

**ALASKA STATE LEGISLATURE
HOUSE RULES STANDING COMMITTEE**

May 10, 2016
9:34 a.m.

MEMBERS PRESENT

Representative Craig Johnson, Chair
Representative Kurt Olson, Vice Chair
Representative Mike Chenault
Representative Bob Herron
Representative Jonathan Kreiss-Tomkins
Representative Chris Tuck
Representative Charisse Millett (via teleconference)

MEMBERS ABSENT

Representative Mike Hawker

OTHER LEGISLATORS PRESENT

Representative Steve Thompson
Representative Paul Seaton
Representative Dan Ortiz
Representative Dan Saddler
Representative David Guttenberg
Representative Les Gara

Senator Cathy Giessel
Senator Bill Wielechowski

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
03/08/16 (H) Heard & Held
03/08/16 (H) MINUTE(RES)
03/09/16 (H) RES AT 1:00 PM BARNES 124
03/09/16 (H) Heard & Held
03/09/16 (H) MINUTE(RES)
03/11/16 (H) RES AT 1:00 PM BARNES 124
03/11/16 (H) -- MEETING CANCELED --
03/14/16 (H) RES AT 1:00 PM BARNES 124
03/14/16 (H) Heard & Held
03/14/16 (H) MINUTE(RES)
03/14/16 (H) RES AT 6:00 PM BARNES 124

03/14/16 (H) Heard & Held
03/14/16 (H) MINUTE(RES)
03/16/16 (H) RES AT 1:00 PM BARNES 124
03/16/16 (H) Scheduled but Not Heard
03/18/16 (H) RES AT 1:00 PM BARNES 124
03/18/16 (H) Scheduled but Not Heard
03/19/16 (H) RES AT 1:00 PM BARNES 124
03/19/16 (H) Heard & Held
03/19/16 (H) MINUTE(RES)
03/21/16 (H) RES AT 1:00 PM BARNES 124
03/21/16 (H) Heard & Held
03/21/16 (H) MINUTE(RES)
03/21/16 (H) RES AT 6:00 PM BARNES 124
03/21/16 (H) -- MEETING CANCELED --
03/22/16 (H) RES AT 1:00 PM BARNES 124
03/22/16 (H) Heard & Held
03/22/16 (H) MINUTE(RES)
03/22/16 (H) RES AT 6:00 PM BARNES 124
03/22/16 (H) Moved CSHB 247(RES) Out of Committee
03/22/16 (H) MINUTE(RES)
03/23/16 (H) RES RPT CS(RES) NT 5DP 1DNP 1NR 2AM
03/23/16 (H) DP: CHENAULT, OLSON, JOHNSON, NAGEAK,
TALERICO
03/23/16 (H) DNP: TARR
03/23/16 (H) NR: HERRON
03/23/16 (H) AM: SEATON, JOSEPHSON
03/23/16 (H) RES AT 1:00 PM BARNES 124
03/23/16 (H) <Bill Hearing Canceled>
03/24/16 (H) FIN AT 9:30 AM HOUSE FINANCE 519
03/24/16 (H) Heard & Held
03/24/16 (H) MINUTE(FIN)
03/25/16 (H) RES AT 1:00 PM BARNES 124
03/25/16 (H) <Bill Hearing Canceled>
03/31/16 (H) FIN AT 1:30 PM HOUSE FINANCE 519
03/31/16 (H) Heard & Held
03/31/16 (H) MINUTE(FIN)
03/31/16 (H) FIN AT 5:00 PM HOUSE FINANCE 519
03/31/16 (H) Heard & Held
03/31/16 (H) MINUTE(FIN)
04/01/16 (H) FIN AT 1:30 PM HOUSE FINANCE 519
04/01/16 (H) Heard & Held
04/01/16 (H) MINUTE(FIN)
04/01/16 (H) FIN AT 5:00 PM HOUSE FINANCE 519
04/01/16 (H) Heard & Held
04/01/16 (H) MINUTE(FIN)
04/02/16 (H) FIN AT 8:30 AM HOUSE FINANCE 519
04/02/16 (H) -- Continued from 4/1/16 --

04/02/16 (H) FIN AT 2:00 PM HOUSE FINANCE 519
 04/02/16 (H) -- Public Testimony --
 04/04/16 (H) FIN AT 8:30 AM HOUSE FINANCE 519
 04/04/16 (H) Heard & Held
 04/04/16 (H) MINUTE(FIN)
 04/04/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/04/16 (S) <Pending Referral>
 04/05/16 (H) FIN AT 8:30 AM HOUSE FINANCE 519
 04/05/16 (H) Heard & Held
 04/05/16 (H) MINUTE(FIN)
 04/05/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/05/16 (S) <Pending Referral> -- Invited Testimony
 Only --
 04/06/16 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 04/06/16 (H) Heard & Held
 04/06/16 (H) MINUTE(FIN)
 04/06/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/06/16 (S) <Pending Referral> -- Invited Testimony
 Only --
 04/07/16 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 04/07/16 (H) <Bill Hearing Canceled>
 04/07/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/07/16 (S) <Pending Referral> --Invited Testimony
 Only--
 04/08/16 (H) FIN AT 8:30 AM HOUSE FINANCE 519
 04/08/16 (H) -- MEETING CANCELED --
 04/08/16 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 04/08/16 (H) Moved CSHB 247(FIN) Out of Committee
 04/08/16 (H) MINUTE(FIN)
 04/08/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/08/16 (S) <Pending Referral> --Invited Testimony
 Only--
 04/09/16 (H) FIN RPT CS(FIN) NT 1DP 4DNP 2NR 4AM
 04/09/16 (H) DP: THOMPSON
 04/09/16 (H) DNP: PRUITT, WILSON, KAWASAKI, GATTIS
 04/09/16 (H) NR: SADDLER, NEUMAN
 04/09/16 (H) AM: GARA, GUTTENBERG, EDGMON, MUNOZ
 04/09/16 (S) RES AT 9:00 AM BUTROVICH 205
 04/09/16 (S) <Pending Referral> --Invited Testimony
 Only--
 04/09/16 (S) RES AT 2:30 PM BUTROVICH 205
 04/09/16 (S) <Pending Referral> --Invited Testimony
 Only--
 04/11/16 (S) RES AT 3:30 PM BUTROVICH 205
 04/11/16 (S) <Pending Referral> -- Invited Testimony
 Only --
 04/13/16 (H) BEFORE HOUSE IN THIRD READING

04/13/16 (H) RETURNED TO RLS COMMITTEE
 04/13/16 (S) FIN AT 1:30 PM SENATE FINANCE 532
 04/13/16 (S) <Pending Referral> Invited Testimony
 04/13/16 (S) FIN AT 5:00 PM SENATE FINANCE 532
 04/13/16 (S) <Pending Referral> Invited Testimony
 04/14/16 (S) FIN AT 8:00 AM SENATE FINANCE 532
 04/14/16 (S) <Pending Referral>
 04/14/16 (S) FIN AT 1:30 PM SENATE FINANCE 532
 04/14/16 (S) <Pending Referral>
 04/14/16 (S) FIN AT 5:00 PM SENATE FINANCE 532
 04/14/16 (S) <Pending Referral>
 04/20/16 (H) RLS AT 2:00 PM GRUENBERG 120
 04/20/16 (H) -Postponed to a Call of the Chair on
 4/21/16 TBD-
 04/21/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/21/16 (H) -Postponed to a Call of the Chair on
 4/22/16 TBA-
 04/22/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/22/16 (H) -Postponed to a Call of the Chair on
 4/23/16 TBA-
 04/23/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/23/16 (H) -Postponed to a Call of the Chair on
 4/24/16 TBA-
 04/24/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/24/16 (H) -Postponed to a Call of the Chair on
 4/25/16 TBA-
 04/25/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/25/16 (H) -Postponed to a Call of the Chair on
 4/26/16 TBA-
 04/26/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/26/16 (H) -Postponed to a Call of the Chair on
 4/27/16 TBA-
 04/27/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/27/16 (H) -Postponed to a Call of the Chair on
 4/28/16 TBA-
 04/28/16 (H) RLS AT 0:00 AM GRUENBERG 120
 04/28/16 (H) -- Meeting Postponed to 5/2/16 --
 05/02/16 (H) RLS AT 9:30 AM BELTZ 105 (TSBldg)
 05/02/16 (H) -- Meeting Postponed to 5/3/16 at 9:30
 a.m. --
 05/03/16 (H) RLS AT 9:30 AM BELTZ 105 (TSBldg)
 05/03/16 (H) -- MEETING CANCELED --
 05/10/16 (H) RLS AT 9:30 AM BILL RAY CENTER 208

WITNESS REGISTER

RENA DELBRIDGE, Staff

Representative Mike Hawker
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented the proposed CS for HB 247, Version 29-GH2609\D, Nauman/Shutts, 5/6/16, on behalf of Representative Hawker, member of the House Rules Standing Committee, sponsor by request of the governor.

JANAK MAYER, Chairman & Chief Technologist
analytica
Washington, D.C.

POSITION STATEMENT: Gave a PowerPoint presentation outlining the impacts of HB 247 on developers.

ACTION NARRATIVE

[9:34:43 AM](#)

CHAIR CRAIG JOHNSON called the House Rules Standing Committee meeting to order at 9:34 a.m. Representatives Chenault, Herron, Olson, Kreiss-Tomkins, Tuck, Millett (via teleconference), and Johnson were present at the call to order. Also present were Representatives Thompson, Seaton, Ortiz, Saddler, Guttenberg, and Gara, and Senators Giessel and Wielechowski.

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

[9:35:02 AM](#)

CHAIR JOHNSON 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."

CHAIR JOHNSON stated that the fiscal challenges before the state are unprecedented. He said the state must stop writing checks to the oil companies. He explained that resource exploration incentives of the past have worked - Cook Inlet is now energy sufficient and for the first time there has been an increased flow in the pipeline - but under today's fiscal situation, he opined, the state cannot continue [to give those incentives]. Chair Johnson stated that a proposed committee substitute (CS) would make significant cuts to future spending. He pointed out that the industry "faces those same, harsh decisions that we're making on a daily basis"; the fates of the industry and Alaska are intertwined, and the solution is not about "us versus them," but about working together. He said the proposed CS for HB 247, Version 29-GH2609\D, Nauman/Shutts, 5/6/16 would phase out the tax credit system for some small producers. He added, "They create jobs; they found many more resources; and there's still a lot to be done."

CHAIR JOHNSON specified that what he does not want is to trim back spending so much that Alaska is "not open for business any longer." He said the CS would also give new companies the chance to develop new plans and finance new structures by phasing out the credits. He reemphasized that the state "cannot sacrifice future oil production for today's budget." He said the proposed CS would strike a balance and is the result of many conversations and review of many other bills that have been heard in previous committee [hearings]. He described it as a starting point that would not go far enough for some and would go too far for others, but expressed his belief that it would allow the state to move forward with a system for generating

revenue while maintaining the opportunity for its partners to continue to do business.

9:38:15 AM

REPRESENTATIVE OLSON moved to adopt the proposed committee substitute (CS) for HB 247, Version 29-GH2609\D, Nauman/Shutts, 5/6/16, as a working document.

CHAIR JOHNSON objected for the purpose of discussion.

9:38:45 AM

RENA DELBRIDGE, Staff, Representative Mike Hawker, Alaska State Legislature, presented the proposed CS for HB 247, Version 29-GH2609\D, Nauman/Shutts, 5/6/16 ("Version D"), on behalf of Representative Hawker, member of the House Rules Standing Committee, sponsor by request of the governor. She said Version D would close out the state's tax credit program, beginning in January 2017 through January 2020, with the exception of one Middle Earth exploration credit, which currently is scheduled under statute to sunset by 2022. She said in phasing out the credit system on the North Slope, the state would transition to a method of carrying forward lease expenditures such that if a business is not able to deduct in the current year while credits are being phased out, then industry would still be able to have the net profit tax system benefit of carrying forward losses.

9:39:38 AM

MS. DELBRIDGE named the following statewide provisions proposed under Version D: a \$75 million cap per company in the amount of credits that can be cashed back annually; a priority on refunds from the oil and gas tax credit fund for credit to those companies that have at least 80 percent Alaska hire; and a required disclosure of some information to the public. She said the Department of Revenue (DOR) would make public each year the name of the company receiving refunds for credit from the oil and gas tax credit fund, as well as the total dollars refunded to that company each year.

MS. DELBRIDGE stated that Version D would maintain some provisions that have been in a number of previous iterations through the legislative process, including: provisions relating to unfunded liability that would allow DOR to withhold the amount of an outstanding liability from a company's refund; a requirement for a \$250,000 surety bond and provisions for

prioritizing those claims; and a requirement for municipal producers to allocate their lease expenditures to taxable production, so that they are not receiving credits for production that is not taxed.

MS. DELBRIDGE relayed that the income tax credits currently in statute to support instate refineries and liquefied natural gas (LNG) storage facilities would, under Version D, be maintained and be refundable, but no longer would come out of the oil and gas tax credit fund. The interest rate on delinquent taxes, including those undergoing audit, would increase from three points above the federal discount rate to five points and from simple interest to being compounded quarterly. She stated that new under Version D would be a provision that says that the gross tax the state assesses on private royalties paid to private land owners may never be less than zero. She said the aforementioned make up the broad, statewide provisions.

[9:41:33 AM](#)

MS. DELBRIDGE moved on to the provisions under Version D that would be specific to Cook Inlet and Middle Earth: credits would end January 1, 2019. She reiterated that Middle Earth would retain its exploration credit through 2022, as currently provided in statute. She said a legislative working group, during the 2016 interim, would develop a new oil and gas tax regime for Cook Inlet and Middle Earth, and it would present that regime to the legislature in 2017. The intent would be for [the new regime] to take place in 2019, after the expiration of all the credits. She clarified that for 2016, all the credits currently in statute for Cook Inlet and Middle Earth would continue. She said this is a 25 percent qualified capital expenditure credit; a 40 percent well lease expenditure credit; and a 25 percent net operating loss (NOL) credit. She stated that in order to receive any credit for Cook Inlet work from 2017 going forward, a company will have to have had oil or gas production in Cook Inlet in calendar year 2016. She said that at the end of 2016, the 20 percent qualified capital expenditure credit would be repealed. Companies would be eligible in 2017 and 2018 for a reduced 20 percent well lease expenditure credit and, in 2017 only, for a 25 percent NOL credit. She reiterated that the legislative working group would be designing a new oil and gas tax regime to take effect with the expiration of those credits.

MS. DELBRIDGE related that specific to Middle Earth, there would be, under Version D, an extension of one credit for the Copper

River Basin only. She indicated that under current statute that credit is set to expire in July 2016; under Version D, the credit would be extended to the end of 2016. She said this would provide an opportunity to a company in the process of drilling wells and "not quite able to meet those deadlines."

[9:43:35 AM](#)

MS. DELBRIDGE stated that on the North Slope, the one remaining credit, after the expiration in July 2016 of an exploration credit, will be the NOL credit of 35 percent, which would remain in statute for the next three years, through 2019. She continued as follows:

The only way that you can get this three-year transitional measure is if you ... have production in the North Slope of less than 15,000 barrels per day in 2016 or, if you are not yet in production but you are developing as a unit, with an approved plan of development or plan of exploration, after those three years, the net operating loss credit expires completely on the North Slope. Meanwhile, we will be shifting to a system of lease ... expenditure carry forward, so that expenses that are not able to be deducted but are still eligible lease expenditures in a current year are carried forward against your liability in a future year. That ... shift to carry forward of lease expenditures has the effect of hardening the gross minimum tax floor at 4 percent.

MS. DELBRIDGE, also regarding the North Slope, said the gross value reduction (GVR) received for new oil - a timeless benefit under current statute - would, under Version D, be limited to a 10-year benefit beginning once regular production starts. She said the proposed Version D also addresses how, for tax purposes, oil receives a new oil benefit once it "graduates and becomes normal oil."

MS. DELBRIDGE noted that previous bill versions all included provisions that would prevent the use of the gross value reduction from amplifying the size of an NOL, and Version D would retain that provision, as well. She offered to answer questions from the committee.

[9:45:54 AM](#)

REPRESENTATIVE TUCK asked Ms. Delbridge to offer more details regarding the surety bond.

MS. DELBRIDGE noted that the surety bond provision could be found on pages 26-27 of Version D. She said it was a provision added by amendment in the House Resources Standing Committee, following concerns, particularly in the Cook Inlet Region, over some companies that have gone into bankruptcy over the past couple years and been unable to pay their bills to local businesses and contractors. She said that in exchange for a business license to conduct oil and gas activities, under Version D, a company would need to file a \$250,000 surety bond with the Department of Commerce, Community & Economic Development, and Version D lists what the company would be promising to pay. She said language on [page 27], lines 16-31, and continuing on page 28, lists the order in which the claims would be prioritized.

MS. DELBRIDGE stated that the bond could be waived by the commissioner of the Department of Commerce if he/she finds the company is producing oil and gas in commercial quantities. She said the surety bond claims "against us" would be satisfied with material, equipment, and supplies delivered in the state; labor, including employee benefits; taxes and other amounts to cities and boroughs; repair of public facilities; and taxes and other amounts due to the state.

[9:47:46 AM](#)

REPRESENTATIVE HERRON asked if the bond had been fully vetted and whether a bankruptcy lawyer had been consulted. He offered his understanding that "even the \$250,000 could get caught up in the bankruptcy claim."

MS. DELBRIDGE replied that she had not been in contact with a bankruptcy attorney. She said the provision had been in the proposed legislation since it was heard by the House Resources Standing Committee, and it [remained in the bill through its hearing by] the House Finance Committee. She offered her understanding that the Department of Law (DOL) had reviewed [the provision], and she said the administration may have some additional comments on the provision when its representative comes to testify before the committee on 5/11/16.

[9:48:31 AM](#)

REPRESENTATIVE KREISS-TOMKINS asked if the provision that relates to municipal production relates to the Beluga field, to Municipal Light & Power (ML&P), or any other entities in Alaska.

MS. DELBRIDGE offered her understanding that [the provision] would be limited to ML&P, which has "ownership at Beluga." She added that a municipal producer like that would produce, and some of its production would go to its own generation, while some of it could be sold to other entities for other uses. She said the provision that was in the governor's original bill and "has carried through the process" essentially says that a municipality that produces and uses that production for its own generation is already not subject to taxes on that portion; therefore, [Version D] would clarify that "you do not receive credits on that portion." She continued, "If you sell a portion of your production, and it's taxable, in that instance you ... can receive credits for that portion ... of your production."

[9:49:45 AM](#)

REPRESENTATIVE CHENAULT asked Ms. Delbridge if by production she meant the actual sale of natural gas to some other entity or if it could mean the natural gas could be turned into electricity and the electricity could then be sold to someone else.

MS. DELBRIDGE answered that there is no distinction in that, per se. She clarified, "Essentially, if you're selling your gas to someone else for generation, rather than to your own use, then you ... would have that limitation; ... you would need to allocate your lease expenditures to receive credits only on the taxable portion."

[9:50:34 AM](#)

REPRESENTATIVE HERRON asked Ms. Delbridge to give examples of lease expenditure deductions.

MS. DELBRIDGE stated that lease expenditures are currently defined in statute, under AS 43.55.165, as the cost of getting oil or gas out of ground that is upstream of the point of production. She said it is the cost of actually working in the field and taking the oil or gas to the processing facility; as soon as it is fed into a transportation line, it is past the point of production. She said lease expenditures have to be upstream, they must be necessary and ordinary costs for the Internal Revenue Service (IRS), and they have to be direct costs. She said there is a long list in statute of those things

that are excluded, including royalties paid, the cost of acquisitions, and lobbying or public relations. She offered to pull up the list to read.

REPRESENTATIVE HERRON said he had just wanted some examples stated for the record.

[9:52:15 AM](#)

The committee took a brief at-ease at 9:52 a.m.

[9:52:28 AM](#)

MS. DELBRIDGE next presented the sectional analysis for Version D, included in the committee packet, which read as follows [original punctuation provided, with some formatting changes]:

Section 1 Adds a new subsection to AS 31.05.030, Alaska Oil and Gas Conservation Act. Requires the Alaska Oil and Gas Conservation Commission to verify the start of regular production of new oil. Effective Jan. 1, 2017.

Secs. 2-6 Amend AS 38.05.036 (a), (b), (c), (f) and (g), Alaska Land Act, Audit of royalty and net profit payments and costs. Conforming to the Section 50 repeal of AS 41.09, an old Department of Natural Resources exploration credit program. Effective Jan. 1, 2017.

Section 7 Amends AS 40.25.100(a), Public Record Disclosures, Disposition of tax information. Conforming to Section 9, which requires the Department of Revenue to make public some taxpayer information. Effective Jan. 1, 2017.

Section 8 Amends AS 43.05.225, Administration of Revenue Laws, Interest. The interest rate on delinquent taxes is five points above the 12th Federal Reserve District rate, compounded quarterly. Effective Jan. 1, 2017.

Section 9 Adds a new subsection to AS 43.05.230, Administration of Revenue Laws, Disclosure of tax returns and reports. Requires the Department of Revenue to make public by April 30 of each year, the name of a company from whom the department purchases a

tax credit certificate and the total amount of tax credit certificates purchased from each company. Effective Jan. 1, 2017.

Section 10 Amends AS 43.20.046(e), Alaska Net Income Tax Act, Gas storage facility tax credit. The Department of Revenue will no longer use the Oil and Gas Tax Credit Fund to refund gas storage facility credits. The credits remain refundable by DOR. Also, definition of "unpaid delinquent taxes" is removed, as a new definition for "outstanding liability" applicable to AS Title 43, Revenue and Taxation, is added in Section 49. Effective Jan. 1, 2017.

Section 11 Amends AS 43.20.047(e), Alaska Net Income Tax Act, Liquefied natural gas storage facility tax credit. The Department of Revenue will no longer use the Oil and Gas Tax Credit Fund to refund LNG storage facility credits. The credits remain refundable by DOR. Also, definition of "unpaid delinquent taxes" is removed, as a new definition for "outstanding liability" applicable to AS Title 43, Revenue and Taxation, is added in Section 49. Effective Jan. 1, 2017. 2

Section 12 Amends AS 43.20.053(e), Alaska Net Income Tax Act, Qualified in-state oil refinery infrastructure expenditures tax credit. The Department of Revenue will no longer use the Oil and Gas Tax Credit Fund to refund instate refinery credits. The credits remain refundable by DOR. Also, reference to "unpaid delinquent taxes" is removed, as a new definition for "outstanding liability" applicable to AS Title 43, Revenue and Taxation, is added in Section 49. Effective Jan. 1, 2017.

Section 13 Amends AS 43.55.011(i), Oil and Gas Production Tax. Ensures the tax assessed on private royalties is not less than zero. Effective Jan. 1, 2017.

Section 14 Amends AS 43.55.011(m), Oil and Gas Production Tax. Conforming to the Section 50 repeal of the DNR credit programs in AS 38.05.180(i) and AS 41.09. Effective Jan. 1, 2017.

Section 15 Amends AS 43.55.023(b), Oil and Gas Production Tax, Tax credits for certain losses and expenditures. The 35% net operating loss credit on the North Slope terminates at the end of 2016, except the 35% credit (refundable) is available through 2019 for companies producing less than 15,000 barrels per day in 2016, and for companies without production operating under a unit plan of development or plan of exploration approved by the Department of Natural Resources. The 25% net operating loss credit in areas other than the North Slope remains at 25% in 2017, then terminates. To receive the credit in Cook Inlet, a company must have regular production of oil or gas in Cook Inlet in calendar year 2016. Also, ensures that the application of a gross value reduction for new oil cannot increase the size of a loss. Effective Jan. 1, 2017.

Section 16 Amends AS 43.55.023(d), Oil and Gas Production Tax, Tax credits for certain losses and expenditures. Conforms to the Section 50 repeal of AS 43.55.023(a), qualified capital expenditure credit. Effective Jan. 1, 2017.

Section 17 Amends AS 43.55.023(e), Oil and Gas Production Tax, Tax credits for certain losses and expenditures. Conforms to the Section 50 repeal of AS 43.55.023(a), qualified capital expenditure credit. Effective Jan. 1, 2017.

Section 18 Amends AS 43.55.023(l), Oil and Gas Production Tax, Tax credits for certain losses and expenditures. Reduces the well lease expenditure credit from 40% through 2016, to 20% in calendar years 2017 and 2018. To receive this credit in Cook Inlet, the producer must have regular oil or gas production in Cook Inlet in 2016. Effective Jan. 1, 2017.

Section 19 Amends AS 43.55.023(n), Oil and Gas Production Tax, Tax credits for certain losses and expenditures. Conforms to the Section 50 repeal of AS 43.55.023(a), qualified capital expenditure credit. Effective Jan. 1, 2017. 3

Section 20 Amends AS 43.55.024(i), Oil and Gas Production Tax, Additional nontransferable tax credits. Companies may apply the \$5 per-barrel new oil

credit only for oil receiving the 10-year gross value reduction. Effective Jan. 1, 2017.

Section 21 Amends AS 43.55.024(j), Oil and Gas Production Tax, Additional nontransferable tax credits. Once new oil is no longer eligible for new oil benefits and is being taxed as normal oil, the oil is also eligible for the sliding-scale per barrel credit. Effective Jan. 1, 2017.

Section 22 Amends AS 43.55.025(m), Oil and Gas Production Tax, Alternative tax credit for oil and gas exploration. Extends a Middle Earth credit for work in the Copper River Basin only, to Jan. 1, 2017. A company that has spudded but not completed a well by Jan. 1, 2017, is also eligible. The AS 43.55.025(a)(6) credit covers 80% of eligible costs, up to \$25 million. Effective immediately.

Section 23 Amends AS 43.55.025(m), Oil and Gas Production Tax, Alternative tax credit for oil and gas exploration, as amended by Section 22. Conforming to the Section 52 repeal of AS 43.55.023. Effective Jan. 1, 2020.

Section 24 Amends AS 43.55.025(o), Oil and Gas Production Tax, Alternative tax credit for oil and gas exploration. Conforms to the Section 50 repeal of AS 43.55.025 (a)(7) and (n). Effective Jan. 1, 2017.

Section 25 Amends AS 43.55.028(a), Oil and Gas Production Tax, Oil and gas tax credit fund. Removes the authority to use the fund to pay refunds for the income tax credits related to the instate refinery, LNG storage facility, and gas storage facility. Effective Jan. 1, 2017.

Section 26 Amends As 43.55.028(a), Oil and Gas Production Tax, Oil and gas tax credit fund, as amended by Sec. 25. Conforming to the Section 52 repeal of AS 43.55.023. Effective Jan. 1, 2020.

Section 27 Amends AS 43.55.028(e), Oil and Gas Production Tax, Oil and gas tax credit fund. Limits the maximum state repurchase of tax credits to \$75 million per company, per year. Requires the Department of Revenue to, before purchasing credit certificates,

find that the applicant is not the result of the division of a single entity into multiple entities that would reasonably have been expected to apply as a single entity. Effective Jan. 1, 2017.

Section 28 Amends AS 43.55.028(e), Oil and Gas Production Tax, Oil and gas tax credit fund, as amended by Sec. 27. Conforms to the Section 52 repeal of AS 43.55.023. Effective Jan. 1, 2020.

Section 29 Amends AS 43.55.028(g), Oil and Gas Production Tax, Oil and gas tax credit fund. Requires the Dept. of Revenue to adopt regulations granting preference to companies with at least 80% Alaska hire, in case there is not enough money in the 4 Oil and Gas Tax Credit Fund to cover all applicants. Also, as credits for LNG storage facilities, gas storage facilities and instate refineries would no longer be refunded through the fund, makes conforming adjustments. Effective Jan. 1, 2017.

Section 30 Adds a new subsection to AS 43.55.028, Oil and Gas Production Tax, Oil and gas tax credit fund. Ensures an outstanding liability to the state related to oil and gas activity is withheld from the amount of a tax certificate purchased by the Dept. of Revenue using the Oil and Gas Tax Credit Fund. The department may use the withheld amount to satisfy an outstanding liability, providing the liability is not being contested through an appeal or adjudicatory process established in law, without the taxpayer's consent. Satisfying a liability in this manner would not affect the applicant's ability to contest a liability. Effective Jan. 1, 2017.

Section 31 Amends AS 43.55.029(a), Oil and Gas Production Tax, Assignment of tax credit certificate. Conforming to the Section 50 repeal of the qualified capital expenditure credit in AS 43.55.023(a). Effective Jan. 1, 2017.

Section 32 Amends AS 43.55.029(a), Oil and Gas Production Tax, Assignment of tax credit certificate, as amended by Sec. 31. Conforms to the Section 51 repeal of the well lease expenditure credit in AS 43.55.023(1). Effective Jan. 1, 2019.

Section 33 Amends AS 43.55.029(a), Oil and Gas Production Tax, Assignment of tax credit certificate, as amended by Secs. 31 and 32. Conforms to the Sec. 52 repeal of the net operating loss credit in AS 43.55.023(b). Effective Jan. 1, 2020.

Section 34 Amends AS 43.55.030(a), Oil and Gas Production Tax, Filing of statements. Conforms to the repeal of the qualified capital expenditure credit in Section 50. Effective Jan. 1, 2017.

Section 35 Amends AS 43.55.030(e), Oil and Gas Production Tax, Filing of statements. Conforms to the Section 50 repeal of the qualified capital expenditure credit, AS 43.55.023(a). Effective Jan. 1, 2017.

Section 36 Amends AS 43.55.075(b), Oil and Gas Production Tax, Limitation on assessment and amended returns. Conforms to the Section 50 repeal of the qualified capital expenditure credit, AS 43.55.023(a). Effective Jan. 1, 2017.

Section 37 Amends AS 43.55.160(d), Oil and Gas Production Tax, Determination of production tax value of oil and gas. Conforms to the Section 52 repeal of AS 43.55.023(b). Effective Jan. 1, 2020.

Section 38 Amends AS 43.55.160(e), Oil and Gas Production Tax, Determination of production tax value of oil and gas. Requires that, for the purposes of calculating a carried-forward annual loss, any reduction due to the Gross Value Reduction for new oil is added back to the tax calculation. This prevents the GVR from increasing the amount of a loss. Also, conforms to the new lease expenditure provisions in Section 42. Effective Jan. 1, 2017.

Section 39 Amends AS 43.55.160(e), Oil and Gas Production Tax, Determination of production tax value of oil and gas, as amended by Sec. 38. Conforming to Section 52 repeal of AS 43.55.023(b). Effective Jan. 1, 2020.

Secs. 40-41 Amend AS 43.55.160(f) and (g), Oil and Gas Production Tax, Determination of production tax value of oil and gas. For the gross value reduction for new oil, reduces the period in which the reduction

applies from a lifetime benefit in current statute, to a 10-year benefit, beginning once regular production starts from a lease or property. The Alaska Oil and Gas Conservation Commission will determine when regular production begins. For new oil already receiving the gross value reduction, the benefit terminates Jan. 1, 2026. Effective Jan. 1, 2017.

Section 42 Amends AS 43.55.165(a), Oil and Gas Production Tax, Lease expenditures. For the North Slope, lease expenditures include lease expenditures incurred in a prior year that have not been previously deducted in determining oil and gas taxes and were not the basis of a credit. This section allows lease expenditures to carry over from a prior year. Also, conforming to the Section 50 repeal of AS 43.55.165(j) and (k). Effective Jan. 1, 2017.

Section 43 Amends AS 43.55.165(f), Oil and Gas Production Tax, Lease expenditures. Conforming to the Section 50 repeal of the qualified capital expenditure credit, 43.55.023(a). Effective Jan. 1, 2017.

Section 44 Amends AS 43.55.170(c), Oil and Gas Production Tax, Adjustments to lease expenditures. Conforming to the Section 50 repeal of the qualified capital expenditure credit, AS 43.55.023(a). Effective Jan. 1, 2017.

Section 45 Amends AS 43.55.180(a), Oil and Gas Production Tax, Required report. Conforms to the Section 52 repeal of 43.55.023. Effective Jan. 1, 2020.

Section 46 Amends AS 43.55.895(b), Oil and Gas Production Tax, Applicability to municipal entities. Requires allocation of lease expenditures and tax credits between taxable and exempt production for a municipal entity. Effective Jan. 1, 2017.

Section 47 Adds a new paragraph to AS 43.55.900, Oil and Gas Production Tax, Definitions. Defines "regular production" as defined in AS 31.05.170. Effective Jan. 1, 2017.

Section 48 Adds new sections to AS 43.70, Alaska Business License Act. Requires a \$250,000 surety bond

for oil and gas businesses, allowing the Department of Commerce commissioner to cancel the requirement once a business is producing oil or gas in commercial quantities. Provides a framework for people with claims against a business required to post the surety bond; prioritizes satisfaction of types of claims. Effective Jan. 1, 2017.

Section 49 Adds a new paragraph to AS 43.99.950, Revenue and Taxation, General Provisions, defining "outstanding liability to the state." Effective Jan. 1, 2017.

Section 50 On Jan. 1, 2017, repeals multiple sections of statute, including the old DNR exploration credit programs; the qualified capital expenditure credit; and pre-2010 tax statutes. (See attached Summary of Repeals)

Section 51 On Jan. 1, 2019, repeals the well lease expenditure credit. (See attached Summary of Repeals)

Section 52 On Jan. 1, 2020, repeals all credits remaining in 43.55.023. (See attached Summary of Repeals)

Section 53 Adds a new section to uncodified law creating a Legislative Working Group to develop a comprehensive tax regime for oil and gas in Cook Inlet and Middle Earth, to take effect Jan. 1, 2019, once the current credits are phased out. The working group's proposal is to be presented to the Legislature in the 2017 regular session, and should include evaluation of incentives other than direct monetary support, including loan guarantees. Effective immediately.

Section 54 Applicability language.

Section 55 Transition language related to the Jan. 1, 2017, repeal of the qualified capital expenditure credit, AS 43.55.023(a). Effective Jan. 1, 2017.

Section 56 Transition language related to the repeal of the well lease expenditure credit. AS 43.55.023(1) and (n). Effective Jan. 1, 2019.

Section 57 Transition language related to the repeal of the carry-forward annual loss credit, AS 43.55.023(b). Effective Jan. 1, 2020.

Section 58 Transition language related to credits. Effective Jan. 1, 2020.

Section 59 Transition language related to lease expenditures and the repeal of AS 43.55.165(j) and (k). Effective Jan. 1, 2017.

Section 60 Transition language related to exploration and seismic expenditures. Effective Jan. 1, 2017.

Section 61 Transition language authorizing the Department of Revenue, Department of Natural Resources, Department of Commerce, Community and Economic Development, and the Alaska Oil and Gas Conservation Commission to adopt regulations for this act. Effective immediately. 7

Section 62 Transition language authorizing the Department of Revenue and Department of Natural Resources to adopt retroactive regulations. Effective immediately.

Section 63 Immediate effective date for sections 22 (extension of Middle Earth credit for a well spudded but not completed), 53 (Legislative Working Group), 61 (authority to adopt regulations) and 62 (authority to adopt retroactive regulations).

Section 64 Jan. 1, 2019, effective date for sections 32, 51 and 56.

Section 65 Jan. 1, 2020, effective date for sections 23, 26, 28, 33, 37, 39, 45, 52, 57 and 58.

Section 66 Jan. 1, 2017, effective date for all other sections.

[10:05:39 AM](#)

The committee took an at-ease from 10:06 a.m. to 10:07 a.m.

[10:07:43 AM](#)

CHAIR JOHNSON announced that the committee would hear a presentation from Janak Mayer.

10:08:50 AM

The committee took a brief at-ease at 10:09 a.m. to address technical difficulties.

10:09:38 AM

JANAK MAYER, Chairman & Chief Technologist, enalytica, noted that enalytica is the legislative consultant to the Alaska State Legislature on the topic of fiscal terms, oil and gas taxation, and natural gas commercialization [of] Alaska Liquefied Natural Gas (AKLNG). He said the presentation would provide a summary of the core issues related to the proposed Version D. He said the first two slides compare differences between the latest version of the bill that passed out of the House Finance Committee and [the proposed committee substitute, Version D]. The next slide looks at areas of commonality between the two. The remaining slides provide additional analysis on a couple of key issues.

10:10:39 AM

MR. MAYER drew attention to slide 2. He stated that the core focus of Version D is on the issue of refunded tax credits. He indicated that in fiscal year 2016 (FY 16) those credits would cost the State of Alaska approximately \$500 million, "with substantially more than that in FY 15 and will again be more in 2017." He said it is a staggering amount of money compared to the relatively small amount of money that the overall oil and gas fiscal system brings in "at these low prices." He said the proposed legislation aims to steadily reduce that amount over time until the refundable tax credits are completely eliminated by 2019/2020. He said there is a substantial difference between the tax credits and how they work for Cook Inlet and the North Slope. For Cook Inlet, the credits are used to incentivize activity in what is already a low and very attractive fiscal regime where there is no production tax on oil and a low tax on gas.

MR. MAYER reiterated that the proposal for Cook Inlet is a gradual reduction to no credits by 2019. Crucially, he continued, the bill would hold the existing credit system in place until the end of the year. He explained that is important

because numerous companies have entered solid contracts between now and the end of the year for work programs, in particular for drilling and other capital works, premised on the basis of receiving those credits. He said there are numerous companies that have not received new credits for that work to be performed between now and the end of the year, which he indicated could result in a question of fundamental financial liability and even bankruptcy. He said the aggressive approach to ramping down and eventually cutting off the credits was crafted with a timeframe that is fairly thoughtfully calibrated in terms of understanding what is required of new companies that are most financially vulnerable to complete their capital programs in order to reach a point of enabling themselves to a sustained cash flow.

[10:13:45 AM](#)

MR. MAYER stated that for the North Slope, the issue was also about ended refunded credits. He noted that for the North Slope, there is only one major refundable credit left in the system. He mentioned some others that have been available in the past, including the capital credit that existed under Alaska's Clear and Equitable Share (ACES), but said the one major one is the NOL tax credit. Unlike other credits, this one simply enables producers to recover costs they incur for which they do not have tax liability in the year in which they incur the costs. He said typically a new developer is incurring major expenses to develop a new project, which has little to no tax liability to deduct that against. However, in the current tax environment, there is a situation where even major producers - because of low prices and substantial ongoing reinvestments - have expenses they cannot deduct. He relayed that under the current system, those companies with more than 50,000 barrels a day can take this credit but have to claim it in the future against liability, while those with under 50,000 barrels a day can take this as a refund - a tax credit - and get cash.

[10:15:18 AM](#)

MR. MAYER said the ability to deduct all expenses, whether they are less than the tax liability or exceed it, is the defining feature of any net profit tax. Under a gross tax system, he added, expenses are not considered or deducted. However, under a net tax system they are; what is being taxed is the profit at the end after subtracting the expenses. He stated that because in the oil and gas industry, as in many industries, investments and subsequent revenue occur at different times in the cycle, it is crucial to say that all expenses, whether able to be deducted

in this year or other years, will eventually be deducted. He said the vast majority of oil and gas tax systems do that by saying that anything that cannot be deducted in the current year can be carried forward. He opined that Alaska has been somewhat unique, in that instead of carrying forward expenses to deduct in future years, it offers the NOL tax credit. He said that for companies with more than [50,000] barrels a day, it performs a role similar to carrying forward an expense deduction to the future, while having the unique feature for smaller companies of allowing them to take the benefit of cash right now, which has enhanced project economics and reduced the amount of working capital needed to pursue various projects.

[10:17:27 AM](#)

MR. MAYER said that for larger producers without tax credit calculated after the tax liability is calculated, there is no longer the ability to reduce the amount of tax paid below the gross minimum floor. He said this has the effect of hardening that gross minimum floor against future losses. He stated there are a number of key differences in the way that would happen [under Version D] versus the way it would happen in the governor's original version of HB 247, wherein an elevated 5 percent hard floor is "completely hardened" and the NOL credits "can't take you below." He said the \$5 per-barrel credits and the small producer credit are not changed by this; therefore, the economics of new production are less impacted.

MR. MAYER emphasized that for companies that had incurred expenses last year they were not able to deduct and hold - NOL credits for future deduction - and for companies undertaking work this year for which they are earning NOL credits because they are spending money in excess of their revenues and reinvesting during difficult times, the impact of hardening the floor immediately would be that those companies could no longer claim those credits they assumed they would have when they made the decision to undertake the work. He indicated that "they have to be claimed at some point in the future." He added, "And that's a substantial change in ... terms of investment for a company that had made decisions on that basis."

[10:19:34 AM](#)

MR. MAYER continued, stating that this approach is quite different, because it says to companies that the NOL credits that they earned in previous years and that they are earning this year can be continued and deducted against the tax

liability over the next several years and continue to reduce the tax liability over the next couple years below the 4 percent gross floor. He continued as follows:

Going forward though, for new expenses, effectively that 4 percent floor is hard against those new expenses. And so, by the time, for instance, when one looks at a fiscal note, when we get out to the later years - 2019, 2020, and beyond - the impact starts to look very similar to floor hardening, but then in the intermediate times it'll sort of graduate and move toward that harder floor regime, because credits that have already been incurred because companies made decisions understanding that they would receive the net operating loss credits - that isn't suddenly changed under these companies the way it would be by immediate floor hardening. I think that's the key difference that ... means that in terms of how the regime is perceived from a stability perspective what companies making these decisions can live with, this might be an entirely viable way to achieve that end in a way that the pure floor hardening, I think though, many, many more problems.

[10:20:53 AM](#)

REPRESENTATIVE TUCK commented that he was having difficulty hearing Mr. Mayer.

[10:21:12 AM](#)

CHAIR JOHNSON made inquiries to attempt to improve the audio, then asked Mr. Mayer to continue with his presentation.

[10:22:15 AM](#)

MR. MAYER continued with slide 2. He said one fundamental distinction that needs to be understood is that the switch to a loss carried forward system has the effect of hardening the floor against future losses, while not changing the fundamental treatments of NOL credits that have been earned thus far. For those companies deeply affected by any move from refunded credits to a system of loss carry-forwards, there is a transition between now and the end of 2019, on the North Slope, where some form of refundable credits will still be given. He said the refundable NOL will continue to exist for companies with less than 15,000 barrels a day production or with approved

plans of oil development or exploration between now and 2019, but will be capped at a maximum of \$75 million per company. He said this would be effective in reducing and eventually eliminating the state's liability on the refundable tax credit fund.

MR. MAYER stated that the refundable credits allow many smaller companies to undertake substantial work, in some cases new projects of \$1 billion or more in capital expenditure, with substantially less total capital than they would otherwise have acquired and with the ability to achieve total rates of return that are attractive to outside financing groups, such as private equity firms, in a way that might not otherwise be the case. If legislation dramatically changes that, a number of companies will have some difficult decisions to make about whether they can continue without anticipated programs and restructure in a way that will allow them to continue, for example, by bringing in larger or better capitalized partners or finding other working interest owners to share the burden or making a substantial change in their work program. The refundable NOL credit on the North Slope has enabled an entire class of much smaller companies to be present and do work on the North Slope, and taking that away, even gradually, will have substantial impacts. He emphasized the importance of understanding that and thinking through that tradeoff and how the tradeoff should be made.

[10:25:36 AM](#)

MR. MAYER showed slide 3 and said another difference between the committee substitute for HB 247 that was created by the House Finance Standing Committee and the one being proposed by the House Rules Standing Committee is regarding time limits on the gross value reduction (GVR). He said currently there are no time limits on how long new developments benefit from the gross value reduction. The House Finance Committee's committee substitute would have allowed the benefit of the gross value reduction for only five years from first production. He said that effectually eliminates a vast amount of the benefit of the gross value reduction, because in most cases, for the first five years of production, there are substantial, ongoing drilling expenses. These drilling expenses mean the company has relatively little tax liability, if any, in that time period anyway, so the gross value reduction applied to those first five years has relatively little effect. He said a 10-year horizon allows for much more benefit of the gross value reduction to be retained; 15 years would allow almost all the benefit, but 10

years would allow at least a substantial portion of the gross value reduction to be returned. He said the House Rules Standing Committee's version would allow 10 years, during which "the gross value reduction should end over time and new oil should, as they say, graduate to old oil, but it should happen at a point in time when some substantial part of the intended purpose of the gross value reduction of that benefit has been able to be realized."

MR. MAYER said in terms of Middle Earth tax credits, the House Finance Standing Committee's version and the House Rules Standing Committee's version are similar: there is a steeper cut-off, with an eventual full elimination of credits. He said that applies to all Middle Earth credits, with the exception of one specific exploration credit that would otherwise sunset July 1, 2016, but is extended to the last completion of wells (indisc.) of July.

[10:27:42 AM](#)

MR. MAYER, regarding interest due on delinquent taxes, said the House Finance Committee's version set it at 5 percent compounded quarterly for three years, then a [5 percent] simple interest after that point. He continued as follows:

That gets enormously complex when you think about the fact that we have [federal] plus 3 percent ... uncompounded at the moment we're already changing, and then this question of how that change is applied when you add a ... second change into the system that says that some period of time is one system, but then another. It gets very difficult to figure out how exactly this should work. This is going ... with a much simpler approach of saying there is one change, which is the 5 percent compounded quarterly.

MR. MAYER, regarding Alaska hire, echoed Ms. Delbridge's summary that [the House Rules Standing Committee's version] would create a preference for Alaska hire, not through the amount of refunded credits, but by placing companies with greater than 80 percent Alaska hire "higher in the queue for refundable credit payments." Further, he stated that private royalties could not go below zero.

[10:02:42 AM](#)

MR. MAYER directed attention to slide 4, which reflects common proposed changes in the House Finance Committee's version and the House Rules Standing Committee's version. He indicated that both versions address the issue of refundable credit withholding; the House Rules Standing Committee's version clarifies that a company would have to dispute a liability in order for withholding not to be used to settle that liability. Regarding .025(a)(6) Middle Earth exploration credits, "this simply specifies though they have to be in Copper River Basin." Regarding municipal production expense deduction, he said credits and deductions could only be claimed in proportion to taxable production for [municipalities] that own production and "used for their own purposes." He indicated there would also be the addition of a surety bond that had been seen in previous versions of the bill.

10:30:13 AM

MR. MAYER directed attention to slide 5, titled "Refunded Credits Reached New High in FY 2015." The bar graph on slide 5 shows, for example, that the amount involved would be more than \$800 million in FY 17. He stated, "It's an enormous amount of money relative to the state's finances as a whole at the moment; under current forecast those exceed \$1.3 billion between FY 15 ... [and] FY 17." He said it is split fairly evenly between the North Slope and the non-North Slope, the latter of which he indicated includes Cook Inlet, which has accounted for a substantial bulk of those credits. He stated, "These are essentially what are being eliminated over time by this CS."

MR. MAYER turned to slide 6, titled "Big Difference Between North Slope and Cook Inlet." He highlighted the following regarding Cook Inlet: no production tax, a much smaller basin with much smaller production, less royalty revenue, and - looking back at FY 15 - vast amounts of credit outflow, indicated by the light gray bars on the bar chart. Of the three bars, he noted: the left-hand bar shows the total for the state for FY 15; all the colored bars above the zero line are the revenues that come in through the oil and gas fiscal system; the gray bars show credit outflow in refundable tax credits of \$628 million. He said, "Fully \$404 [million] of that [credit outflow] in FY 15 was in the Cook Inlet." He said the two bars to the right of that show estimated numbers for the North Slope and Cook Inlet and clearly illustrate the great difference between the two, and "ending the ... outflow of credits in the Cook Inlet is clearly a particular priority in terms of I don't think anyone can look at that situation and think that that's

sustainable." He said the North Slope numbers show a greater degree between expenditures and incoming revenue, and because almost all the money being spent, in terms of refundable credits, is in the form of the NOL tax credits, the question is one of "recognizing expenses and whether we do it now or whether we do that later." He continued:

Through the refundable tax credit, we effectively recognize those expenses now and simply pay that amount out. The alternative is to have companies hold those expenses as things that they can deduct in future years, and that's what this bill would do.

[10:33:21 AM](#)

REPRESENTATIVE TUCK asked Mr. Mayer to confirm that very little in the way of corporate income taxes for Cook Inlet is collected.

MR. MAYER offered his understanding that is correct and is a function of a couple things: partly that Cook Inlet is a smaller basin with less production, but it is also a function of the corporate structure wherein Alaska levied corporate income tax on C Corporations, and the only companies that have to be C Corporations are those that want to list publicly and have access to capital markets. He concluded, "So, if you're able to be, for instance, privately held, you can use other structures like S corporations and LLCs, for instance, that don't pay Alaska's corporate income tax, and ... that also goes part of the way to explaining what you see there."

REPRESENTATIVE TUCK responded, "And it just looks like - to me - ... it's a sliver of everything else, too."

[10:34:38 AM](#)

MR. MAYER stated that slides 7-9 address the issue of changes on the North Slope in terms of ending refundability of the NOL credits, and eventually ending the NOL credit itself on the North Slope, what that would do to new developments by developers that currently rely on that credit being refunded, and what the impact is of the timeframe over which the gross value reduction can be taken. He drew attention to slide 7, titled "How Do Changes Impact New Field Development?" He said the chart on the left shows cash flow, and the modeling is for an 80-odd million barrel field that would produce at a peak of about 20,000 barrels a day, drilling from 30 wells, including

producers and injectors over a period of eight years, with total combined capital and drilling costs of \$1.3 billion.

MR. MAYER explained the colors on the left-hand chart. Purple and light blue indicate drilling and capital costs, respectively. He said negative capital amounts were in the early years. He related that capital expenses have to be incurred before, for example, drilling pads, basic facilities, and infrastructure are built. The light blue indicates the drilling that occurs after that point in time. He said the green indicates the revenue that comes after the project comes on line; there are ongoing drilling expenses for many years "after this project starts bringing in revenue and even after this becomes cash flow positive." Mr. Mayer said the dotted black line indicates the after-tax cash flow that the project receives, while red indicates the government take. He continued:

You can see red, in this case, is a positive amount from a company's perspective in the early years, and that's the impact of those refunded tax credits that we're talking about. And so, for instance, the fact that those are refunded and ... received as a payment by this company - that also means that the cash flow that they receive is not as steeply negative as it would be if they were paying, effectively, the full amounts of the CAPEX or the blue bars, because that's being offset by the credit that's being received.

MR. MAYER said the chart shows that for the first five years, there were substantial expenses being incurred. He said, "The red bars of government take are now negative; ... things like royalty, corporate income tax, and also production tax are relatively small compared to what they are later in the picture." Because of all that ongoing drilling and cost, there is little production tax liability for a project like this in the first five years. The bulk of the production tax liability occurs only after several years of production, which he said is crucial to understanding why a five-year gross value reduction limit is not that different in many ways to taking away the gross value reduction altogether.

[10:37:56 AM](#)

MR. MAYER turned to slide 8, titled "10 YR GVR LIMIT MITIGATES IMPACT ON PROJECT VALUE." He said the chart on slide 8 shows comparisons between the status quo and various results from

limiting the gross value reduction. The "X" axis is the number of years a limit is imposed, while the "Y" axis is how much of the original value is being taken away by making the change. The colored lines indicate different price changes: red is \$60/bbl; orange is \$70/bbl; [yellow is \$80/bbl]; green is \$100/bbl; and blue is \$130/bbl. He said the project is marginal at \$60/bbl; almost all of the net present value that exists in this project at this rate can be attributed to the gross value reduction. Without that, there would be no net present value left in the project. He continued:

For instance, when I say take that away, that's essentially, cost projective, the same thing as saying a zero-a-year limit for the gross value reduction, and you can see that at zero, the red line's at \$50/bbl - all of the value is gone. If you allow the gross value reduction for five years, that's still taking away about ... \$60/bbl - ... more than 60 percent of ... the project value. So, it's a very ... substantial impact by having a five-year limit.

That is less the case at higher prices, but you're still talking higher prices of somewhere between 20 and 45 percent of the value of a project being taken away by going from an unlimited GVR to a five-year GVR; it's a very, very substantial change to the system. Whereas, in a ten-year case, those amounts are all much less, and in general sort of at the 20 percent mark or at higher prices - 10 percent or less of ... value that's being taken away - and that's why consistently we've said if ... the desire is to see a limit - a point in time where new oil incentivized under the gross value reduction becomes old oil - 10 years or above makes a lot more sense to us than ... five years does, and that 10 years, of course, is what is represented in this bill.

[10:40:34 AM](#)

MR. MAYER directed attention to slide 9, titled "ENDING CREDIT REFUND IMPACTS CAPITAL NEEDS, IRR." He emphasized the importance of understanding the substantial impact that ending credit refunds on smaller companies would have. He said refunded credits have enabled a suite of smaller companies that may not otherwise have the resources to undertake major investments on the North Slope. Ending those credits would force major questions for those companies in terms of how they

continue. He said the chart on the bottom-left of slide 9 shows cumulative cash flow of a model with \$1.3 million in investments.

MR. MAYER said a company "under this current credit system" needs to have about \$350 million of capital, because once it has spent it, the project would be on line and generating revenue, with a self-sustaining cash flow. He said eliminating the refunded credit changes that substantially. For example, a company may need \$150 million to undertake a project like this. So, for companies that have already made decisions about certain projects, the question is whether they will be able to continue those investments without refunded credits or with only the next three years of credits at a \$75 million cap. He said it is a difficult question. He said there would be many for whom that sort of activity is possible if they bring in another partner - ideally one that can add substantial capital. He continued:

That's particularly the case when you think about the fact that what you've also done is sort of push up, effectively, the ... break-even or hurdle price, ... so that for any given IRRs that ... one might need to achieve to satisfy investors, the price level at which that occurs ... costs ... only about \$10 higher. And obviously it gets more difficult to ... bring in more capital when your entire rates of return and other things have deteriorated again because ... the refunded credit is going away.

MR. MAYER stated that clearly refunded credits are a difficult expense for the State of Alaska at the present time and need to be brought under control. He said that is particularly the case in the Cook Inlet where what the bill would do is "aggressive" in "a well thought out way." He said in terms of the North Slope, there is a difficult trade-off that needs to be made regarding the impact of the refunded credits paid out to oil companies and the substantial impacts that would be brought by eliminating them. He said it would have a substantial impact on what sort of companies could operate in the basin; it would bring hard choices to those companies as to whether they could continue and what would be required to enable that to occur.

MR. MAYER announced that that completed his presentation.

[10:44:12 AM](#)

REPRESENTATIVE HERRON referred to slide 8 and noted that the House Finance Committee's version of the bill had proposed a 5-year GVR, while the House Rules Standing Committee's version proposes a 10-year GVR. He noted there had been conversation in the legislature about considering a 7-year GVR. He asked what the project value would be at \$60/bbl and how a 7-year GVR limit might benefit the state.

MR. MAYER answered that a 7-year time limit would wipe out about 45 percent of current project value at a \$50 level, which is a substantial impact. He said bearing in mind that only a small portion of North Slope oil qualifies for the gross value reduction at the moment, "the key purpose here ... is to say what we're worried about is that eventually, over time, ... if there is no limit, more and more oil will become under the rubric of the gross value reduction." He stated, "In that context, whether it's 7 years or 10 years, it's not clear to me that that is quite so crucial from the state's perspective, ... as long as there is a limit that says at some point you graduate and become old oil, so more and more isn't cumulatively becoming new oil over time." He continued:

Whereas, while it's not a major difference, it seems to me, from the state's interest perspective, it is a major difference in terms of the impact on a new investment and what the original purpose of the gross value reduction was, and that's been the reason that we have said so far that if a limit's going to be put in place, we really think that 10 years is the sort of responsible minimum amount.

10:46:19 AM

REPRESENTATIVE KREISS-TOMKINS asked Mr. Mayer to confirm that slide 9 was supposing the same hypothetical project that is outlined on slide 7.

MR. MAYER answered that's correct. He added that slide 9 refers to the outcomes outlined on slide 7.

REPRESENTATIVE KREISS-TOMKINS asked how many barrels of GVR-eligible oil are projected to be produced next year and what "the effective value on reduced tax liability" would be for GVR-eligible oil. He then referred to the marked difference for the GVR and GVR limit in varying price environments on project value, as shown on slide 8, and asked if there had been thought or conversation related to tying GVR eligibility to a certain

price environment so that the GVR is not triggered [until the price of oil drops below a certain level], because he said in high-price environments, GVR eligibility is maybe not that vital to project viability.

MR. MAYER responded that he did not know how much GVR oil is forecast in the next year, but deferred to the Department of Revenue for that information. In terms of tying the GVR benefit to the oil price, he said Alaska's oil and gas production tax system started out with a few simple ideas back in 2006 and has become increasingly complex over the years. He continued:

Trying to take a benefit like this - particularly given that there are ... key other things that depend on that, such as ... if you're eligible for the gross value reduction or if it determines whether you're eligible for a fixed \$5 versus sliding \$8 credits - it seems to me likely only to add substantially more complexity. Which (indisc.) creates a lot of instability for the companies involved, right? A key part of all this is to say to any company that as much as possible, at the time you make a final investment decision, you can nail down and know as much as you can, okay? You have certain exposures that you can't change, like commodity price environment. But to the extent that we can make things as certain for you as possible, we want to do that to ... enable you to accurately evaluate your economics and know what you're getting into. And so, to ... the extent that you sort of make benefits like this contingent on the oil price environment seems to me adds a lot of complexity, doesn't necessarily provide a huge amount of benefit to the state in the broader context, but also adds, sort of, instability into the system, as well.

[10:50:24 AM](#)

CHAIR JOHNSON asked Mr. Mayer if it is normal for smaller companies to have partners or more usual for them to be "going it alone."

MR. MAYER answered that it is usual for small companies to have partners. He added that to some extent, credits have allowed small companies to do work in Alaska without a partner. He indicated that withdrawing the credits would force smaller companies to consider how to come up with the necessary capital

if bringing in a working interest partner is not a viable solution. He suggested the counter consideration is whether it has been difficult to get as many independent companies into Alaska as the state might have liked. He listed the North Slope being an expensive place to invest and produce and the issue of fiscal instability as reasons that Alaska, despite its enormous resource potential, has not "attracted as many independent players as one might like." He emphasized the huge role that credits have played, and suggested there would be cases where some smaller companies could make it work in Alaska without the credits, while others could not. He concluded, "I don't think anyone has a completely firm answer to that ... question."

CHAIR JOHNSON asked what impact the hardening of the floor would have on the industry and the state. He commented that it certainly would be a tax increase.

MR. MAYER confirmed that Chair Johnson is correct about the implicit hardening of the floor that occurs by taking away the NOL credits and switching to a pure, expense carry-forward system that has the impact of effectively raising the floor against future years' expenses. That is a substantial tax increase. He continued:

It, on the one hand, provides that sort of basic level of protection of the amount of revenue the state receives should we have an extended period of ... low prices. It also ... creates a corresponding liability, if you will, that says ... in the same way as that the pure hardening [of] the floor would mean that should prices stay low for a long period of time and companies' expenses not adjust, you could have mounting net operating loss credits, and you've seen that in some of the fiscal notes that the Department of Revenue has handed out previously, in the same way, under this system, you have, sort of mounting expenses. One of the things that's important to understand ... is because those expenses are at above the line rather than below the line amount, when you see them in credit terms, they're one amount of money; when you see them as expenses, they're about almost three times as much, because, of course, the question of multiplying them or dividing by 35 percent of the amount of the credits. Those two amounts are effectively the same thing, right? Above the line they look almost three times greater, because they're not being multiplied by 35 percent, but in terms of a

sort of ongoing liability that effectually, you know, is what's being held over to be claimed against companies' future tax liabilities, those two things are the same. So, one shouldn't sort of see bigger amounts in terms of expenses being carried forward on fiscal notes and be suddenly terrified by the fact that they grew three times bigger. That's simply an artifact of the fact that they're being shown as expenses to ... be deducted in the future rather than credits to be claimed in the future; they're still basically the same thing.

MR. MAYER said in terms of the impact on companies, they have already been paying effective tax rates in Alaska, at current prices, at or above 100 percent. He stated, "Obviously, hardening the floor makes life that much more difficult if we have an ongoing low-price environment for those companies." He continued:

The key difference here is that you're at least allowing the credits that have been earned so far - through work last year, through work being undertaken this year - that companies have already factored into all their planning in making those investments, but those can still taken, ... including against the floor, and that sort of more gradual imposition of the harder floor, I think, is crucial in creating something that on the one hand, provides some of the ... revenue certainty for the next couple years the state wants if we have an extended, ongoing period of low prices, while doing that in a way that doesn't fundamentally disrupt things for companies the way that pure ... floor hardening might have.

[10:56:10 AM](#)

REPRESENTATIVE TUCK requested that Mr. Mayer slow his pace of speaking when answering questions. He offered his understanding that the manner in which the floor is hardened is related to NOL credits, but asked if there is another way that the floor is hardened.

MR. MAYER answered that "while this bill doesn't explicitly harden the floor the way the others have done," it would have the implicit effect of doing so by ending the NOL credits and switching, instead, to a system of carrying forward expenses. He continued:

Because those expenses are carried forward above the line, as it were, there is no credit any more that can take you down below the floor. And so, for legacy production, that means that when we look solely from this point forward at future expenses and what those future expenses can do for companies, they can't take them below the gross minimum floor any more. The only thing for legacy production that could take those companies below the floor is net operating loss credits that they have already incurred before the end of 2016 that they can continue to claim against their gross minimum tax liability in the future, if we stay in that gross minimum tax world. And once those have worked their way through the system, the floor is at that point, effectively, for legacy production, completely hard. That's slightly different for new production, where ... things like ... small producer tax credits and other things that ... remain in the system could still reduce liability for new producers and for ... new production below the floor amount.

REPRESENTATIVE TUCK said it sounds like there is a hardening of the floor by cancelling net operating losses for any producer of over 15,000 barrels per day, whereas there is no floor for those with less than 15,000 barrels per day. He said, "I'm trying to find out where we were on how far the legacy wells can continue taking those net operating losses. Apparently they can still do the ones that they have now." He asked, "How far does that carry forward?"

MR. MAYER said for legacy producers there will not be any more credits after 2016; the credits they have earned up to that point can be taken against their tax liability for the next several years, depending on what that tax liability is. He clarified that once those tax credits work their way through the system, they will be done and completely eliminated.

[10:59:54 AM](#)

REPRESENTATIVE TUCK asked if it is possible to forecast when those credits would run out.

MR. MAYER recommended that Representative Tuck could get specific information from the Department of Revenue, because analytica does not have access to that sort of tax payer data. He relayed that a fiscal note he had seen indicated that "the

revenue difference between this and floor hardening was pretty similar" by 2020.

[11:01:01 AM](#)

REPRESENTATIVE KREISS-TOMKINS referred to slide 5, regarding past expenditure payouts, and - relating that to Chair Johnson's opening comments about Alaska's fortune waxing and waning - said he would like to know what the quantitative relationship is between credit investment in the industry and marginal increased production or revenue to the State of Alaska - the return on investment relationship.

MR. MAYER responded that when looking at slide 5, he would emphasize that Cook Inlet and the North Slope differ in terms of credit outlay and benefit to the state. In the Cook Inlet, he explained, there is no tax on oil and a very low tariff tax on gas, and credits are purely a means by which the state incentivizes behaviors that it wants to see. He continued:

What we have said so far in our analysis is when ... we look at the state of things in the Cook Inlet - particularly from the perspective of ongoing and additional investment in gas, which seems to us has always been the key ... aim of the credit program in the Cook Inlet - that ongoing drilling in the mature field is highly economic under most circumstances that one can imagine, particularly when one has ... \$6 or higher gas price.

... Development of new resources is fundamentally made difficult by a very limited gas demand - a very limited market to address - and ... unless one can find a way of changing that, credits have some effect at the margin, in terms of making almost impossible projects otherwise possibly vaguely viable and, as a result, we've seen ... one, new substantial gas project in ... the Cook Inlet on that front. But then, ultimately, unless that question of market ... size and market access can be addressed, credits by themselves haven't got a huge weight in solving that problem, and mostly what they've done is incentivize a lot of drilling for oil and cover a lot of costs for a lot of activity that in many ways is probably economic regardless.

... This is a program that, I think, made a lot of sense when the overall fiscal system was bringing in up to \$10 billion in annual revenue, these were small amounts of money we're talking about to try to stimulate activity in the Cook Inlet and turn that basin around. The cost of that program is much, much harder to justify, I think, in ... the current time, given all those things.

MR. MAYER reiterated that the North Slope is a different situation, because the only substantial credit remaining is the NOL credit, and that really is a question of the timing of cash flows rather than absolute amounts. He said that credit is given in recognition of expenses that have been incurred that would otherwise be held over and deducted against future revenue. He said, "It's a cash outlay now in place of lower revenue in the future. By not having that now, you're solving a major, sort of, cash flow timing problem for the state, but that's revenue that one might have in the future, instead." He continued:

So, understand in that sense that the question on the North Slope about net operating loss refundable tax credits is all about timing of cash flow and the fact that the outlay and ... spending that money and then providing it to smaller companies now who qualify is really difficult from a cash perspective at the moment, but it doesn't change fundamentally the amount of revenue that the system over time itself will generate.

[11:06:40 AM](#)

REPRESENTATIVE HERRON remarked to Chair Johnson that by FY 17 nearly all the credits already will have been earned, so there will be "a significant invoice when those come due." He asked, "But is this version - your version - is it your intent to get rid of them over time and then not pay credits to people that will not seek reduction in the future?"

CHAIR JOHNSON answered that he thinks that is, in general, an accurate statement. He indicated that the state would like to continue to incentivize companies, but it needs to ask what it can afford. He questioned whether the state could continue to write checks to oil companies "in this environment." He said he thinks Representative Kreiss-Tomkins "hit the nail on the head" with his remark that the state had incentives that worked in the

Cook Inlet and on the North Slope, and the state continues to pay those out while in the midst of a revenue shortfall. He opined that the state certainly does not want to be paying credits to companies that are never going to pump a barrel of oil, but wants to incentivize those that might. He added, "But this is what we can afford and what's ... out there."

[11:08:44 AM](#)

REPRESENTATIVE TUCK restated that he had had trouble hearing Mr. Mayer's presentation, but would listen to the audio recording before the next meeting.

CHAIR JOHNSON said Ms. Delbridge would be available to anyone to answer questions, and he proffered that Ms. Delbridge could get specific questions answered by Mr. Mayer.

[HB 247 was held over.]

[11:09:28 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Rules Standing Committee meeting was adjourned at 11:09 a.m.