

HOUSE FINANCE COMMITTEE
March 21, 2017
9:46 a.m.

9:46:41 AM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 9:46 a.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 Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

Representative Scott Kawasaki

ALSO PRESENT

Lisa Weissler, Staff, Representative Andy Josephson;
Representative Geran Tarr, Sponsor; Representative Andy Josephson, Sponsor; Ken Alper, Director, Tax Division, Department of Revenue.

SUMMARY

HB 111 OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

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

Co-Chair Foster addressed the meeting agenda.

#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."

9:47:49 AM

LISA WEISSLER, STAFF, REPRESENTATIVE ANDY JOSEPHSON, addressed the sectional analysis for the bill.

Section 1. It is the intent of the legislature that, contingent on passage of a fiscal plan, a substantial portion of outstanding credits eligible for purchase will be purchased.

Ms. Weissler expounded that the amount of outstanding credits under current law amounted to \$900 million.

Representative Wilson asked whether the section was legal. She wondered about "tying an obligation" to passage of a bill. She believed that the intent language "sounded like blackmail."

REPRESENTATIVE GERAN TARR, SPONSOR, answered that Legislative Legal Services did not point to the language as problematic, which they did with other provisions when drafting the bill. She thought that since intent language was uncodified there was not a legal issue.

Ms. Weissler relayed that under current law, payment of the outstanding credits was "discretionary." The statutes authorized that if the balance of the fund used to pay credits was insufficient, the amount available was allocated among the applicants "by regulation." She furthered that the credits still existed and could be carried forward, transferred, or sold. She observed that the legislature wanted to pay the credits when sufficient funds were available.

Representative Tarr related that after hearing testimony from banks that held credit certificates and some of the companies waiting for credit payments, she wanted the bill to express the interest of the House Resources Committee in addressing the obligation "contingent on passage of a fiscal plan." She indicated that the statutory minimum payment was \$76 million, which extended the payments over

decades. She voiced the desire to pay the debt off "much sooner."

Representative Wilson stated the bill addressed oil taxes and not a fiscal plan. She wondered whether the language was in the appropriate vehicle. Representative Tarr referred to HB 247 [HB 247 Tax; Credits;Interest;Refunds;O & G - CHAPTER 4 4SSLA 16 - 06/28/2016] from the previous year related to oil and gas taxes and credits. She recounted that the governor had created a fund to pay down the credit balance. She maintained that it was uncertain what amount the state could afford to pay towards the credit balance lacking a fiscal plan; therefore, the House Resources Committee elected not to attach a fund or fiscal note related to the credits. She felt "a sense of urgency to come up with a solution on how to pay the obligations."

Co-Chair Foster noted that he would request a legal opinion for Section 1.

Representative Pruitt believed the concern expressed by Representative Wilson was relevant. He spoke to the meaning of the term fiscal plan. He stated that the language was very "vague." The state had an obligation it needed to pay, but he was very uncomfortable with the vagueness of the language in Section 1 referencing a fiscal plan. He urged the committee to proceed with "caution" and characterized the language as "for lack of a better term, extortion."

[9:55:20 AM](#)

Representative Tarr stated that the alternative was not including any language regarding paying the "obligations at all." She emphasized that the intent was to pay the credit obligations. She relayed that under the current statutory minimum, the payments would extend over many years. She advised that one option was not addressing the credits at all, another was paying the credits over many years, and another option devised a solution like the intent language, "to make it a more short-term problem."

Co-Chair Foster interjected that the committee would revisit the issue after obtaining a legal opinion.

Vice-Chair Gara emphasized that the section was merely intent language. He informed the committee that intent language was non-binding and was not subject to legal

analysis. He spoke about a fair fiscal plan. He countered that the intent language "was not extortion, it was logic." He interpreted the intent language that if the state had sufficient funds the credits would be paid at a faster pace, but lacking funds the state was not able to pay the credits.

Representative Pruitt responded that the language put him in an uncomfortable position of voting for a bill that was predicated on another bill passing the legislature.

Co-Chair Foster spoke to the importance of the issue.

Ms. Weissler addressed Section 2 of the bill:

Section 2. Amends AS 43.05.225 regarding interest on delinquent oil and gas production tax payments to remove a three-year limit on accrual of interest. Since 2014, the interest rate for delinquent taxes was set three points above the Federal discount rate. HB 247 added a new section increasing the rate for oil and gas to seven points above the Federal discount rate compounded. The higher rate applies only for the first three years after the tax becomes delinquent after which there is no interest. The amendment repeals the three-year limit because zero interest discourages companies from settling tax disputes with the state.

Ms. Weissler elaborated that the section removed the three-year limit and was included because the limit "worked against the Department of Revenue's (DOR) attempts to settle tax disputes."

Representative Tarr interjected that current statute provided DOR six years to complete the audits and that the limit conflicted with the statute. She thought that making improvements to the auditing system could assist in completing the audits more quickly, which was in everyone's best interest.

[9:59:45 AM](#)

Co-Chair Foster recognized Representative Josephson in the audience.

Representative Wilson underscored that the three-year limit had not stopped DOR from completing the audit, but the interest could not accrue after year three. She asked whether the interest would not accrue after three years if the state was unable to complete an audit within the time period. She noted that the audit could proceed up to six years. Representative Tarr replied that a prolonged audit was not only the fault of the state. She detailed that each side had responsibility for the length of time it took to audit a disputed tax issue. Representative Wilson emphasized that the audits would continue after three years, only the interest on delinquent tax ceased accruing.

Representative Thompson asked when the "clock started ticking" when taxes were disputed.

Representative Tarr answered that if the taxes were delinquent the interest would begin to accrue after the taxes were due. She pointed out that the interest was applied equally to an underpayment or overpayment. She noted that many audits took the entire six years to complete. She relayed that there had been much discussion about how to fix the problem resulting in audits proceeding more quickly. She suggested directing questions to DOR regarding how to make the audit process less complex. Representative Thompson wanted to ensure the provision was not retroactive. Representative Tarr answered that the section was retroactive to January 1, 2017 in order to prevent a time lag in the way the provision was applied to the delinquent taxes.

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Vice-Chair Gara wondered whether the interest referred to in the bill was the only interest charged on delinquent taxes. Ms. Weissler deferred to DOR on the question.

Vice-Chair Gara asked whether the delinquent tax provision only applied to the amount of tax that was underpaid. Representative Tarr responded in the affirmative. She furthered that in some instances the interest paid had been more than the amount owed. She believed that scenario was a reason for the criticism of the current system. She felt that everyone benefitted if audits could be completed more quickly. She favored the legislature acting to address the issue even if additional staffing was necessary to solve the problem.

Ms. Weissler addressed Sections 3, 4, and 5:

Section 3. Amends AS 43.05.230(a) in accordance with the addition of information requirements related to tax credits (see sections 20 to 22).

Section 4. Amends AS 43.05.230(1) to allow the Department of Revenue (DOR) to make public (1) the aggregate amount of oil and gas production tax credits issued to a person in the preceding calendar year and (2) expenditure descriptions added by sections 20 and 21 of the bill.

Section 5. Adds a new subsection (m) to AS 43.05.230 allowing DOR to disclose confidential tax information relating to oil and gas tax credits to legislators, an agent of a legislator or legislative committee, or a legislative contractor in executive session in conformance with a signed confidentiality agreement.

Ms. Weissler pointed out that Sections 3 and 4 were related to the public disclosure of information regarding tax credit certificates. Section 5 was relevant to the disclosure of confidential information concerning tax credits. The confidential information would be disclosed to the legislature subject to a confidentiality agreement. She delineated that the tax credits referred to in both sections were transferrable, related to investment credits and would only apply to Middle Earth tax credits if HB 111 was adopted. She addressed Section 6:

Section 6. Amends AS 43.55.011(f) to change the North Slope minimum tax to 5 percent of the gross value at the point of production when the average West Cost price per barrel for Alaska North Slope crude oil is \$50 or more; and 4 percent when the average price is less than \$50; removes the variable minimum tax that would occur at sustained oil prices below \$25 per barrel. Applies the minimum tax to gas produced on and after January 1, 2018 and before 2022; and to oil produced on and after January 1, 2018. In 2022, the net production on gas will change to a gross value tax system and the minimum tax for gas will end.

Ms. Weissler elaborated that Section 6 applied to provisions in SB 138 [SB 138 Gas Pipeline; AGDC; Oil & Gas Prod. Tax - CHAPTER 14 SLA 14 - 05/08/2014] that changed

the gas tax in 2022 to a gross value tax system and eliminated a minimum tax on gas.

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Vice-Chair Gara asked whether the bill retained the 3 percent minimum tax when the price dropped below \$25 per barrel and 2 percent below \$20 per barrel. Ms. Weissler answered that the section did remove the variable sliding scale minimum tax. She turned to Section 7 that contained the hardening of the minimum tax floor:

Section 7. Adds a new subsection (q) to AS 43.55.011 to provide that the application of any tax credit issued under the oil and gas production tax may not be used to reduce the minimum tax with the exception of oil subject to the gross value reduction. For oil subject to the reduction, subsections (q) and (s) provide that the minimum tax will be calculated on 70 or 80 percent of the gross value at the point of production to ensure companies receive benefit from the gross value reduction. New subsection (r) prevents a taxpayer from applying per barrel credits that cannot be used in one month due to the minimum tax floor to offset a tax liability from a different month in that calendar year (the "migrating" credit issue). This issue only occurs in a year where the tax rate is below the minimum tax in some months and above the minimum tax in other months in a year.

Ms. Weissler expounded on Section 7. She drew a picture to demonstrate that the minimum tax only applied to oil that was not subject to the gross value reduction (GVR).

Representative Tarr furthered that the section was added in recognition that the GVR provisions had been put in place for the early stages of production, which allowed the full value of the GVR reduction to be realized.

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Ms. Weissler continued to address Section 7, new subsection (r). She relayed that the subsection prevented companies from saving the sliding scale per barrel credit for months when it then could be applied to decrease taxes below the minimum floor. The language was intended to stop the practice.

Representative Guttenberg asked how difficult it would be to monitor. Ms. Weissler deferred the question to DOR.

Representative Tarr interjected that currently the department was performing monthly estimates and the "true-up" process happened yearly. She expected that the true-up process would uncover any unrealized credits and apply them appropriately.

Ms. Weissler addressed Section 8:

Section 8. Amends AS 43.55.020, related to monthly installment payments in accordance with the changes to the minimum tax in sections 6 and 7.

Ms. Weissler noted that the section contained conforming language. Ms. Weissler turned to Section 9:

Section 9. Eliminates the North Slope carried-forward annual loss (net operating loss) credit.

Ms. Weissler moved to Sections 10 and 11:

Section 10. Amends AS 43.55.023(c) in accordance with the hardening of the minimum floor in section 7.

Section 11. Amends AS 43.55.023(d) to remove the ability for taxpayers to apply for a cash payment for net operating loss credits issued under AS 43.55.023(b).

Ms. Weissler expounded that if the bill passed the only cash credits left were for the Middle Earth qualified capital expenditure credit, well lease expenditure credit, and the exploration credit.

Representative Wilson referred to \$900 million previously mentioned in the intent language. She asked what portion of the \$900 million would be able to be used as a cash payment and what amount could be used as deductions. Ms. Weissler answered that the \$900 million in credits were already "on the books" and the amount would not change.

Representative Tarr added that the Middle Earth credits were due to expire on a timeframe set in existing statute.

Ms. Weissler moved to Sections 12 through 14:

Section 12. Amends AS 43.55.024(g) in accordance with the hardening of the minimum floor in section 7.

Section 13. Amends AS 43.55.024(g) in accordance with the hardening of the minimum floor in section 7.

Section 14. Amends AS 43.55.024(j), the sliding scale per barrel tax credit, to \$8 at oil prices less than \$60; \$7 at \$60 to less than \$70; \$6 at \$70 to less than \$80; \$5 at \$80 to less than \$90; \$4 at \$90 to less than \$100; \$3 at \$100 to less than \$110; and zero when oil prices are \$110 and above.

Vice-Chair Gara asked Ms. Weissler to repeat the sliding scale numbers. Ms. Weissler complied.

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Representative Guttenberg stated that the difference between \$99 and \$100 was \$0.99 for the calculation of oil tax revenue for the state. He asked how the issue was dealt with. Representative Tarr reminded the committee that she distributed an analysis of the per barrel credit ["CS HB 111 Analysis of Per Barrel Credit by Rep. Tarr" (copy on file)]. She answered that an amendment had been offered in the past during the SB 21 [SB 21 Oil And Gas Production Tax - CHAPTER 10 SLA 13 - 05/21/2013] deliberations to address the issue and "smooth out the formula." The amendment did not pass, but she still possessed the legal language to address the \$99.99 to \$100 problem. Representative Guttenberg asked how the department dealt with the issue at present. Representative Tarr replied that the department followed the strict price guidelines and used the \$0.99 cut off. She reiterated that a formula existed that would address the issue.

Ms. Weissler addressed Sections 15 through 17:

Section 15. Amends AS 43.55.025(g) in accordance with the addition of a dry hole credit in section 17 of the bill.

Section 16. Amends AS 43.55025(i) in accordance with the hardening of the minimum floor in section 7.

Section 17. Adds a new subsection (q) to AS 43.55.025 to allow an explorer to take a purchasable tax credit of 15 percent of exploration expenditures incurred for drilling that results in a dry hole. The credit may be allowed only if (1) the explorer has no oil or gas production; (2) all service contracts are paid in full; (3) the lease is returned to the state; and (4) the expenditure is not the basis for another credit claimed under the production tax.

Ms. Weissler indicated that Section 17 contained a new idea proposed by the consultant, Rich Ruggiero, Castle Gap Advisors, LLC, which changed the net operating loss credit that resulted in a dry hole to a net operating loss carry forward.

Representative Guttenberg stated that not every well drilled was meant for production. He asked whether the section specifically dealt with holes drilled for production. Ms. Weissler stated the provision applied exclusively to production wells.

Co-Chair Seaton asked whether the provision applied to issues prior to unitization. He wondered whether a non-productive lease area could be returned. He asked about the size of the lease that would be returned to the state for the dry hole. Representative Tarr answered that the issue had not been "flushed out" in prior discussion. She thought that the provision would be "geared toward the early exploration work." She spoke to the risk involved in the early stages of development and ensuring that some compensation was received for the work if unsuccessful. She voiced that by revoking the lease the opportunity existed to offer the lease to another entity in the future.

Co-Chair Foster invited Representative Josephson to testify.

[10:21:22 AM](#)

REPRESENTATIVE ANDY JOSEPHSON, SPONSOR, shared that the bill would end cash credits on January 1, 2018 except for Middle Earth credits. He relayed that the previous committee believed that adoption of a fiscal plan could bring "some solace and comfort to principally the independents, to continue their work given that passage of the bill would be some statement by the legislature that

future cash credits would be unaffordable." He referenced a comment about the audit period and concern about the fact that interest earned was greater than the delinquent tax. He clarified that the concern was addressed in SB 21 and may have gone too far by creating a 3-year limit on interest when the appeals and litigation process could last much longer.

Vice-Chair Gara asked whether the exploration credit referenced in Sections 17 applied within a lease that was already producing or not in production.

Ms. Weissler did not know the answer. She surmised that the idea was to compensate for the operating losses for a dry hole. She qualified that the explorer had "to have no oil or gas production." She deduced that if the explorer was in the middle of a lease with other wells that were producing they already had a tax liability and the section was not applicable. Vice-Chair Gara ascertained that if the section only applied to entities not in production the answer was acceptable. He asked whether the credit only applied after exploration was unsuccessful and the lease was returned to the state. Ms. Weissler replied in the affirmative. Vice-Chair Gara asked Ms. Weissler to repeat her explanation of Section 16. Ms. Weissler replied that the section reflected the hardening of the minimum floor.

Representative Wilson referred to Section 17, page 20, lines 5 through 7. She read the following:

...A credit under this subsection may only be allowed if
(1) the explorer does not produce oil or gas in the calendar year in 6 which the credit is earned;

Representative Wilson asked whether it took longer than one year to produce oil after drilling the hole. She added that "explorers and developers were not necessarily the same company."

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Ms. Weissler responded that the provision related to an explorer that was not producing anything to eliminate tax liability. She indicated that the explorer chose to take the credit. Representative Wilson thought the answer did not make sense. She understood the reason for the provision, but she thought that new areas took longer to

get to the point of production. She wondered if it was possible to meet the one-year expectation.

Representative Tarr answered that the section was much more limited in scope to areas where nothing was found. She elucidated that the companies would still be compensated to encourage risk. She thought that the DNR could speak more to the topic. She noted that more detailed information was available, and it was less and less likely the circumstance would happen in the future. She recalled a situation in Middle Earth where a company thought an area was promising but the drilling was unsuccessful and thought the provision was more applicable to a similar circumstance. She indicated that Middle Earth had not had much development in contrast to the North Slope where more information was available.

Representative Wilson could not imagine any company anywhere drilling in a location they did not expect to find oil. She expressed doubt that the expectation could be met. She wanted to avoid unintended consequences.

Co-Chair Seaton referred to the company Caelus Energy Alaska. He hypothesized a situation where the company drilled dry holes in a new field. He deemed that the company could not claim the tax because other fields were in production. He asked whether a new company without any other development could use the credit that reimbursed 15 percent of expenses, if it was not deducting the expenses off any other exploration or production tax. Representative Tarr replied in the affirmative.

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Vice-Chair Gara spoke to the intention in Section 17 and asked for clarification about Representative Wilson's concerns.

Representative Wilson asked whether the provision pertained only to situations where no oil was found. Representative Tarr answered that the exploration company would have to apply for the credit and meet certain stipulations. She indicated that one of the stipulations to receive the credit was that no oil or gas was found in the one-year period the credit was earned. Representative Wilson asked what happened if oil was found but not produced within one year. Representative Tarr replied that the credit was for

companies that were unsuccessful. She furthered that the state wanted to balance the risk for companies that engaged in work and were unsuccessful. She related that the credit was used elsewhere to incentivize companies that typically were very successful at exploration.

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Representative Wilson asked whether unsuccessful was defined as finding nothing. She wondered what made the exploration unsuccessful. Representative Tarr pointed to line 2 of Section 17 and read the phrase "for drilling that results in a dry hole." She observed that a dry hole suggested that there wasn't enough for production.

Representative Pruitt inquired about the genesis of the section. Representative Tarr replied that the previous [House Resources] committee had listened to a variety of industry representatives, public testimony, and its consultant. She elucidated that the committee heard a lot of testimony regarding the high cost of development and related risk in the state. The provision was chosen as a tool to incentivize and attract exploration work in the state. The specific suggestion was offered by the consultant and industry representatives.

Representative Pruitt surmised the section would apply to a brand-new company that would have to fail. He was unsure of the definition for a dry hole. He was trying to determine the need for the section. He was uncertain about being supportive of any new credits.

Representative Tarr referred to a slide that had been provided by either DOR or the consultant, Rich Ruggiero that depicted the development profile of a major field. She remembered that once peak production declined the major oil producers were less interested in the field. She related that when production was trending downward it was beneficial to attract new entrants who were willing to explore for the remaining oil in the field. She stated that over the last several years "quite a number of new companies" came to the state to engage in exploration work. She delineated that some companies like Great Bear only engaged in exploration work and the incentive was intended for explorers. She furthered that transitioning to a net profits system that carried forward losses to a tax liability and eliminated cashable credits only befitted

producers. Production tax liability was not applicable to exploration companies; the credit incentivized exploration work in the state.

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Representative Pruitt interpreted that the section specifically applied to an explorer but intended that the explorer would turn into a producer. He deduced that if a company was solely an explorer the credit could not be transferred. He wondered what the value of the credit was for explorers who would not "make it to production" but also could not transfer the credit. Representative Tarr answered that the explorer received a cash credit for 15 percent of the exploration costs; the value would be the cash payment the company received. She reiterated that some companies were more interested in exploration work. Representative Pruitt thought there was a goal to move away from cash credits, which he endorsed. He was skeptical about adding a new one. He spoke to the potential utilization of the credit. He thought the credit was contrary to the intent of the legislation. Representative Tarr replied that the bill was taking a different direction in the overall tax system. She offered that the state learned a valuable lesson in avoiding situations where the state became "over obligated." The bill changed the system to one where losses were a deduction against taxes. If a company never became a taxpayer the opportunity could not be realized. The credit was "isolated" to a group of companies that would not become producers. The credit incentivized continued exploration and helped ensure that work continued in all stages of development to halt the decline in production. She suggested that the incentive was beneficial for Cook Inlet and noted the success of incentives that increased production.

10:47:00 AM

Representative Tarr recommended that if cashable credits were unacceptable other incentives should be established to ensure that exploration continued in the state.

Representative Josephson interjected that the existing cash credit system was unsustainable. He relayed that Mr. Ruggiero suggested that the exploration credit was an option to consider. The "uplift feature" incentivized independents to remain in the state. In consultation with

DNR and DOR, the credit was perceived as a modest cash credit.

Representative Pruitt asked about the precise definition for a dry hole. Representative Tarr responded that it would be best to consult with DNR. She added that a definition was not included in the bill, but the regulations would be definitive.

[10:50:04 AM](#)

Representative Guttenberg expressed his long-time support for explorers who were at the "high risk end of the equation." He asked whether the credit applied independently to each lease the explorer held. Representative Tarr indicated that each lease was independent and handled separately. Representative Guttenberg inquired whether the credit applied if the explorer had another lease in production. Representative Tarr referred to page 20, lines 5 and 6 and read the following:

...A credit under this subsection may only be allowed if
(1) the explorer does not produce oil or gas in the
calendar year in 6 which the credit is earned;

Representative Tarr pointed out that the credit was lease specific provided that the explorer was not currently a producer.

Co-Chair Seaton mentioned that he did not see a provision in the section that authorized the state to acquire the data regarding the lease. He thought the provision seemed like it was designed for the small companies that explored and sold the lease to a major oil company to develop. He commented that the provision enabled the company to "sell the investment" the state made in the company or if they drilled a dry hole the state paid the cash credit. He wondered how the credit corresponded with the claw back provision if oil eventually was discovered and the lease was sold. He inquired whether the state could "retrieve" the states cash credit investment from the transaction sale. He wondered whether it was part of the previous discussion. Ms. Weissler responded that it was not part of the discussion. She reiterated that a dry hole made a company eligible for the credit and if it was not and the lease was sold, she presumed that the costs would be

recovered through the sale of the lease. Co-Chair Seaton was trying to figure out if the credit was fair and balanced.

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Representative Tarr answered that a dry hole was the only circumstance that the company was eligible for the credit and they would also be required to relinquish the lease back to the state. She detailed that the other circumstance would enable the losses to be carried forward; if the company sold the lease the value of the carry forward losses became part of the commercial transaction.

Representative Josephson encouraged the committee to ask the department to add a claw back provision.

Vice-Chair Gara was trying to determine whether the existing language worked. He asked whether exploration expenditures were a "limited scope of expenditures" and if they were defined somewhere. Representative Tarr answered that exploration expenditures were currently defined in statute.

Ms. Weissler moved on to Sections 18 and 19:

Section 18. Amends AS 43.55.028(a) in accordance with section 11 that removes the ability for taxpayers to apply for a cash payment for net operating loss credits.

Section 19. Amends AS 43.55.028(e) to limit the state's purchase of credits to \$35 million per company. Only companies with production of not more than 15,000 barrels per day may apply for a cash payment. Current law sets the purchase limit at \$70 million and applies to companies with not more than 50,000 barrels per day.

Ms. Weissler elaborated that Section 19 only applied to Middle Earth if the bill passed as written. She moved on to Sections 20 through 22:

Section 20. Amends AS 43.55.030(a) to require an oil and gas producer to submit to DOR information required under regulation and, for each expenditure that is the basis of a credit under AS 43.55.023 or AS 43.55025, a

description of (1) the expenditure, (2) the purpose of the expenditure, and (3) a description of the lease or property for which the expenditure was incurred.

Section 21. Amends AS 43.55.030(e) to require an explorer or producer without production to submit to DOR information required under regulation and, for each expenditure that is the basis of a credit under AS 43.55.023 or AS 43.55025, a description of (1) the expenditure, (2) the purpose of the expenditure, and (3) a description of the lease or property for which the expenditure was incurred.

Section 22. Requires the department to annually report to the legislature the information collected under new subsections AS 43.55.030(a) (10) and (e).

Ms. Weissler suggested that if net operating loss credits were eliminated Sections 20 and 21 would need to be amended to reflect net operating loss deductions. She mentioned that DOR noted that Section 22 was not necessary since reporting requirements already existed in statute.

[10:58:53 AM](#)

Ms. Weissler moved to Section 23, which was new:

Section 23. Adds a new section to AS 43.55.150 to ensure that the gross value at the point of production does not go below zero. The gross value is determined by subtracting tariffs and transportation costs from the West Coast sale price per barrel. The gross value at the point of production is used in various calculations throughout the production tax statute.

Ms. Weissler moved to Sections 24 through 25:

Section 24. Amends AS 43.55.160(e) in accordance with section 25 that provides for the carry-forward of net operating losses.

Section 25. Amends AS 43.55.165(a) to add a new subsection (3) that allows 50 percent of net operating losses to carry forward to when a taxpayer has production. The carry forward and uplift proposed in section 26 allows producers to recover costs before paying production tax.

Ms. Weissler noted that Section 24 was conforming language. She addressed Section 26:

Section 26. Amends AS 43.55.165 to add new subsections (m) and (n). Subsection (m) provides an uplift for seven years of seven percentage points above the Federal Reserve rate for the 50 percent in net operating losses carried forward to production. Subsection (n) directs the Department of Natural Resources to develop regulations to establish a review process for pre-approval of lease expenditures that will generate a carry-forward annual loss.

Ms. Weissler elaborated that Section 26 subsection (m), stated that the Federal Reserve rate was currently 8 percent. She furthered that the consultant suggested adding the timeline to incentivize more rapid production. She reported that subsection (n) "needed work" and offered her assistance. She detailed that the intent was to enable the government and industry to work together to ensure that both entities' needs, and policies were being met. She noted that the subsection was incomplete and did not adequately convey the intent. She moved to Section 27:

Section 27. Repeals AS 43.55.028(g)(3) that set the purchase of \$70 million in tax credits at 100 percent of the first \$35 million and 75 percent of the other \$35 million in a year; repeals AS 43.55.028(g)(3) that allowed for the assignment of production tax credits to a third-party assignee.

Ms. Weissler explained that AS 43.55.028(g) (3) in Section 27 was repealed due to the change to a \$35 million cap in the legislation. She pointed to AS 43.55.028(g) (30) and noted that the statute was added to a fish tax bill in 2013 and was believed to exclusively apply to Cook Inlet gas. The statute was no longer necessary because of the elimination of cash credits. In addition, the statute caused more problems for the state due to the transfer of credits to banks, which changed "the whole dynamic of the incentive system." She addressed the remainder of the sections:

Section 28. Establishes a legislative working group to analyze the Cook Inlet oil and gas fiscal regime.

Section 29. Applicability. Provisions relating to the minimum tax, migrating credit, net operating loss credit, and repeal of third-party assignments apply on or after January 1, 2018.

Section 30. Transition: carried-forward losses and lease expenditures. The department may purchase purchasable tax credits earned before January 1, 2018. The net operating loss carry forward provisions added sections 25 and 26 apply to lease expenditures incurred on or after January 1, 2018.

Section 31. Transition: assignment of tax credit certificates. The department may continue to apply and enforce tax credit assignments to third-parties for credits applied for before January 1, 2018.

Section 32. Transition: payment of tax; filing. Taxpayers shall pay the tax as provided in current law for a tax or installment payment for production before January 1, 2018.

Section 33. The change to delinquent interest in section 2 is retroactive to January 1, 2017.

Sec. 34. The intent language, delinquent interest provision, Cook Inlet Working Group, and retroactivity of the delinquent interest provision are effective immediately.

Sec. 35. All other sections take effect January 1, 2018.

[11:04:15 AM](#)

AT EASE

[11:12:07 AM](#)

RECONVENED

Co-Chair Foster noted the committee would stop the presentation at noon. The subsequent DOR slides would be heard during the afternoon meeting.

Representative Pruitt asked whether he could assume that the presentation was on behalf of the governor.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, answered in the affirmative but qualified that he was doing

his best to analyze the nuances in the bill. He could not speak to the governor's opinion on every detail of the legislation. He voiced that he was present to merely explain the bill and not take a position on HB 111. Representative Pruitt asked whether the governor was supportive of the current legislation. Mr. Alper answered that the governor did not typically take a position on legislation while under the committee process. He stated that some elements in the bill were similar or identical to provisions in previous legislation introduced by the governor. He did not want to speak for the governor beyond what was previously introduced by him. Representative Pruitt asked at what point Mr. Alper had first received copies of the current version of the legislation. Mr. Alper answered that he had seen the committee substitute (CS) at the same time as the public. He had spoken with the House Resources Committee chairs prior to the introduction of the original bill. He was not involved in the creation of the legislation. He shared that his role was to provide some technical guidance.

[11:16:00 AM](#)

Mr. Alper provided a PowerPoint presentation titled "New Sustainable Alaska Plan, Pulling Together to Build Our Future; CSHB 111(RES)\N by the House Resources Committee, Oil and Gas Production Tax and Credits: Background and Bill Analysis" dated March 21, 2017 (copy on file). He began with a table of contents on slide 2:

Background on Alaska's oil and gas taxes and analysis of CS HB 111(RES)\N

- Money- how oil has funded the state in the past
- Transition- how we've adapted to falling prices
- Credits- what we know, what has accrued
- Last year's HB247 and remaining concerns
- Overview of CSHB 111(RES) with detail of selected tax sections
- Fiscal note

Mr. Alper turned to slide 3: "History Of Oil And Gas Taxes In Alaska."

Four Main Sources of State of Alaska Oil Revenue

Property Tax (\$0.1 billion in FY12, \$0.1 billion in FY16) Pipeline, Equipment, Facilities Numbers are state share; \$0.4 is shared with local governments

Royalty (\$2.9 billion in FY12, \$1.2 billion in FY16) Landowner's share, usually 12.5%. Most North Slope production is on State land. At least ¼ of royalties go to the Permanent Fund

Production Tax (\$6.1 billion in FY12, \$0.2 billion in FY16) Based on net profits; most tax legislation in recent years is over this tax. North Slope 35% less a variable "per taxable barrel" credit

Corp. Income Tax (\$0.6 billion in FY12, \$0.0 billion in FY16) Taxes remaining profit after production tax Global asset apportionment; 9.4%, but effectively closer to 6.5% Total dropped from \$9.7 billion to \$1.5 billion in 4 years

Mr. Alper elaborated that the zero-amount depicted for corporate income tax in FY 16 was "a bit of a distortion." He explained that companies made quarterly estimated tax payments, which in the calendar year 2014 amounted to overpayments due to price decreases in 2015. The large refunds in FY 15 for the estimated overpayments were reflected against revenue in FY 16.

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Vice-Chair Gara asked about corporate income tax related to worldwide apportionment. He asked whether the zero-amount in FY 16 meant that no profits were realized in Alaska or if it reflected worldwide profits and specific Alaska figures were unknown. Mr. Alper answered that the amount reflected worldwide profitability apportioned but not specifically Alaskan profitability. He reiterated that the zero amount was due to the Alaska specific circumstance when the companies overpaid estimated taxes during calendar year 2014 and the zero-amount reflected the states refund.

Representative Pruitt asked what the profitability would have been if the refund was not due. Mr. Alper answered that he would provide a precise number but estimated that the number ranged from \$50 million to \$100 million. He turned to slide 4 titled: "The History Of Oil And Gas Taxes In Alaska."

Six changes to the production tax since 2005:

1. 2005: Gov. Murkowski aggregates Prudhoe Bay satellite fields for ELF calculation
2. 2006: Petroleum Production Tax "PPT" changed from taxing gross revenue to net profits (needed for Gov. Murkowski's "stranded gas act" gasline)
3. 2007: Alaska's Clear and Equitable Share "ACES" corrects revenue shortfalls due to bad cost estimates in PPT. Major tax increase
4. 2010: Cook Inlet Recovery Act "CIRA" provided additional credits outside the North Slope targeted at southcentral gas supply issues
5. 2013: SB 21 was a tax cut at most prices (small tax increase at low prices) and provided "new oil" benefits
6. 2016: HB 247 began tax credit reform, phasing out Cook Inlet credits and limiting "new oil" benefits

Mr. Alper explained that the Economic Limit Factor (ELF) calculation was a multiplier applied to the tax rate between zero and one which resulted in the owners of the fields paying a lower rate. He added that Governor Murkowski "chose to count them as one thing," which led to a \$150 million tax increase. The limit factor only stayed in place for about 15 months until the Petroleum Production Tax (PPT) bill in 2006 was adopted. He spoke to the Alaska Supreme Court decision on December 2016, ruling in the state's favor on the "Prudhoe Bay aggregation" case that would have cost the state a total of \$500 million from the accumulated interest on the original \$150 million. He indicated that the switch to a net profits tax required an estimate of a per barrel cost. The revenue estimate was \$800 million less than estimated due to higher than anticipated costs per barrel, which led to the creation of Alaska's Clear and Equitable Share (ACES) tax system under Governor Sarah Palin. He reported that the Cook Inlet Recovery Act [HB 280 Natural Gas: Storage/ Tax Credits - CHAPTER 16 SLA 10 - 05/12/2010] was targeted at the gas shortfall in Southcentral Alaska and was created to ensure an adequate gas supply. The act added many new credits and expanded existing credits. The credits applied to oil and gas in Cook Inlet and became a large portion of cashable credits. He noted that SB 21 partially hardened the minimum tax floor. When the price of oil dropped to \$60 and below, the state received approximately \$100 million more in production tax than it would have under ACES. However, the

tax cut in SB 21 amounted to approximately \$1 billion at \$120 per barrel price of oil, which was the price of oil at the time the bill was in the committee process.

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Mr. Alper addressed the final point on slide 4 related to HB 247 that phased out the Cook Inlet credits. He reported that the bill would change oil taxes for the seventh time in 12 years.

Mr. Alper moved to slide 5 titled "Government Take."

- Government Take* Oil as a percentage of government
- In high price / high revenue years, oil has provided 90% or more of state UGF revenue
 - FY2017 estimated at 67% of revenue
 - In FY2017 oil revenues are only covering 22% of the budget. About 2/3 is being paid out of savings

- Since TAPS, in years 1978 -2016, Alaska has received \$141 billion in petroleum revenue
- Since the switch to Net, in years 2007 -2016, Alaska has received \$64 billion
 - Highest single year was 2008: \$11.3 billion

Any discussion of the appropriate state "share" needs to clarify- "share of what?"

Mr. Alper pointed out that in FY 17 the state received approximately \$1 billion in unrestricted oil and gas revenue. He addressed the share received by government and defined what comprised oil revenue beginning on slide 6 titled "Government Take:"

- Market Value? (sales price, or "ANS")
 - Market value of all Alaskan oil was \$527 billion
 - State averaged 27% 1978 -2016
- Wellhead Value? (price after subtracting transportation, or "GVPP") (Gross Value at the Point of Production)
 - Wellhead value of all Alaska oil was \$347 billion
 - State averaged 41% 1978 -2016

- Profits? (value less costs; "PTV" + royalty)
(Production Tax Value)
 - Data only available since 2007 (switch to "net")
 - Divisible profit of all Alaska oil was \$111 billion
 - State averaged 57% 2007 -2016
 - SB21 passed based on "total government take" estimates of about 65% at a wide range of prices, including federal revenue

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Mr. Alper pointed out that currently in a low oil price environment, the royalties were high and government take was roughly 70 percent. He advanced to slide 7, titled "Government Take" which included a chart showing the government take and the state's share of wellhead value or GVPP (Gross Value at the Point of Production) between 1978 and 2016. The slide contained the GVPP definition as follows:

Approximate ANS (Alaska North Slope) state share of GVPP Total Value: (State Revenue from North Slope as a portion of wellhead value after subtracting transportation, offset by state repurchased credits from North Slope.)

Mr. Alper highlighted that in 1994 the state received major royalty lawsuit settlements that endowed the Constitutional Budget Reserve (CBR). He indicated that from 1978 until 1998 oil revenue averaged 40 percent and was relatively stable and predictable. He pointed out that under the ELF system from 1998 through 2005 the state shares markedly decreased which prompted tax reforms; PPT and ACES. He noted that in 2007 through 2013 due to high oil prices and a net profits system the state's share of GVPP averaged 46 percent. He delineated that the 46 percent comprised the state's retained tax after paying out cash credits represented by the red bar. The blue portion at the top of the red bar indicated the amount paid in cash credits. When the price of oil declined in more recent years 2014 through 2016, the state's share had decreased to about 27 percent. He ascertained that the nature of a net profits tax system meant that the state received a lower share at low oil prices and a higher share at high oil prices.

Representative Pruitt recalled that due to the cash credit system under ACES which created a "lag time" some credits were not paid out until 2014 through 2016 contributing to the lower state share that was exacerbated by low oil revenue. Mr. Alper replied that he would not characterize the situation as a lag-time. He explained that a provision in ACES specified that capital credits had to be used within a two-year period; half in the first year and half in the second year. He explained that SB 21 eliminated the capital credit on the North Slope. The situation created a "one-year catch up" that allowed the company to take one and a half year's credit in one year, therefore by 2014 the capital credits were removed. The cashable credits from 2014 through 2016 were the operating loss credits earned by producers that were not in production. He turned to slide 8 and continued to address government take:

What does "percent of value" translate to?

- 185 million NS barrels produced in a year
 - If oil is \$50 / bbl., that's \$9.25 billion; 1% of total value is about \$90 million
 - At \$50 oil, wellhead value is about \$40; that's \$7.4 billion. 1% of wellhead value is about \$75 million

- 160 million NS "taxable" (non-royalty) barrels
 - \$1/ bbl. in added tax (or reduced credit) is \$160 million
 - At \$50 oil, 1% increase to a "gross tax" is about \$65 million
 - Each \$1 / bbl. above "break even" is \$160 million in divisible profits. State revenue is about \$25 million per dollar in price below \$75; \$80 million above

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Representative Ortiz asked how Alaska ranked compared to other sovereigns in relation to government take. Mr. Alper did not possess current knowledge or details on the subject. He replied that every regime was different and remembered the comparative graphs offered by state hired consultants that placed Alaska in the 60 to 70 percent range for government take representing "the middle of the pack." Representative Ortiz asked if the current numbers reflected and included tax credit payments. Mr. Alper answered that the 46 percent and 27 percent shown on slide

7 included tax credit payments. He added that one or two percentage points were deducted for the credit payments. Representative Ortiz asked for verification that the numbers reflected payment of the full amount of the cash credits. He replied the figures represented the actual amount paid in full in the given fiscal years. He noted that the figures only included North Slope revenue and credits.

Vice-Chair Gara wondered whether Alaska was more generous than other tax regimes. He stated that Alaska allowed companies to take their deductions in one year. He wondered how that compared to locations that required companies to amortize the deductions over many years. Mr. Alper clarified that Vice-Chair Gara was referring to depreciation. He indicated that most oil producing states had a tax based on gross and depreciation was not relevant. He added that many countries had some variant of a "production sharing contract" type system that included cost recovery and a subsequent share of the profits. Alaska was unique because it had five different taxes; 4 state taxes and the federal corporate income tax. He delineated that the state's corporate income tax used depreciation whereas the state's severance or production taxes could be taken in one year. Vice-Chair Gara thought there was value to letting a company take all the deductions in one year due to the time value of money. Mr. Alper considered the state's production tax as a "cash flow tax" rather than a "profits tax." The system taxed a company's net cash flow of retained earnings after reinvestment.

[11:42:35 AM](#)

Vice-Chair Gara recalled a response from Mr. Alper and Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue earlier in the session that estimated the state earned roughly \$200 million in production taxes. He asked whether the credits earned in FY 18 were subtracted and if the earnings were negative. Mr. Alper stated that "in general, the state's tax credit burden was equal to or greater than revenue in the current low oil revenue climate. The revenue had dropped, but the credit burden had stayed relatively the same.

Representative Thompson spoke to the 27 percent and 46 percent state share noted on slide 7. He asked whether the

data included the state's royalty. He answered in the affirmative. He delineated that the oil and gas repurchased tax credits were deducted as a percentage of the wellhead value.

Mr. Alper resumed his discussion of slide 8. He reviewed the bullet point on the slide [see above]. He scrolled through slide 9 titled "What I'm talking about today":

Background on Alaska's oil and gas taxes and
Analysis of CS HB111(RES)\N

Money- how oil has funded the state in the past
Transition- how we've adapted to falling prices
Credits- what we know, what has accrued
Last year's HB247 and remaining concerns
Overview of CSHB111(RES) with detail of
selected tax sections
Fiscal note

Mr. Alper moved to slide 10 titled "A Net Profits Tax is very Volatile to Price":

SB21 Tax Calculation (legacy / non-GVR oil)

- Gross ("GVPP" or "wellhead") value obtained by subtracting transportation costs
- State receives royalty share in kind or in value
- Lease expenditures subtracted from Gross value of taxable (non-royalty) barrels to get "Production Tax Value" ("PTV" or "Net")
- Calculated Tax is 35% of PTV
- Subtract per barrel credit of between \$0 and \$8 depending on price (credit increases as prices decrease;
\$8 at all prices below about \$90 / bbl.)
- Minimum Tax "floor" is 4% of Gross (GVPP)
- Amount paid is the higher of these two calculations (35% of Net less per-bbl. credit, or 4% of Gross) 10

Mr. Alper reviewed slide 10. He offered that the state share of royalties was 12.5 percent.

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Representative Guttenberg stated that over the years, tariffs and transportation cost calculations had been a

divisive issue. He wondered how transparent the costs were. Mr. Alper replied that the public transparency was not high, but the department saw the complete picture. He related that a provision in statute allowed DOR to establish a reasonable cost of transportation lower than the actual costs. The Federal Energy Regulatory Commission (FERC) were also involved and regulated the pipeline tariffs.

Mr. Alper discussed the chart on slide 11 titled "A net Profits Tax is very Volatile to Price" that depicted the SB 21 tax calculation at different prices based on the FY 17 average North Slope costs. He noted that the total costs were deducted to determine the GVPP and the PTV or net. The 35 percent tax was applied to the net subtracted by the per barrel credit that varied according to price from \$8 to \$2. The chart showed the net profits tax and the minimum tax of 4 percent of the gross. The higher value was the amount of tax paid. The minimum tax was applicable at the \$40 to \$60 per barrel price point and somewhere between \$60 and \$80 per barrel the net profits tax applied. The chart also portrayed the tax as a percentage of price, GVPP, and PTV. The numbers all varied widely as the price increased.

[11:53:11 AM](#)

He segued to slide 12 titled " A Net Profits Tax is very Volatile to Price":

Important take-aways from previous slide:

When the price of oil falls by half from \$120 to \$60

Wellhead value declines by 54%(\$110.67 to \$50.67)

Taxable "net" declines by 75%(\$79.79 to \$19.79)

Production taxes paid declines by 91%(\$23.93 to \$2.03;
or for a full year over \$3.8 billion to \$325 million)

Mr. Alper reported that the scenario depicted in slide 12 happened when the price of oil precipitously dropped.

Vice-Chair Gara referred to an analysis provided by DOR [letter addressed to Vice-Chair Gara dated February 6, 2017 (copy on file)]. He cited slide 11 and asked whether the figures represented non-GVR oil. Mr. Alper replied in the

affirmative and added that the costs and prices were based on averages. He notified the committee that the data in the letter Vice-Chair Gara referred to employed FY 18 costs. Vice-Chair Gara asked that the crossover point from the minimum tax to the net profits tax was approximately \$74 per barrel. Mr. Alper answered in the affirmative. Vice-Chair Gara believed the state had one of the lowest profits taxes (15 percent) in the world at a price of \$80 per barrel. He asked about worldwide averages. He asked whether a 15 percent profits tax at \$80 per barrel was on the low end compared to other regimes. Mr. Alper believed Vice-Chair Gara was "probably right," but most regimes did not have five taxes they were adding up. He suggested that royalties and other tax revenues were included in the calculation. He thought that the "effective tax rates in SB 21 that reduced the state's share at lower prices" likely placed the state at the lower end of a comparative range at low oil prices.

[11:57:05 AM](#)

Representative Pruitt referenced slide 10. He inquired whether a company still had to pay the minimum tax while carrying a net operating loss in the same year. Mr. Alper responded in the affirmative. He added that the element of the gross tax made the tax a hybrid rather than a net profits tax.

Co-Chair Foster addressed the schedule for the afternoon meeting.

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

ADJOURNMENT

[11:59:18 AM](#)

The meeting was adjourned at 11:59 a.m.