

SENATE FINANCE COMMITTEE
FIFTH SPECIAL SESSION
July 13, 2016
1:35 p.m.

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[NOTE: Meeting was held in Anchorage, Alaska at the Legislative Information Office]

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 1:35 p.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

Ken Alper, Director, Tax Division, Department of Revenue;
Jenny Rogers, Audit Master, Tax Division, Department of Revenue;

PRESENT VIA TELECONFERENCE

Senator Click Bishop; Senator Peter Micciche, Vice-Chair;
Randall Hoffbeck, Commissioner, Department of Revenue.

SUMMARY

SB5005 TAX;CREDITS;PMTS;INTEREST;LEASE;O & G

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#sb5005

SENATE BILL NO. 5005

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to oil and gas lease expenditures and production tax credits for municipal entities; relating to the interest applicable to delinquent tax; and providing for an effective date."

Co-Chair MacKinnon welcomed the presenters.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, introduced Jenny Rodgers, the Audit Master. She has been with the division for 28 years. She was a part of the production tax group.

JENNY ROGERS, AUDIT MASTER, TAX DIVISION, DEPARTMENT OF REVENUE, introduced herself.

Mr. Alper introduced the PowerPoint presentation: "Oil and Gas Tax Credit Reform SB 5005." He began with slide 3: "Purpose of the Bill":

SB5005 is a smaller, more targeted credit reform and minimum tax package than HB247

- Addresses "North Slope NOL" issue
- Re-introduces several smaller parts of HB247 that did not pass
- Increases the minimum tax at certain prices
- Technical fixes to HB247 sections that may have implementation issues

Mr. Alper indicated that the current tax bill addressed the North Slope net operating losses (NOLs). He informed the committee that the bill was a smaller and more cognitive tax reform and minimum tax package. It was a far simpler bill than what was passed through the legislature in the previous session. It did a few things including addressing the North Slope net operating issue. It brought up some of the smaller parts of HB 247 [Legislation passed in June, 2016 - Short Title: Tax; Credits; Interest; Refunds; Oil and Gas].

Senator Dunleavy asked if the bill went beyond tax credits into tax policy.

Mr. Alper responded in the affirmative. He explained that there were issues in the bill that affected the minimum tax and how it was calculated.

Senator Dunleavy asked if the bill addressed SB 21 [Legislation passed in 2013 - Short Title: Oil and Gas Production Tax] beyond tax credits.

Mr. Alper responded that the bill addressed the tax system. The administration had stayed away from the core provisions of SB 21 including the tax rate, the per-barrel credit, etc. He furthered that by adjusting the minimum tax, a portion of statute that had been around since the Petroleum Production Tax (PPT) regime came into being, it addressed some of the residual older oil and gas tax laws rather than the parts placed into SB 21. He reaffirmed that the legislation was beyond the world of credits.

Co-Chair MacKinnon asked if there was a reason why the administration introduced several of the smaller measures that had already been denied.

Mr. Alper responded that the governor thought it was important to revisit the issues. He expounded that they fit into the rest of the reform package. He commented that sometimes the third time was a charm.

Co-Chair MacKinnon responded that the committee would see.

Mr. Alper continued that the bill addressed the minimum tax (the so called "floor") and how it was calculated. There were also a couple of technical fixes that if another bill was going to move, they would address. Otherwise, the department would address the issues through the regulation process. He moved to slide 4: "History of Oil and Gas Production Tax Credits":

Update: FY 2007 thru '16, \$8.0 Billion in Credits
North Slope

- \$4.4 billion credits against tax liability
 - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- \$2.3 billion refunded credits

- New producers and explorers developing new fields
- Non-North Slope (Cook Inlet & Middle Earth)
- \$0.1 billion credits against tax liability
 - Another \$500 to \$800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- \$1.2 billion refunded credits (most since 2013)

He explained that in the previous year the governor limited the credits to \$500 million. Although the books were not 100 percent closed, he anticipated the number would be similar, about \$498 [million]. He relayed that if a person were to add the FY 16 number of \$498 million to the prior history, about \$8.0 billion had been put into tax credits in the so-called tax credit era going back 10 years. He detailed that of the \$8.0 billion in tax credits \$4.4 billion went to credits against tax liability on the North Slope. The majority of credits were used by the major producers. He reported \$2.3 billion going towards refunded credits to new producers, explorers, and developers on the North Slope. He relayed that of the \$500 million spent in the prior year a little over \$200 million was invested in the North Slope and less than \$300 million was invested outside of the North Slope.

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Co-Chair MacKinnon had several questions. She mentioned that from FY 16 to FY 17 the state had issued \$8 billion worth of credits. She was aware that when the state issued a credit it did not always receive revenue in the same time period. Under the same time period how much revenue came from production in the oil and gas industry.

Mr. Alper mentioned he had documented the information Co-Chair MacKinnon was asking about. However, he did not have it with him. He noted that the number was roughly \$60 billion in overall oil and gas revenues comprised of royalties, production taxes, and corporate income taxes. He thought the number was about \$62 billion, the bulk of which came from the legacy fields like Prudhoe Bay.

Co-Chair MacKinnon had asked Mr. Alper to bring the information with him. She mentioned the importance of being able to convey to the general public not only what the state was paying out but also what the state was receiving

from the industry, an amount large in magnitude. She referred back to slide 3. Director Alper had indicated that if the administration was not able to accomplish some of the policies proposed in SB 5005 then it would move to the regulatory process to begin implementation of those things. She asked him to point out where the administration would make regulatory changes should the legislature deny a change in state statute.

Mr. Alper responded affirmatively and assured Co-Chair MacKinnon it was none of the larger pieces. He clarified that he was talking about technical language relating to the piece that dealt with the pro-rationing of a utility that owned its own gas field and how its costs might get apportioned. There was a technical issue with how the final language was written that the department was hoping to clean up. The administration believed it could be resolved through the regulatory process without doing anyone any harm. He assured the committee large changes to the tax law would not be made without going through the legislature.

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Co-Chair MacKinnon thought it depended on perspective. She suggested that if an entity's tax credits were not coming in, the entity might think it was more important than if it was receiving tax credits based on regulations. She requested that Mr. Alper point out items that the division could change through regulation if the legislation did not move forward.

Mr. Alper was happy to point out the two places the public could expect to see changes.

Senator Dunleavy asked Mr. Alper to explain why the governor was introducing a new bill. He asked him to clarify the purpose of changing the tax credits. He wondered if it was to generate new revenue or something else. He wondered if the goal was generating more revenue or spending less. He asked him to highlight the goals.

Mr. Alper responded that it was important to view the bill in the context of the rest of the package. The governor introduced the passage of bills for regular session and had been trying to move the administration's comprehensive fiscal package, the New Sustainable Alaska Plan. It was the governor's goal to pass the overall package. The current

bill before the committee was only one component of the whole. Regarding oil and gas there was a broader goal to pass a series of bills that would place Alaska on a sustainable footing given the state's constrained fiscal circumstances. In looking at the specifics of the bill, the fiscal note reflected a savings to the state of about \$100 million to \$150 million per year and would raise a little bit of money in some years through the minimum tax changes. For the most part, it was a savings to the state which would help in reducing the state's deficit.

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Senator Dunleavy, as an educator, had seen certain benefits for schools when oil had taken off in the 80s. He wondered how the bill would ensure ongoing oil exploration, development, and production to keep oil in the pipeline. He mentioned that there were two camps; pro-oil and pro-other. However, he believed everyone was pro-Alaska. He wanted to make sure that whatever policy was put in place by the legislature helped Alaska in the short, mid, and long-term. He wondered how the approach would ensure investment.

Mr. Alper could not ensure anything. As a state government, the executive in the legislative branch could not ensure, guarantee, or force private companies to act. The government could encourage and incentivize. Things such as resources and the price of oil (currently very low) would influence investment. He concluded it was reasonable to say that there might be fewer investors in the short-term because of oil prices. He added that the state's taxes and tax credits were considerations but were not the only consideration. The bill reduced the state's participation in and incentives for new players which could result in fewer investors. However, tax credits were only one consideration. The overarching question was could the state afford the level of support it was currently providing.

Senator Dunleavy asked about the administration's response to a negative effect on the oil industry with the legislation.

Mr. Alper was sure the administration would be engaging with the oil industry. He acknowledged that the oil industry was the state's "bread and butter." The administration would be looking to maximize the state's position to develop its resources for the maximum benefit

of the people of Alaska and to make sure the maximum were developed. He suggested that if the state moved too far in one direction there would be a movement to bring it back. He stated that it was an inherently dynamic process as seen from year-to-year.

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Co-Chair Kelly thought it was important to describe the approach the legislature was taking versus the approach some members around the table would take regarding oil revenue. He relayed that the legislature was looking at revenue stream. He believed the administration was looking at an expense stream. He mentioned that Mr. Alper's opening comments had to do with the amount of revenue the state had received. The state spent \$8 billion on tax credits which resulted in \$61 billion in revenue. Most people would say that that was a pretty good deal. The legislature realized that the tax regime in 2009, 2010 and 2011 was going in the wrong direction. The state was attempting to extract as much revenue as possible from oil companies, but the legislature realized that it was discouraging production and exploration. Therefore, the state adopted SB 21 with the approval of the people of Alaska. He pointed out that the sometimes more investment was needed to achieve additional revenue. He reiterated his question about what the bill did to increase production. He wondered if the legislation would increase production, leave production the same, or decrease production. He supposed the legislation would decrease production. The state might extract a little more money, but would ultimately tilt the production curve downward again. He wanted to see a tax or credit regime from the governor that increased production or, if changes had to be made, at least kept it from declining. The state should be in the business of getting more oil through the line resulting in more money for the state.

Mr. Alper could not argue that the legislation would increase production. The bill reduced incentives for the oil industry and, there was nothing inherently in it that would make producers want to do more. He wondered how much less production the state would see and whether the cost benefit analysis would show the state giving up more than what it was gaining. The credits were put into place to invest in Alaska's future during a time when the state understood it had a large amount of money coming in from the industry. The state wanted to reinvest some of its

surplus revenue in future production. At the time, the state was receiving \$3 billion to \$6 billion just from production tax and putting about \$300 million back into tax credits, which made intuitive sense and was a rational behavior towards the future. With the drop in the price of oil, the state's revenue shrunk to a level of less than \$1 billion. Currently, it appeared that oil prices would not be returning to previous levels anytime soon. He wondered if the state could afford the same level of investment in the industry at a time when there was no longer a reinvestment of surplus profits. He suggested there was an entire diversion of the bulk of Alaska's revenue. The paradigm had shifted to the point that Alaska needed to look more aggressively at ramping back its support of the industry based on fiscal reality. He argued that Alaska could not afford the level of participation it had previously.

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Co-Chair MacKinnon asked if the committee would be seeing some statistical analysis on where the administration's proposal set Alaska's tax regime in comparison to other sovereigns around the world and in comparison to other US states. She recalled a previous conversation about the past oil regime. Some felt Alaska's government take was excessive overall. The state tried to balance its tax regime nationally between Texas, North Dakota, Wyoming, and other sovereigns that had production. Alaska was not looking so much at the goal of what it took to pay for state government. Alaska was looking at how to compete with other state structures. Alaska then went to a broader perspective looking at how Alaska compared to other nations. There was a debate about who Alaska should compare itself to. She restated her question. She asked if the committee would see statistical analysis on the administration's proposal during the special session.

Mr. Alper responded that the Department of Revenue (DOR) did not currently have outside analysis on contract to provide such work. If the conversation continued into the next regular session the administration would expect to provide the information. The administration had been in touch with the new consultant, Mr. Meyer, hired by the Legislative Budget and Audit Committee. He was putting together his modeling, presentation, and package. He believed Mr. Meyer would be bringing the type of analysis

the legislature was looking for to the committee. He mentioned that the current bill was not touching on the core government take issues that were being discussed. The comparable total government take percentage of different price points was the significant analysis of SB 21. The credits were not a part of the calculation or analysis for SB 21. The change in the legislation before the committee was a tax increase between prices of around \$55 to \$80 per barrel. Taxes remained neutral above \$80 per barrel. He did not believe there would be significant movement than what was brought before the legislature with SB 21.

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Co-Chair MacKinnon asked if Mr. Alper saw a difference between tax credits and a net operating loss (NOL).

Mr. Alper was unclear about the senator's question.

Co-Chair MacKinnon relayed that in the previous special session the legislature passed a bill that removed about \$400 million from available funds for the oil and gas industry, more specifically in the Cook Inlet Region. The gross value was touched and the floor was hardened a bit with allowable deductions. She explained that NOL's were similar to a federal income tax. She relayed an example. If she submitted her federal income tax and had an expense that qualified, it was a deduction rather than a credit. Net operating losses were allowable expenses. She specified that a tax credit was a tool used to incentivize. She speculated if the committee was talking about how to incentivize or not incentivize exploration in Alaska. She also wondered if the committee was discussing a structural change concerning allowable deductions. She was not sure there was a difference between the two.

Mr. Alper replied that much of the language in the bill was similar to what the House passed late in the regular session. He explained that it prevented operating losses from being carried forward, moved, and turned into credits by the major producers. He understood that it was a large and controversial step. Alaska had a large and broad fiscal system related to oil and gas. Many of the comparable countries had one tax with a fixed percentage. Norway had a 78 percent tax. Alaska had a property tax, a corporate income tax, a royalty, and there was a federal income tax. Alaska's royalty was strictly a gross tax, regressive at

low prices. The state had a corporate income tax in which losses carried forward and were recaptured in a future year receiving full value. Alaska's production tax was a hybrid; it was not a pure income tax or a pure royalty or a severance tax. Commissioner Hoffbeck had done a good job of explaining that Alaska had a net profit tax at high prices. As the prices decreased and a minimum tax kicked in it became a gross tax. Once the break-even point was crossed at about \$45 per barrel it became a net profits tax again in the negative. The producers received the full value of their loss at the 35 percent rate. The administration thought it was unbalanced. He reported that if the state was at the gross at a relatively small tax, between \$45 and \$80 per barrel, he questioned why the state should return to a net below \$45 per barrel. He suggested the more appropriate approach would be that if a producer was losing money only a small minimum tax would apply or no tax would apply. However, a producer should not be allowed to go negative carrying the losses forward, specifically for the production tax. No one was questioning the ability to carry forward loses within the corporate income tax structure.

Co-Chair MacKinnon asked Mr. Alper to remind her whether the 35 percent NOL dropped to 25 percent at a particular point.

Mr. Alper confirmed that it remained at 35 percent. The bill that passed by the other body ramped it down towards 25 percent. It did not stay in the version passed by the Senate Finance Committee.

Co-Chair MacKinnon was trying to recall the credits that were supposed to sunset in 2017 but were extended under the bill that was just passed.

Mr. Alper responded that for the North Slope specifically there were no material changes to the credits. The capital credit had been previously eliminated as part of SB 21. The exploration credit was sunseting and continued to sunset. The operating loss credit of 35 percent remained. There was a temporary bump to 45 percent for 2014 and 2015 that ramped down. The Frontier Basin, with a large 80 percent credit, was specifically extended to 2017. Ahtna, Inc. addressed the committee with their concern about missing their window because of a lost rig. That credit was extended for a single year and was the only short extension in HB 247.

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), wanted to explain that the net operating loss credit came in two flavors. First, credits were used by developers and explorers and, they were truly credits. They were cash flow credits paid by the state. Secondly, credits were used by the producers as deductions or write offs against revenues. A net operating loss credit was a credit in one circumstance and a deduction in another.

Co-Chair MacKinnon thanked the commissioner for the clarification.

Mr. Alper indicated he was halfway through slide 4. He reported there were very little credits against tax liability outside of the North Slope because of the tax caps, the very low maximum taxes in place going back to the PPT bill from 2006. He relayed there was a robust amount of refunded credits in the amount of \$1.2 billion, primarily in Cook Inlet and within the previous 3 or 4 years.

Mr. Alper turned to slide 5: "Work Done Since January":

- Spring 2016 Revenue Forecast includes large expected operating losses from major producers, which would offset minimum tax payments for several years
- Forecast also updates FY17 demand for refunded credits to \$775 million (includes \$200 million that had been vetoed from the FY16 budget, carried forward)
- HB247 passes after over 60 hearings with substantial reforms in Cook Inlet credits and how North Slope "Gross Value Reduction" is treated
 - FY17 budget passes with \$30 million GF funding for credits via statutory formula, plus \$430 million from other funding sources in the HB247 fiscal note
 - Governor Walker vetoes the additional \$430 million, leaving only the \$30 million from the formula

Mr. Alper reported that the bill was introduced with a set of expectations at the beginning of the last regular session. Those expectations changed with the spring forecast released in late March or early April [2016]. Suddenly, with the extended period of low oil prices, large anticipated operating losses could be seen for the major

producers. It changed how the administration calculated things. He furthered that because of the ability to use operating loss credits carried forward against the minimum tax it started seeing zero minimum taxes for production for 2,3, and 4 years into the future rather than receiving roughly \$150 million to \$200 million the state had been counting on as the minimum tax payment in a low price environment. In a low price environment the department still saw \$775 million in expected demand for refunded tax credits in FY 17. He explained that of the \$775 million there was \$575 million of new applicants and \$200 million carried forward from the previous year's veto. The demand equaled \$775 million. He explained that with the passage of HB 247 there were tremendous reforms to the Cook Inlet credits which would be completely phased out by 2018. On the North Slope the calculation and the application of the new oil provisions of the gross value reduction were aggressively reformed. The underlying credits, the operating losses, and how they were treated on the North Slope, were not reformed. Meanwhile, the legislature passed an operating budget with \$30 million in general fund (GF) funding determined by a statutory formula and \$430 from other funding sources making up \$460 million in tax credits for FY 17. He reported that the governor vetoed the additional \$430 million which left only \$30 million from the formula. It meant that the state only had \$30 million to be spent on \$775 million worth of demand. He thought there would be a large amount of tax credits carried forward into FY 18 if additional action was not taken.

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Mr. Alper moved to the spreadsheet on slide 6: "Potential NOL Carry-Forward Liability." He explained that the top half of the slide reflected the beginning of the credit era through the last fiscal year. The third column showed how many credits were claimed and how much the state spent on tax credits. He relayed that the columns further to the right showed the calculation had the legislature funded at the statutory formula which was tied to 10 percent to 15 percent of production tax revenue. He pointed to the column titled "Credit Cap per AS 43.55.028 (c) showing what the appropriation would have been. He noted that the numbers between FY 09 and FY 13 were larger than the amount spent on credits. In other words, had the formula appropriation taken place, rather than funding what had been requested, the state would have been out of funds. The state would

have built up an amount of set-aside money to fund tax credits. The end year fund balance was the balance of the fund which would have peaked at \$655 million at the end of FY 13. He continued that beginning in FY 14 the revenue would have been dropping off but there would have been the money in the fund and with the demand the state would have spent the fund down. The fund would have been close to wiped out by the end of FY 15. Going into the last budget cycle a year previously the state would have been roughly in the same place - the state would need to find money to pay for tax credits only there would not be the cultural expectation that the legislature would fully fund the demanded tax credits over a year. The expectation would be that the state would fund at the statutory formula. There would not have been the same level of anxiety from short funding.

Mr. Alper pointed to the bottom of the page. He queried what would happen if the state continued the process into the future. He highlighted the blue numbers. The blue numbers were updated based on the passage of HB 247. He noted there had been different and larger numbers when he had presented the same slide a month prior. Due to the changes, the Cook Inlet tax cuts, and additional revenue from a couple of other calculations the state would be spending less money on tax credits. It would also have slightly smaller carry forward NOLs for the major producers. The demand in the following year [FY 17] would decrease to about \$760 million down from \$775 million. In FY 18 the demand would be \$445 million down from \$500 million. He suggested that in looking at the \$760 million, when the legislature was only paying the statutory amount of \$30 million, left a carry-over of \$730 million. If \$730 million of carry forward was added to \$445 million (the claimed credits for FY 18) it would result in a credit demand worth almost \$1.2 billion in FY 18. Meanwhile, only \$33 million would be appropriated in FY 18 by the statutory formula leaving a \$1.1 billion carry-forward. By FY 25 the state would be behind in tax credits by about \$2.0 billion if it continued to fund at the statutory cap.

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Co-Chair MacKinnon stated that what the slide showed her was that by FY 18 the governor would have created a \$600 million hole in the state's budget by not paying a bill that was owed via his veto power.

Mr. Alper stated that it was moving an obligation from FY 17 to FY 18. The producers would have certificates of credits, an obligation of the state. With the certificates in-hand the companies would request payment and would be waiting until the state had money available to make the payments.

Co-Chair MacKinnon stated that the administration was creating the problem while advocating for a solution. She conveyed that with the current veto, over half of the problem stemmed from the administration not paying a bill when it was supposed to. It was something the legislature could override, but more importantly she wanted to understand the administration's reason for not advocating a fix and for creating more of a problem by not paying its bill.

Mr. Alper stated that through legislation the administration was attempting to change the underlying programs so that there were less tax credits owed and earned in the future. The veto had to do with when past obligations had to be paid. He argued that the state was not required to pay the obligations immediately. There was no requirement that the state buy the credits and there was not cost of delay. The governor struggled with his decision to execute his veto power. Mr. Alper reported being part of the discussions around the governor's veto. He reported the decision was heart-felt, difficult, and would potentially put a strain and burden on the industry. The governor's original proposal in January [2016] included an appropriation to fund all the credits wiping the slate clean. However, the original proposal was part of a comprehensive fiscal package. There were several pieces of legislation that would solve the state's problem and balance its budget into the future. In the absence of a comprehensive plan in place, the governor's larger concern became how to keep the light on for the coming 2 or 3 years. The state was on a path to deplete the Constitutional Budget Reserve (CBR) a year from the present. The state had school obligations, healthcare obligations, transportation obligations, pension obligations, and other costs related to the day-to-day functioning of government. If the state was uncertain that it would be able to meet the obligations listed, he wondered if it could afford to fully fund the tax credit program. He suggested that the state could legally make a

smaller installment payment, save some money for the future, and hopefully resolve its underlying fiscal problems in the following year.

Co-Chair Kelly suggested that Mr. Alper's slide essentially cried out, "Help stop me before I make another irrational veto!" He agreed with what Senator McKinnon had said about the governor creating a problem with his veto and the administration asking the legislature to make a complete change to Alaska's oil tax regime rather than the governor acting more sanely. He also pointed out that prior to the governor's plan of paying off the tax credits with a larger fiscal plan, he recalled that it assumed the use of the CBR. He asked Mr. Alper if he was correct.

Mr. Alper responded affirmatively.

Co-Chair Kelly stated that there was an assumed CBR draw that was never, ever, ever going to happen. He thought it was impossible. He reported telling the governor that a CBR draw was impossible early on in the current year's regular session. He relayed that the governor seemed surprised at his comments. He continued that the administration saying it had a plan that was not working and wanting to do something else was a poor response. He opined that the larger fiscal plan the administration was hoping would be enacted was irrational. He thought 2 things were going on in slide 6. First, the governor created a problem, and now the legislature had to do something else instead of the governor changing his behavior. Second, the Tax Division came up with a \$2 billion number, an extremely political number - the number that had been thrown around for several years as the \$2 billion give away. It was never true and the people of Alaska voted for SB 21 because of what a sham it was. Currently, the state was back with another slide. He reiterated that he thought slide 6 was a very political slide.

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Senator Olson realized that the State of Alaska was in a bind. He wondered about any considerations being made for the smaller companies trying to survive. Late payments to businesses made survival difficult and effected people's livelihoods. He was not only talking about producers but also the contractors. He was concerned that some of the private sector businesses would go bankrupt.

Mr. Alper replied that the state had significant obligations not just to the oil industry. It had the rest of the government to run. The anxiety over how to handle the state's fiscal condition with reserves rapidly depleting became the overarching factor. He suggested that if the state paid its obligation in full it might not be allowed to do something else in the following day. He believed a comprehensive fix was necessary either in the current year or the following year. He conveyed the message of the governor. He mentioned that the governor's office had released paperwork regarding what would happen if the state went off of the cliff. He supposed he would have to generate a couple of bullet points about how his agency would function with 75 percent less funding. He was certain it would not be pretty. The state did not want to do damage to its private sector investors. He thought it was about priorities and making sure the lights stayed on longer.

Senator Olson asked about assurances that the administration could give to the private sector. HE compared the governor's veto to either paying a partial credit card payment or making a full payment of the balance.

Mr. Alper stated that it was about making a minimum payment on a credit card rather than paying off a balance as the state had been with the tax credits for the past 3 or 4 years. He could not speak for the governor or guarantee any future action. He believed that once the governor was satisfied the state had solved its fiscal woes, he would want to set aside the funds to pay down the state debt. There was nothing positive about having \$1 billion debt over the state. The state needed to get to the point of knowing it had the money.

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Co-Chair MacKinnon commented that the state did not pay interest in reference to Mr. Alper's credit card example and could make the monthly payment, the issue that the Senate Finance Committee was concerned with was job loss, bankruptcy, and people having similar loses, and the state's credit down rating. The governor had been a proponent of maintaining the state's credit worthiness. She was not sure, as bankruptcy occurred as a result of the non-payment of tax credits, she could consider it a minimum

payment. The interest would be very different. It would be job loss, downgraded credit, and other things. She asked Mr. Alper to respond.

Mr. Alper wished he had an answer for her. It was obviously a burden on the industry. It was not a place the state was comfortable being in or wanted to be in. She was accurate that the state did not have to pay any interest. However, the companies did have to pay interest to their finances. Many of them had cash calls. He continued that the great bulk of the credits were owed against borrowed money. The companies did not have their own cash reserves to invest in their field but rather they borrowed money with the expectation of paying it back. The administration understood. It was an uncomfortable and unfortunate reality of the state's fiscal situation. He noted Co-Chair Kelly's prior comments about how a CBR draw to pay the credits would not work. The reality was that the budget that just passed was funded 2/3 out of the CBR. Whether the funds were GF or set a side special CBR appropriations, if the state placed \$600 billion into tax credits the money would be coming out of the CBR.

Senator Bishop returned to the forecast on slide 6 regarding the NOL liabilities. He wanted to see the same numbers ran with the debt paid as it was encumbered to see what the bottom looked like. He thought that the administration was chasing a red herring. Alaska was not Texas, North Dakota, or Wyoming. It took 10 years, at best, from an initial discovery to point of production to bring a field online. It was a long-term commitment. He reiterated his desire to see the numbers ran with the debt paid in the year the credits were encumbered ultimately looking for the bottom line.

Co-Chair MacKinnon asked if the numbers could be run.

Mr. Alper responded in the affirmative. He addressed Senator Bishop. He emphasized that the state would stay abreast of its obligations every year in the scenario on the slide and pay it. It meant that the state would spend about \$2 billion more which would come out of reserves assuming the money was available. The state would butt up against the bottom of the CBR and would possibly have to get into the earnings reserve account (ERA) and address fundamental questions of restructuring. The Senate passed a bill that had gone a long way towards fixing the problem.

Part of the administration's struggle was that the rest of the legislature had not followed suit. The number on the slide of \$2 billion was the real obligation of the state for the next 6 or 7 years. He added that what was interesting in updating the slide was that it used to be \$3 billion. The reason for the change was due to the passage of HB 247. There was an authentic savings of \$1 billion on tax credits reducing the burden to the state.

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Co-Chair MacKinnon appreciated the information and suggested that it be referenced in some of the governor's press releases. She commented that the general public believed that the legislature did not act on anything in the governor's package. However, the legislature took action. She loved the idea of saving \$1 billion over the following 10 years based on what the legislature passed which was part of the fiscal plan. However, the information had not been conveyed in a press release.

Mr. Alper turned to slide 7: "Regional Impacts of HB 257":

Cook Inlet

- Complete phase-out of NOL, QCE, and WLE by 2018
- Extends "tax caps" on gas indefinitely and adds a
- \$1 / bbl "tax cap" on oil
- Municipal utility pro-ration of costs

Middle Earth

- Reduces the NOL, QCE, and WLE credit rates
- Extends "Frontier Basin" exploration credit for one year to July 2017

North Slope

- GVR "Graduation" provision after three to seven years
- GVR can't be used to increase an NOL

Statewide

- \$70 million per company per year cap (\$61 with discount)
- Interest rates increased for 3 years, then drops to zero

- Transparency, local hire, state obligation offsets, surety bond

Mr. Alper listed the bulk of the changes.

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Co-Chair MacKinnon asked how many of the provisions were in the new bill SB 5005. She noticed interest changes on page 1 of the bill.

Mr. Alper responded that there were interest changes and the municipal pro-ration had a technical cleanup section. The administration was looking at extending things on the North Slope when the state was done in Cook Inlet. However, the administration was not looking to changing any of the pieces already addressed in HB 247.

Mr. Alper moved to slide 8: "Fiscal Impact of HB247":

Revenue

- \$0 to \$25 million increase through FY21 due to loss of Cook Inlet credits used against tax liability, plus new \$1 / bbl oil tax
- \$40 to \$115 million tax cut beginning FY22 due to above combined with up to \$20 million from sunset of GVR tax break, but offset by extension of Cook Inlet gas tax caps

Spending

- Full impact of credit cuts won't be seen until FY19
- Annual savings \$65 to \$115 million. Largest portion is Cook Inlet cuts, less from the per-company cap and the fix to the GVR / NOL interaction issue

Mr. Alper indicated that the slide was a snapshot of the fiscal note for HB 247. He explained that all of the bills had 2 halves to the fiscal note; raising or changing revenue in some way and changing spending such as buying tax credits. He reported that the \$1 per barrel tax would generate about \$5 million to \$10 million. There was also a tax cut in the bill which might lead to seeing negative revenue. He had stated there was \$1 billion in savings and spending on the previous slide that was offset by the tax cut in some of the out years. As a result the public's perception of the impact of HB 247 might have been diluted

because of the extension of the Cook Inlet tax caps past 2022. They were scheduled to come off the books and the underlying 35 percent tax would kick in in 2022. By extending them into the future it showed up as a negative in the revenue estimates. He thought that it was an overblown number. No one really expected the 35 percent tax to kick in in 2022. However, it was the administration's statutory base line.

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Co-Chair MacKinnon asked Mr. Alper to pause and discuss why the 35 percent would not likely come to fruition in the Cook Inlet.

Mr. Alper explained that when the Petroleum Profits Tax (PPT) system legislation came before the legislature in 2006 the Economic Limit Factor (ELF) system had been in place for 20 years or more. The ELF formulas were thought to be distorted. It generated tax from fields tied to per-well productivity including the Prudhoe Bay and Alpine fields. However, most of the other fields on the North Slope were paying a low production tax (less than 1 percent of the gross). In Cook Inlet the tax was zero. The Cook Inlet gas taxes under ELF were also low. While there was a desire to raise revenue from the North Slope through the PPT bill (it was an important reform package and part of Governor Murkowski's Stranded Gas Development Act process), no one wanted to raise the tax on gas in Cook Inlet. At the time there was a larger concern about gas supply and utility security. He suggested that in the ELF bill there was a hold harmless provision which outlined that taxes on oil and gas in Cook Inlet would not exceed what they were prior to the passage of the bill (from 2005). It was a 15 or 16 year hold harmless provision until 2022. He relayed that in 2022 the underlying statutes kicked in. However the underlying statutes had not been built for Cook Inlet leaving the state with a hodge-podge of multiple other bills. There was the 35 percent SB 21 tax rate without a per-barrel credit or comparable benefit on the North Slope. There were no new oil benefits and the 20 percent capital credit was going away. There would be a large 35 percent net tax. He opined that sometime between now and 2022 someone would have to fix the system. He suggested that the attempt made with HB 247 extending the tax caps, was probably too low. The 17 cent per MCF tax on gas in Cook Inlet was probably not the state's highest and best use of

the resource. Another part of the equation was \$150 million more from at 35 percent net tax. He thought the right answer was somewhere in the middle.

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Co-Chair MacKinnon asked where the oil from the Cook Inlet region was sold.

Mr. Alper responded that it went to a refinery in Cook Inlet and used in Alaska.

Co-Chair MacKinnon stated that the oil was sold to an instate refinery, and accounted for about 30 percent of the feed stock at the Tesoro refinery. She asked Mr. Alper to comment.

Mr. Alper reported hearing similar numbers. He stated that the refineries in Alaska were ready to absorb all of the oil production from Cook Inlet and were still importing crude oil.

Co-Chair MacKinnon asked how the refinery would collect an increase of 35 percent.

Mr. Alper responded that if there was a higher tax on Cook Inlet oil it would be taxed similarly to North Slope oil. It would likely be worked through. He thought that Cook Inlet gas was what was really being referred to. He suggested that if there was a higher tax it would affect the utility rates in South Central.

Co-Chair MacKinnon emphasized that rate payers in Anchorage and the Central region would have to pay the tax. From a political perspective folks that would be opposed to a 35 percent increase in taxes within the region were trying to protect the consumers on the other side.

Mr. Alper clarified that it was not a 35 percent increase but a 35 percent net profits tax which would be a very high tax in Cook Inlet, 5 or 6 times the current tax.

Commissioner Hoffbeck concurred that a large portion of the Cook Inlet gas tax would get passed to consumers. As far as the oil and its use in refined products, prices depended largely on the competition of other refiners. It really depended upon the refining margins and whether refiners

could absorb the tax. There was a good chance the 35 percent tax rate would not be passed to the consumers because the price was set based on other competitive products delivered by other West Coast refiners.

Co-Chair MacKinnon concurred that about 30 percent of the feed stock going into the local refinery came from Cook Inlet. She continued that 70 percent came from another source. She was depending on others in the market. Cook Inlet gas was being sold at some of the highest prices in the world. Alaska's consumers would be picking up some of the proposed price changes.

Commissioner Hoffbeck concurred.

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Vice-Chair Micciche also concurred. He added that the less competitive Alaska oil was, produced by Alaskan jobs at an Alaskan facility, the more likely imports would compete. In the current market, he thought throwing another tax in the way could have a negative effect. He believed a 35 percent tax on Cook Inlet oil and gas was unreasonable. He suggested that the reason for holding off on another increase would be to take the time to evaluate what the proper tax should be rather than simply applying a 35 percent rate in 3 years.

Mr. Alper stated that there was no change proposed for the Cook Inlet oil and gas tax in the current legislation. He mentioned that the administration had an issue with the extension of the caps in the previous legislation. The administration was not looking to make a change until 2022. He indicated that if the sunset remained in place the administration would be passing a tax cut because of something that would occur in 2022. However, when looking to put in the right Cook Inlet tax in the future it would be sold with a tax increase and would be more difficult to get accomplished.

Co-Chair MacKinnon asked the question because when the committee looked at the \$775 million that was distorted by the \$200 million veto that would be distorted further in the following year by the \$430 million veto he interjected the comparison. She agreed that it would have never reached the 35 percent. There was a reason why the legislature would walk cautiously into the conversation. She wanted the

people in the Central Region to understand that the committee was trying to look at who in the end would pay some of the increases. The state would not be the one to pay the increases, it would be the consumer that would be covering the costs as the state withdrew tax credits and increased taxes.

Mr. Alper noted that his point was a distraction from the current legislation. He raised the issue because it explained why the legislature had not received enough credit for the good HB 247 did. He furthered that if a person was to read the fiscal note for HB 247 the bottom line did not add up to \$1 billion. It added up to a much smaller number because the number was eroded by the paper tax cut on the Cook Inlet side. On the spending side it added up to \$1 billion. Negative numbers could be seen on the revenue side. He pointed to the spending reductions of about \$1 million on the bottom of slide 8. The state would not see the full impact of the spending reductions until FY 19 as a result of the slow ramping down of the Cook Inlet tax credits. The annual saving would be between \$65 million to \$115 million. There would be an overall reduction in what the state would be spending on tax credits and cash credits, or obligated to spend. He estimated the reduction to be between 30 percent and 40 percent. The largest portion of the spending reductions were the Cook Inlet cuts.

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Mr. Alper turned to slide 9: "Original HB 247 Components Not Passed":

- Minimum tax increase to 5%
- Floor "hardening" against various credits
- Per-barrel credit migration ("true up") issue
- GVPP cannot go below zero for a field
- Restrict repurchase to companies with < \$10 billion revenue and sunset NOLs after 10 years
- Interest rate increase limited to three years, and then reduced to below current rate after that

Mr. Alper continued to slide 10: "House-Passed HB 247 Components Not Passed":

(In addition to components of Governor's original bill)

- Cash payments limited to companies with less than 15,000 bbl / day
- NOL credit rate ramps down to 25%
- No NOLs earned by companies with production over 15,000 bbl / day
- Cook Inlet tax cap sunset moved up to 2019
- ARM Board alternative purchase option

Mr. Alper moved on to slide 11: "Major Features of SB 5005":

1. North Slope Operating Loss (NOL) credit phased out: 35% today to 15% in 2017 and zero in 2018
 - Effectively sets a tax rate that can't go below zero for
 - non-profitable companies
 - Impacts major producers by preventing credits from carrying forward, indirectly "hardening" the minimum tax floor
 - Impacts independents by eliminating credits earned during the development stage prior to a company's profitability

New language not in any version of HB247

Mr. Alper added that the new language was a more aggressive stance towards operating losses than seen in any of the prior versions of legislation during the current session.

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Senator Dunleavy asked if price impacted the NOLs. He wondered if there was a certain price at which the NOLs disappeared.

Mr. Alper responded, "Half yes, half no." He explained that for independents developing a field that did not have any revenue price it did not matter. Their NOL would be 35 percent of whatever their costs might be. He continued that for the major producers it was only relevant if they had a loss. It varied dramatically from company-to-company. The weighted average breakeven price on the North Slope at present was about \$45 per barrel. If the price of oil was demonstratively higher than \$45 the state would not expect to see a significant amount of NOLs from the major producers. The provision would be mute.

Senator Dunleavy thought the price of oil was currently close to \$45 per barrel.

Mr. Alper reported that the previous day's price was about \$44 per barrel. Two weeks prior the price reached \$50.

Senator Dunleavy asked Mr. Alper about his comment regarding investing or dealing with the oil patch as Alaska had done 35 years prior.

Mr. Alper responded that when Prudhoe Bay and Kuparuk and other large fields were built there were no tax credits or carry forward operating losses. Instead there was a gross tax and no incentives for development. There were just oil fields.

Senator Dunleavy asked if new technologies, such as those used in North Dakota, had altered the concept of traditional oil exploration, development, and production.

Mr. Alper responded that the increase in technology, precise directional drilling, hydraulic fracturing, and the like had made pools available that might not have otherwise been developed. He thought there was a significant amount of oil available that might not have been available without new technology. He believed the biggest difference between the current day and the past was scale. There were larger economies of scales and the North Slope was smaller. Smaller fields had a higher per barrel cost. He surmised that the higher per barrel cost was behind the push to provide incentives for operators.

Senator Dunleavy remarked that the world was vastly different than it was 35 years previously in terms of science advances and technology.

Co-Chair Kelly asked if the regulatory environment had resulted in companies spending more money to develop a field. He mentioned Senator Dunleavy's reference to a number of technological changes in developing fields. He wondered if regulatory practices from 35 years ago had been taken into consideration.

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Mr. Alper answered "probably." He commented that Senator Bishop had discussed that it took 7 years to 10 years to get an oil field in place. He clarified that not all of the time had to do with logistics, much of it was devoted to permitting. He believed the state was tighter in handling the unique environmental issues on the North Slope. He added that the frozen season being shorter made it more difficult to operate. The ability to build ice roads and other factors made it more challenging. He admitted that it was not easy to develop an oil field on the North Slope of Alaska.

Co-Chair Kelly asked how long it used to take to bring an oilfield online. He noted that 10 years was frequently mentioned. There had been an earlier reference made to the Lower 48 fields being brought online within 30 to 60 days. He acknowledged that both the physical and regulatory environments in the Lower 48 were completely different from those in Alaska. He reiterated his question about how long it used to take in 1979 or 1980.

Mr. Alper answered that in 1930 it was nothing. Once the Clean Air Act and Clean Water Act passed there was a fairly robust process in place. He recalled companies shipping a lot of pipe to Alaska which ended up sitting in piles along the haul road for 4 or 5 years waiting on federal permits to build the Trans-Alaska Pipeline System (TAPS).

Commissioner Hoffbeck relayed that the last field developed on the North Slope was Alpine which took close to 10 years to develop.

Co-Chair MacKinnon asked about ConocoPhillips' CD-5 field.

Commissioner Hoffbeck answered that CD-5 did not take as long. He explained that the Alpine field was brand new in the Colville Delta with no infrastructure around it. He indicated that CD-5 had a bridge issue that held it up for a long time. He was unclear of the total number of years it took to develop it.

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Mr. Alper addressed slide 12: "Major Features of SB5005":

2. Reduces eligibility for cash credits from 50,000 bbl / day to 15,000

Was in House-passed HB247

3. Minimum tax increased to 5% when the price of oil is greater than \$55 / bbl
 - Current 4% rate is at all prices above \$25; would remain in effect between \$25 and \$55
 - Current "crossover" between minimum tax and SB21 profits tax is about \$75-\$80 / bbl

Gov orig. bill had a 5% minimum tax at all prices.
House-passed HB247 had a 5% minimum above \$65

Mr. Alper explained that the change in number 1 was of relatively limited impact. It would make a difference in 2017 where there was the 15 percent NOL. He furthered that by eliminating the operating loss credit on the North Slope it became a Middle Earth credit. Feature number 2 restricted the eligibility to producers of less than 15,000 bbl/day. Currently there was no production from the Interior.

Mr. Alper discussed item 3 which was the minimum tax increase. It was a milder version of what the administration had proposed 6 months prior. It did not kick in to the 5 percent level until the price of oil reached \$55 /bbl (per barrel). He explained that the 4 percent rate in statute was actually a stair step. He claimed that the steps were written years ago and were unrealistic. The price had to be below \$25 /bbl for a full year for the percentage rate to go to 3 percent, \$20 /bbl to drop to 2 percent, etc. As long as the price was about \$25 /bbl the rate would be 4 percent.

Co-Chair Kelly asked about a mandatory 4 percent rate between \$25 and \$55 regardless of losses. He also asked about the percentage between \$75 /bbl and \$80 /bbl and whether it essentially returned to the current regime.

Mr. Alper answered that currently the rate was 4 percent between \$25 /bbl and \$75 /bbl or \$80 /bbl. In SB 5005 it would be 4 percent from \$25 /bbl to \$55 /bbl and then 5 percent from \$55 /bbl to the crossover point.

Co-Chair Kelly asked if it returned to the current regime at \$75 /bbl to \$80 /bbl.

Mr. Alper replied that there was a breakeven point in the calculation where 35 percent of the net minus \$8 /bbl (the per barrel credit) was exactly equal to 4 percent of the gross, the crossover point. It was roughly between \$75 /bbl to \$80 /bbl. As the minimum tax was raised it pushed the crossover point to the right a couple of dollars. It would go from \$76 /bbl to \$78 /bbl if there was an increase to the 5 percent.

Ms. Rogers believed that the annual tax was one calculation, but the monthly installment payments went back and forth.

Co-Chair MacKinnon asked for clarification of the specific language in the bill. She suggested that the people required to pay the tax would want specificity concerning how the tax calculations worked. She understood that once the price of oil went over \$55 /bbl for a year the minimum tax would be triggered. She wondered whether it stayed at 5 percent or whether it went back and forth. She requested additional information.

Mr. Alper replied that the division would supply something in writing. He confirmed that it was one minimum tax rate based on the average price for a calendar year. The number could be a different number from one year to the next. The state received estimated tax payments and there was a true-up at the end of the year. Every year was a separate calculation.

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Mr. Alper spoke to slide 13: "Major Features of SB5005":

4. "Migrating Credits" fix preventing per-barrel credits from being used in another month than the month they were earned
 - Important volatility protection for the state

In both the Gov. Orig. and House versions of HB247

5. Gross Value at the Points of Production can't go below zero for a lease or property
 - Protects the state from effective negative taxation at high-transportation cost fields

In both the Gov. Orig. and House versions of HB247

Mr. Alper continued that item 4 created some confusion about the issue of the interaction of the per barrel credit, a monthly credit that changed value from month-to-month. In a year with significant volatility such as in 2014 when there were certain months the tax calculation fell below the minimum tax only a portion of the \$8 /bbl figure could be subtracted because of the 4 percent of gross calculation. A per barrel credit was non-transferrable and could not be carried forward. It was a use-it or lose-it credit. Credits would be lost in the low priced months. In other months the full credit would be used and the companies would pay a net profit tax. At the time of annual true-up companies were able to recapture the unused per-barrel credits from the low price months effectively offsetting tax obligations from the higher priced months. The state paid about \$110 million in refund checks after the 2014 tax true-ups. A fixed number floor would prevent it from happening. It would turn the per barrel credit into a true monthly tax calculation. It was not an overall monthly tax such as in the Alaska's Clear and Equitable Share (ACES) system. It was a limited application of a monthly tax for one specific issue. It would only kick in in a year with a lot of volatility. The item was in the governor's original bill and also in one of the versions of HB 247. He highlighted item 5 which stated that the gross value at the point of production could not go below zero. The provision had to do with avoiding negative taxation. He provided an example where if there was a high transportation cost and a very low price it might result in a negative wellhead value. Point Thomson was used as an example in testimony. Point Thomson filed tariff to return to the preexisting infrastructure at about \$19 /bbl. By the time oil went from Point Thomson all the way to market the tariff was at about \$31 /bbl. If the price of oil was \$30 /bbl there would be a negative wellhead value of \$1 /bbl which could be offset against the wellhead value from other fields and impacted some of the other taxes. If corrected, for a given field the gross value could not go below zero. It was rare for the provision to apply. He brought up the example of the Smith Bay prospect.

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Mr. Alper discussed item 6 on slide 14: "Major Features of SB SB5005":

6. Interest Rate on delinquent taxes changed from HB247 amendments

- Change from 7% + Fed compounding, for three years and then zero after that; to 5% + Fed compounding, for four years and 5% + Fed, with simple interest after that
- Substantial concern that zero interest rate will make it difficult to settle tax cases. Also it may kick in immediately even if a delinquency has paid only the 3%-4% "SB21" rate for three years
- Changes applied to all taxes rather than carving out the O&G Production Tax

Language was in House-passed HB247

Mr. Alper addressed item 6 dealing with the interest rate on delinquent taxes. He relayed that the law that passed as part of SB 21, included a simple interest rate of 3 percent above the federal discount rate. The simple interest was an amendment error in the late stages of SB 21 when the bill was in the House Finance Committee. Prior versions had compound interest. The administration wanted to raise the interest rate from 3 percent to 7 percent. The rate under ACES was 11 percent. He mentioned reverting to simple interest after 4 years of entities paying compound interest. He added that the administration had real concerns about the impact of a zero interest rate. It was not about years 4, 5, and 6, but about years 7, 8, and 9. If a company were to get assessed and decided to fight the audit findings there would be no reason to hurry the process along because no interest would be accrued. He remarked that zero interest was unsustainable for the state. The administration also wanted some clarification on transitional language from the previous version of the bill. Another change was to the interest rate language. House Bill 247 carved out a new regime for just the oil and gas production tax and left the old interest rates in place for all other taxes. It created some programming complexity and the administration would like to have a consistent interest regime across all of its taxes.

Co-Chair MacKinnon encouraged Mr. Alper to continue to try to make his case. However, there were 3 members in the House that stepped forward to send the ball down the field to the Senate, but she was uncertain that everything in the House version would be acceptable to the group. The Senate

had a difficult time removing over 10 years of tax credits worth billions of dollars. The Senate would listen carefully, as they did not want auditors to have more complex procedures. The Senate had done battle regarding some of the issues in the bill already. She remarked that although the House passed a certain version of a bill, the Senate would pass a bill that reflected what it thought was the right thing to do in a compromise position. She encouraged Mr. Alper to provide a more detailed proposal. She thought the issue had already been vetted.

Mr. Alper appreciated her words. He emphasized that the administration wanted a more enforceable and rational structure for the interests. There were some technical concerns with the Senate language which gave the administration some anxiety, but it would adapt to the law if it remained in its current form.

Co-Chair MacKinnon highlighted that Mr. Alper had stated that he would try to solve the problem through a regulatory process if the legislature did not take it up statutorily.

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Senator Dunleavy asked if Mr. Alper had stated that if the bill did not pass he would accept the law as it was and implement it.

Mr. Alper responded affirmatively. He added that the regulations would provide some clarity as to how the administration enforced different pieces. The part that could be addressed from a regulatory standpoint was how exactly the effective date applied to existing debts of a certain age and how things kicked in. He thought the language needed to be cleaned up for a transition period. He commented, "The law is the law and, we will, of course, enforce it".

Senator Dunleavy wondered if there would be any further attempts to change SB 21 if the bill was not passed.

Mr. Alper was not in a position to promise one way or another.

Senator Dunleavy was trying to clarify.

Mr. Alper advanced to slide 15: "Major Features of SB5005":

7. Technical correction to Sec. 30 of HB247. Fixes error in the municipal entity / only a portion of production is sold / proration of costs issue.

New language

8. Allows for seismic and geophysical data to be released in less than 10 years if the lease for which the data was acquired is terminated.

New language

Mr. Alper explained that in a circumstance where a municipally owned utility owned a gas field and consumed all of their own gas in their own turbines they would not be taxable and they would not get credits for their expenses. If they sold some of their gas and gained a small amount of revenue and became a tax payer, they would be able to get credits on all of their spending. The technical correction would allow the utility to get credits only on the share of the costs related to the amount of gas sold.

Ms. Rogers detailed that all of what the municipally owned utility produced was taxable. However, because they were a municipal entity they could not be taxed. In other words, the portion that they sold was subject to tax and the other portion that they produced and did not sell was still taxable. However, because they were a municipal entity they were not taxed. The technical correction aligned the expenditures with the portion that was produced and sold.

Mr. Alper clarified that the issue was technical in nature. It was not that the gas was taxed low, it was that the tax payer was exempt. The language needed to be changed to restrict the ability of a municipal owned utility to receive certain refundable credits.

Co-Chair MacKinnon stated that it was her understanding. She wondered if the legislature had changed the language. She thought the original administrative language was inserted in an attempt to help the administration with the issue.

Mr. Alper responded that every committee had kept the administration's language. The Tax Division realized late in the game that the language was written incorrectly. He

reported that item 8 addressed the issue of seismic and geophysical data becoming public. Currently, if a company owned a credit and obtained certain data it became public in 10 years. The proposed change was that if a company gave up a lease in less than 10 years the data would become public immediately upon giving up a lease. The state could then use the data publically to release the land to get a new developer in place.

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Co-Chair MacKinnon asked if item 8 applied to a lease that was willingly forfeited or a lease forfeited through litigation.

Mr. Alper would have to get back to her.

Co-Chair MacKinnon made reference to the Prudhoe Bay unit. She wanted clarification on data associated with a lease in litigation.

Mr. Alper responded that litigation would likely take about 10 years.

Co-Chair MacKinnon suspected Mr. Alper was probably correct. She wanted to better understand what the language did.

Mr. Alper replied that he would get clarification. The issue impacted DNR more than the tax division. He would consult with them and provide a coherent response to the committee.

Mr. Alper scrolled to slide 16: "Implementation Cost":

- The changes anticipated in this bill will require additional reprogramming of the Tax Revenue Management System (TRMS) and Revenue Online (ROL) which allows a taxpayer to file a return online and update the current tax return forms
- The fiscal note from HB247 included \$1.2 million in capital funds for this purpose
- We are not requesting any additional funds with this bill
- We do not anticipate any additional costs to administer the tax program

- We are beginning the scoping process for the major regulatory changes to implement HB247

Co-Chair MacKinnon was waiting for the regulatory review process.

Mr. Alper offered to review the sectional analysis beginning on slide 17 "Sectional Analysis". He began reading the sectional analysis.

Co-Chair MacKinnon called an "at ease."

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AT EASE

[3:22:34 PM](#)

RECONVENED

Co-Chair MacKinnon asked Mr. Alper to send the sectional analysis in a word document for members.

Mr. Alper would provide a copy for the committee.

Co-Chair MacKinnon stated that a separate document was easier for the general public to access online.

Mr. Alper responded that the documents that were presented to the committee included the fiscal note, the PowerPoint Presentation, and a one page analysis of the expected future spend for credits as modified to HB 247.

Co-Chair MacKinnon notified the public that the document titled, "Estimated Tax Credit Payments with Impacts of FY 17 Budget and HB 247", was prepared by Dan Stickle and was available online. The document was dated, July 12, 2016 and was 2 pages. The second page contained a graph.

Mr. Alper explained that the graph on the second page reflected what he had mentioned earlier: 30 percent to 40 percent of the credits were reduced in HB 247.

Senator Hoffman had a question on the fiscal note. He wondered if the numbers would continue to decline beyond 2022. He asked Mr. Alper what he envisioned for 5 years, through 2027.

Co-Chair MacKinnon noted that there was a fiscal note number attached to SB 5005, Fiscal Note 1, dated 7-11-2016. It had fiscals from FY 17 through FY 22.

Mr. Alper relayed that the fiscal note was a 4 page document. Most of the narrative had been covered throughout the meeting. He noted on the back page there was a horizontal formatted table showing the years and the line item description of the different provisions of the bill. Going past 2025 there were two halves to it: The half that reduced the state's spending on credits and the increase of a minimum tax in the years of 2022, 2023, 2024, 2025. Once the price of oil increased the additional revenue would not be seen.

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Co-Chair MacKinnon thought it was important for the people of Alaska to know that for the first time in the prior decade the state had an increase in oil production of about 3.3 percent. She wondered if she recalled the number correctly.

Mr. Alper confirmed that she was correct. There had been 15 thousand barrels per day of production more than last year or the year before.

Co-Chair MacKinnon asked if the state was above or below the price point provided in the spring revenue forecast. The spring forecast lowered when the legislature modified the price per barrel amount. She wondered if the price was lower or higher than the state was currently experiencing.

Mr. Alper responded that the spring forecast had an FY 17 price of \$39. Currently, the price was in the \$43-\$44 range. If the price held, the state would be about \$4 above the estimate - round numbers at these prices was \$1 and the price of oil made the state about \$30 million per year.

Co-Chair MacKinnon supposed the state was over estimating expenses and under estimating revenue on what was before the committee.

Mr. Alper stated that the administration was estimating revenue based on the price of oil. The volume of oil would not make a material bit of difference. Much of the new and incremental production that lead to the increase was in

NPRA and areas that did not pay a high royalty to the state. At low prices the so called new oil, the gross value reduction eligible oil, did not really pay a production tax.

Senator Dunleavy commented that the transportation of oil would help by lowering the pipeline costs overall.

Mr. Alper agreed. The administration was more or less diluting the annual operating costs of TAPS with every extra barrel of oil.

Senator Dunleavy asked if the bill contained all of the changes to SB 21 that the administration would be proposing.

Mr. Alper responded that he could only speak to the bill before the committee. He did not know what might be proposed at a future time.

Senator Dunleavy asked, "So there could be more proposals to 21?"

Mr. Alper replied that it was not for him to say. He suggested that perhaps the commissioner could respond.

Commissioner Hoffbeck was uncertain whether there would be additional changes. The governor stated when he came into office that rewriting SB 21 was not on his agenda. The administration had found areas that needed fine tuning. He believed that until the entire fiscal package was put together it would be difficult to make a commitment that there would be no other changes. He was not aware of any changes in the works.

Co-Chair MacKinnon asked if there were other tax credits that would be suspended.

Commissioner Hoffbeck responded that the film tax credit had been eliminated in the prior year. In terms of smaller credit programs he deferred to Mr. Alper.

Mr. Alper stated that the programs, themselves, were not being suspended. However through the veto the administration was suspending the purchase of tax credits. Many different credits fall under the same umbrella. Only

the refundable tax credits were suspended. The state only refunded credits in the world of oil and gas.

Co-Chair MacKinnon asked about an indirect expense report showing millions of additional dollars going to other industries. /she wondered if there would be a bill in the session to suspend the tax credits or delay the implementation of paying those tax credits.

Mr. Alper stated that they were all credits used to reduce tax payments.

Co-Chair MacKinnon was aware.

Mr. Alper explained that no one was preventing or trying to prevent anyone from using them to reduce their taxes. If someone earned them and had a tax obligation they could reduce it. There had been legislation regarding indirect expenditures eliminating some of the credits. He personally wanted to see a more aggressive look into some of the items.

[3:32:29 PM](#)

Senator Dunleavy noted that Mr. Alper had just provided an opinion on where he would like things to go.

Mr. Alper had opinions.

Co-Chair MacKinnon responded that there were industries that contributed across the state. All of those industries were being hit at the same time the oil and gas industry was being affected based on either the jobs created or money that was coming into the state of Alaska from revenues. The money was paying for, not receiving, taxes from the other industries. It was not a tongue and check matter. She was asking if there was any reason the administration was holding off paying all of the other industries that were contributing to Alaska's economy but were paying less taxes to the government in doing so. She would appreciate an evaluation. She opined that one industry was being held as a reason to argue about their business practices, while other industries were benefiting from the revenue of a particular industry that had contributed to Alaska for more than 35 years. Everyone was trying to ride the fiscal situation the state was in. She wondered if the state could suspend the other credits or

delay paying the other credits against their tax liabilities so that the state saw more revenue rather than a deferral of the revenue by allowing other deductions.

Mr. Alper agreed that it was worth investigating and would talk to the assistant attorney general. He was aware of a credit reduction built into the mining tax component.

Co-Chair MacKinnon responded that it was the only bill the committee had at present.

Mr. Alper expressed his gratitude to the committee for hearing the administration's bill. He mentioned other bills that were looking for other industries to contribute more. There was a mining bill, a fisheries bill, a motor fuel bill, and an alcohol and tobacco tax bill. The intent was to pass all of them along with a Permanent fund restructuring bill. He encourage moving towards building Alaska instead of fighting over how to fix Alaska. He was paraphrasing the governor.

Co-Chair MacKinnon apologized to the committee. Her office did not receive the governor's tax bill until late afternoon on Monday. She reported reaching out to contractors to look at the bill before the beginning of the special session. The legislature's contractor was not available. The legislature had to change contractors in May and actively pursued another contractor to do the fiscals. That person was not available at least until the following Monday. The committee also reached out to the industry to give them a chance to review the legislation. They were not available until after Monday. At present she had nothing else to go before the committee between now and Monday. She wondered if any committee members wanted more from the administration. The analysts also wanted to be well prepared to provide the legislature with correct information.

[3:37:45 PM](#)

Vice-Chair Micciche was processing the points brought before the committee.

Co-Chair MacKinnon added that the committee would continue to pursue the analysis as well as prepare for the industry that was affected by the bill and then move to public testimony. She encouraged committee members to email her

office with any requests for additional information on the bill.

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Co-Chair MacKinnon added that the committee had reached out to the industry and would hear from the legislature's analysts prior to hearing from the industry.

#

ADJOURNMENT

[3:39:23 PM](#)

The meeting was adjourned at 3:39 p.m.