

HOUSE FINANCE COMMITTEE
March 20, 2017
2:23 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 2:23 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue;
Representative Garran Tarr; Lisa Weissler, Staff,
Representative Andy Josephson.

PRESENT VIA TELECONFERENCE

SUMMARY

HB 111 OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS

HB 111 was HEARD and HELD in committee for further consideration.

HB 115 INCOME TAX; PFD CREDIT; PERM FUND INCOME

HB 115 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the agenda for the day.

#hb115

HOUSE BILL NO. 115

"An Act relating to the permanent fund dividend; relating to the appropriation of certain amounts of the earnings reserve account; relating to the taxation of income of individuals; relating to a payment against the individual income tax from the permanent fund dividend disbursement; repealing tax credits applied against the tax on individuals under the Alaska Net Income Tax Act; and providing for an effective date."

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Representative Thompson MOVED to ADOPT Amendment 13 (copy on file):

Page 2, line 9:

Delete "a new subsection"

Insert "new subsections"

Page 2, following line 18:

Insert a new subsection to read:

"(c) In accordance with AS 37.13.145(b)(1), and subject to appropriation, 33 percent of the amount available for distribution under (b) of this section shall be reserved for dividends. The remainder of the amount calculate to be available for distribution under (b) of this section shall be reduced by the difference between the amount calculated under (1) of this subsection and the amount under (2) of this subsection if the amount calculated under (1) of this subsection exceeds the amount under (2) of this subsection:

(1) the total amount of oil and gas production taxes under AS 43.55.011 - 43.55.180, mineral lease rentals, royalties, royalty sale proceeds, net

profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments and bonuses received by the state from mineral leases that are deposited into the general fund in the current fiscal year;

(2) the sum of \$1,200,000,000."

Co-Chair Seaton OBJECTED for discussion.

Representative Thompson read from a prepared statement:

In times of higher revenue, we reduce how much is spent from the Permanent Fund. This concept is no different than from a family manages their money: when they make more money, they quit drawing from their savings account. The draw limit was modeled by the administration. The \$1.2 billion threshold is not arbitrary. The administration vetted this number using their model, a model that was vetted by Mackenzie, a very reputable financial consulting firm. The administration determined that the draw limit is a critical addition to protecting the dividend and preserving the Permanent Fund value. The commissioner of revenue last year in May signed a letter that states, "In preserving the value of the fund, the revenue limit also protects the dividend. In short, the revenue limit is a critical addition to the bill." Members who say the draw limit is unnecessary because the forecasts are low need to consider that the forecasts have consistently been inaccurate. Their forecasts only go forward 5 years. When you look over the last 10 years the forecasts have not been correct. They have been way off. Without the draw limit the state will have a smaller Permanent Fund, a smaller percent POMV, and a smaller PFD.

Representative Thompson pointed out that the commissioner was in the room if anyone wanted to hear from him.

Co-Chair Foster invited the commissioner to come up to provide a statement.

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, concurred with the statements made by Representative Thompson. The administration had always felt that the draw limit was an important component within the bill to protect

the durability of the fund and the dividend and to take volatility out of the State of Alaska's revenue stream. He reiterated that it was one of five "must haves" in the bill. The administration supported the amendment.

Co-Chair Seaton continued to have some interest in the amendment. He had looked at a draw point of \$1.5 billion. He also looked at different levels, but had not decided on an appropriate amount. He was concerned that if the proposal was enacted at \$90 per barrel of oil the state would still be in a deficit. He opposed the amendment. He suggested that perhaps it would be appropriate down the road.

Co-Chair Seaton MAINTAINED his OBJECTION.

A roll call vote was taken on the motion.

IN FAVOR: Tilton, Wilson, Pruitt, Thompson
OPPOSED: Gara, Grenn, Guttenberg, Kawasaki, Seaton, Foster

The MOTION to ADOPT Amendment 13 FAILED (4/7).

Co-Chair Seaton indicated a CS would be drawn up that reflected the adopted amendments.

Co-Chair Foster reported the amendment would be set aside. The committee would bring back a clean CS for review.

HB 115 was HEARD and HELD in committee for further consideration.

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AT EASE

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RECONVENED

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hb111

HOUSE BILL NO. 111

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

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REPRESENTATIVE GARRAN TARR, relayed that the House Resources Committee thought the state's oil and gas system was broken. She elaborated that when SB 21 passed [Legislation passed in 2013 - Short Title: Oil and Gas Production tax] the price of oil was \$94 per barrel. The state had been operating with oil prices ranging from \$60 to \$100 per barrel. The legislature did not spend a significant amount of time crafting an oil and gas tax system that worked well in a low-price environment like the one the state was presently experiencing. There were unintended consequences resulting from the low-price environment that were not well studied and placed a significant burden on the state equating to hundreds of millions of dollars of credits for some of the most profitable corporations in the world. In crafting HB 111 the House Resources Committee had looked at an alternative for credits, keeping in mind that Alaska wanted to remain an attractive place for investment and to continue working towards a shared goal of more oil in the Trans-Alaska pipeline. The committee adjusted the underlying tax structure that would result in a more appropriate value for Alaska's oil when prices were lower. The current price of oil was \$51 per barrel, below what the legislature thought the low-price environment was in 2013 when considering SB 21.

Representative Tarr pointed to slide 24: "SB 21 Tax Calculation AT Different Prices." The slide was from a presentation by Ken Alper, the Director of the Tax Division within the Department of Revenue (DOR). It showed the SB 21 calculation at different prices. She noted there were some mathematical errors on the sheet. However, she wanted to use it as an illustration.

Representative Guttenberg wanted to be sure he had the correct form. "Oil Tax Analysis by Rep. Tarr" (copy on file).

Representative Wilson asked if the committee would review the corrections. Representative Tarr responded affirmatively. She was using the example to illustrate how the tax equation worked. She would transition to her examples that were corrected. She directed members' attention to the top line containing the price per barrel of oil at \$40, \$60, \$80, \$100, \$120, \$140. The second line

reflected allowable transportation expenses of \$9.33. The price per barrel minus transportation expenses equaled the gross value at the point of production (GVPP) shown beginning in the first column with \$30.67. As the price of oil went up the GVPP went up by \$20. She highlighted the fourth line that showed the lease expenditures in the amount of \$30.88. The lease expenditures subtracted from the GVPP equaled the production tax value (PTV) net. In a low-price environment, the PTV was a negative number and became positive as the price per barrel increased. Once the PTV was determined it was multiplied by 35 percent to get the per-barrel tax degrading the PTV by one-third.

Representative Tarr highlighted the following line representing the per barrel credit. The committee had some adjustments to the per barrel credit to retain more value per barrel. She explained that the reason the committee chose the per barrel credit was that it was the easiest way to adjust the underlying tax system. She emphasized that the per barrel credit was subtracted after transportation costs, lease expenditures, and degrading the value by 1/3. The net profit system allowed investors to deduct transportation costs and lease expenditures (although not 100 percent but a significant portion of operating and capital expenses). She continued to explain the calculation. The production tax value minus the 35 percent tax minus the per barrel credit reflected the tax per net. The per barrel credit had a significant amount of power in the equation because of where the per barrel credit was subtracted from the value. She reported that the minimum tax reflected in the line below the tax per net on the slide represented 4 percent of the GVPP. She clarified that the GVPP at \$30.67 multiplied by .04 equaled the minimum tax. The system was designed such that the state took the higher of the two: the tax per net or the minimum tax. In the example, the minimum tax was the higher of the two. She wanted everyone on the same page in understanding how the tax calculation worked. She reemphasized that the per barrel credit had significant power in the equation because the state had already provided certain allowable deductions and reduced the amount by one-third with a tax of 35 percent.

Representative Tarr pointed to the last few rows on the slide - tax as percent of price, tax as percent of the GVPP, and tax as percent of the PTV. She highlighted the tax as the GVPP in the first couple of columns, which

reflected the current minimum tax of 4 percent. She would be paying close attention to the tax as percent of the PTV in the upcoming documents based on the recommendation of the state's consultant, Rich Ruggiero. She elaborated that when looking at the overall tax amount in a net profit system the focus should be on a percentage of the PTV because it represented the net amount. The production tax value was determined after subtracting transportation costs and lease expenditures. She suggested that to understand the overall effective tax rate the tax should be calculated by using the percent of the PTV. In looking at the tax as a percent of the PTV at lower prices it was extremely low. For instance, at \$60 per barrel for oil the tax as percent of the PTV was 10 percent and at \$80 it was 18 percent. People talked about the state's net profit system having a 35 percent tax. However, in the current system, the state never reached the high rate of taxation until the price of oil reached \$140 and higher. The state had rarely reached that level of pricing for oil. She noted that in 2008 oil prices peaked at \$147 per barrel but was short-lived. The state had never seen that price before or since then. She opined that getting to the 35 percent tax amount would not likely happen in the near-term or longer term. She continued that when the committee looked at the tax as a percent of the PTV it wanted to focus on the \$60 to \$80 per barrel price range. She surmised that the state would likely be operating in the lower range for a while and wanted to do something more reasonable.

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Vice-Chair Gara gave kudos to Representative Tarr for being able to do the math on the \$8 per barrel credit. He pointed out that the chart was really for older oil. He did not think it applied to the post 2002 gross value reduction. He asked if he was correct. Representative Tarr indicated that Vice-Chair Gara was correct.

Vice-Chair Gara asked about the post 2002 gross value reduction (GVR) oil and whether there was a minimum tax. Representative Tarr responded that in the bill the floor was hardened and there was a minimum tax. However, the information did not reflect the GVR reduction, a 20 percent reduction in the value plus a \$5 credit. She would be bringing up the issue when the change from credits to deductions was discussed.

Vice-Chair Gara was eager to hear how the bill would change. He wondered if he was correct in saying that presently, without the bill, there was no minimum tax and the GVR tax rate was lower than the bigger field tax rate. Representative Tarr answered in the affirmative.

Representative Kawasaki wondered if there was some point between the \$60 to \$80 range that made a difference. He wondered if there was a graphic showing that point. Representative Tarr indicated that Mr. Alper would be providing a chart in his presentation to the committee. She concluded that legislators should be able to do the math themselves rather than relying on the Department of Revenue. She wanted members to have a more intimate understanding of how the equation worked. She did not try to take on any of the modeling activities.

Representative Kawasaki asked whether the line would be linear. He thought there would be a pivotal point. Representative Tarr responded that it had a stair step approach. Currently, the per barrel credit was applied when oil prices reached between \$60 to \$70. She remarked that there was a strange transition point between \$69.99 and \$70.00 - there was a significant tax hike. In prior years she reported running an amendment that used a formula to smooth out the transition. She reported that it was not in the current version of the bill but thought the House Finance Committee should consider it.

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Vice-Chair Gara had been told that the 35 percent tax rate did not take effect until oil reach \$150 to \$155 per barrel. He wondered how it was possible to reach a 36 percent tax rate when there was a maximum tax rate of 35 percent. Representative Tarr explained that most of the time she looked at the tax as a percent of the GVPP. The consultant advised that in a net profit system it was better to determine the tax value based on the PTV more accurately reflecting the effective tax rate.

Representative Tarr turned to the per barrel credit sheet titled: "CS HB 111 Analysis of per Barrel Credit by Rep. Tarr" (copy on file). She highlighted the first column of the per barrel credit. She noted that the per barrel credit was not applied relative to the overall price per barrel. It was applied to the GVPP, which already reflected the

transportation reductions. Under the current system, everything below \$80 received an \$8 credit. It stair stepped down \$7, \$6, \$5, \$4, \$3, \$2, \$1 to zero. However, under the current system once zero was reached the state was still offering a credit between \$140 to \$150 for the GVPP. It meant the state was offering a credit when oil prices were at \$160 per barrel.

Co-Chair Seaton asked for clarification as to the chart being discussed. Representative Tarr reported that the chart was in members' packets. She responded, "It should say per barrel credit at the top." She made clear that the first column reflected the GVPP. Under the current system the state gave \$1 credit for oil priced at \$160 per barrel. She had been continually told by the consultant that in the low-price environment more would not be gained because of expenses. The way the state could take less at the low end was by making sure to have a windfall on the high end. However, under the current law, the windfall would not happen until oil reached \$160 per barrel. She opined that the problem was the state had never seen \$160 price for oil per barrel. She thought the state would be waiting a long time for a windfall since it had never seen \$160 per barrel oil. The legislation reflected adjustments in the lower price environment scaling back how dramatically the per barrel credit was changed. The original version of the bill had a \$5 credit. However, in the lower price environment, making a dramatic change to the per barrel credit was a significant tax increase. The committee had chosen to scale the change back to reflect a step-down. A windfall would result between \$130 and \$147 (the highest price per barrel the state had seen).

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Representative Wilson asked why the state was looking for a windfall versus having a structure that worked no matter the price. The committee was discussing a tax structure that many companies built their businesses around.

Representative Tarr offered that it was suggested that the state move to a gross tax - a flat tax rate based on the gross value. However, it could be seen through different presentations that in the lower price environment the flat tax did not work well. However, a net profit system could work well in a low-price environment. She reported that in the bill, when oil prices were below \$40, the minimum tax

was 4 percent. Alaska would only take 4 percent in low oil price climates, but the only way to take such a small percentage was to balance it by taking more at higher oil prices. She tried to incorporate a balance in the bill. She continued that the state needed to get more value out of the production tax. Balance could be found by taking a lesser amount at lower prices and a little bit more at higher prices.

Representative Wilson commented that she thought Alaska had done well with what the oil companies had been forced to give the state. The state's infrastructure was an example. She suggested that although 4 percent sounded like a low amount, relative to low oil prices, it was significant. She was trying to understand the idea of a windfall.

Representative Tarr suggested that Representative Wilson's point might be one they disagree on. She was not sure she could sway the representative otherwise. She reported that in terms of the math some people favored the "Jay Hammond" one-third, one-third, one-third approach. She argued that if the target was a 33 percent tax, the state would never come close operating in a 4 percent tax world. She suggested that over time, and what the state had seen with the historical average over the previous 30 years, the one-third, one-third, one-third approach had prevailed. She indicated that the way to accomplish the split was to take a little bit less at lower prices and a little bit more at higher prices.

Representative Wilson wondered if there would be a side-by-side comparison between HB 111 and SB 21. She thought it was important to have one. Co-Chair Foster responded that he would be open to suggestions.

Representative Wilson expounded that she wanted to be able to have a comparison so that she could explain it to her constituents. Co-Chair Foster agreed that the more information available, the better.

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Representative Pruitt argued that under the current tax structure the state had the best of both worlds. It had the net at the top where a larger percentage tax was collected ensuring a large amount of revenue for the state. At the bottom, when the net typically generated zero, a 4 percent

gross minimum tax applied. He suggested that even when companies were losing money, the state had money coming in. The state had structured the tax system so that the state was always receiving money no matter the price of oil.

Representative Tarr indicated that if the tax structure worked in the way Representative Pruitt was describing, there would not be a problem. She suggested there was a significant amount of confusion about the issue. She clarified that there was no minimum tax presently. In some circumstances, the state was currently paying more than 100 percent of the cost. Even though there was a "4 percent minimum tax" the credits were used against the tax so that the value went below zero. She thought the state needed to harden the floor so that the state had a 4 percent minimum tax. She reiterated that at present there was no minimum tax enforced. In the current legislation there is a hardened floor.

Representative Pruitt commented that it was going to be a fascinating week. He indicated that Representative Tarr was incorrect. The state still taxed the oil companies even when they could move over the net operating losses (NOL)'s and transfer the loss. The state still charged companies a gross tax of 4 percent.

Co-Chair Foster urged Representative Tarr to finish up her presentations. He thought policy calls and issues were being discussed and would be debated. He wanted the introduction on the record.

Vice-Chair Gara indicated he would be distributing an analysis done by DOR showing the tax rates the state received at various prices. He agreed with Representative Tarr that the 4 percent minimum tax lasted up to \$70 or \$72 per barrel. The state received no taxes up to \$70 barrel for 7 years on GVR oil.

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Representative Tarr clarified that there was no minimum tax, as there was no hard floor in current law. Credits could be used to go below the minimum tax potentially reducing the value below zero. There were several sections of the bill where the floor was hardened. Such provisions of law would not be necessary if it was in existing law.

She was happy to share her sources that substantiated her point.

Representative Tarr drew members' attention back to the per barrel credit handout. She pointed out that the paper showed what was currently in place and what was being proposed in the bill. She would also be looking at some additional Excel spreadsheets (Document: "Oil Tax Analysis by Rep. Tarr") (copy on file).

Representative Tarr looked at per barrel prices of \$25 to \$145 because the lowest per barrel price the state had seen was \$27 and the highest was \$147. She relayed that committee members were looking at the severance tax which was a combination of a gross tax and a net tax. It was one component of the overall taxes. There were also property taxes paid to municipalities and corporate income tax paid to the state. However, the severance tax was deductible from the corporate income tax and the corporate income tax was deductible from the federal corporate income tax. There were different places where there were built-in incentives. Companies could continue to deduct the same thing multiple times.

Representative Tarr pointed to the lease expenditure row, the fourth row down, showing lease expenditures of \$25, \$30.88 (average), \$40, and \$50. In looking at the different lease expenditure amounts it helped to understand how behavior would change as the price of oil changed. The overall value would change. In the \$25 range the PTV was negative. Once the 35 percent tax was applied and the per barrel credit of \$8 was subtracted the tax per net was always lower than the minimum tax which was \$.60 per barrel. At \$35 per barrel the minimum tax would always equal \$1. Companies were losing monies, therefore, the House Resources Committee kept the minimum tax low at 4 percent, but hardened the floor to ensure that the state would receive a minimum tax even at lower prices.

Representative Wilson clarified that when the price of oil was at \$25 or \$35 per barrel companies were losing money. Even at the lower prices, the bill would allow the state to charge 4 percent. Representative Tarr responded in the affirmative. She explained that by hardening the floor the state would collect a 4 percent minimum tax at lower prices.

Representative Wilson suggested that companies would experience an additional loss to what they were already experiencing because of the lower prices of oil. Representative Tarr responded, "It could be characterized in that way."

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Representative Tarr moved to page 2 of the spreadsheet. The chart showed that at \$45 oil, the PTV was a positive value. It would be unlikely for companies to spend money at lower oil prices because the PTV would be degraded. Lease expenditures trended downward by \$10 over the past few years due to the price of oil dropping. She also mentioned a lag time when companies needed to lay down a rig or people needed to be laid off. She concluded that when oil prices went down companies did not immediately respond but would over time, hence the lag. For example, from the previous year to the current year there was a \$5 difference in lease expenditures. It reflected companies scaling back on capital and operating expenses. In the \$45 range the 4 percent minimum tax was higher than the tax per net. She suggested that even when the production tax was a positive value, \$1.44, the minimum tax would apply because the per barrel credit was a significant value. At \$55 per barrel the number [PTV] stayed positive farther out. Companies could increase their expenditures a little and there would still be a PTV. However, the generous \$8 per barrel credit made the tax per net a negative value. again, the minimum tax would apply. She indicated that the examples were the reason she chose \$50 per barrel to be the point of demarcation for raising the minimum tax from 4 percent to 5 percent. She reasoned that the tax of a percent of the PTV was 12.7 percent with a 4 percent minimum. She relayed that when the minimum tax was raised to 5 percent (from \$1.80 to \$2.25) the difference was about .45. She calculated that by raising the minimum tax to 5 percent would result in bringing in an additional amount of \$70,000,000 in revenues. She reviewed the formula: Subtracting the royalty share from 500,000 barrels oil production per day equaled 437,500 barrels per day. She multiplied 437,500 barrels per day by 365 days per year to total about 160,000,000 barrels per year. She multiplied 160,000,000 times .45 totaling approximately \$70,000,000 in additional revenue.

Representative Tarr explained that the committee had considered a 4.5 percent minimum tax. She suggested

dividing the previous number in half. The committee did not raise the minimum tax below \$50 per barrel. However, it hardened the floor - a 4 percent minimum tax below \$50. Above \$50 the committee raised the minimum tax to 5 percent. She pointed to the spreadsheet indicated that instead of \$1.80 per barrel in taxes it would be \$2.25 per barrel reflecting a 5 percent minimum tax. She continued that the 5 percent minimum tax equaled 15.9 percent of the PTV. The overall change of the effective tax rate was only a few percentage points increasing 12.7 to 15.9 percent. She reiterated the minimal percentage difference. She had asked Mr. Ruggiero if Alaska would remain competitive if it made a 2 to 3 percent adjustment to the effective tax rate. He responded affirmatively. The committee tried to come up with something reasonable.

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Representative Wilson was aware Representative Tarr had stated that the hard floor would go to 5 percent at \$50 oil prices. However, she asked if the 4 percent was a hard floor and a raise in taxes under the \$50 mark. She wondered if she was accurate. Representative Tarr responded that she was correct.

Representative Wilson asked at what point the oil companies would stop laying down rigs because of the implementation of new taxes. Representative Tarr responded that, in looking at the original slide and why she reviewed several different lease expenditure scenarios, the overall price per barrel would have significantly more influence over oil companies' decisions than the tax amounts. She thought companies would likely spend less money in the lower price environments. She continued that companies would be in harvest mode rather than spending money on exploration and development without the extra spending dollars.

Representative Wilson commented that she had learned that at \$65 per barrel, before the legislation, companies would decide whether to continue drilling or lay down rigs. She indicated that their decisions were based on profitability. She wondered if the \$60 to \$65 mark would change with the passage of the legislation. Representative Tarr responded that she would expect the companies would change their mark. She thought it was reflected in the lease expenditures. In 2016, the average lease expenditure was \$30.22. In 2015, the amount was an additional \$5 and in

2014, it was another additional \$5. In Fall 2014 when prices were low, and it became apparent they would remain low for a prolonged period companies scaled back. They began laying off workers and slowing down other activity. It made sense to her while that would happen. She did not think it was reasonable to expect that companies would take on major projects if the price per barrel continued in the \$30 and \$40 range.

Representative Wilson did not expect companies to take on more. However, she argued that the state could tax more but would not gain more if less oil was being produced. She was concerned that if companies were looking to have their rigs back in operation at \$60 to \$65 based on the current tax structure, the price per barrel might have to increase to \$80 or \$85 with the proposed change. She thought incoming royalties might go down with less production. She would direct her questions to the oil companies.

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Vice-Chair Gara was unclear about the GVR oil - the post 2002 production units. He asked if the 4 percent minimum would apply to those fields in the first 7 years. He reported that under current law they paid no tax within the first 7 years up to \$70 per barrels. Representative Tarr relayed that the intent was to harden the floor at 4 percent even for GVR oil.

Vice-Chair Gara suggested there would not be a 7-year tax holiday. Representative Tarr replied that the tax holiday would include a 20 percent reduction and a \$5 credit. The same circumstance of "higher of" would apply. For example, if the 4 percent minimum tax was higher of the other the 4 percent minimum tax would apply. She would discuss it more when the committee looked at the reductions.

LISA WEISSLER, STAFF, REPRESENTATIVE ANDY JOSEPHSON, reported that there was a provision in HB 111 that protected the GVR from the minimum so that the minimum tax would apply to the 70 percent or 80 percent that was not subject to the GVR.

Vice-Chair Gara noted that under current law the GVR fields, what he called the post 2002 fields and all future fields, did not pay the minimum tax. Given the discount they received, the average GVR field paid no production tax

up to \$70 or \$72 per barrel. He understood two separate things. He wanted to clarify that a GVR field currently received a 7-year tax holiday from the gross minimum tax. He wondered if those fields, in the first 7 years, would still have the holiday from paying the minimum tax, or if they would start paying the minimum tax in the first year like every other field.

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Representative Tarr explained the portion equaling the original value minus the deduction of 20 percent would not be subject to the minimum tax. However, the remaining 80 percent would be subject to the minimum tax provision. The gross value reduction would still apply, but the remaining value would be subject to the minimum tax.

Representative Tarr explained that above \$50 per barrel, the 5 percent minimum tax kicked in and the relative value was about \$70 million. She suggested the \$70 million would be paid by about 5 potential production companies.

Representative Tarr continued to the spreadsheet on page 3. If the price of oil was \$65 per barrel companies would still be operating in the minimum tax unless companies significantly slowed down activities and expenditures went to \$25. The committee felt that the minimum tax had to be 5 percent rather than 4 percent. She pointed out that the PTV net was positive. Companies subtracted transportation expenses and lease expenditures. If oil were to reach \$65 per barrel, there would be about \$25 prior to the 5 percent equaling about \$8.44 of profit per barrel. She noted that once an \$8 credit was applied the value would be significantly reduced to \$.44 per barrel or the minimum tax of \$2.20 per barrel. The committee felt that amount was too low because they wanted more value in the low-price environment of \$50, \$60, \$70, or \$80 range. The difference would be \$2.75 minus \$2.20 which equaled \$.55 per barrel. She highlighted a scenario where the price per barrel was \$.45 and how more value would result by adding \$.55 per barrel.

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Representative Tarr discussed scenarios at \$75 per barrel. She indicated that at \$75 the minimum tax would apply if the lease expenditures increased to what they had been 2

years prior. She opined that the state could not have a such a low minimum tax at \$75 per barrel. She advocated raising the minimum tax to 5 percent comparing the difference of \$3.25 and \$2.60.

Vice-Chair Gara spoke to a concern about just raising the minimum floor to 5 percent at higher prices versus going to 6 or 7 percent as prices increased. He surmised that as the price of oil increased so did the industry's profits. He referred to her analysis that at \$55 per barrel the effective profits tax rate was 15.9 percent. He continued that leaving the minimum tax at 5 percent at \$65 per barrel the effective tax rate went down to 11.4 percent. At \$75 per barrel it decreased to 9.5 percent. He wondered if the decreases were due to the minimum tax remaining at 5 percent.

Representative Tarr answered in the affirmative. She elaborated that it was also why the per barrel credit made a difference. She relayed that the consultants advised the state to move away from things attached to the price per barrel. Depending on which side of the equation someone was on, the value would degrade over time due to inflation. A way to get around that was to use a per barrel credit. The House Resources committee stepped down the per barrel credit. In existing law, the per barrel credit was \$8. In the proposed legislation the per barrel credit stepped down to \$7. She pointed to the area of the slide that showed the step down from \$8 to \$7, which added \$1 to the tax per net. She continued to highlight areas of the page that showed where the state currently stood and pointed to some differences. She reiterated the importance of maintaining a minimum tax that retained enough value, so the state would still get some value when the price was around \$75.

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Representative Tarr moved to slide 4. She reviewed that in the existing law the per barrel credit was \$8 even when the price per barrel was \$85 because of the GVPP (it was reflected as \$75 on the slide). She highlighted percentages on the chart pertaining to existing law. She continued to point to certain areas on the chart noting the changes where the per barrel credit was scaled back from \$8 to \$6. She pointed to the effective tax rate on the chart. She restated that the adjustment was about a couple of percentage points. One way to make things smoother was to

use a formula. She thought there was a significant amount of variability in the overall tax rate. She added that it had to do with a company's behavior and their spending at different prices. She did not feel the overall effective tax rate was too high. In terms of a relative value currently, Mr. Alper stated that every dollar change in price equaled \$60 million to the state. She used the example of the per barrel credit being reduced from \$8 to \$6, a reduction of \$2. The reduction, because the per barrel credit was applied as a full dollar deduction, would be equal to \$120 million.

Vice-Chair Gara spoke to the \$75 per barrel level on slide 3. He noted that the credit went down by \$1. He expressed his concern that at an oil price of \$50 per barrel the effective tax rate was 15.9 percent of profits. At \$65 per barrel the tax rate was 11.4 percent of profits and at \$75 per barrel the rate went down to 9.4 percent of profits applying the 5 percent minimum tax. He was aware that there was some impact of the \$7 per barrel credit, as it would change from \$8 under current law. He asked about the effective tax rate on profits for an average field where the per barrel credit was \$7. He wondered if it was 9.5 percent or if there was another adjustment he was not factoring in.

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Representative Tarr commented that she thought a row was missing on slide 3. In the circumstance brought up by Vice-Chair Gara, the tax per net at \$4.94 was higher than the minimum tax and, therefore, would apply. She relayed the formula: \$4.94 divided by \$34.12.

Vice-Chair Gara surmised it was one-seventh. Representative Tarr answered that it was about 14.5 percent. Her opinion was that the overall effective tax rates were still very reasonable and kept Alaska in the competitive category relative to other regimes and opportunities for companies.

Representative Tarr advanced to the other price per barrel examples on slides 4-7 and addressed the 35 percent tax rate recommended by the state's consultants. She suggested that a way of balancing the system was to scale back on the lower end to get some on the higher end. She thought it was the reason a low minimum tax such as 4 percent or 5 percent would be acceptable. In other words, the state would

receive a higher percentage of the value as prices increased. Relative to the existing law, she noted \$130 per barrel. She indicated that existing law was \$4, and she went down to zero. She emphasized that the windfall portion would come at higher prices where they approached the 35 percent tax rate. She relayed that she had reviewed the first part of the bill: how the state could get more value for the resource being severed at lower prices. She summarized that below \$50 per barrel the bill hardened the floor to a true 4 percent minimum tax. The bill raised the minimum tax to 5 percent between \$50 to \$70 per barrel. The bill adjusted the per barrel credit above \$70. She indicated that the committee substitute was scaled back from the original bill, which she thought softened the impact of the provision. She suggested that the per barrel credit was an area that could be adjusted because of the way it was applied and because it was less sensitive in certain ways. She concluded that she had reviewed how to obtain more value at a lower price environment in which the state was currently operating.

Co-Chair Seaton referred to the original version of SB 21 which had the maximum per barrel credit set at \$5 per barrel. He asked if she had looked at that in the analysis. He suggested that if she had corresponding graphs, he would like them forwarded to him.

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Representative Tarr responded affirmatively. She explained that the way the Senate configured the bill the \$5 credit applied even at the highest of prices. She recommended an adjustment to moderate the system so that less would be taken on the low end and more on the high end. If the state kept the \$5 per barrel credit at high prices it would never see a windfall. It would eat away at the value. However, if the credit was scaled back to zero at higher prices, the effective tax rate would reach closer to 35 percent and result in windfall profits.

Co-Chair Seaton did not like characterizing a 35 percent severance tax rate on profits as a windfall because it was the tax rate. He added that the purpose of a \$5 per barrel credit was an adjustment to the Alaska's Clear and Equitable Share (ACES) \$25 at \$100 per barrel. A sliding scale was incorporated in the House Resources Committee

providing a windfall on the lower side. He was interested in seeing the charts she had.

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Representative Wilson remarked that the taxes kept changing so frequently they started mixing with each other. She was pretty sure with SB 21 and in discussions regarding per barrel credits that there were other tax credits given up in exchange. She did not believe the legislation had come over to the House and subsequently changed by the House. Other tax credits were changed as well. She asked Representative Tarr to comment.

Representative Tarr responded, "That's true." She continued that the ACES system relied heavily on the qualifying capital expenditure (QCE) credit. There was criticism of the credit because it was not linked to production. For example, some work done to a runway on the North Slope was in question in terms of whether the type of work qualified for a capital expenditure credit. The alternative was a per barrel credit linked to production which was also criticized. The criticism stemmed from not having a clear way to delineate whether it would be applied to oil coming on as new oil or to oil that would be produced. She thought it was still a point of contention about the system. People had varying views on whether the state should be giving a credit for oil that was already slated for production.

Representative Wilson commented that there had also been a lot of criticism for changing the oil tax system so much. She brought up having reduced or eliminated small producer credits. She was aware of some trade-offs that had been made prior to the legislature instituting a per barrel credit. She wanted to be clear what had been given up at the time. She agreed with Representative Tarr that the legislature wanted better checks and balances regarding where credits were going and what the state was receiving in exchange. She was certain the state had eliminated some of the other credits that had been valuable to the small producers versus the larger producers.

Representative Tarr responded that the small producer credit was still in place and was applicable to work commenced by January 1, 2016. The state also had well lease expenditure (WLE) credits and exploration credits. The important question to consider was which ones worked best

and incentivized desirable behavior. She indicated that the state had been challenged in answering that question. Mr. Alper would be able to provide aggregate data in his presentation. For example, he would be able to provide the amount spent on the North Slope or in Cook Inlet. Further, he would be able to report how much was being spent on projects in production. However, beyond that, the state would not have specifics about money spent on stages leading to production or on unsuccessful leads.

Representative Tarr noted that the bill contained a couple of provisions that would be helpful in legislators understanding. She suggested that the consultant brought up the need for things to be more opaque. The state did not have access to all the information that would help the legislature to better understand the way things worked and how it could provide incentives to the state's desired outcomes such as increased production. The bill would enable legislators to have access through signing confidentiality agreements about tax information. It would also require reporting of some aggregate amounts that would be publicly available. It attempted to differentiate what the public might be interested in versus what policy makers would be interested in knowing. From her point of view, it was not that the subsidies or incentives were 100 percent problematic but, given the state's fiscal situation, it did not make much sense to spend millions of dollars on things that did not lead to production. She wanted to be able to get the answers why certain investments did not result in production. She suggested that it would be helpful for legislators to have more information to make decisions.

Representative Tarr also commented that, relative to the different tax changes, there had been several requests for stability. In the volatile industry of oil stability was a challenge. She thought it would be best for the legislature to provide something that could last for 3, 5, or 7 years. There were so many things beyond the legislature's control relative to the price of oil. She reflected that when the legislature based its budget on \$60, \$80, and \$100 per barrel oil prices in FY 15 and the price dropped significantly, everyone was surprised. She posed the question about how the state was being more strategic about the dollars being invested. She relayed that some investment changes were made in Cook Inlet, Middle Earth, and on the North Slope. She mentioned that having 3 separate regimes within the state was another complicating

factor to the state's tax system. One of the things the legislature would attempt to move towards was how to address credits. Under the current system the net operating losses were converted into credits which could be presented for an exchange of cash.

Representative Tarr reported that another problematic issue was that credit certificates could be used as collateral at a bank for financing. The amendment that was offered to allow the certificates to be used at a bank for borrowing money, was offered at 1:00 A.M. and attached to a fish tax bill. During the amendment debate in committee, it was reported that the amendment would only apply in Cook Inlet. However, in practice, it applied statewide. She indicated Bank of America and ING Company had talked about how presently they were bridging loans from some of the companies. However, if the companies defaulted the banks became the lease holders of the credits. She wondered if the banks would have a fire sale. She thought the whole system had become too top heavy. From the committee's perspective there was not a significant amount of value in offering an incentive that would not be honored. If the state was not going to pay its obligations or could not pay them in a timely fashion, what good was it to have them in statute. She mentioned there being concern about cashable credits and whether the state should continue to offer them.

Representative Tarr reported was also concern about the certificates being able to be used for bank financing. Mr. Ruggiero had indicated that it was typical of other regimes around the world to allow losses to be carried forward and used as deductions. She suggested that it was not much of a change for the three largest producers. They were currently tax payers in the State of Alaska. They had losses in a year and likely used them in the same year they were earned due to having a production tax liability. The same happened with corporate income tax where companies carried losses forward and used them against their corporate income tax. She relayed that the state was not really making a change for a tax payer. In a circumstance where a loss had to be carried forward into a second year, a change was being made. The larger change would affect the companies in the exploration and development phase of their work and were not currently tax payers to the State of Alaska. The resources committee took away cash credits and repealed the portion of statute that allowed them to be used for bank

financing. She indicated that instead certain carry forward losses were allowed.

Representative Tarr pointed to the handout titled: "CS HB 111 Carry Forward Analysis by Rep. Tarr" (copy on file). She explained that during the third, fifth, or seventh year of development phase of work companies would be carrying forward losses and once they became tax payers they would use the losses against production taxes. She reported that Mr. Ruggiero had relayed that in some places companies were offered an uplift - interest earned on a loss. She spoke of having looked at a couple of different scenarios and pointed to the first column. A loss equaled 100 percent of a loss minus 50 percent carry forward with an 8 percent uplift - slightly below the uplift amount in the current legislation. Column 2 showed a 100 percent loss minus a 100 percent carry forward with 10 percent interest. The committee preferred the scenario in the second column and an amendment was offered that brought the bottom line to a similar amount.

Representative Tarr pointed out that when a company carried forward 50 percent of its loss for 7 years, the value at the end of the period would equal about \$85.70. In other words, a company would gain about 85 percent of the loss by carrying them forward. In the second scenario, if a company allowed 100 percent of the loss to be carried forward, by the time the 7 years was over, they would earn about 200 percent of the loss. It was the feeling of the House Resources Committee that it could not obligate the state to such a significant incentive. She furthered that a company in exploration and development that completed work to get to production (on average it took 7 years to reach production) would become a producer of new oil and would qualify for the GVR, a provision associated with new oil. The gross value reduction took 20 percent of the value and the per barrel credit. By applying the GVR provision some of the value would be reduced. The committee felt that if the carry forward percentage was too high and the GVR provisions were applied, the state would be subtracting too much of the value leaving little for the state. She reminded members that not only were the carry forward provisions applicable for 7 years, so was the GVR provision. In her opinion, each provision should not be considered without the other. She reviewed that the state would be providing carry forward losses with a generous uplift for 7 years. Once companies became producers GVR

provisions would apply and losses could still be subtracted. She opined that if either of the provisions were too generous, at times of high prices and high production, the state would receive nothing. The House Resources Committee had been concerned with striking the right balance which was the reason it did not opt for a 100 percent carry forward at 10 percent.

Representative Tarr spoke about how to match up the two numbers. She detailed that column 1 needed to be adjusted to about 57 percent. For example, if 57 percent of the loss was carried forward at 8 percent, after 7 years it equaled 100 percent of the value. She offered that, as a policy call, at the end of the 7 years if companies wanted to retain the value of 100 percent of their losses, the committee could adjust the 50 percent carry forward slightly higher. She wanted to be more conservative with that number. The combination of the current provision and the GVR provisions which could be applied by a company becoming a new producer would quickly reduce the value available to the state.

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Vice-Chair Gara commented on the difficulty of finding consensus in a committee. He wanted to return to the tax rate issue. He was aware Representative Tarr wanted to honor what the proponents of Alaska's Clear and Equitable Share (ACES) and of SB 21 characterized in the respective legislations. The representative had noted in ACES that producers received their credits based on how much they spent. Whereas, with SB 21 credits were based on production. He supposed the \$8 credit had nothing to do with production, just price. He wondered if he was accurate. Representative Tarr indicated he was correct.

Vice-Chair Gara wanted that point made clear. He agreed with Co-Chair Seaton that 35 percent was not a windfall profits range. He relayed that all the taxes combined in Norway equaled about 78 percent. He thought a person could find a different tax rate in every jurisdiction. He was concerned about the declining effect of a profits tax rate in the price range between \$50 and \$70 per barrel where the price of oil would likely stay for the following 10 years according to DOR. He suggested that beyond the 4 percent or 5 percent minimum tax it would be the greater of the SB 21 profits tax rate or the gross tax.

Co-Chair Seaton asked what slide Vice-Chair Gara was referring to.

Vice-Chair Gara confirmed he was not referring to a slide. He clarified that he had a general question on credits. Under current law, producers deducted 35 percent of costs when the profits tax range applied. He asked if the deduction remained in the legislation being discussed. Representative Tarr responded that losses were treated as losses. There would be 100 percent to work from carrying forward 50 percent. She explained that the difference was when the loss was converted to a credit versus simply taking deductions, which was much easier to follow.

Vice-Chair Gara suggested that in current law companies pay an effective tax rate of about 12 percent of profits at \$90 per barrel. However, companies also received a 35 percent deduction as if paying a 35 percent tax. He asked if, under HB 111, it would always be a 35 percent deduction. Representative Tarr responded in the affirmative. She explained it was one of the things the consultant spent a significant amount of time talking about - the mismatch between the effective tax rate and the deduction. Essentially, the value would be doubled because companies would be paying an effective tax rate of 50 percent of the allowable deduction amount.

Co-Chair Seaton asked if a company's expenses were 100 percent deductible. He suggested that until there was a conversion to a tax credit, deductions were deducted at 100 percent. He wanted to clarify that companies could write off their deductions at 100 percent until they reached the minimum tax. Once a minimum tax kicked in, deductions would be converted into a tax credit at which time the 35 percent would apply. He asked Representative Tarr to comment. Representative Tarr replied that both people were correct. A company could carry forward its losses, but the conversion to tax credits was at the rate of 35 percent. It was a mismatch because the overall effective tax rate was much lower. She relayed that when SB 21 was crafted, the two numbers were supposed to match each other. The reason the net operating loss (NOL) credit was offered at 35 percent was because the tax rate was 35 percent. She opined that the two things did not work well together when the effective tax rate was never 35 percent.

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Vice-Chair Gara commented that he agreed there was a problem with being able to write off 35 percent of costs. He thought he and representative Seaton were using different words. Companies deducted 100 percent of their costs and multiplied it by 35 percent when they were only paying a 12 or 14 percent tax rate. Representative Tarr had made a change. He asked her to explain the change in the bill. Representative Tarr replied that by only using deductions the other issues were eliminated. Companies took 100 percent of their deductions to get to the value that they worked from. The bill would also allow 50 percent of the value to be carried forward. The bill did not require converting to credits. Tax payers would use their deductions against their production tax liability.

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Vice-Chair Gara thought the change was an improvement. He hoped to hear from the consultants about what was done in other states. Louisiana let companies carry forward for 2 years just for horizontal well expenditures and nothing else.

Representative Tarr responded that she found it was difficult to compare Alaska to anywhere else. She learned that in comparing Alaska to another jurisdiction it was important to consider the producer share versus the non-producer share. The development in Alaska was occurring on state lands. In states such as Louisiana and Texas, development was more likely to occur on private land. She suggested that the scenario was much different when the lease expenditure cost or overall lease per acre might be substantially costlier. The royalty would be going to the private land holder and another portion would be going to the state and federal government (combined they were the non-producer's share). In Alaska's case, it was receiving the severance tax because the state was the land holder and the lease payments tended to be lower than other entities. The state had a significantly longer development timeline, which was why the state used 7 years. She spoke of the slow set-up time of a drilling operation in Alaska in comparison to other states. She thought the consultant had a good suggestion of looking from the stand point of producer share and non-producer share to understand how Alaska compared. Mr. Ruggiero told of companies being able to get

100 percent of the value of their loses. She indicated that there had been criticism of the current legislation due to only 50 percent being carried forward. However, she highlighted the GVR provisions in the bill. She suggested that if the state wanted to do something different, it also needed to look at the interaction of the GVR. She opined that the state could not give up all the value by allowing the deductions to be carried forward adding value to them while also having the GVR provisions. She asserted that nothing would be left. Mr. Ruggiero also recommended a fundamental shift to the existing tax structure to reflect the overall profit profile; to do something bracketed on the net. In that vein, he recommended eliminating per-barrel credits and GVR provisions altogether. Although the House Resources Committee did not get rid of either of them, it started looking at a tax as the percentage of net. Mr. Ruggiero's suggested that if the state had a true net profits system, the focus should be on the tax as a percentage of the production tax value - that was what happened in a net system.

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Representative Pruitt thought the committee could spend a significant amount of time discussing the details of the bill. He asked for the number of additional barrels of oil per day that would result from the legislation and wondered how many extra people would be put to work.

Representative Tarr responded that she had never seen them as a component of a tax bill. She relayed that the legislature had not looked at employee hiring for SB 21. However, it had bench marked it against ACES where there had been an uptick in investment, the number of individuals working on the North Slope, and the number of operational rigs. She thought that staff from DOR might be able to provide the answers to Representative Pruitt's questions. In terms of the number of barrels per day, she worked from the information provided by DOR. The department had indicated that over the following 10 years the state would be down to a few hundred thousand barrels per day. She suggested that it was difficult for the department to make estimations beyond 5 years because of the everchanging environments and the price volatility of the oil and gas industry. She mentioned the \$80 price shift in the price per barrel in the last few years. She opined that it would be difficult to make accurate estimations. She reported

that the House Resources Committee had moderated some of the changes in the bill to avoid causing a downturn if the price per barrel returned to \$30-\$40.

Representative Tarr continued that the committee felt that hardening the floor was a reasonable approach. She highlighted that at the profit range beginning at \$55 per barrel [she pointed to an unidentified handout] 4 to 5 percent was applied to ensure the state had more value. She noted that a change in the per barrel credit kicked in at \$75. She pointed to page 3 of the "Oil Tax Analysis by Rep. Tarr" document and highlighted that even with high lease expenditures the production tax value would remain high. The committee wanted to hit the reset button on lower prices. She reported that during the SB 21 deliberations the committee did not look at what happened below \$60 per barrel because, at the time, the possibility of price dropping was not a concern. She thought that if someone had suggested looking at what would happen if oil went to \$30 per barrel, they would have been accused of not using their time wisely. It did not seem like it was possible for the price to drop as it did. She continued that in reviewing the 10-year price profile from 2013 and prior, the price had been between \$60 to \$100 except for a spike to \$147 in 2008. The price spike had been very short in duration. She indicated that the committee looked at the typical price range from \$80 to \$100, as the legislature had done its budgeting based on \$100 per barrel oil. However, there was a huge shift down in price. She had spent a significant amount of time trying to understand how the committee had estimated so poorly. In the same year, Texas, budgeted around \$65 per barrel oil. Someone suggested that perhaps Texas came closer in its estimation because more of the oil headquarters were located there. She acknowledged that her answer was not scientific. She had wondered if Alaska had missed some information and had not uncovered anything.

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Representative Pruitt asked if the plan would put additional oil in the pipeline. Representative Tarr responded that she believed so. She thought the legislation kept Alaska an attractive place for investment. The state's overall effective tax rates were very reasonable in comparison to other jurisdictions. She relayed that the per barrel credits were retained because it mattered where the per barrel credit was applied in the equation. She

suggested that because it came after the other deductions, the per barrel credit - even scaled back - was a generous credit.

Representative Tarr noted other attractive incentives including changing the investment opportunity with the carry-forward losses and leaving in the GVR provisions. She explained that retaining a net system meant that companies could take deductions for transportation and lease expenditures. The companies were made whole or protected in some ways because they had their deductions prior to the tax rate being applied. She believed Alaska would remain an attractive place for development. She supposed that several things made Alaska attractive including geology, access to information, the tax rate, the local skilled workforce, and the price per barrel. She remarked that Alaska was stable politically (she was not speaking in terms of the stability of Alaska's tax system), unlike other regimes in a civil war. Alaska had a good workforce of people knowledgeable in the industry and had been working in the industry for decades. She believed that the modest adjustment in the tax structure provided the state more value in a lower price environment. She thought it was something the committee would have put in place when looking at SB 21 had the committee been thinking oil would be at \$50 per barrel for the long term rather than \$90 or \$100.

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Representative Pruitt noted that Representative Tarr had mentioned several times the attractive environment. He wanted to know what kind of response she had received from investors since the bill was made available to the public. He asked if she had received letters. He wondered if investors had indicated that the legislation would create additional investment, and consequently more oil in the pipeline. He wanted to see something that indicated support from the entities that would be affected. He wanted to know if companies thought the legislation was more attractive than what was already in place.

Representative Tarr reminded Representative Pruitt of the 735,000 plus shareholders that they represented. She had heard from several constituents that the legislation did not go far enough and that the credits should be done away with altogether. There were others that did not want to see any changes made to the tax system. She noted that in

talking about the credits provision of the bill, 93 percent of the people she represented responded to a budget survey in which they advocated eliminating the credits. She relayed that during the session in an earlier pole by the Senate Majority it showed that 65 percent of about 7000 Alaskans that responded wanted to do away with the credits. She saw her role as a member of the board of directors of the people she represented. She did not believe the state's goals were perfectly aligned with the oil industry. She thought the largest point that would be discussed had to do with the loss carry forward and whether the right balance was struck with a 50 percent carry forward and interest of 8 percent. She recommended looking at the interactions with the GVR provisions within the first 7 years of production. She was aware that with long lead times peak production would occur in years 5, 6 and 7. Once oil was in peak production the state needed to make certain to extract some value before production declined. The state needed to be thoughtful about where incentives were offered and how generous they were, a balance the House Resources Committee tried to strike.

Co-Chair Seaton indicated others had questions as well.

Representative Pruitt relayed that Representative Tarr kept saying that the legislation made Alaska an attractive place for investment. He wanted to understand the explanation about how the bill made Alaska a more attractive investment place for him to speak to his constituents. He understood the severance aspect of the bill making sure that Alaska received its share. He wondered whether the legislation would make Alaska more attractive for investment. In other words, what policy put more oil in the pipeline.

Co-Chair Seaton stated that the consultants would be presenting to the committee at which time they could address Representative Pruitt's question.

Representative Pruitt argued that the consultant was not stating that the legislation made Alaska an attractive place for investment. Co-Chair Seaton responded that Representative Pruitt did not know because he had not asked.

Representative Pruitt responded that Representative Tarr was saying that it attracted more investment, which was the reason he was asking her. Co-Chair Seaton would allow

Representative Tarr to answer Representative Pruitt's question but did not want an argument about philosophy to ensue.

Representative Tarr responded that Alaska would be an attractive place for investment. She claimed that if she was deciding where to invest her dollars she knew that in Alaska she would be allowed to carry forward 50 percent of her losses and would earn 8 percent interest. She would be able to do so for 7 years. At such time that she became a producer, in addition to being able to use her losses, she would be able to have the GVR provisions in place that would be a 20 percent reduction. She noted that the legislature was not eliminating the obligation of what the state did currently with credits. She brought up writing a check on one side of a balance sheet and deducting against the tax liability to the state on the other side of the balance sheet. The state would not be writing checks to companies, but rather shifting the burden to the other side of the balance sheet in the form of a reduction against the tax liability. The State of Alaska would still lose the value of the reductions. The value would be gone. However, the state would no longer be paying a cash credit and writing a check to a company while they were doing the work. She claimed that no other regime in the world wrote cash checks. She furthered that if someone thought eliminating writing cash checks made Alaska unattractive then every other regime was unattractive as well. Alaska was the only place that had written cash checks and encouraged using the credit certificates as collateral to borrow against. She remarked that under the current system, investment in Alaska had become less attractive because of the state not being able to fulfill its obligations making the incentive not worth having at all. She opined that shifting the obligation from writing checks to the other side of the balance sheet as a deduction against liability made investment more attractive. She cited similar examples of the type of incentives offered in the bill such as refinery credits. She mentioned a time when people were looking to reopen the refinery facility in Kenai. She reemphasized that the state would be shifting from writing checks to companies to pay for their development. The companies would have to be well financed enough to become a producer at which time they would be able to use the deductions against their tax liability. She asserted that it would make Alaska like every other regime in the world. If Representative Pruitt thought that the provision would

make it unattractive for companies to invest, then Alaska was as equally unattractive as every other location in the world.

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Representative Wilson asserted that Alaska was not like any other regime. She did not believe a fair comparison could be made. She was glad to hear that the fact the state could not meet its obligations was viewed as a problem. She believed that part of the reason the issue was currently being discussed was because when the state was making a significant amount from oil, it spent it on government instead of saving it to pay its obligations. She noted that when SB 21 was under consideration she had spoken with subcontractors in the private sector about the effects of Alaska's Clear and Equitable Share (ACES), as they had been most affected by the changes the state made to its oil tax structure. She wondered if any research had been done regarding the effects HB 111 would have on private businesses. She thought they would be most affected by the proposed changes. Representative Tarr responded positively. She elaborated that she had been in contact about changing from a credit to a deduction.

Representative Wilson interrupted Representative Tarr's response to clarify her question. She explained that she was not talking about oil companies. She was talking about suppliers such as Flowline Alaska in Fairbanks. She indicated they were a supplier that had contracts in place prior to the implementation of ACES. She continued that when ACES occurred the projects did not happen. At the implementation of SB 21 many projects began again. She conveyed that the suppliers explained what happened, what they expected to happen, and what was happening. She wanted to clarify which group she was talking about. She reiterated that she was not talking about the oil companies. Representative Tarr responded that she had heard from companies that they had contracted their workforce in response to low oil prices, a circumstance beyond the state's control. A domino effect was felt due to low oil prices rather than the state's tax policy. Suppliers and support businesses were affected as a result. She explained that the reason for the modest change made in HB 111 was to avoid imposing something that pushed too far or had unintended consequences.

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Representative Wilson responded that in the 7 years she had been in office the legislature had taken up legislation having to do with oil taxes every year. She suggested that the legislature either had not gotten things correct or could not admit it was right. She surmised that it was the state's budgeting that landed the state in its current fiscal situation. She thought the legislature was trying to re-coop its mistakes from the oil companies. She wanted to see real numbers to be able to make an informed decision. She did not think it was fair to compare the fields, as they varied significantly because of location, the type of oil, and other factors. She mentioned some fields were modest. She wondered about other presentations in the House Resources Committee. She was happy to listen to previous presentations for the information.

Co-Chair Seaton added that the charts showed the low, average, higher, and high costs representative of the distance from fields and the different kinds of oil.

Representative Wilson did not believe the information revealed the effects. She was trying to figure out the effects on the low and high ends and whether companies would go forward with projects.

Representative Tarr continued to explain (working from page 4 of the spreadsheet packet). She looked at 4 different scenarios for the lease expenditures because she wanted to understand the companies' different behaviors. The lease expenditures reflected increased capital or operating expenditures. She suggested that a company earlier in development would be on the higher end of spending. Whereas, some of the other companies that were in the phase of production would not be spending as much. In the oil tax analysis handout, she used the average lease expenditure of \$30.88. However, some were below, and some were above which prompted her to look at lease expenditures of \$25, \$40, and \$50. There was a big difference in the equation depending on how much was being spent. She did not make changes to the transportation line. She spoke of the Smith Bay development. She noted that even in a higher priced environment, if a company's lease expenditures were high and transportation costs were pricey, certain developments would not make sense until the price of oil reached well over \$100. The economics would not make sense. She used

Point Thomson as an example. One of the things that was costly in the project was the pipeline which was located close to the Trans-Alaska Pipeline System (TAPS). The Smith Bay project was 124 miles away from the existing TAPS infrastructure. A pipeline of over 100 miles long would have to be built for oil to reach TAPS. She asserted that the transportation costs would be phenomenal. Such a development would not occur without the price of oil being high enough for the transportations costs to be deducted. She went up to \$145 per barrel in her handout because the legislature did not look at the high price environment when Alaska's Clear and Equitable Share (ACES) was considered, or at the low-price environment when SB 21 was considered. She wanted to look at the entire breadth of prices the state had seen. The range she had looked at was \$25 to \$145 per barrel. She also looked at 4 different lease expenditure scenarios. She had not spent much time with Mr. Alper and his staff doing the same equation because it was something she wanted to understand. However, he had an analyst that did life cycle modeling. She had done a presentation for the House Resources Committee using a smaller scale model of a development that produced 50,000 barrels per day and another that was a 200,000 barrel per day development. She interjected that the overall volume of production influenced spending habits. The modeling showed what happened in the development stage and the production stage and the relative impacts of both. She hoped the analyst would have an opportunity to bring her presentation to the House Finance Committee.

Representative Wilson was looking for the number of additional barrels of oil that would be produced through the different processes. There were expectations when the legislature took up SB 21. She suggested that a column be added to Representative Tarr's handout.

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Vice-Chair Gara had only heard one oil company, a company in the Cook Inlet, claim that Alaska's tax system was too generous. He wondered if Cook Inlet had been addressed in the bill. Representative Tarr responded that it was addressed in a reinstated working group. The group had been a feature of the original HB 247. Currently, there was not much oil production in Cook Inlet, a circumstance which had the potential to change. The bill contained a place holder tax of \$1 per barrel. She added that there was a weird

interaction on the tax on gas based on SB 138 [Capital Budget legislation passed in 2016] so that after 2022 the tax on gas became a gross tax. The working group was included in the bill to get ahead of the 2022 deadline. She also wanted to avoid a big surprise to any of the operators there. As a Southcentral legislator, she had a significant amount of concerns about a stable supply of gas. She had found a pamphlet in some old files that contained some contingency planning. It had been only a few years prior that there had been talks of importing natural gas. The working group was a means to allow for more thoughtfulness in the area.

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Representative Ortiz had a question regarding accrued credits that would become losses and carried forward against future obligations. He asked what happen to the credits or losses when a larger company took over a smaller company under current law. He wondered what would be different under HB 111. Representative Tarr replied that currently the value of the carry forward losses would go to the new owner. She thought that it would not change under the proposed legislation. She provided a hypothetical scenario where if a company did 3 or 4 years of exploration work and another company took over the value of the carry forward losses would be a part of the commercial transaction.

Co-Chair Seaton asked if there were any claw back provisions in the bill for companies that sold their assets, including credits. Representative Tarr responded in the negative. It only applied to a commercial transaction between a willing seller and a willing buyer.

Co-Chair Seaton commented that it sounded like the state was investing money while someone else was making money by selling their operation, receiving the credits, and receiving the profits. The state did not receive it and the new buyer did not receive anything because they paid money for the leases. He thought the committee would look at the issue further.

Representative Guttenberg asked if Middle Earth was included in the legislation.

Representative Tarr responded that Middle Earth credits remained in place except for entirely doing away with cashable credits. The Middle Earth credits would no longer be cashable, but would be transferable to another producer. Ms. Weissler added that two of the credits would remain cashable. The net operating loss credits would not be cashable but the well-lease expenditure and well exploration credits would be subject to cash. She explained that there were provisions in the bill that included a cap of \$35 million per company and companies that produced 15,000 barrels per day as opposed to 50,000.

Representative Guttenberg reported that at the subcommittee level he had recommended keeping some of the industry credits. The Legislative Finance Division had rationalized that there was no transparency - the numbers were aggregated figures between producers. In other words, it was not possible to know what credit resulted in added production. He elaborated that a company might take credits and see no additional production and someone else might not take any credits but see significant increased production. He asked Representative Tarr to speak to the issue of transparency and how other tax regimes around the world dealt with it.

Representative Tarr responded that there were 3 ways the House Resources Committee approached it based on what kind of information the state wanted. At the recommendation of the consultant, language was inserted for a new pre-approval process. The consultant talked about how, in many regimes around the world, he had to go before a government entity prior to money being spent to allow for the sovereign to scrutinize the anticipated expenditures. She elaborated that even if they were converted to a carry forward loss, it was a loss of revenue to the state when a company became a producer and tax payer. She suggested that there was still an investment on the part of the state. She clarified that the committee did not envision a line-by-line review of each lease expenditure like an audit, as there had been some criticism from industry. The state had not envisioned something that would be extremely detailed. Instead, it would be a chance for the state to understand the possible investment opportunities. It would also help with a timeline for development. She suggested thinking about every dollar being precious and the state offering an opportunity for the losses to be carried forward and used against tax liability. She asked if members thought the

state should pick up a portion of the costs resulting from companies with poor management that allowed slippage in a schedule for instance. Alternatively, the state could have an opportunity to scrutinize the circumstances and indicate the increased cost. The idea was for the state to have an early stage opportunity to look at development, get a sense of the work schedule, and have an understanding that it would be a well thought out project.

Representative Tarr continued. She indicated that currently there was a plan of development and a plan of production. However, both were too far along in the process to accomplish what the committee hoped. The consultant provided suggestions about adding clarifying language. The committee left the bill purposefully vague because the regulators at the Department of Natural Resources (DNR), in consultation with the industry folks providing the information, would be best suited to make the decisions. She thought that leaving the language somewhat vague would allow the regulatory process to occur without micromanaging the type of information the state would receive. It would allow regulators and DNR to work through the process together. She relayed that anytime regulations went out there was a public comment period. She imagined industry folks would way in. It seemed the process would provide the best work product. She remarked that she did not have any personal attachment as to how that was define in statute. She was amenable to a clearer definition. The committee looked at the opportunities that existed in the current the way work was done. She relayed that a plan of development was not done until something was unitized, which was far along in the work. She suggested the state wanted to be more engaged in the early part. She suggested that the plan of approval was one way in which the state could be more engaged. A second means was through a provision worked on in HB 247 in the prior year.

Representative Tarr reiterated her affection for delving into details. One of the things she was trying to figure out was how to better understand the overall tax system. She looked at numbers including the over \$100 million spent on things in production and the other \$100 million on things not in production. She wanted to understand why the state had spent \$100 million and more on credits that had not lead to production. From her point of view, it was not a good use of state dollars. The committee worked with the Alaska Oil and Gas Association (AOGA) to get their input on

an amendment, Amendment 45 to HB 247. She elaborated that through a confidentiality agreement the state would have access to some information. However, the legislature would not be able to leave the room with information, take photos, or write down any information. Criminal penalties would be imposed in doing so. She also relayed that because the information was privileged tax information members would be subject to a background check and finger printing by the Department of Revenue, as they were federal Internal Revenue Service requirements. If legislators wanted to have some access to certain information they would be subject to the same procedures. She thought it was quite restrictive in nature and she thought it was like giving up a person's first-born child. She understood from the companies' view point why the information was so sensitive and why they would be very careful. She thought there might be people who would not be able to keep information confidential after seeing it. She thought those individuals should not sign confidentiality agreements or have access to the information. She would approach it as a learning opportunity. She thought knowledge was very powerful and if legislators were able to answer some of their unanswered questions they might do a better job of deciding how to regulate the issue.

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Representative Tarr continued that Representative Josephson had a bill, HB 99 [legislation introduced in 2017 - Short Title: OIL & GAS TAX CREDIT REPORTING] that would require public reporting of aggregate credit amounts. The information would not be broken down by company. However, public reporting would be available. Alaskans would be able to weigh in on state dollars being spent. She thought in going forward with a fiscal plan Alaskans might be asked to contribute to the state's fiscal future and more stable budgeting. She thought it was very appropriate for Alaskans to know where state dollars were being spent. The resources committee had approached the transparency need for information in three ways: preapproval, access for legislators, and publicly reported transparency provisions.

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Representative Guttenberg wanted to target credits related to getting production online instead of funding major maintenance or other things on projects that might be done

anyway. The state did not know and that was problematic. Representative Tarr agreed with Representative Guttenberg.

Co-Chair Seaton commented that most of the charts showing the economics of SB 21 were based on oil priced between \$80 to \$120 per barrel. He noted only one chart encompassing \$60 pricing, the lowest presented. Everything else was based on prices of \$80 to \$100. He mentioned that Chesapeake Energy had a probability of 80 percent (P80) - the price would range from \$50 to \$70 per barrel for the following 10 years. No one paid any attention to the published P80. Alaska's companies would not divulge their P80 number. He asked if there was anything in her bill regarding reinvestment in Alaska.

Representative Tarr responded that there was not. She reported that under ACES to earn a credit there was a requirement that dollars be invested in Alaska. The requirement went away in SB 21. She restated prior to SB 21. She explained that under current law a company doing work in Alaska as well as elsewhere might have a loss earning a credit. That credit could essentially subsidize work outside of Alaska. She suggested that the legislature might want to revisit the policy call. She added that some Alaska hire provisions were incorporated in HB 247 [Legislation passed in 2016 - Short Title: TAX;CREDITS;INTEREST;REFUNDS;O and G]. It outlined that there would be priority given to companies with a higher Alaska hire percentage. She thought feedback would be helpful, as there were possibly some challenges to how the policy was implemented.

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Co-Chair Seaton asked if there were any provisions in the bill linking the percentage of credit a company would earn to the percentage of royalty it paid to the state. Representative Tarr responded in the negative. She thought his point was something that should also be considered by the legislature. She reported that Caelus Energy had royalty relief on a couple of their projects. It was expected that their application would be under reconsideration soon. In addition to other things that kept Alaska attractive in a low-price environment, companies could come to the state and request royalty relief. There were many articles in the Anchorage Daily News that had reported on the issue.

Co-Chair Seaton clarified that he was talking about a little something different. He provided an example of a private royalty on private land. He wondered if the state would pay full deductibility and full credits if the development occurred in an area that did not generate royalties or offshore under HB 111. Representative Tarr responded affirmatively. She explained that all fell under the net profit system. The royalty was not considered under that system.

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Representative Kawasaki returned to the question about the preapproval process in Section 20 and 21. He wondered if it would allow the department to deny a request if there was a process in place.

Representative Tarr indicated that it was not clearly defined in statute whether there would be a denial. She indicated that the committee had gone around and around trying to determine the best way to approach the issue. The committee concluded that the people best suited to make an evaluation would be the resource managers and the companies. She suggested if it was determined that the department should not be allowed to deny expenses, then it should be expressly outlined in statute. She used the Smith Bay development as an example of a project very far away from existing infrastructure and would be extremely costly to develop. The development of the project was estimated at \$10 billion. The state would allow the project to carry forward 50 percent of the losses, earn the interest, and deduct it once becoming a tax payer in addition to the GVR provisions. She suggested that in such a circumstance where a good portion of the value was lost in a low-price environment the state might not think it was reasonable. She thought the state needed to determine the level of scrutiny necessary. The state needed to make sure not to over-obligate itself. She pointed to the United Kingdom and Norway as examples. She reported that virtually everything was found online such as lease expenses, capital expenditures, personnel costs, losses, joint venture agreements, and planned activities. There were other jurisdictions where details were being reported publicly. The folks from development companies had to go to their board of directors to make the case why dollars should be invested in Alaska rather than other places. They had to

provide details and certain information to their board to obtain approval for their own capital spend. In turn, it was the same kind of information the committee hoped would be shared with the state.

Representative Tarr suggested that the state could do other things. She noted that in the governor's State-of-the-State address he talked about building gravel roads and of the changing climate limiting the number of days ice roads were available. Currently, people were talking about putting in permanent gravel roads. It would change the amount of time the work would be able to be done in a year. She argued that by having better information the state could possibly make the circumstances more attractive for companies. She did not want to approach things in such a way that the anticipated outcome would be negative. She thought more information was a good thing rather than a bad thing. She believed that it would allow parties to work better together.

Representative Kawasaki agreed that the state needed more information. He thought the state's regulators needed information. He expressed a concern that the state would have an opportunity to say no. He also argued that if a regulator did not want oil and gas development in a certain region they could potentially deny a company the ability to receive credits making it a political issue. He would have to hear more about the preapproval process and how it worked in practice.

Vice-Chair Gara commented on having once tried to increase a \$.05 per barrel surcharge by \$.01 and was told that it was excessive. He mentioned the 1 percent increase from 4 percent to 5 percent. He asked if she had looked at the interplay between that and what a company could get in royalty relief. He explained that royalty relief could bring a company's 16 percent or 12.5 percent down to 3 percent or 5 percent. Therefore, a company could get a 7 percent to 11 percent reduction in the royalty by showing that without royalty relief a field would not be economical. He asked if what he described came into play when deciding on a 1 percent tax change.

Representative Tarr responded, "Yes." She added that in total all the other provisions made any new development attractive including the GVR and the royalty relief provisions. She furthered that because the opportunities

existed and because companies had no complaints nothing was changed regarding that option.

Co-Chair Foster concluded by providing the agenda for the following day.

HB 111 was HEARD and HELD in committee for further consideration.

ADJOURNMENT

4:56:20 PM

The meeting was adjourned at 4:56 p.m.