

SENATE FINANCE COMMITTEE  
May 17, 2016  
9:08 a.m.

9:08:01 AM

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:08 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Pete Kelly, Co-Chair  
Senator Peter Micciche, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Laura Cramer, Staff, Senator Anna MacKinnon; Randall Hoffbeck, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Senator Cathy Giessel; Senator Mia Costello; Representative Tammie Wilson.

SUMMARY

2d CSHB 247(RLS)am

TAX;CREDITS;INTEREST;REFUNDS;O & G

SCS 2d CSHB 247(FIN) was REPORTED out of committee with "no recommendation" with one new fiscal impact note from the Department of Revenue; and one previously published zero fiscal note: FN 5(DNR).

#hb247

2d CS FOR HOUSE BILL NO. 247(RLS) am

"An Act amending the powers of the board of trustees of the Alaska Retirement Management Board to authorize purchase and sale of transferable tax credit certificates issued in conjunction with the production tax on oil and gas; relating to interest applicable to delinquent tax; relating to the oil and gas production tax, tax payments, and credits; relating to exploration incentive credits; 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 confidential information status and public record status of information in the possession of the Department of Revenue; relating to oil and gas lease expenditures and production tax credits for municipal entities; requiring a bond or cash deposit with a business license application for an oil or gas business; establishing a legislative working group to study the fiscal regime and tax structure and rates for oil and gas produced south of 68 degrees North latitude; and providing for an effective date."

[9:08:38 AM](#)

Vice-Chair Micciche MOVED to ADOPT proposed committee substitute for 2d CSHB 247(RLS)am, Work Draft 29-GH2609\Z (Nauman/Shutts, 5/17/16).

Co-Chair MacKinnon OBJECTED for discussion.

[9:09:00 AM](#)

AT EASE

[9:10:29 AM](#)

RECONVENED

LAURA CRAMER, STAFF, SENATOR ANNA MACKINNON, discussed the sectional analysis for SCS CSHB 247(FIN) (copy on file):

\*Section 1: Relates to the Alaska Oil and Gas Conservation Commission's determination of the commencement of regular production of oil eligible for a Gross Value Reduction. Conforms to Section 31

\*Section 2: Removes reference to the explorer incentive credit from the provisions of the Department of Natural Resources audit statutes

\*Section 3: Removes reference to the explorer incentive credit from the provisions of the Department of Revenue royalty and net profits payments

\*Section 4: Removes reference to the explorer incentive credit from information the Department of Natural Resources would obtain to carry out their responsibilities and functions

\*Section 5: Removes reference to the explorer incentive credit from information that is kept confidential as the result of an audit

\*Section 6: Removes reference to the explorer incentive credit from the publishing of statistics

\*Section 7: Changes the interest rate of delinquent taxes effective January 1, 2017 to 7% above the Federal Reserve rate, compounded quarterly for three years. For the following years of the statute of limitations, no interest would be accrued

\*Section 8: Conforms to the new definition of outstanding liability found in Section 26

\*Section 9: Conforms to the new definition of outstanding liability found in Section 26  
\*Section 9: Conforms to the new definition of outstanding liability found in Section 26

\*Section 10: Reduces, then eliminates, the in state refinery tax credit. Reduces by 50% January 1, 2017 and eliminates the credit January 1, 2018

\*Section 11: Conforms to the new definition of outstanding liability found in Section 26

\*Section 12: Removes the sunset on the Cook Inlet gas tax cap

\*Section 13: Removes the sunset on the Cook Inlet oil calculation, and imposes a tax not to exceed \$1 per barrel of oil

Ms. Cramer noted that the oil tax in Section 13 was equivalent to the amount of tax on gas in the Cook Inlet.

[9:13:16 AM](#)

Ms. Cramer continued reviewing the sectional analysis:

\*Section 14: Removes the sunset on the cap for gas produced in state for use in state

\*Section 15: Calculation for Cook Inlet oil and gas taxes

\*Section 16: Reduces the qualified capital expenditure in Cook Inlet sedimentary basin from 20% to 10%

\*Section 17: Reduces the net operating loss in the Cook Inlet sedimentary basin from 25% to 15%, prevents the Gross Value Reduction on the North Slope from increasing the size of the net operating loss when calculating the net operating loss

\*Section 18: Eliminates the net operating loss for the Cook Inlet

\*Section 19: Conforms to the elimination of the qualified expenditure found in Section 16

\*Section 20: Conforms to the elimination of the qualified expenditure found in Section 16

\*Section 21: Reduces the well lease expenditure in the Cook Inlet from 40% to 20%

\*Section 22: Conforms to subsequent changes related to the tax credit fund (43.55.028)

\*Section 23: Establishes a per company limit of \$70 million annually for eligible purchases from the Department of Revenue; prevents an applicant from dividing into multiple entities; and reestablished the 50,000 barrel per day limit on accessibility to the fund

\*Section 24: Restricts repurchasing for tax credits to a preference of at least 75% of the applicants workforce being Alaska residents. Divides the annual repurchase limit per company into two categories: first 50% of the annual eligible appropriation can be repurchased at 100% of the certificate value; and the second 50% can be repurchased at 75% of the certificate value

\*Section 25: Conforms to Section 24

\*Section 26: Creates a definition of outstanding liability to the state. Allows the Department of Revenue to restrict repurchase of credits after notifying the applicant for any liability related directly to the applicant's oil or gas exploration development or production

\*Section 27: Conforms to the elimination of the well expenditure credit and the qualified capital expenditure credit found in Section 41 effective January 1, 2018

\*Section 28: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 29: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 30: Imposes a lifespan on the Gross Value Reduction for a term of seven years, or three years, consecutive or nonconsecutive, in which the annual

price on Alaska North Slope crude oil sales averages more than \$70 per barrel

[9:16:13 AM](#)

Ms. Cramer continued to discuss the sectional analysis:

\*Section 31: Conforms to the Gross Value Reduction lifespan found in Section 30, and directs the Alaska Oil and Gas Conservation Commission to determine the commencement of regular production of eligible oil

\*Section 32: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 33: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 34: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 35: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 36: Conforms to the elimination of the qualified capital expenditure found in Section 41

\*Section 37: Limits a municipality from receiving a credit to only an amount that is proportionate to its taxable gas

\*Section 38: Creates a new definition of the qualified capital expenditure to conform with the elimination of the qualified capital expenditure found in Section 41

\*Section 39: Requires an applicant engaged in oil or gas exploration, development, or production to file a surety bond in the amount of \$250,000 to the state; creates new Alaska Statute 43.70.028, stating that the surety bond is meant to satisfy claims for labor, employee benefits, taxes and contributions due to the state, city, and borough, material and equipment claims for negligent or improper work or breach of contract, repair of public facilities

\*Section 40: Repeals listed statutes effective January 1, 2017

\*Section 41: Repeals listed statutes effective January 1, 2018

\*Section 42: Applicability language

\*Section 43: Transition language for oil refinery credits

\*Section 44: Transition for the qualified capital expenditure and well lease expenditure credits

\*Section 45: Transition language for the net operating loss credit

\*Section 46: Transition language for lease expenditure language removed

\*Section 47: Regulations language for Department of Revenue, Department of Natural Resources, Department of Commerce, Community, and Economic Development, and the Alaska Oil and Gas Conservation Commission

\*Section 48: Retroactivity clause

\*Section 49: Effective dates for authorization of regulations effective immediately

\*Section 50: Effective date of January 1, 2018 for Sections 18 -20, 22, 25, 27 - 29, 32 - 36, 41, 43 - 46, and for the new definition of qualified capital expenditure

\*Section 51: Effective date of all previously unlisted sections of January 1, 2017

Ms. Cramer pointed out that there were items removed from the bill version the committee had received from the other body. The items removed included language related to the Alaska Retirement Management (ARM) Board repurchasing credits; language related to disclosure of company info-related credits; language preventing the gross value at the point of reduction being less than zero; and language preventing an annual true-up of the per-barrel credit on the North Slope for legacy oil. She added that the House Rules Committee substitute had eliminated the Net Operating Loss (NOL) credit, and replaced it with the ability to carry forward lease expenditures. She continued that the version that was amended on the House floor and passed to the Senate did not contain the language, so effectively there was no language in the committee substitute (CS) that hardened the floor directly or indirectly.

Co-Chair MacKinnon REMOVED her OBJECTION. There being NO further OBJECTION, the proposed committee substitute was adopted.

[9:20:19 AM](#)

AT EASE

[9:20:46 AM](#)

RECONVENED

Co-Chair MacKinnon thanked the Legislative Legal Department and the Legislative Finance Division for their work on the CS. She shared that the committee was trying to move as quickly as possible while ensuring accuracy. She encouraged

the legislature and the public to notify her office of any errors. She continued that the committee had worked with the Department of Administration, the director of the Tax Division, as well as Commissioner Randall Hoffbeck over the preceding twelve hours to ensure the group had an initial opportunity to provide a fiscal note. She asserted that the committee would continue to work to make necessary changes.

9:22:33 AM

AT EASE

9:23:26 AM

RECONVENED

Co-Chair MacKinnon recognized Senator Cathy Giessel and staff for their work on vetting language for the committee's consideration. The Senate Resources Committee had been following the bill and trying to provide feedback to the committee.

Vice-Chair Micciche MOVED to ADOPT Amendment 1:

Page 5, line 26:

Delete "and"

Page 5, line 28, following "year":

Insert "; and

(3) the aggregate amount of tax credits purchased under each statutory section or subsection, as applicable, for the preceding calendar year, classified to prevent the identification of a particular taxpayer"

Co-Chair MacKinnon OBJECTED for discussion.

Vice-Chair Micciche discussed Amendment 1, which he noted was technically incorrect with reference to the location of the amendment. He stated that it would be incorporated the redrafting of the bill. He continued that the amendment would allow the Department of Revenue to put out a report that categorized and aggregated tax credits to be made available for the review of the public and the legislature.

Co-Chair MacKinnon WITHDREW her OBJECTION. There being NO further OBJECTION, it was so ordered. Amendment 1 was conceptually amended to technically conform to the committee substitute.

9:25:44 AM

RECESSED

4:15:49 PM

RECONVENED

Vice-Chair Micciche MOVED to ADOPT the committee substitute for 2d CSHB 247(RLS)am, Work Draft 29-GH2609\AA (Nauman/Shutts, 5/17/16).

Co-Chair MacKinnon OBJECTED for DISCUSSION.

4:16:52 PM

AT EASE

4:19:07 PM

RECONVENED

Ms. Cramer discussed the document, "Summary of Changes from Z to AA," (copy on file):

\*Section 7: New section, conforms to confidentiality disclosure requirements under the newly created Section 9

\*Section 8: Corrects drafting error to correct the interest rate at 7% on delinquent taxes

\*Section 9: Confidentiality provision

\*Section 24: Adds language for oil graduating from gross value reduction eligibility to legacy oil eligibility. Ensures newly classified legacy oil is able to receive the sliding scale per barrel credit

\*Section 25: Adds language for oil graduating from gross value reduction eligibility to legacy oil eligibility. Ensures newly classified legacy oil is able to receive the sliding scale per barrel credit

\*Section 28: Clarifies the original intent of this section. Of a company's annual repurchase limit (\$70 million), established in Section 27, the following restrictions are imposed: up to the first \$35 million is eligible for reimbursement at 100% of the certificate value; the second \$35 million is eligible for reimbursement at 75% of the certificate value

\*Section 29: Conforms to the changes in Section 28

All sections and references to effective dates have been renumbered and reordered accordingly.

Co-Chair MacKinnon WITHDREW her OBJECTION. There being NO further OBJECTION, the proposed committee substitute was adopted.

Senator Dunleavy asked if the committee would be reviewing fiscal notes for the bill.

Co-Chair MacKinnon answered in the affirmative.

[4:21:51 PM](#)

AT EASE

[4:23:32 PM](#)

RECONVENED

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, referred to his opening remarks pertaining to the bill made in earlier meetings. He reflected that there were many portions of the bill that had retained the House version language, as well as some changes. He informed that his department had structured its presentation using the House version of the bill as a baseline, and then showing changes to the bill and flagging areas of the bill that were in the original Senate Resources Committee substitute.

Co-Chair MacKinnon asked to start with a review of the DOR fiscal note (OMB component 2476).

Senator Dunleavy referred to recent communications he had observed (on blogs or newsletters) asserting that if the state took action on oil and gas tax credits, it would realize a \$775 million reduction in spending in the current year. He did not consider the assertion was true, and wondered if testifiers could address the matter.

Commissioner Hoffbeck agreed with Senator Dunleavy, and stated that the \$775 million that was referenced was in credits that had already been earned, was a liability the state had acquired, and needed to be paid. He continued that the legislation concerned forward-looking credits and liabilities.

Senator Dunleavy thought the \$775 million was a liability the state must honor and pay.

Commissioner Hoffbeck concurred.

Senator Dunleavy thought it was important to clarify the matter, and thought there was confusion on the issue.

4:26:28 PM

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, thought that none of the versions of the bill had tremendous impact on the FY 17 budget spend. He noted that the governor's original bill, which had a retroactive hardening of the floor, would have had brought in more money yet would not have reduced spending on the tax credits. He furthered that the aforementioned \$775 million subject to appropriation, was the obligation of the state. He explained that, presuming the major changes in the bill took effect in 2017, the credits that were earned in calendar year 2017 would impact the spend on repurchasing them in FY 19. He summarized that there was a two-year gap between the expense and the actual expenditure by the company.

Mr. Alper continued discussing the bill, and noted that the fiscal note used a structure that was used for previous versions of the bill. He commented that he did not fully understand all the accounting mechanics of the fiscal note.

Co-Chair MacKinnon mentioned the \$700-plus million that Mr. Alper had referred to, and asked if the amount was affected by the Governor's \$200 million veto [in FY 16].

Mr. Alper answered in the affirmative. He furthered that the expectation of credits earned (normally due in FY 17) was approximately \$575 million. The number expected in FY 16 was \$700 million, but only \$500 million was funded due to the governor's veto. The remaining \$200 million obligation would roll forward and increase the \$575 million to a total of \$775 forecasted for FY 17.

Co-Chair MacKinnon asked to clarify that it had been the governor's intent, rather than the legislature, to fund only \$500 million.

Mr. Alper answered in the affirmative. He recounted that the governor had put a \$500 million cap on tax credit spending, and noted that the \$700 million that was in the budget that passed the legislature was an estimate. The way the budget had been drafted, the amount presented for repurchase (of tax credits) was appropriated. The

governor's veto had removed the syntax and replaced it with the amount of \$500 million.

Senator Bishop emphasized that the estimate of \$775 million was a debt owed, and was a debt that would be repaid.

Mr. Alper concurred, and furthered that the governor's initial submission of the bill had come with a fund capitalization fiscal note in excess of the amount, to pay off the obligation.

Co-Chair MacKinnon expressed appreciation for the clarity, and thought it was confusing when people started discussing 100's of millions of dollars in what the state owed and what we might owe. She asserted that the state planned on paying its credits; and that the governor was proposing to pay the credits, including the \$200 million that was vetoed.

Mr. Alper concurred, and furthered that the changes made in the legislation (should it pass) would affect state spending to a substantial degree in future years, however there was not much that could be done about the \$775 million.

[4:30:05 PM](#)

Vice-Chair Micciche referred to the 2016 Revenue Sources Book, which he considered out of date regarding oil prices, and possibly containing some "spin" on credits and other issues. He wondered when an update would be available to reflect the impact of the credit spend and production tax revenue.

Mr. Alper was confident in the estimate of the \$775 million debt, which had evolved from the fall forecast. He conveyed that once the state ran out of money in the fund, there would be approximately \$650 million worth of obligation request applications that were currently before the tax division. There were many more coming in, including some large exploration expenditures. He thought the difference from the forecast would be if the price of oil exceeded the estimated \$39 per barrel, and the carried-forward NOL credits (not cashable for major producers) would be dramatically lower than previously estimated and shown on the fall forecast.

Vice-Chair Micciche asked for elaboration on the term "dramatically."

Mr. Alper relayed that at the end of FY 16, the tax division was estimating \$657 million in obligation requests, and at the end of FY 17, the division was estimating a little over \$600 million. He stated for every dollar the price of oil moved above the estimate of \$39, the amount would reduce by \$65 million. He summarized that if the price was \$5 greater than estimated, it would equate to \$325 million less.

Co-Chair MacKinnon asked Senator Bishop for the current price of oil.

Senator Bishop stated the price of oil was \$48.01 per barrel. He clarified that the price was West Texas Intermediate (WTI), and was not adjusted for Alaska North Slope crude oil (ANS).

Mr. Alper confirmed that if the price of oil stayed at \$48 per barrel through the end of FY 17, the state would not have carried forward NOL credits to any substantial degree.

Co-Chair MacKinnon appreciated having the information on the record.

Mr. Alper continued discussing the fiscal note, explaining that the structure of the note showed revenue, but the reduction and expenditure were not reflected on the cover page, because the numbers were for a budget that did not yet exist. The front page of the fiscal note showed \$10 million to \$12 million in new revenue; which mostly came from a new tax on the Cook Inlet side, as well as from a sunset of certain credits that would be used against tax liability. He explained that the \$10 million represented only a small part of the story, and the great bulk of the fiscal impact was on the reduced expenditures reflected on the large table on page 4 of the fiscal note.

Mr. Alper continued discussing the fiscal note, which he considered to be complicated. He directed attention to the sub-heading "Total Revenue Impact" on page 4 of the fiscal note, which summed up the new revenue that came from the various changes in the bill. The line showed ranges of numbers for subsequent fiscal years, which were represented on the first page under the bottom line "Change in

Revenues." He highlighted a second subtotal under the subheading "Total Budget Impact," which represented a reduction in spending, or a decrease in the state's obligation to buy credits in future years. He continued that the next grey subtotal, "Total Fiscal Impact," was the sum of the two subtotals, or the net impact of the additional revenue plus the reduction in spending. He asserted that the bill would reduce state spending and increase its revenue in the amount of approximately \$125 million on average over the next 3 to 4 years, beginning in FY 18.

[4:34:32 PM](#)

Co-Chair MacKinnon stated that she had heard individuals combining four to five years together and suggested there was \$500 million worth of savings during a four year time period.

Mr. Alper thought Co-Chair MacKinnon made a fair statement.

Co-Chair MacKinnon wanted to revisit the topic of debt owed to a group of taxpayers. She wondered how many individual companies were qualified to receive the amount of funds being discussed.

Mr. Alper stated that different companies filed differently, which made the question difficult to answer. Sometimes an operator filed on behalf of all partners, and other times the same project might have a dozen different applicants due to the differing ways of internal accounting. He thought the tax division wrote 50 to 60 different checks for tax credits in a given year.

Co-Chair MacKinnon was raising the issue because she thought there was a sentiment in the general public that only three taxpayers were receiving a huge number of tax credits from the liability that the state had on its books, while in reality the people that the state was paying the \$775 million to many more entities. She wondered if the payees included "the big three" [BP, Exxon Mobil Corp., and ConocoPhillips].

Mr. Alper clarified that the big three were specifically excluded from getting cash credits. Alaska statute stipulated that when a company produced more than 50 thousand barrels a day, it was not eligible to get cash

repurchases for credits. In such cases, the companies carried the credits forward to use against a future year's tax liability. When there was the issue of the NOL carry-forwards (when the price of oil was very low), it was because the major producers explicitly could not get cash for their credits.

Senator Dunleavy referred to the \$775 million figure, and wondered how much of it was from Cook Inlet as opposed to the North Slope.

Mr. Alper referred to the spring revenue forecast and noted the information was on Table 8.4 of the publication. The FY 17 forecast showed \$447 million in tax credits for North Slope, and \$325 million in tax credits for non-North Slope (predominately Cook Inlet). He stated that although the Cook Inlet area had comprised roughly 60 percent of the total in past two years, the numbers were changing and in FY 17, 60 percent were for the North Slope.

Senator Dunleavy thought the numbers were important if the bill were to go to the floor for debate.

Mr. Alper stated that in the FY 17 forecast there was an unusually large number of \$120 million in exploration credits, believed to be due to the impending sunset of the exploration credit. He thought companies had done some exploration work the previous year in order to earn the credits while it was still possible.

[4:38:26 PM](#)

Vice-Chair Micciche observed that without the changes proposed in the CS, the assumed total refunded credit liability for the state trickled off substantially and then leveled off around \$250 million per year from 2021 through 2025. He asked if Mr. Alper could explain.

Mr. Alper stated that the state's credit forecast was tied very closely to the production forecast and the lease expenditure forecast. Data provided twice a year by the companies would communicate information about wells and fields, and how much the companies intended to spend. He continued that the forecasts tended to shrink in the out years due to uncertainty about future activity. He referenced \$250 million as the "stabilizing placeholder"

that was an estimate; since after three or four years estimates were very weak in terms of known activities.

Vice-Chair Micciche asked if the changes in the bill (if it passed with the Cook Inlet credits) would cause a change in the next forecast for FY 17, then from FY 18 forward there would be a significant reduction.

Mr. Alper expected that the non-North Slope numbers to be very close to zero around FY 20. He referred to the "Total Budget Impact" line on the fiscal note, and directed attention to the range of numbers starting in FY 20. He thought for the sake of simplicity, one could equate the ranges to equal approximately \$125 million, which would be half of the estimated spend of \$250 million per year.

Co-Chair MacKinnon asked if there was anything on the fiscal note that Mr. Alper wanted to highlight.

Mr. Alper noted that there had been a draft fiscal note that did not include the narrative, and the numbers had since changed and would need to be moved slightly back. The change had to do with the bill revision in Section 28 as previously discussed by Ms. Cramer. He referred to changes to Version Z of the bill, that stated that of a credit under the \$70 million cap, half would be paid at the full amount and half would be paid at the 75 percent rate. The department had worked the interpretation into line "C" on the second half of the fiscal note. The new CS, or Version AA of the bill, stipulated that the first \$35 million of the credit would be paid at the full amount, while any amount in advance would be paid at the smaller amount. He summarized that the sum of the smaller credits made a material difference. The difference would equate to approximately \$15 million or \$20 million less than what was shown on the fiscal note.

Co-Chair MacKinnon expressed appreciation for work that had been done the previous evening.

Mr. Alper recounted working with the Commissioner Hoffbeck and updating the fiscal note using the language of the new committee substitute.

[4:42:20 PM](#)

Mr. Alper discussed the presentation, "Oil and Gas Tax Credit Reform; Senate CS to CS HB247(FIN); Department of Revenue; Initial Review of Changes in Senate Finance CS; May 16, 2016" (copy on file). He addressed slide 2, "Introduction":

- This bill is substantially changed from what passed the House
- We have attempted to describe the changes made in the current CS, but have only had the document for a few hours. We apologize for any oversights
- We're using the same format as we did on Friday and Saturday before this committee, describing the prior two versions of the bill
- To color-code our text:
  - Purple items are as they are in the "House" version
  - Red items are as they are in CSSB130(RES)
  - Black items are current law but not in either version
  - Blue items are new to this version

Mr. Alper looked at slide 3, "Major Provisions in SCS-CSHB247(FIN)":

1. Exploration Credits
  - House bill
    - Allows existing credits to sunset on 7/1/16
    - Keeps "middle earth" extension to 1/1/22
    - Repeals older dormant DNR exploration credits
    - Extends the "Frontier Basin" credit one year to protect ongoing AHTNA investment
  - Senate Finance CS
    - Keeps the first three changes from the House
    - Does not include the Frontier Basin extension

Mr. Alper noted that there had been four major changes from the House version of the bill. He noted that the component to extend the Frontier Basin credit was not in the CS before the committee, and was scheduled to sunset on July 4, 2016.

Mr. Alper highlighted slide 4, "Major Provisions in SCS-CSHB247(FIN)":

2. Cook Inlet (and Middle Earth) Credits

- House bill
  - NOL kept at 25% in 2017 but only if producing by end of 2016. To 0% in 2018
  - QCE repealed 7/1/16
  - WLE reduced to 20% for 2017 and zero in 2018
  - Middle Earth maintained at 25% NOL if under a POD, along with a 10% QCE
- Senate Finance CS
  - NOL reduced to 15% in 2017 and zero in 2018
  - QCE reduced to 10% in 2017 and zero in 2018
  - WLE reduced to 20% in 2017 and zero in 2018
  - Middle Earth same as Cook Inlet with full elimination of all three credits by 2018

Mr. Alper thought that slide 4 was substantive, and commented that all versions of the bill had been working with the same set of components. The Middle Earth credit regime and its relationship to other credit regimes was a variable that could be seen to change throughout differing versions of the bill. He pointed out that the reduction in the NOL rate was language from an earlier version of the bill, and the qualified capital expenditure (QCE) credit language was new. He continued that the well-lease expenditure (WLE) change listed on the slide was taken from the House version of the bill, and the arrangement of Middle Earth credits referenced at the bottom of the slide was new to the version of the bill being considered.

Mr. Alper continued to discuss the NOL, QCE, and WLE reductions included in the CS and listed on the bottom of the slide. He summarized that the elements would be approximately be cut in half for a year of transition in 2017, and then the tax credit system would go to zero. The state would no longer be offering credits for capital expenditures or operating losses in Cook Inlet and in Middle Earth beginning January 1, 2018. He specified that the credits earned in 2017 would still show on the books through FY 19, because of the natural delays of tax filing and receipt and cashing of credits. The first year with zero Cook Inlet credits being spent would be FY 20.

[4:46:03 PM](#)

Mr. Alper looked at slide 5, "Major Provisions in SCS-CSHB247(FIN)":

### 3. Cook Inlet (and Middle Earth) Taxes

- House bill
  - Moves up 2022 tax cap sunset to 2019, for Cook Inlet gas, Cook Inlet oil, and Gas Used in State (GUIS)
  - Imposes a high underlying tax in 2019; expectation of new system as proposed by "working group"
- Senate Finance CS
  - Eliminates sunset of Cook Inlet Gas and GUIS tax caps
  - This extends indefinitely the Cook Inlet Gas and GUIS tax at an average of 17.5 cents/mcf
  - Adds a new Cook Inlet oil tax cap of \$1.00/bbl
  - No sunsets, no working group. These are intended to be long term changes

Mr. Alper discussed the different types of what was considered "in-state" gas. He specified that gas used on-well for production purposes was not taxed; as opposed to gas sold to the Trans-Alaska Pipeline System (TAPS), and gas sold to the municipal utility in Barrow. He pointed out that the Cook Inlet oil tax cap referenced on the slide was new to the CS. He quantified that there was roughly 5 million taxable barrels of oil produced in Cook Inlet per year, all sold through local refineries and able to make a \$5 million revenue impact after the change.

Vice-Chair Micciche thought the committee had been focused on credit exposure, and had evaluated the value of the credits in both basins. He suggested that the state did not have the money for some of the credits. He referred to the statement on slide 5, "These are intended to be long term changes," and recognized that the committee did not have foresight into what would happen with future legislatures or future Cook Inlet production.

Mr. Alper stated that recent state history had proven that the government tended to re-address the matter of tax credits every few years.

Vice-Chair Micciche thought that stability was important and did not want to endlessly revisit the subject. He

emphasized that the legislature's focus was managing the environment of a low oil price with a high fiscal gap.

[4:49:46 PM](#)

Mr. Alper discussed slide 6, "Major Provisions in SCS-CSHB247(FIN)":

4. North Slope Credits, Limits, Carry-Forwards
  - House bill
    - No NOL credit or carry-forwards after 2016 for companies producing over 15,000 barrels / day
    - Smaller producers still eligible for refunded NOLs with cap of \$70 million / company / year
    - Must be from a lease from which the state receives a royalty, under a plan of development, and in which the producer has a working interest
    - NOL rate ramps down: 32% in 2017; 29% in 2019; 26% in 2021; 25% in 2023

Mr. Alper noted that slide 6 and 7 worked together. He pointed out that the ramp-down of the NOL rate would reduce future liabilities as well as the level of future incentive.

Mr. Alper highlighted slide 7, "Major Provisions in SCS-CSHB247(FIN)":

4. North Slope Credits, Limits, Carry-Forwards
  - Senate Finance CS
    - Limit for cashing credits remains 50,000 barrel / day
    - Cap for refunds \$70 million / company / year
    - First half of each credit certificate, up to the cap, is paid at face value. Second half is paid at 75% of face value or, at the company's option, can be carried forward into a future year
  - NOL rate remains 35%
    - In the case of a company with \$70 million in certificates, they will receive \$61.25 million in payment ( $\$35 + 75\% \times \$35$ ), which equals an effective NOL rate of 30.6%

Mr. Alper stated that the changes to the bill on slide 7 were quite broad. He noted that the third bullet on the slide was the point at which his presentation diverged from

the most recent changes of the bill as presented earlier by Ms. Cramer.

Vice-Chair Micciche remarked that the governor's bill, the bill that passed the House, and the bill that was before the committee had morphed between a net tax and a gross tax system. He thought that by eliminating the carry-forwards and some of the NOLs, which he thought were present in most business-type taxes, the bill became somewhat of a gross tax.

Mr. Alper stated that the current tax was a net tax, although the gross minimum floor imposed the idea of a gross tax at certain lower prices below a crossover point. He continued that because of the operating losses, once a company went below zero it more or less reverted back to a net tax for carry-forwards. The House version of the bill had kept the structure of the net tax becoming a gross tax as it got lower, and then staying gross as it went negative.

Vice-Chair Micciche recalled that the governor's bill had not dealt with carry-forwards, and the estimated carry-forward exposure had been \$1.2 billion at the end of FY 20. He reflected that the CS was closer to the House version of the bill, with less than half of the remaining exposure in FY 20 in the governor's bill.

Mr. Alper stated that the governor's bill had dramatically increased the carry-forward exposure, primarily because the bill was a firm hardening of the floor. Companies would have had to pay the full 4 percent, which would have added another \$150 million to \$200 million per year to the exposure. The status quo number (the official forecast for the end of FY 20) was \$585 million. He considered the CS was a small and not dramatic decrease from the status quo.

[4:54:52 PM](#)

Mr. Alper addressed slide 8, "Major Provisions in SCS-CSHB247(FIN)":

5. Minimum Tax Changes

- House bill
  - Adds a 5% "floor" but only if yearly price is over \$70 / bbl. Doesn't harden against additional credits

- Because NOLs are no longer carried forward by large producers, floor indirectly hardened
- Revenue impact delayed to 2020 because pre-effective date NOLs can still be used to go below floor
- Senate Finance CS
  - No increase to minimum tax
  - No hardening of floor against NOLs, new oil per-barrel credits, or other credits

Mr. Alper discussed the hardening of the floor and historical changes. He pointed out that the CS went back to default language that was in existing statute. There was no increase to the minimum tax, and hardening of the floor. The original governor's bill had looked to harden the floor against the per-barrel credits of new oil or gross value reduction (GVR) eligible oil. He stated that although the per-barrel credit was limited by the floor for legacy oil, the per-barrel credit could still go to zero for new oil. Additionally, there was a change to the definition of "new oil," which he would address further.

Mr. Alper looked at slide 9, "Major Provisions in SCS-CSHB247(FIN)":

#### 6. New Oil "GVR" Provisions

- House bill
  - 7-year "graduation" of GVR oil to become legacy oil 5-year graduation for 10% additional GVR for high-royalty fields
  - If the average price of oil exceeds \$70 for any three years, the GVR sunsets early, with the production reverting to legacy oil
- Senate Finance CS
  - 7-year "graduation" of GVR oil to become legacy oil, for all royalty levels
  - If the average price of oil exceeds \$70 for any three years, the GVR sunsets early, with the production reverting to legacy oil

Mr. Alper thought the Senate version (with regard to the GVR provisions) was very similar to the House version of the bill, with the exception of the removal of the 5-year category for the 30 percent GVR. He specified that all oil that was new, and met one of the 3 provisions to qualify for the GVR, would qualify for 7 years and then revert to become legacy oil.

Mr. Alper continued to discuss slide 9, referencing a technical change Ms. Cramer had mentioned: once the new oil went from the new to the old category, it also went to the sliding scale per barrel credit category. He noted that the three-year early graduation provision remained in the CS.

[4:58:08 PM](#)

Mr. Alper highlighted slide 10, "Major Provisions in SCS-CSHB247(FIN)":

7. New Provisions from House Bill

- "Migrating Credits / True-up": Prevent per-barrel credits not usable in one month, due to minimum tax, from being applied in another month.
- "ARM Board Alternative Purchase Option": Authorizes Alaska Retirement Management Board to repurchase credits at 60% of face value. DOR mandated to repurchase at full value within 5 years
- Senate Finance CS
  - Neither provision retained

Mr. Alper explained that the Migrating Credits/True-up provisions were not in the current version of the bill, nor was the ARM Board Alternative Purchase Option.

Mr. Alper looked at slide 11, "Major Provisions in SCS-CSHB247(FIN)":

8. New Provision in Senate Finance CS

- Refinery Credit
  - Refinery credit repealed early.
  - Rate reduced from 40% to 20% in 2017, and eliminated in 2018
  - Credit was scheduled to sunset at end of 2019, so effectively this removes 2 ½ out of the 5 years of initial eligibility and value

Mr. Alper pointed out that the early repeal of the refinery credit (on the first bullet of the slide) was a major new provision of the bill that had not been seen in any earlier versions. The language took effect in 2015, and was a 5-year credit of up to \$10 million per company for each of the refineries in the state, for 40 percent of infrastructure expenditures for major projects. He

mentioned the highly publicized asphalt plant project by Petrostar, which had discussed using the credit. He noted a \$10 million impact on the fiscal note in 2017, and then a \$20 million impact on what would be affected in 2018 and 2019.

Mr. Alper discussed slide 12, "Major Provisions in SCS-CSHB247(FIN)":

9. Misc. and Technical Provisions

a) House: GVR can't be used to increase the size of an NOL

Sen Fin: Same as House

b) House: Municipal Utility Lease Expenditure pro-  
ration

Sen Fin: Same as House

c) House: Transparency, can release name of company  
and amount of refundable credits received

Sen Fin: Amendment provides amounts but not names

d) House: Increase to 5% over Fed, compounding, with  
simple interest after four years

Sen. Fin: Increase to 7% over Fed, compounding, with  
zero interest after three years (5% in draft text)

Mr. Alper referenced earlier lengthy discussions about the GVR provision listed on the slide. He noted that the department had some concern with the section relating to compounding interest, specifically what might happen after the sixth year. He described a hypothetical situation in which a company contested a state assessment and took it to court, which he contemplated could result in a lengthy court case with zero percent interest carrying forward for the entirety of the legal process.

[5:02:02 PM](#)

Mr. Alper displayed slide 13, "Major Provisions in SCS-CSHB247(FIN)":

9. Misc. and Technical Provisions (cont'd)

e) House: Level of Alaska Hire as prioritization for  
repurchase given limited funds, including contractors

Sen Fin: Priority for repurchase for companies with  
Alaska Hire greater than 75%, not including  
contractors

f) House: Credits can be used to offset other delinquent obligations to the state related to oil and gas business

Sen Fin: Same as House, requires notice if credit funds are used to pay liability on company's behalf

g) House: \$250k surety bond with local vendor priority

Sen Fin: Same as House

Mr. Alper discussed the Alaska Hire provision and used an analogy of a company that had a small number of employees and had the bulk of its work done by contractors. He mentioned corporate income tax filers, who may have a great number of out-of-state workers. He wondered how the language in the bill would be interpreted, and thought there might need to be a regulatory fix. He continued that the language on the slide pertaining to a surety bond had stayed relatively consistent since it had been first introduced in the House Resources Committee.

Vice-Chair Micciche referred to Mr. Alper's earlier comments regarding compounding interest and potential court cases, and asked about how the interest and the liability might work together. He wondered if it would be possible to use credit funds to help with the expense. He wondered if Mr. Alper's concern pertained to an ongoing case with no interest burden on the remaining time.

Mr. Alper mused that if a court case dragged on there would be no interest and obligation, and therefore little incentive to settle. If the company had forthcoming future tax credits, provision (f) (on slide 13) could pay the obligation. In the case that the company won its case, the state would reimburse it as needed. He continued that the state routinely paid back companies with interest when a settlement went in the company's favor. He noted that the provision would only be relevant if the company had a cashable credit. Major producers were excluded from the provision as they did not have cashable credits.

[5:05:21 PM](#)

Senator Olson addressed the issue of zero interest earned in the event of an ongoing court case, and wondered about the timeline of state audits and the effect on businesses.

Mr. Alper discussed the progress of audits in the tax division. He stated that the department had gotten behind

in audits two years previously, after Alaska's Clear and Equitable Share (ACES) tax came in to effect and the division was busy writing regulations. He noted that there was an active plan for the division to catch up on audits, and thought it would be a gradual process. He qualified that there was no fiduciary interest in the tax division to accrue more interest.

Senator Olson made the point that businesses were also subject to the pressures of the fiscal environment.

Commissioner Hoffbeck did not have a strong disagreement with years 4 through 6 of the audit timeline. He qualified that the department had issue with litigation that could extend to years 7 through 10. He echoed Mr. Alper's comment that with no interest accruing, there was less incentive to settle the case. He relayed that typically litigation was driven from the taxpayer side rather than from the state.

Senator Olson referred to Former Governor Walter (Wally) Hickel, and understood there was a historical perspective on the matter.

Vice-Chair Micciche stated that there was a consequence he had not considered, and mused on finding other ways to motivate payment when there was liability was owed to the state.

Commissioner Hoffbeck did not want to overstate the matter, and did not think there was that many economic decisions made on the amount of accrued interest on litigation. He considered that people wanted litigation to be complete, and did not think the potential zero interest years was a huge issue, but rather a concern that the department wanted to point out.

[5:09:16 PM](#)

Mr. Alper addressed slide 14, "Summary of Fiscal Impact," which he stated was a stripped down version of the fiscal note to illustrate the different versions of the bill. The slide showed a table entitled "Summary Analysis of Bill Versions (\$millions)." He noted that the slide tracked not only the total bill impact; but the savings on spending and the increase in revenue, as well as tracking the NOL carry-forwards. He commented that should the price of oil be as low as predicted, there would be \$500 million worth of

carry-forwards at the end of FY 20. If the price prediction was off by \$8 or \$9 over the course of the next four years, the number could be wiped out completely.

Mr. Alper continued discussing slide 14; noting that under the CS the expected total bill impact was \$115 million in FY 18, \$140 million in FY 19, and \$130 million in FY 20. He expected the numbers to reduce by \$15 million to \$20 million, because of the adjustment he described earlier relating to the \$35 million (and how it was calculated) in Section 28 of the bill.

Vice-Chair Micciche discussed the spring revenue source book, which he assumed was off by about 25 percent. He wondered if the actuals continued in the same direction, the number would be wiped out quite a bit sooner.

Mr. Alper stated that the forecast had a price point below break-even through the end of FY 18. He thought the FY 18 prediction was about \$43 per barrel, and the FY 19 prediction was up to \$48. The three years of losses equated to a fairly large buildup of NOLs. If the price of oil ended up closer to \$46 per barrel for three years, it would make a significant difference.

Co-Chair MacKinnon thanked Mr. Alper for his hard work through the preceding hours.

Senator Bishop referred to a new computer program to aid the tax audit division, and thought it would alleviate the backlog of audits.

Commissioner Hoffbeck confirmed that the program was up and running. He relayed that the program would have more granular data as well as increased accuracy in the audit filings.

Co-Chair MacKinnon noted that the fiscal note showed \$1.2 million already included in the capital budget that was contingent on passage of the legislation to support some of the reporting requirements.

Commissioner Hoffbeck concurred.

[5:12:47 PM](#)

Senator Olson referred to slide 11, and the reference to refinery credits. He mentioned projects in his district, and asked Commissioner Hoffbeck to comment on the administration's view of the recent changes to the bill.

Commissioner Hoffbeck shared that based on available information, it appeared that most work to be done on refineries would be able to be completed within the timeframe of the modification listed on the slide. He did not think the new provision would impact most refineries.

Co-Chair MacKinnon recognized the hard work of the legislative legal department.

Vice-Chair Micciche MOVED to report SCS 2d CSHB 247(FIN) out of Committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

SCS 2d CSHB 247(FIN) was REPORTED out of committee with "no recommendation" with one new fiscal impact note from the Department of Revenue; and one previously published zero fiscal note: FN 5(DNR).

5:15:00 PM

AT EASE

5:17:37 PM

RECONVENED

#

ADJOURNMENT

5:17:53 PM

The meeting was adjourned at 5:17 p.m.