the state's annual spend by a

substantial amount, to a number that is thought sustainable and affordable. However, it is not wanted to do this in such a way that would pull the rug out from anybody, that all of the credits that are earned from last year up through the effective date are made whole. The intent of the DOR-OGTCF fiscal note is to provide that number. Although \$926.575 million looks like a particularly precise number, it is simply the difference between the 15 percent figure in the operating budget and \$1 billion. The intent is to put \$1 billion into credit repurchase.

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MR. ALPER addressed the fiscal note identified as DOR-OGTCF, Fund Capitalization. He noted that originally all of these numbers were in a single fiscal note. But, per the advice of the Office of Management & Budget, they were split into two fiscal notes because the fund capitalization is really a separate appropriation that would be somehow attached to this bill that would move almost \$1 billion into the oil and gas tax credit fund. Included in the governor's [FY 2017] request is the \$73.425 million, and the columns for later years depict the expected reduction in tax credit spend that are tied up in this bill, meaning how much less it is thought the state would pay should HB 247 pass. That number is somewhat fungible because as the future gets closer a lot more is known about what companies are spending and DOR is basing these numbers on its forecasted credit spending in these future years minus about \$50 million. It is assumed that the state is still going to be paying about \$50 million in refunded credits. The department will continue to refine these numbers each year.

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REPRESENTATIVE HERRON drew attention to the paragraph on page 2 of the Fund Capitalization fiscal note regarding FY 2016 that talks about the \$200 million credit liability expected at the end of the fiscal year. Observing that the fiscal note was written on February 1, 2016, he asked whether that \$200 million is real, given it was heard in testimony before the committee that it is unlikely that \$200 million would be called upon.

MR. ALPER replied there are credit applications that DOR has in hand that could bring the state closer to \$700 million. To date, DOR has issued about \$475 million in credits. Everything that has been asked for has been bought back, which is essentially all of them, although there might be one or two in process right now. There is a tremendous frontloading in the

fiscal year, he explained, with the great bulk of the credit applications coming in in March when the companies file their taxes because the great bulk are for operating loss credits. The department tends to issue the credits about four months later in July and then they are paid out early in the fiscal year. The exception to that is some of the drilling credits in Cook Inlet, the specific credits that HB 247 looks to repeal. Because those do not require an operating loss, they do not require an end of year tax true-up to apply for them. So, certain companies based on their own cash flow needs or on their own housekeeping might apply for their qualified capital expenditure credit or well lease expenditure credits quarterly. The department has not been issuing those credits simply because it was known that those were the ones there would not be money for; DOR is choosing to hold them until receiving the operating loss credits at the end of the year. So, through its own activity, DOR is forcing that \$200 million to get rolled forward into FY 2017.

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MR. ALPER concluded his discussion of the two fiscal notes. One reduces spending and capitalizes the fund, he noted, and the other raises a bit of extra revenue through strengthening and increasing the minimum tax. Should a revised version of the bill move to the next committee, DOR would like to take a fine-tooth comb to the fiscal not as per the committee's request at an earlier hearing. The bill would benefit from having a full page spreadsheet of all the bill's provisions lined out with each one having its own cost parsed out. He said the department is prepared to do that level of analysis for the 15-18 separate provisions in the bill when it is in the next committee. However, he added, DOR is comfortable with the numbers it is presenting to this committee - the bill would raise about \$100 million in the short term and save \$400 million in the short term, although FY 2017 is a hard one because of the structure of the fiscal note. Fiscal year 2018 would save \$325 million.

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REPRESENTATIVE TARR observed the DOR-OGTCF fiscal note includes \$200 million for the Alaska Industrial Development and Export Authority (AIDEA). She asked how DOR sees that as functioning within HB 247. She offered her understanding that [HB 246] is separate from the credit program and would provide a pot of money that is available for loans to do work that has not previously been part of a company's portfolio.

MR. ALPER confirmed that this is correct, and advised that the reference to [HB 246] and the \$200 million was in this fiscal note for informational purposes. He said the fiscal note before the committee was written by DOR at the same time as the fund capitalization fiscal note for HB 246, although AIDEA will be the primary testifier on HB 246. When HB 246 comes before the committee, members will see another fund capitalization fiscal note containing \$200 million.

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REPRESENTATIVE SEATON noted that DOR has circulated several other documents to committee members, one document being Pedro van Meurs' update. He drew attention to the speculation in that update for an oil price of \$60 for the next two decades. He offered his hope that as the committee goes forward it will look at different analyses of the potential price.

MR. ALPER drew attention to a spreadsheet that DOR provided to members yesterday ["Production Tax Credits Detail FY 2007 to FY 2025, Table 8-4: Detail on Historical Production Tax Credits and Forecast]. He explained that this spreadsheet was put together per the request of the co-chairs' staff and summarizes all of the oil and gas tax credits that currently exist in statute, how they work, what statute they come from, what their history is, whether they have any built-in sunsets, and what parts of the state they are used for. At the bottom of the spreadsheet is a section saying how [the administration] is proposing to change the different provisions.

[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 2:54 p.m.