

HOUSE FINANCE COMMITTEE
April 7, 2017
2:06 p.m.

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[Note: Meeting recessed and continued on April 8, 2017 at 1:59 p.m. See separate minutes dated April 8, 2017 for detail.]

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 2:06 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

Jane Pierson, Staff, Representative Neal Foster; Ken Alper, Director, Tax Division, Department of Revenue; Representative Louise Stutes; Representative Andy Josephson; Representative Geran Tarr.

SUMMARY

HB 111 OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS

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

Co-Chair Foster reviewed 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."

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Co-Chair Seaton MOVED to ADOPT the proposed committee substitute (CS) for HB 111, Work Draft 30-LS0450\M (Nauman, 4/6/17).

Representative Wilson OBJECTED.

JANE PIERSON, STAFF, REPRESENTATIVE NEAL FOSTER, explained the changes in the CS with a document provided by the House Finance Committee co-chairs titled "HB 111 - Comparison" dated April 6, 2017 (copy on file). She read from prepared remarks detailing the changes in the legislation:

In the Resources version, Section 1 was contingency language, which is deleted from the finance version. Section 1 of the finance version has to do with the powers and duties of the commissioner under AS 31.05.030(n). It can be found on page 1 of the bill. It deletes a reference to a 10 percent gross value reduction under AS 43.55.160(g) in accordance with the repeal of this provision.

Section 2 has to do with the Department of Revenue disposition of tax information AS 40.25.100(a); it can be found on page 2 of the finance version. It amends disclosure of tax information in accordance with the new provisions allowing certain tax credit and lease expenditure information to be made public.

Section 3 is interest AS 43.05.225, found on page 2 of the bill. It removes the three-year limit on interest and is the same as was in the House Resources version. The disclosure of tax and credit information, AS 43.05.230(a) was deleted and it referenced preapproval

small producer credit and the floor and disclosure of tax information.

Section 4, disclosure of tax and credit information is found in AS 43.05.230(l); it can be found on page 3 of the bill. It provides for a report making certain oil and gas tax credit and lease expenditure information public.

Section 5, is disclosure of tax information, AS 43.05.230(m), found on page 3 of the bill. It adds subsection (m) allowing disclosure of publicly available production tax information or tax credit information related to gas storage, service industries, processing facilities, and adds subsection (n) making public certain information regarding oil refinery tax credits. It also allows for certain confidential taxpayer information relating to tax credits, to be disclosed.

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Ms. Pierson continued to address changes in the CS:

We deleted Section 5 of the Resources bill, which was allowing certain confidential taxpayer information related to tax credits, to be disclosed to legislators in executive session, in conformance with a signed confidentiality agreement.

Section 6, oil and gas production tax, AS 43.55.011(e) is found on page 4 of the bill; it changes the tax rate to 25 percent after January 1, 2018 and it retains the 2022 change to gas rate after 2022, and amended in accordance with the secondary tax bracket provision. Setting a minimum tax at 5 percent was deleted, leaving a hardened 4 percent floor. Minimum tax is also deleted, which was making necessary corrections to a piece that was eliminated in the original HB 111.

Section 7, oil and gas production tax, AS 43.55.011(g) is found on pages 5 and 6 of the bill; it establishes an additional 15 percent tax bracket, triggered at a production tax value of \$60, which is equal to approximately \$100 ANS.

Section 8, is a minimum tax, AS 43.55.011(q), (r), and (s), found on pages 6 through 8 of the bill. It maintains the hardened minimum floor and is adjusted in accordance with deletion of changes to the minimum tax previously (r), which is deleted, previous (s) is now (r). The per barrel credit that was found in Section 7 of the House Resources version has been deleted.

Section 9, payment of gas or tax for gas, AS 43.55.014(b) is found on page 8; it is conforming language to the new tax rate in AS 44.55.011(e).

Section 10 is payment of tax, AS 43.55.020(a) on page 8 through 19 of the bill; it amends the section governing tax payments and conforms language to the new tax rate and the repeal of AS 43.160(g).

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Ms. Pierson continued to list the changes in the CS:

Section 11, payment of tax, AS 43.55.020(g), is found on page 19; it makes conformation to the new tax rate.

Section 12 is also payment of tax, AS 43.55.020(h), found on pages 19 and 20 of the bill; it is also conforming to the new tax rate.

Section 13, payment of tax, AS 43.55.020(k), is found on pages 20 and 21 of the bill; it is also conforming to the new tax rate.

Section 14, payment of tax, AS 43.55.020(l), is found on page 21; it is also conforming to the new tax rate.

Section 15, net operating loss, AS 43.55.023(b); it eliminates net operating loss credits for the North Slope and is the same as in the House Resources version, but it has been amended for the repeal of AS 43.55.160(g).

Section 16, net operating loss, AS 43.55.023(c), can be found on page 23. It's conforming an amendment to reflect the hardened minimum floor and it is the same as in the Resources version, except it reflects that credits cannot reduce payments below the minimum

floor. The net operating loss was deleted, which was Section 11 in the Resources version. Also deleted was Section 12, which is language that was conforming to the new hardened floor.

Section 17, non-transferrable tax credits, AS 43.55.024(i), is found on page 23 of the bill; it's a conforming amendment to reflect the hardened minimum floor and it remains the same as in the Resources version. The per barrel credit found in AS 43.55.024(j) has been deleted from the House Finance version. We are repealing the per barrel credit. The dry hole credit, which was found in Section 15 of the Resources version has been deleted.

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Ms. Pierson continued reviewing changes in the CS:

Section 18, exploration credit, AS 43.55.025(i) can be found on page 23 of the bill; it's a conforming amendment to reflect the hardened minimum floor and remained the same as in Section 16 of the Resources bill. The dry hole credit was Section 17 of the Resources bill and that has been deleted from the House Finance version. The oil and gas tax credit fund found in AS 43.55.028(a) - the language was deleted from the House Resources version so it is kept as is currently in statute. The oil and gas tax credit fund, AS 43.55.028(e), which changed the cash payment limits on credits, was deleted from the House Finance version, that too is kept as is currently in statute.

Sections 19 and 20, tax credit information, AS 43.55.030(a) and (e) is found on pages 23 through 55 of the bill. It requires taxpayers to report certain information to the Department of Revenue, removes the requirement to file a detailed description for the purpose of the expenditure. New language is added to ensure that the credits and carry forward lease expenditures are reported by the lease or property to which they were incurred.

Section 21 is gross value at the point of production, AS 43.55.150; it can be found on page 25 of the bill. It adds a new section to ensure that the gross value

at point of production does not go below zero and that stays the same as was in the House Resources version.

Section 22, determination of production tax of oil and gas, AS 43.55.160(a), is found on pages 25 through 27 of the bill and is conforming language to the new tax rate.

Section 23, determination of production tax value of oil and gas, AS 43.55.160(e), can be found on pages 27 and 28 of the bill and it conforms to net operating loss carry forward provisions in Section 26 of the bill.

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Ms. Pierson continued to highlight the changes in the CS:

Section 24, determination of production tax value of oil and gas, AS 43.55.160(f), can be found on page 28 of the bill and it conforms to the new tax rate.

Section 25, determination of production tax value of oil and gas, AS 43.55.160(h), is found on pages 29 through 31 of the bill. It is conforming to the new tax rate and the calculation of the second tax bracket. We eliminated AS 43.55.160(g) by repealing it, which is a 10 percent GVR reduction for higher royalty fields.

Section 26, is net operating loss carry forwards, AS 43.55.165(a), found on page 31 through 32 of the bill. It adds AS 43.54.165(a)(3), allows 100 percent of net operating losses to be carried forward when there is production.

Section 27, also net operating loss carry forward, AS 43.55.165(m) and AS 43.55.165(n), is found on pages 32 and 33; (m) is a rollback provision on the net operating losses, reducing the 100 percent lease expenditures by 10 percent of the full original value every year after seven years; (n) is a ring fence provision, a carry forward lease expenditure can only be applied to a lease or property where the expenditure occurred. Section 26 of the Resources version directed DNR to develop regulations to

establish a review process for DNR preapproval. This has been deleted from the House Finance version.

Section 28, oil and gas competitive board, AS 43.98.050, on pages 33 through 35 is conforming to the repeal of AS 43.55.160(g).

Section 29 is the repealer; it can be found on page 35 of the bill. It repeals AS 43.55.024(j), which is the sliding per barrel credit. AS 43.55.029, third party assignment of credits and AS 43.55.160(g), the 10 percent gross value reduction for higher royalty fields.

Section 30 is the Cook Inlet working group, AS 43.98.050, found on pages 35 through 36, establishes a legislative working group to analyze the Cook Inlet fiscal regime; it stays the same as in the House Resources version.

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Ms. Pierson continued to read the changes in the CS:

Section 31 is an applicability, the provision is found on page 36 and reflects provisions relating to the minimum tax floor - effective, January 1, 2018. Section 30 of the Resources version has been deleted.

Section 32, transition, carry forward lease expenditures, is found on page 36. The net loss carry forward provisions apply to lease expenditures occurred on or after January 1, 2018.

Section 33, transition tax credit assignments, is found on pages 36 and 37 of the bill; it states the department may continue to apply and enforce tax credit assignments to third parties for credits applied before January 1, 2018 and it remains the same as in the House Resources version.

Section 34, transition payment of tax filing. Taxpayers shall pay the tax as provided in current law for a tax or installment payments or productions before January 1, 2018. This has been amended in the House Finance version for the new sections.

Section 35, is transition gross value reduction, found on pages 37 and 38; a taxpayer who produces oil or gas before January 1, 2018 qualifies for an extra 10 percent gross value reduction as provided in current law for the oil and gas produced before that date.

Section 36, is transition - retroactivity regulations, found on page 38 and allows for retroactivity of regulations to carry out this act.

Section 37, also has to do with retroactivity. The change is to delinquent interest in Section 3, it is retroactive to January 1, 2017.

Section 38, is effective dates. Sections 3 (Interest rates), 30 (Cook Inlet Working Group), 36 (retroactivity of regulations), and 37 (delinquent interest rates) take place immediately.

Section 39, is also effective dates found on page 38. The reduction of net operating losses takes effect in 2018.

Section 40, is effective dates found on page 38. It deals with all other sections of the bill and takes place on January 1, 2018.

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Representative Wilson stated the bill was vastly different than the prior bill version. She appreciated hearing the changes, but she needed more detail. She asked if there was a fiscal note.

Co-Chair Foster replied that the committee would address the merits of the bill and receive additional explanations; however, he wanted to have a working draft before the committee.

Representative Pruitt OBJECTED to the working draft. He supported the prior version over the current bill. He emphasized that the CS did not represent a credit discussion. He underscored that it would revamp oil taxes. He opined that the new document was a way to destroy industry. He stressed his frustration about the new bill. He believed the CS constituted a complete rewrite of the oil tax system. The CS would "ring fence" the net operating

loss (NOL) credits, if companies were able to keep them. He stated that the bill would not even maintain a competitiveness review board to provide information to the legislature on the state's competitiveness in the industry. He reiterated his objection to the work draft. He stressed that the CS was not good for Alaska. He stated that "I could not believe that you're going to ask me to go back to the other one as the place to start from."

Co-Chair Foster stated if the committee adopted the CS the intent was to hear modeling detail from DOR.

Vice-Chair Gara addressed some of the concerns that had been vocalized. He thought it was clear that many House Finance Committee members were uncomfortable with the two tax rates under the current production tax system. He addressed new fields (post-2003 fields) on the North Slope that had a zero percent production tax rate on average up to about \$73 per barrel. The state currently paid tax credits for fields that paid zero production tax - or some fields paid a 4 percent production tax. He remarked those rates would continue for at least five to seven years. He continued that the next year there would be more credits generated that would be owed to industry than would be generated in production taxes. He stated that much of the public believed it was an unfair transfer of a burden to the public and an unfair benefit to the oil industry. He stated that Mr. Rich Ruggiero [legislative consultant] had talked about a fairer profits tax.

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Co-Chair Foster asked members to steer clear of debate and making a case for the CS because the CS had not yet been adopted. He detailed that if the work draft was not adopted there would be nothing to debate regarding the new CS.

Representative Pruitt did not believe it was appropriate for a committee member to tell other people they did not understand. He also believed the comments strayed from the differences between the previous bill version and the work draft.

Representative Wilson stated her understanding that if the work draft was adopted it would be committee members' responsibility to find their own experts - she had not been a part of writing the bill. She asked if the committee

would be hearing from industry again because she believed the work draft constituted a total rewrite of the legislation. She stressed that the state could lose the industry due to the changes. She referred to statements that production tax did not cover the number of credits provided. She agreed, but noted there was also corporate tax and royalties. She stressed that the state had benefitted for years off the credits that were due at present. She detailed that the money had been put into the CBR instead of into the oil taxes. She continued that the state had benefitted and had received the money. She opined that it was not fair to the public to "only be taking it from one or the other." She stated that the bill was supposed to be about fixing the state's liability issue regarding taxes it owed. She referred to testimony from an expert who had been clear that a rewrite of the taxes was not needed and that it could be dangerous to do what she believed the current work draft did. She asked for the co-chair's expectation and intent.

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Co-Chair Foster stated that the bill had been introduced a few weeks earlier and the committee had heard from industry and a number of experts. He believed the committee knew the position of the various groups. He stated it was the intent to see if the committee would adopt the working draft.

Representative Wilson MAINTAINED her OBJECTION to the adoption of the work draft.

Representative Pruitt remarked that the work draft had come from one of the co-chairs' offices. He wanted to understand the intent of the bill going forward. He wanted to know if the intent was to get as much money from the industry as possible.

Co-Chair Foster replied that part of the answer would come forward with the presentation from the Department of Revenue (DOR).

Co-Chair Seaton relayed that as the bill had been developed, part of the intent was to get a fair return for

Alaska at prices that had not been modeled during the original timeframe, to generate production tax to pay back cashable credits, and to eliminate the portion of the budget gap resulting from the excessive amount credits.

A roll call vote was taken on the motion.

IN FAVOR: Gara, Grenn, Guttenberg, Kawasaki, Ortiz, Foster, Seaton

OPPOSED: Wilson, Pruitt, Thompson, Tilton

The MOTION PASSED (7/4). There being NO further OBJECTION, Work Draft 30-LS0450\M was ADOPTED.

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Co-Chair Foster relayed the committee would hear from DOR.

Representative Wilson stated that unless the committee heard something different from DOR, the bill would impact industry in a very different way than the prior bill version. She believed the industry should have an opportunity to weigh in.

Co-Chair Foster replied that as the end of session neared nearing the pace accelerated and the goal was to get things accomplished. He understood Representative Wilson's comments and he would look into the suggestion.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, relayed he did not have a specific presentation and would come back to the committee at 5:00 p.m. with modeling detail and a new fiscal note. There were numerous changes in the CS; the most fundamental was getting out of the business of cash credits - of earning net operating loss (NOL) credits subject to cash. He addressed that Mr. Ruggiero had talked about simplifying the tax system with a flat rate and including some step ups to the rate. There was a disconnect in the current law where the effective tax rates were lower than the nominal 35 percent tax rate, which led to some unusual circumstances where NOLs were carried forward and earned at 35 percent when the cash payment for tax was somewhat less than that amount. He believed it was the rationale of the previous committee to reduce the carry forward to 50 percent, which aligned the NOLs to 17.5 percent - closer to the effective tax rate. The current CS changed that provision and all losses were

carried forward - all could be used against future tax liability, but because the per barrel credit went away and was replaced with a lower tax rate, the effective and nominal tax rates were now the same thing. The value of the carry forwards would be at the tax rate and people would gain value from their losses in the future at the same rate that people were paying profit taxes at present.

Mr. Alper continued that it was no big surprise that at lower prices (between the breakeven point and around \$80 to \$90 per barrel) there were relatively low effective tax rates under the current tax law because of the per barrel credit and the 35 percent rate. Throughout most of the range it was the minimum tax - the 4 percent floor. The 25 percent net tax raised taxes in the \$50 to \$90 per barrel range. He continued that the 25 percent net rate was comparable to the original version of SB 21 [oil and gas tax legislation passed in 2013] as initially proposed by the former Parnell Administration. He expounded that the taxes - at that range - were the same as what they would have been had the original version of SB 21 had passed.

Mr. Alper explained that the progressive bracket created a surtax on the portion of the profits (the production tax value greater than \$60 per barrel), which was very different from progressivity under the prior Alaska's Clear and Equitable Share (ACES) tax system. Only the portion of the production tax value greater than \$60 was paying the surtax. For example, if a company had \$70 per barrel in profits, which would occur at oil prices of \$110 to \$115 per barrel, the first \$60 would be taxed at 25 percent and only the last \$10 would be taxed at the 40 percent combined rate (25 percent plus 15 percent surtax). He elucidated that the actual taxes at the higher price ranges (greater than \$100 per barrel) were almost identical to the current law's base tax. Therefore, at higher prices the bill did not create a tax increase and at prices of \$130 and above it was a small tax cut. The real impact of the tax changes was in the \$50 to \$90 per barrel range. The changes to the carry forwards were much more foundational and on the credit side of the equation. He relayed that he would be back before the committee with additional information beginning at 5:00 p.m.

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Representative Pruitt asked if Mr. Alper had advised the governor on the makeup of the current bill version.

Mr. Alper replied on the negative. He had been in some discussion with the co-chairs' offices in previous weeks so he knew what they were working on and had informed the governor several days earlier of some of the things he thought were going to be in the bill. He expounded that some of the information had turned out to be incorrect because the direction had been changed several times in the past few days.

Representative Pruitt asked for verification that Mr. Alper had a decent understanding of the current bill version.

Mr. Alper answered that he had received the current version of the bill that morning along with everyone else. He confirmed that he was "more or less" familiar with all the provisions.

Representative Pruitt asked if Mr. Alper would advise the governor to sign the bill in its current form.

Mr. Alper replied that he did not know if it would be appropriate for him to give that advice. He did not know the situation well enough. He understood the intent of the co-chairs and what they were trying to do with the effective tax curves. He also understood the governor's desire to get the state out of the cash credit business. The bill met those needs. He did not know how he would advise the governor and would need to study the bill in greater detail. He added that inevitably the bill would be debated by the Senate and much more would be learned about all the various provisions included.

Representative Pruitt understood the need for the cashables as well. He remarked that at some point the governor could either reside over a state that decided it wanted to destroy the oil industry or he could get active and become involved. He thought it was time for the governor to step in to communicate how he felt about the bill. He stressed the bill was a terrible message to send to industry. He referred to current price battles between Saudi Arabia and Russia. He detailed that Saudi Arabia was looking to get its market share back in Europe and because of that it would lower its price. He requested that the governor get

involved. He thought the governor should be a part of ensuring the viability of the oil industry.

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Vice-Chair Gara remarked that an important part of the bill was to make sure that companies were taxed based on their profitability. He detailed that what had formerly been a 5 percent gross tax that could have put companies under water financially was replaced by a profits tax - companies would not be taxed if they were not profitable. Profitable companies would pay 25 percent of their profits. He thought the previous speaker had made an overstatement. He did not want to scare people about things they should not be scared about.

Representative Wilson asked if the bill constituted a total tax rewrite.

Mr. Alper answered that the bill was a partial tax rewrite. He elaborated that it used elements of bills the legislature had considered in the past; it included elements of various versions of SB 21. He noted that large portions of the statute would remain the same; therefore, he would not characterize the bill as a complete tax rewrite, but it was substantial.

Representative Wilson asked if the DOR modeling would be based on numbers representing how much more the state could take from industry.

Mr. Alper replied that he would not word it in the same way. He answered that the modeling would show the effective tax rates and the total revenue that would be brought in at a range of prices and circumstances compared to the current law.

Representative Wilson relayed that she had read the bill a couple of times. She wanted to know what information the department would provide later in the day to show what impact taking away all credits would have.

Mr. Alper answered there were no credits removed in the current version compared to others. The sliding scale credit would be eliminated, but it was a counterbalance to the 35 percent tax, which was also going away. The bill was

reverting to an earlier version of a bill [SB 21] that was debated several years earlier.

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Representative Wilson stated that everything she had heard about the original intent of the bill was that it was aimed at taking care of one very specific point - how to pay the owed cashable credits and to quit going more into the hole regarding what was owed. She believed an expert had testified and recommended to the committee that the issue was something the committee could take care of in a bill first.

Mr. Alper answered that Mr. Ruggiero had described it as the most pressing issue. Many members of the legislature and the governor had also characterized as the most pressing issue facing the state in oil and gas law at present. The issue of changing and simplifying the tax code and getting rid of the per barrel credit was a part of Mr. Ruggiero's recommendations. He recalled Mr. Ruggiero pointing out to the House Resources Committee the inherent distortion in the per barrel credit. He stated that the per barrel credit threw numerous things off and there was probably good public policy value in getting rid of it, but what it should be replaced with was the pertinent question.

Representative Wilson recalled hearing that making too many changes or turning too many knobs at one time could have substantial negative consequences. She surmised that the CS made numerous changes that had not been in the previous bill version the committee had heard public testimony on.

Mr. Alper answered that he would prefer to describe the components individually later in the day. He was uncertain which changes Representative Wilson or other members found problematic. He was happy to explain each of them. He reiterated his earlier statement that at a wide range of prices the effective tax (actual tax collected by the state) was nearly identical to the status quo.

Representative Wilson assumed DOR's projection for oil in the pipeline was based on current tax law. She asked if the department would present updated numbers to show the effects and possible negative impacts of the bill. She believed the bill should scare the public.

Mr. Alper responded that the department was not in the position to question how company decision making may change based on any changes in the bill. He did not know how the industry would react. He believed that like committee members, companies were still trying to digest the language in the CS. His staff was currently working to get the changes modeled and the department would not be able to contemplate behavioral changes. He concluded that once the individual line items of the bill were considered, he did not think it would add up to something quite as onerous as it was being made out to be.

Representative Wilson stated that she found the magnitude of the bill incredible. She noted that the department had limited time to articulate a response to provide information to the committee. She did not believe it was fair to have a rushed response. She agreed that the governor needed to weigh in on the issue. She underscored that it would impact all Alaskans.

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Representative Thompson stated the CS appeared to be close to a complete rewrite of SB 21. He did not believe SB 21 had been given an adequate chance to show how it had impacted the industry and production. He was disappointed that the DOR revenue forecast had not yet been published. He remarked that the last revenue forecast had included oil at \$38 per barrel. He emphasized that the price had been over \$50 per barrel for quite some time. The last revenue forecast had projected under 500,000 barrels per day for the next year's production; however, production was currently well over 550,000 barrels per day (not 490,000 dropping to 450,000). He hoped the modeling would take the actual production into consideration. He stated that the department was three weeks behind on getting its revenue forecast out. He wanted to know what had been accomplished and how changing everything would impact the status. He hoped the modeling would reflect things that would be coming out in the revenue forecast. He stated that the committee did not have all the pertinent information and it was difficult to make sound decisions when the bill may reverse accomplishments that had been made.

Mr. Alper replied that the comment pertained more to the revenue forecast than the bill. He corrected that the fall forecast had included a price of oil for the current year

at \$47 per barrel; the \$39 per barrel figure had been from the previous spring. The price of oil had tracked relatively close to the fall forecast - the actual price was a couple of dollars above the projected price. He noted that production was also ahead of the forecast. When the spring forecast came out - the following Friday - he expected to see a small amount of additional revenue, perhaps around \$200 million. He did not like that the department was a bit behind on its forecast. He referred to a current newspaper article explaining that there was a regulatory interpretation issue that DOR needed to get to the bottom of. It had brought everything to a standstill - the department had to publish an advisory bulletin and rework many of the forecast assumptions, including the sequencing of credits, how certain credits interacted with each other, and how it would impact the anticipated amount of purchased credits (where one company purchased them from another). Given the circumstances the department could not publish a revenue forecast with incomplete information, which meant the process was delayed a couple of weeks. The department was on target to provide the forecast to the legislature the following week.

Representative Thompson referred to the \$8 per barrel credit. He asked for verification that if a company used the credit they could not use any other credits to take the amount below the [tax] floor.

Mr. Alper replied in the affirmative.

Representative Thompson asked what it meant that the \$8 per barrel credit was being eliminated.

Mr. Alper answered that the \$8 per barrel credit had been limited in SB 21 to go below the floor. The CS eliminated the per barrel credit and the floor was hardened in other specific language in several places in the bill. Therefore, the 4 percent minimum tax would still be the hard floor - no credits could be used to go below the floor. He referred to the crossover point where the net tax and the gross tax intersect on the graph - for the average producer it happened around \$73 per barrel. The CS drove the crossover point substantially to the left at about \$55 per barrel. Only relatively low-priced production would actually pay the 4 percent minimum tax and higher prices would be subject to the new 25 percent net tax.

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Representative Tilton remarked that the state already received more than the industry at all price points. She wondered if the change was wise. She wondered what the goal was. She thought the goal should be long-term production. She was skeptical about the bill's ability to achieve that goal.

Mr. Alper did not believe he was the appropriate person to answer. He recognized the importance of the question, which was up to the legislature to debate. His job was to implement the taxes passed by the legislature.

Vice-Chair Gara compared the CS to the House Resources Committee version. He stated that the Resources version had a 5 percent gross tax (a percentage of revenue, not profits) at \$50 and above and a 4 percent gross tax at prices below \$50 per barrel. The CS returned to the SB 21 rates - zero at low prices, 1 percent at low prices, increasing to 4 percent at \$25. He asked for verification that the rates in the CS remained the same [as in SB 21] and had been hardened.

Mr. Alper replied that Vice-Chair Gara was describing what happened to the minimum tax at very low prices below \$25 per barrel. He agreed that the existing law, retained in the CS, of a stairstep from zero below \$15 per barrel, 1 percent above \$17.50, and all the way up to \$25 was the same. He relayed that across most price points the current CS was less onerous on the industry than the House Resources Committee version.

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Co-Chair Seaton thought it was important to remember the committee had heard testimony about the gross tax at 5 percent. He stated that industry had testified that the 5 percent gross tax represented a 25 percent increase in its taxes. The change was eliminated under the current CS. The current bill version included a net tax - if a producer did not have much net income they would not pay tax. The 25 percent tax rate applied to net positive income. The prior bill version would change the per barrel tax credits and lowered where they were effective by about \$20, which had also been changed in the current CS. The current bill would eliminate new cashable credits. Additionally, industry had

testified in opposition to only being able to carry forward 50 percent of NOLs - the current CS allowed industry to carry forward 100 percent. The major elements of the CS accomplished the established goals. He continued that all the elements had been available to and testified on by industry and the legislative consultant. He stated that the consultant had testified that his preference would be to go to a stepped net tax. He reminded committee members that the bill did not include a change in progressivity as had previously been the case where a higher tax applied to all profits. He explained the tax under the current version was more like an income tax. The bill included a new component - a 15 percent additional tax, which was only taxed on the amount above \$100; it was bracketed just like an income tax. The lower tax was paid if the production tax value was lower than \$60. He believed the model would show the CS structure was beneficial across a wide range. The bill was much simpler than having an interaction between a net tax and gross sliding scale per barrel credits.

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Representative Guttenberg asked if the bill contained anything that was unique or that had not been previously discussed. He remarked that there were many concepts that the legislature had discussed for years. He believed part of the problem was that when one concept was changed in the oil tax structure something else needed to be adjusted. He asked if the bill contained anything new that had not previously been analyzed.

Mr. Alper replied that many of the transparency components were relatively new to the current year, but they had been in the House Resources Committee version of the bill. The current CS contained the ring fencing concept, which was new. He believed the topic merited substantial discussion. He had spoken with the co-chairs about their intent, which in some ways stemmed from the previous committee's desire for a preapproval process or some control over making sure the state knew what it was getting when someone was investing using state money. Ultimately the ring fence language was intended to recognize that a company had carry forwards from a project, but they had a loss - it only kicked in when a company was operating at a loss. The carried forward lease expenditures could only be used to offset the production value from the actual property where the initial investment had been made. He explained that it

took away the possibility that someone may spend a significant amount of money and use the offsets to reduce their taxes from another part of the North Slope. The more dramatic possibility would be the failure circumstance. He provided a scenario where a company spent a significant amount of money and was unsuccessful. He detailed that the company had \$1 billion in carried forward lease expenditures and was looking to get out of Alaska. Without some sort of ring fence or limitation, the company could sell its entire Alaskan subsidiary to a major producer for any price. Under the circumstance, the buyer would be purchasing the \$1 billion worth of carried forward lease expenditures and could use it to offset its production from one of the major legacy fields. He believed it would be detrimental and not fit within the intent of the program. He understood the ring fencing language in the CS was a means to prevent that from happening. He relayed that everything else in the bill had been at a minimum introduced as an amendment or in a previous version of another bill; there was nothing brand new in the current CS.

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Vice-Chair Gara requested to hear about the statutory relief valve pertaining to royalty relief. He stated that the provision had been included in all the state's recent oil tax systems going back to the Economic Limit Factor (ELF) system. He was interested to hear about the possible royalty reduction depending on the royalty a field paid and whether it was a new or existing field.

Mr. Alper clarified that royalty relief is a function of royalty, which was a function of state lands and state leases and fell within the Department of Natural Resources (DNR) purview. He explained that a company made the case that its field was challenged economically and could ask for a reduction in the royalty rate for some period. He stated that it was not unusual for the contractual 12.5 percent royalty to be reduced to something like 5 percent for a number of years; 7.5 percent of the 12.5 percent (two-thirds) would be foregone - the state would take less royalty, which would help the field get over the hump. After a designated period, the rate would increase to the full amount. He stated that it was an application process that required a best interest finding and quantitative analysis; a report from DNR staff would determine whether

the application should qualify. The most recent royalty relief case had been the Nuna field (Caelus's expansion near Ooguruk) - the company had applied and had received royalty relief. The company had testified that it was contingent on meeting certain investment thresholds. He furthered that because of the economy and the price of oil, the development had been slowed down - the company would likely have to reapply for royalty relief when the project started back up.

Vice-Chair Gara stated that the basic standard for royalty relief was if a company with a new or existing field proved the field to be uneconomic under current conditions to the department, it could receive the royalty reduction to try to make the project economic.

Mr. Alper answered yes and that the question pertained to DNR, which was outside of his expertise.

Representative Pruitt followed up on the NOL changes. He questioned whether it was really possible to compare being able to use the full 35 percent NOL credit to future liabilities. He stated that in theory going back to the current structure would make sense, but he viewed the ring fencing as a dramatic shift. He asked if the value in ring fencing remained for the companies in the same way that 100 percent of their NOLs would.

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Mr. Alper expressed uncertainty about his understanding of the question. He relayed that typically once an investor began making major investments they expected to be producing oil within five or six years. Under the scenario the company would have production and value and its carried forwards would be used to offset production from that field. The value of the ring fence was to ensure that the tax reduction did not occur until the company successfully developed the field it had been investing in in the first place.

Representative Pruitt understood. He asked if requiring companies to narrow [carried forwards] down to specific fields would maintain the value for a company to continue to invest in Alaska. He stated that currently a company could take the losses against investment, which incentivized them to invest. Whereas, the bill would

require a company to wait on that on the specific field. He asked if the value to the company remained in the same capacity if the ring fencing provision was implemented.

Mr. Alper did not believe he was qualified to answer the question. He deferred to industry. He clarified the ring fencing provision in the bill. He provided a scenario of a company with existing production that was also investing in a new field somewhere on the North Slope. The investment would be fully usable, as it was presently, to offset the company's taxes from the company's existing production; the provision did not change the commingled nature of the North Slope tax. The difference resided in a loss scenario. He detailed that the carried forward losses were the only thing that would be tied to the lease or property.

Representative Pruitt asked if the industry had asked for ring fencing.

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Mr. Alper replied that he did not believe anyone would ask for ring fencing. He detailed the purpose of ring fencing was to protect the state's interest, most notably in the failure scenario when a company with carried forwards was unable to bring a field into production. Under the scenario, in the absence of ring fencing, it would be necessary to have some other means to protect the state from carried forwards being used to offset taxes the state would otherwise receive. He furthered that the goal was to prevent a company from selling the carried forwards to a major producer. He believed ring fencing seemed to be a reasonably elegant way to accomplish the goal. The protection was necessary in a world of large amount of carried forward lease expenditures.

Representative Pruitt thought he had heard testimony earlier in the meeting that industry had requested some of the things in the CS. He did not recall the component being requested.

Representative Ortiz asked if ring fencing was used elsewhere in the United States or in other locations competing [for investment] with Alaska.

Mr. Alper replied in the affirmative. He expounded that field-based taxation was not unusual throughout the world.

He explained that before Alaska had switched to a net profits tax with the Petroleum Production Tax [PPT] system in 2006, ELF had been a ring-fenced tax - every field had a separate tax. He elaborated that the Cook Inlet oil and gas tax, which was still tied to ELF was a ring fence tax. The specific reasons for bringing the structure back were unique, but field-based taxation cost recovery was not unusual.

Co-Chair Foster reminded committee members that amendments on the bill were due the following day.

Representative Pruitt asked if the committee would hear from Mr. Ruggiero [legislative consultant].

Co-Chair Foster replied that he would look into the possibility.

Representative Pruitt asked if Mr. Ruggiero had been involved in the current CS.

Co-Chair Seaton replied that Mr. Ruggiero had supplied the model and had done follow up work on the model. Mr. Ruggiero had suggested (to the committee) implementing a stepped net tax - a better system that would eliminate some of the current problems. He had also asked Mr. Ruggiero in a prior committee meeting whether the state should use its net tax system to offset royalties with the 10 percent gross value reduction. Mr. Ruggiero's comment had been that it did not make sense to use the tax system to lower its royalties.

Representative Pruitt remarked that the CS included a dramatic change. He thought it would be helpful to hear from Mr. Ruggiero.

Co-Chair Foster relayed that he could check into the possibility during the coming recess.

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RECESSED

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RECONVENED

Co-Chair Foster relayed that Mr. Ruggiero was not available to testify. He discussed the agenda.

Mr. Alper provided a PowerPoint presentation titled "CS HB 111(FIN) Oil and Gas Production Tax and Credits: Analysis of House Finance Committee Substitute" dated April 7, 2017 (copy on file). He turned to slide 3 and addressed the minimum tax (floor). The purple text throughout the presentation indicated new components of the legislation. The House Resources Committee increased the minimum tax rate to 5 percent at oil prices above \$50 per barrel; it had removed changes at zero to 3 percent. The CS under consideration reverted to current law and maintained minimum tax rates and structures from SB 21. The House Resources Committee had hardened the tax floor, which prevented all credits from being used below the minimum tax. There were many circumstances in current law where a taxpayer could go below the 4 percent with certain credits. The House Finance Committee CS made an exception - the small producer credit could still go below the minimum tax.

Mr. Alper addressed slide 4 related to the hardening of the tax floor for gross value reduction (GVR) eligible new oil. Under current law the \$5 per barrel credit could reduce a tax liability to zero. The House Resources Committee had created a hard "adjusted" minimum tax where the 20 to 30 percent reduction was applied before calculating the minimum tax. The effective minimum tax rate was between 2.8 and 3.2 percent for new oil. Whereas, HB 111(FIN) kept the adjusted minimum tax structure. He explained that the percent GVR benefit was eliminated and the effective minimum tax was always 3.2 percent for new oil. He added that new oil had a limited duration under current law that had been changed the previous year in HB 247; GVR eligibility was only good for between three and seven years.

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Mr. Alper turned to slide 5 and explained the treatment of North Slope NOLs. The 35 percent NOL credit - was the biggest consternation about future state liabilities - and was eliminated and replaced with a carry forward structure. The House Resource Committee bill version had allowed for 50 percent carry forward of losses, with the possibility of earning an "uplift" or interest of about 8.5 percent annually for up to seven years. The finance version allowed 100 percent of losses to be carried forward without the uplift. After seven years the carried forward value began

to decrease by 10 percent per year. Additionally, the carried forward expenditures could only be used to offset value from the lease or property where they were incurred (ring fencing). The bill included reporting requirements to ensure the state knew where expenses were incurred and where they could be used.

Co-Chair Foster noted Vice-Chair Gara and Representative Pruitt had joined the meeting. He recognized Representative Andy Josephson in the audience.

Representative Wilson wanted to ensure she understood the ring fence concept. She provided a scenario where she had an oil field with two developments. She stated that currently she could combine the losses and gains of the two fields. She believed under the ring fencing concept the two fields would become their own separate entities. She continued that if there was a loss on one field and a gain on the other, the loss could only be taken down to the minimum and the full gain on the other field would be counted. She asked for the accuracy of her statements.

Mr. Alper replied that the word "field" did not exist in statute - statute referred to lease or property, which usually meant a unit, which was defined in regulations. He believed that two fields in the same unit would be interpreted as one entity. The ring fence concept applied to two very different production areas on different parts of the North Slope. If one of the fields was making money and the other was losing money, the losses on the field losing money would have to be used against future gains from that field. He provided a scenario where a large producer made good money on legacy production and reinvested a portion of profits in a new development. He explained that the scenario was fine and was all part of the intermixed tax structure on the North Slope. He continued that it only became relevant if the company was operating at a loss for the year for its North Slope investments - at that point, the loss amount would be locked into the field where incurred.

Representative Wilson used restaurants as an analogy. She provided a scenario where she owned two very different types of restaurants. Currently in her federal taxes she would combine the two businesses together to determine her gain or loss. She surmised that under the ring fencing structure, if one restaurant had a loss she could only take

the tax minimum to 3.2 percent and could carry forward the losses. She stated that the entire gain on the other restaurant would have to be included. She continued that it appeared the state would be charging less at the 25 percent, but in reality she could actually be paying more under her example because the two restaurants could no longer be combined.

Mr. Alper continued with the analogy. He detailed that if the first restaurant was making \$50,000 and the second restaurant lost \$40,000, the owner would pay taxes on the \$10,000 profit. However, if the second restaurant had a \$60,000 loss, the overall \$10,000 loss (between the two businesses) could only be carried forward and used against the second restaurant's future profits.

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Representative Wilson thought Mr. Alper had previously stated that two fields in different areas on the North Slope could not be combined to have a loss or gain. She thought that under the ring fencing structure, that would no longer be possible.

Mr. Alper replied there were different degrees of ring fencing. There was full ring fencing where every field had a separate tax calculation and potentially separate progressivity. He detailed that under ELF every field had been separate and had a separate multiplier. That structure was not in the CS. The taxation on all oil and gas on the North Slope was a single tax or a "segment." He explained that if the overall North Slope was operating at a loss, the attachment of the expenditures associated with the loss were tied to the field where they were incurred. In a profit situation it was still a single combined tax.

Mr. Alper advanced to slide 6 and addressed the North Slope tax rate, which was 35 percent of PTV less a per barrel credit. The House Resources Committee bill version had shifted the per barrel credit so the break points of the different dollars (e.g. \$3 to \$4 or \$2 to \$3) were moved by \$20, meaning that the typical producer would receive \$2 less in credits. The change resulted in a tax increase of about \$300 million. The House Finance Committee CS did not include the provision and removed the entire per barrel credit, replacing it with a lower tax rate. The current CS reduced the base tax back to the original SB 21 rate of 25

percent at prices below about \$90 to \$95 per barrel. The CS added a bracket of progressivity with a 15 percent surtax. He acknowledged that it added up to a 40 percent tax, but it was only 40 percent on profits that were greater than \$60 per barrel. The bracketed structure was similar to HB 110, a tax reform bill from 2011 offered by the former Parnell Administration - the tax had stepped up, rather than being a blanket tax increase across all price points. The effective tax rates closely tracked current law at the higher price rates. Additionally, the CS aligned the value of the carry forward with the effective tax rate. He explained that one of the structural errors in SB 21 was that the NOL or loss rate at 35 percent was higher than the effective tax rate companies pay when profitable at almost any price. He detailed that the tax value of a loss became greater than the tax value of a gain. He addressed ramping down of NOL rates and noted that HB 247 (passed the previous year by the House) had a 25 percent NOL rate that was designed in part to rationalize the effective tax rate with the statutory tax rate. The current CS resolved the issue by removing the per barrel credit and using the 25 percent tax rate - it became the nominal and effective tax rate. He furthered that if a company had a loss that was carried forward, it was saving future taxes at the 25 percent rate. There was more parity for the companies making money and the companies losing money.

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Representative Wilson asked why the bill used a production tax value versus an actual barrel cost. She wondered who determined what the value was.

Mr. Alper asked if Representative Wilson was referring to the progressivity trigger point.

Representative Wilson referred to a bullet point on slide 6 that stated a bracket of progressivity was added [with a 15 percent surtax] on a portion of PTV greater than \$60. She stated it was not \$60 per barrel and equated to a price of around \$94 to \$95 per barrel.

Mr. Alper answered that it was closer to \$104 to \$105 per barrel. The PTV was the statutory definition of net, it was the profit. The production tax did not kick in until a company had a profit. The 25 percent tax (or 35 percent tax in current law) was calculated on PTV. He detailed that if

a company was making \$1 per barrel, it was taxed at the 35 percent. The structure specified that if a company was making \$1 to \$59 per barrel it was taxed at 25 percent. He furthered that if a company was making \$61 per barrel, \$60 would be taxed at the 25 percent and the remaining \$1 would be taxed at 40 percent. Likewise, if a company was making \$100 per barrel, \$60 would be taxed at 25 percent and \$40 would be taxed at 40 percent. He concluded that because it was a net tax, the trigger points for different breaks should generally be tied to net amounts.

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Representative Wilson asked for verification that aside from the small producer credit, there were no other credits that would reduce the tax. She surmised that the profit would be multiplied by the applicable tax percentage to determine the amount owed.

Mr. Alper replied it was possible companies may have other credits. For example, if a company was doing work in Middle Earth and had capital, exploration, or well lease expenditure credits, those credits could reduce a tax payment below the statutory number, but not below the 4 percent floor.

Representative Wilson asked for verification that other than the small producer credit, there would be no other credits to reduce a company's tax on the North Slope.

Mr. Alper replied in the affirmative. However, if a company had purchased credits from another company, it could use the purchased credits to reduce its taxes below the statutory rate, but not below the 4 percent floor.

Vice-Chair Gara spoke to the intention that at high prices the tax rate would not exceed the 35 percent under SB 21. He detailed that the surtax applied to a PTV greater than \$60. He explained that for a low profit field with high costs the surtax may not kick in until \$150 per barrel because it had \$90 in costs at the field. If a flat price of oil was picked it would kick in much faster for the low profit fields.

Mr. Alper replied in the affirmative. He detailed that it would be the average comingled profits of the company's

overall North Slope operations. The higher the cost, the higher the price would lead to the \$60 PTV.

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Vice-Chair Gara asked for verification that if there was a high-cost field that was not profitable until \$80, the structure requiring \$60 of profits [PTV] before the surtax kicked in, would be fairer (to the company) than attaching the surtax at \$100 per barrel.

Mr. Alper responded he was trying to steer clear of words like fair, but Vice-Chair Gara's statements made sense.

Mr. Alper turned to slide 7 and addressed GVR. The CS maintained the 3.2 percent modified hard floor introduced in the House Resources Committee bill version. The CS also maintained the \$5 per barrel credit. He noted that the other sliding scale per barrel credit had been eliminated in the bill. He explained that the \$5 per barrel credit meant that GVR-eligible fields would pay no more than the minimum tax up to prices of about \$90 per barrel. New oil would pay the 3.2 percent for a very wide range of prices. The CS would eliminate the 30 percent GVR for high royalty fields, which had been added in the late stages of SB 21.

Mr. Alper advanced to slide 8 and discussed other changes in the CS. He explained that most of the other changes were non-monetary and were more technical or impacted a policy issue that did not necessarily have a cost. He stated that the interest rate was one of the administration's priorities. There was a problem with existing law where the interest rate went to zero after three years on oil and gas production tax. He explained the provision made it very hard to get anyone to settle their taxes and pay an assessment; it was cheaper to appeal and take the issue through the court system if there was no interest liability. He stated that the 7 percent interest rate in the CS was more flexible and seemed fair; it was halfway between the historic rate and the 3 percent implemented by SB 21.

Mr. Alper continued to address other changes on slide 8. He stated that the transparency sections were somewhat different than what had been passed by the House Resources Committee. The CS added references to the carried forward lease expenditures - information would be provided to the

public - to the legal extent - regarding the amount of carried forward lease expenditures a company had (its credits earned but not cashed). The dataset became the building block to enable DOR to administer the ring fence. One of the potential problems with a ring fence was how much work it could be for DOR staff. So long as the taxpayer was providing the information regularly as part of their tax filing, the department would have the information. The CS maintained House Resource Committee language specifying that the gross value at the point of production (GVPP) could not go below zero. He spoke to a scenario with a remote, single field with high transportation costs. He stated that if the wellhead value (the GVPP - the value after subtracting transportation) went below zero, the negative value could not reduce taxes from other fields.

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Mr. Alper continued to address other changes in the legislation on slide 9. He relayed that there had been a per barrel credit volatility problem associated with the migrating credits. He detailed that if there were certain months within a year with high prices and others with low prices where some were above the minimum tax and others were below it, the state could be liable for large refunds. He expounded that credits earned in one month could have been used in another. The issue was made moot by the current version of the bill - it had been tied specifically to the per barrel credit, which the CS eliminated. The CS repealed the ability to assign a tax credit certificate to a financial company through a third party where the credit was paid by the state to a banker directly. He noted the feature had been added in non-oil and gas legislation several years earlier. Although the CS did not address any Cook Inlet tax or credit issues (it addressed only the North Slope), it would establish a new legislative working group to look at possible future changes to be addressed in a future legislative session. The Cook Inlet tax cap, the ELF-based \$0.17 on gas that was originally scheduled to sunset in 2022 had been extended in HB 247 and was ongoing.

Co-Chair Foster recognized Representative Geran Tarr in the audience.

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Vice-Chair Gara asked for verification that under the CS there would continue to be no production tax on oil in Cook Inlet.

Mr. Alper replied that HB 247 had changed the Cook Inlet tax cap to \$1 per barrel. For the most part Cook Inlet oil production was taxed at the \$1 rate.

Vice-Chair Gara stated that in two prior statutes there had been a structure that migrated from a base-profits tax rate that moved up. He stated that the inflection point was at \$60 in profits. He asked about the inflection point in prior laws that contained the feature.

Mr. Alper replied that ACES had been a progressive tax structure that had a 25 percent base rate. Under the ACES structure the tax rate began to increase at \$30 PTV - the rate had increased by four-tenths of a percent for every \$1 above \$30.

Vice-Chair Gara asked for verification that PPT under the former Murkowski Administration had a similar feature. He asked where the point had occurred under PPT.

Mr. Alper replied that PPT, the original net profits tax from 2006, included a 22.5 percent base rate that had increased by two-tenths of a percent for every dollar above \$40 PTV.

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Mr. Alper advanced to slide 10 and addressed items that had been removed from the bill including intent language regarding appropriations (buying the backlog of credits); executive sessions/legislative access to confidential information under limited circumstances; the Department of Natural Resources (DNR) preapproval process of lease expenditures; the dry hole credit; and no changes had been made to per-company credit cap, haircut, or barrels per day cash thresholds. He elaborated that in many ways the ring fencing provision compensated for the removal of the DNR preapproval process language. He explained that if the issue was that the state needed to ensure that a project it was funding was in its best interest, the issue would be resolved if no one would be getting the value until the field came into production - if someone sold the lease they would retrieve the value. He explained that the dry hole

credit had been a recommendation by Mr. Ruggiero as a way of buying out a failure case carry forwards. He remarked that he did not believe the dry hole provision in the House Resources Committee version had been as intended. He explained that the CS removed any changes made in prior bill versions to the per-company credit cap (\$70 million per year). The discount companies had to take on the amount of cash beyond \$35 million had been taken out of the CS. The House Resources Committee version had reduced the barrels per day threshold from \$50,000 to \$15,000 (the size company to become ineligible to get cash for credits), but the current CS removed the change. He concluded that the status quo was maintained for credits and company size. He stated that the world of cash, caps, and thresholds would be limited to Middle Earth under the CS. He detailed that Cook Inlet credits were gone and North Slope credits would be eliminated by the bill.

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Mr. Alper moved to slide 11 that contained a graph showing effective tax rates (the amount of taxes received net of credits as a percentage of profit) on legacy/non-GVR oil. The blue line represented current law (SB 21). He stated the curve to the left was unusual; it represented the impact of the minimum tax - where the company got closer to break even or losing money, the tax rate became higher. He highlighted that in the low \$70 range (at the bottom of the point) the net profits tax kicked in and increased. The jagged nature of the line represented the various stair steps of the per barrel credit (\$8 to \$7 to \$6 and so on down to zero). He explained that the 35 percent statutory tax rate was reached when the credit went to zero at about \$160 per barrel. The dotted blue line represented SB 21 NOL rate at a range of prices. He detailed that the losses under SB 21 were always earning at 35 percent, although the tax rate was much lower. The red lines represented the House Resources Committee bill. The impact on the left was the 5 percent minimum tax and the impact on the right was the \$2 shift in the stagger to the per barrel credit; it was a tax increase across all price ranges reverted to the 35 percent curve much more quickly. The value of losses was at about 17.5 percent, which related to the idea of the 50 percent carry forward. He furthered that if a company took half its losses, carried them into a future year, and used them against the 35 percent tax rate - it was the equivalent of a 17.5 percent NOL.

Mr. Alper continued to explain slide 11. The green line represented the current CS; it included the 4 percent minimum tax and should overlap the blue line on the left side of the chart. The large horizontal segment of the line at 25 percent reflected the 25 percent net profits tax that kicked in at about \$50 to \$55 per barrel and went all the way to where the progressive surcharge would start at about \$100 per barrel. The green curve bending upwards to the right represented the weighted average of the 40 percent tax for the high value and the 25 percent tax for the first \$60 of value. He elucidated that the line closely tracked the status quo. The bill was close to revenue neutral above oil prices of about \$100 per barrel. He explained that because there was no per barrel credit distorting the NOL rate between the value of a loss and the value of a profit, the NOL rate was the same as the profit rate - meaning a company would get their losses, presuming the price of oil was less than \$100, at the 25 percent rate; if the price of oil exceeded \$100 the company would cash in its losses (when it carried them forward) at a higher rate that related to the tax rate they would be paying at that point. There was some parity on both sides of the equation.

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Mr. Alper noted he had an additional slide not included in the presentation meant to go between slides 11 and 12 related to effective tax rates for new/GVR oil. He intended to address the slide at the end of the presentation. He addressed a line graph on slide 12 related to total production tax revenue. The red line represented the SB 21 status quo, the green line represented the House Resources Committee bill version, and the purple line represented the current CS. The slide showed a moderate increase in tax revenue between oil prices of \$55 or \$60 to \$90 or \$100, with the greatest impact around \$80 per barrel. He pointed to the space between the purple and red lines at those prices and explained the difference was the same in dollar value as the effective tax rate curve between the green and red on slide 11. He noted that at higher oil prices actual revenue came in slightly lower - there was a crossover at around \$100 to \$110 per barrel. He stated that at \$4 billion to \$5 billion in revenue at very high prices, a couple hundred million could get lost in the noise of the underlying math - it was hard to tell what was really going

on. Effectively, in the current CS it was a minor tax decrease at very high oil prices.

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Representative Wilson asked if SB 21 also had a \$5 per barrel credit before it had been turned into a sliding scale.

Mr. Alper replied that there were three primary stages to SB 21. The original version introduced by the former Parnell Administration had been a 25 percent tax with no per barrel credit. The bill version that had passed the Senate was a 35 percent tax with a \$5 per barrel credit. The House Resources Committee had added the sliding scale to replace the \$5 [per barrel credit].

Mr. Alper addressed the fiscal note summary on slide 13. He explained that the fiscal note narrative was still in transit, but its tables were included in the presentation. He highlighted that the tax impact was concentrated in the \$55 to \$90 per barrel price range; it was the difference between 35 percent minus the per barrel credit and \$25 percent flat, which was higher. The crossover of the gross and net tax moved substantially lower, from about \$74 to \$55. He returned to slide 11 and explained the blue line (current law) showed a crossover of the minimum and net taxes at about \$75 per barrel; whereas, the crossover in the green line was at about \$50 to \$55 per barrel. He returned to slide 13 and added there was a comparably small revenue impact at high prices.

[5:44:06 PM](#)

Mr. Alper moved to slide 14 and addressed the fiscal note summary related to the budget. He stated that tax credit bills all had two halves: 1) how much money would be brought in because of the tax change and 2) how appropriations were changed. He detailed that the appropriations side related to how many credits people were earning and how much the state would be required to appropriate to purchase the credits. He clarified that because the bill came close to eliminating cash credits, it would result in reduced spending. The long-term forecast was for a cash credit demand of about \$150 million per year. He noted the estimate was on the low end and was based on certain expectations of known company spending -

it did not include the possibility of some of the larger multi-billion projects/discoveries moving forward. He stated that whatever the number, it would be close to wiped out by the bill - there would no longer be liabilities to buy cash credits. The associated projects would not come into production during the fiscal note period; carry forwards would not turn into offset taxes during the timeframe addressed in the fiscal note. He stated that until a project was sanctioned, and its life cycle modeling was generated, it would be difficult to see the impact of the carry forwards.

Mr. Alper turned to a fiscal note table on slide 15, showing the impact at forecast prices. He relayed the information would be included in the fiscal note. He pointed to a blue row on the table showing the revenue impact of the 25 percent tax and elimination of the per barrel and sliding scale credit - beginning at \$20 million in FY 18 through \$100 million in FY 21 and continuing to increase in later years to over \$300 million. The revenue was projected to increase because the higher forecasted oil price. The maximum change showed up at about \$80 per barrel. Another blue row near the bottom of the page represented cash credits. A substantial fraction of the \$150 million forecasted to be spent on credits was disappearing (\$130 million to \$135 million). The yellow row reflected the total of the bill's fiscal impact, which was relatively modest in the short-term and over \$400 million in the out-years. He directed attention to the bottom row on table "change in year-end balance due to proposal." The item pertained to carried forward lease expenditures - it was a new concept. He expounded that there were currently no carried forward lease expenditures other than a small amount of carried forward losses by major producers (the 14 shown in the status quo in FY 18). He furthered that without credits companies would carry forward their losses - in the future the state would see \$160 million in revenue lost (25 percent of \$640 million) once the companies were able to use the carry forward credits to offset their production tax value.

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Mr. Alper advanced to slide 16 and addressed a fiscal note table showing the bill's impact at a range of prices including the forecast, \$20, \$40, \$60, \$80, \$100, and \$120. He noted that slide 15 showed forecast prices - the price

was currently \$47 per barrel and was projected at \$50 for the following year and was projected to increase into the \$70 to \$80 range in out-years. He elaborated that an oil price of \$20 per barrel was difficult to model - especially when sustained at that price - because company behavior would change, and many would stop drilling wells at that price point. At that price everyone operating in Alaska would be losing money and large operating loss credits would be earned. He noted it was difficult to contemplate the \$20 per barrel scenario ever happening. The \$60 price was closer to the forecast - it included a certain amount of increased taxes due to the change in tax rate and per barrel credit, in addition to the impact of the elimination of the credits. He pointed out that the fiscal impact came close to disappearing at oil prices of \$120 per barrel with the impact concentrating in the lower price ranges.

Mr. Alper moved to a slide separate from those in the presentation titled "Fiscal Analysis: Effective Tax Rates (New/GVR oil) (add between slides 11 and 12 of presentation)" dated April 7, 2017 (copy on file). He pointed out that the blue line showing the status quo and the red line showing the House Resources Committee bill version were the same beginning at \$80 per barrel. He explained that GVR oil under current law paid no tax because the per barrel \$5 credit could go to zero until around \$70 - at that point there was a 35 percent tax reduced by the GVR itself, minus the \$5 credit. The curve increased and reached a maximum effective tax rate of around 22 percent. The green line, representing the current CS, came in higher at low prices due to the hard floor, but lower at high prices because of the 25 percent base rate (instead of the 35 percent base rate). He pointed to the red line and noted the higher floor was visible to the left. The minimum tax curve went to \$90, which was the impact of the lower 25 percent tax with the \$5 credit. The curve began increasing again at prices between \$100 and \$105 per barrel because of the 25 percent net tax minus the \$5 credit. There was a bit of a bend in the curve where the progressive tax kicked in above \$105. He pointed out that the green line tapered up and eventually caught up with the red and blue line at about \$160 per barrel. He elucidated that although the bill raised taxes on GVR oil at low prices, it lowered taxes on GVR oil at high prices.

Representative Pruitt asked when DOR projected oil prices would reach \$75.

Mr. Alper answered that he did not believe the forecast price of oil was moving substantially over what had been in the fall. He believed it would be in about three or four years.

Representative Pruitt asked how the recent rulings by DOR concerning tax credits would be impacted by the bill.

Mr. Alper believed Representative Pruitt was referring to the ordering of credits advisory bulletin he had mentioned earlier. He explained that the issue raised in the bulletin had to do with the interaction of the per barrel credit with other credits; because the per barrel credit would be eliminated by the bill, the issue would be moot. The advisory bulletin also related to the fact that certain credits would harden the tax floor while others did not, and how they would interact with each other. He explained that because nearly all credits were hardened to the tax floor in the bill, it would make moot most of the points raised in the advisory bulletin.

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Representative Pruitt asked about credits that could potentially be used in future years. He asked if the bill would impact a company's ability to use credits in future years since the advisory bulletin dealt with more recent timeframes under the current tax structure - prior to HB 111. One of the issues the state was wrestling with was the \$500 million and growing pool of unpurchased credit certificates largely as subject to the veto. He continued that due to very low prices and major producers were at the minimum tax, it was difficult for them to be able to buy any. The department was hoping that prices would recover to the point where some head room was afforded to give the ability to purchase certain credits, which would recreate the secondary market. He believed that ideally "we'd all like that issue to go away as part of a broader solution."

Representative Pruitt asked about the administration of the ring fencing. He discussed that currently taxpayers had a consolidated return. He asked how the concept would impact the administration for the department and companies.

Mr. Alper shared that he had a recent conversation with the supervisor of the production audit group. He explained that

companies already reported their expenses to the lease or property - the department already received the detailed information. The bill added a new section in AS 43.55.030 (taxpayer reporting requirements) that tied to the transparency section specifying the department would create a report with the information and release it to the public. He spoke to the importance of building more functionality into the department's tax handling software to track the information. For example, a company may have \$300 million worth of carry forwards, but half were from one field and half were from another field - once the company began earning a profit on the fields the department could track them. He noted that the department's software was already robust, it would merely need a new feature added. He added that the department had included a \$1.2 million fiscal note to account for substantial programming time for the contractor to build in the various tax changes. The number had not been increased with the addition of the ring fence feature.

Representative Pruitt addressed the auditing aspect. He stated there were currently various scenarios auditors faced due to the various tax regimes the state had implemented in throughout the past six years. He reasoned that adding another tax structure would bring another challenge for companies to meet auditing requirements. He wondered if there would be a need for additional auditors.

Mr. Alper responded that the department did not anticipate new staff. There was an inherent time lag in the audit process - longer than he was comfortable with. He relayed that DOR had recently completed the series of 2010 tax audits (which fell within the six-year statute of limitations) - 2010 had been under the ACES tax structure. He had one group of staff who were leading up the effort and were fully enmeshed in all the nuances of ACES. The department also had other staff concentrating on tax credit reviews of current lease expenditures or exploration credits for 2016, which fell under the SB 21 tax system. He added that the group was also beginning to get HB 247-based submissions for review. He expounded that his staff was very capable and would adapt to the new regime.

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Representative Pruitt observed that the structure facing DOR auditors was incredibly complex. He thought at one

point there had been a discussion about simplifying the process. He reasoned that the bill would add an additional and different layer of complexity for auditors to understand. He asked if the structure would be more difficult for the state to administer.

Mr. Alper acknowledged that the ring fence was complicated and would be a challenge to administer. He believed it was an important feature if the legislature's goal was to create carry forwards. The feature would ensure the state's interests were protected from carry forwards leaking from project to project. He stated there were other ways to do it. For example, he had spoken to a committee member about possible claw backs where the state could recapture value if a field changed hands. The preapproval mechanism in the House Resources Committee version was another option. He underscored that the department could administer the ring fence provision. He assumed there would be some wrinkles in figuring out how to do it, but that was the department's job.

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Representative Pruitt remarked that current oil prices were around \$50 per barrel and that Mr. Alper had estimated the price would potentially rise to \$75 per barrel in the next three to four years. He referred to the supplemental graph related to effective tax rates for GVR oil (royalties were not included). He noted the change was substantial. He referred to a tax increase shown on the graph and asked if the department anticipated a change in attitude regarding investment decisions.

Mr. Alper replied that he did not know how companies would react to what amounted to a tax increase at prices of \$50 or \$60 per barrel. He knew that many producers had been supportive of SB 21 as it had been originally introduced - they had preferred it to ACES. The current bill, across that range of prices, imposed the original SB 21 structure. He stated that the bill was worse on companies than current law because of the per barrel credit, which resulted in lower taxes at \$50 to \$60 per barrel. He believed companies would not prefer the bill because it was only rational to want to pay lower taxes. He was not in a position to say whether the bill would impact companies' investment decisions.

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Representative Wilson asked Mr. Alper to list the difference between the current SB 21 tax structure and the bill's tax structure.

Mr. Alper replied that the overarching change was that the bill would eliminate the concept of cashable tax credits for losses. He believed the reason the legislation had been introduced to deal with the long-term liability of cash credits. Beyond that issue, the bill changed the tax rate and per barrel credit in a way that would raise revenue during a certain range of prices. The third most substantial change was the increased transparency that would result from the bill - much more information would be made public so that policy makers and the public would know what was going on at a particular oil patch. He stated many of the provisions would be pushing up against the limits of taxpayer confidentiality.

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Representative Wilson referred to the state's current cashable tax credit liability. She asked for clarification on how many credits the state would be liable for that had not been included in the appropriation vetoed by the governor the previous year.

Mr. Alper answered that the pool of January 1, 2017 credits was about \$500 million and was an important number to have because the regulations had changed with the passage of HB 247. The next \$500 million appropriated would pay off those credits in pro rata share. He continued that if the current legislature appropriated \$74 million (the number in the House's version of the operating budget), roughly 15 percent of the January 1 liability would be paid off. He furthered that if \$400 million was appropriated, companies would receive \$0.80 on the dollar. The issuance of an additional \$500 million in credits was anticipated during 2017. By the time the bill's effective date was reached the liability would be about \$1 billion.

Representative Wilson referred to a tax rate change on higher revenue. She asked if the change occurred at oil prices between \$60 to \$85 per barrel. She asked about the higher revenue range.

Mr. Alper addressed the change in the current bill from the status quo. He stated that under the CS, increased revenue would occur from the crossover point from the minimum tax at around \$50 to \$55 per barrel up to around \$90 to \$100 per barrel.

Co-Chair Seaton remarked there had been a statement made earlier that the CS would eliminate the competitive review board. He clarified that the bill did not remove the competitive review board.

Mr. Alper answered that there was an amendment to the competitiveness review board sections to conform with the elimination of the 30 percent GVR. He confirmed that the competitiveness review board would remain in place in law.

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Co-Chair Seaton asked Mr. Alper to address cashable credits and efforts to eliminate them. He asked for detail about the components needed due to the elimination of cashable credits, such as carried forward NOLs and the ring fence provision.

Mr. Alper responded that the bill would eliminate cashable credits. He explained that companies would hold onto the value for use against future taxes. He stated that without any further change, the action would preserve the existing distortion between the nominal 35 percent tax rate and the tax rate companies actually paid. He continued that the bill's change to the 25 percent tax rate had been designed to clean up the discrepancy. Although it was not a mandatory change to get out of the cash credits business, it resolved the remaining factor. He detailed that a possible leakage of credits was created. There were multiple ways to deal with the problem. He provided a scenario where a company spent \$1 billion and subsequently decided the project was a failure. He questioned how the company would reclaim value for the loss. The dry hole credit, which had been in a previous version of HB 111, was one way to address the problem. He explained that if the state was not cashing out credits, the company could potentially sell its investment for \$0.05 on the dollar, but the company purchasing the investment could potentially use the carried forward credits to offset profits on another one of its fields. He explained that the ability for the situation to occur was way outside the intent of

the law, but it would be viable if the ring fence was not included in the CS.

Mr. Alper continued that there were other options to address the problem. He did not personally have a strong preference about the option selected, but he emphasized that the issue was a problem and something needed to be done to prevent the leakage of value from field to field to protect the state's long-term interest. The state did not want the taxes from major producers to be lost because of another company's failed project in another part of the North Slope. He stated that the pieces were interlinked - when one problem was solved, the next problem became more visible. How far the committee wanted to go was the decision of the committee. He agreed with Representative Wilson's earlier observation that the bill made a substantial change to the underlying tax system. He questioned whether it was worth solving numerous problems at the same time while making changes to the tax statutes or if the legislature only wanted to solve the one largest problem, while leaving other problems for a later year. He stated that the question ultimately became the choice of the legislature.

Co-Chair Seaton referred to the ring fencing and other aspects of the bill. He had foreseen that there would be less push to develop a field if NOLs could be transferred when a field was under development was purchased and used by another company for another location. He provided a scenario where a project's internal rate of return was not sufficient for one company to pursue, but it could be profitable.

[Note: power outage caused computer shutdown.]

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Co-Chair Seaton spoke to the state's goal of trying to push fields into production by offering credits, cashable credits, and other incentives. He reiterated his concern that switching from credits to carry forward losses could mean a company could sell [a field] and make its NOLs available for the purchasing company to use against another

property - it may be more advantageous to the purchasing company than moving into production on the field. He asked if there were alternatives to ring fencing that would encourage projects to move forward into production.

Mr. Alper replied that if a company was stuck with not getting value back until a project moved into production, perhaps on the margins a company may be incentivized to push forward even if the rates of return were not stellar. He considered that if the carry forwards were sellable to a company working someplace else it may create an incentive to never bring a field into production. The counter argument would be that the state was creating something of less value because they were shackling a company to a lease. He surmised that it may be true, but it may be a good idea. The idea was that if the state was going to provide a benefit, it should not be provided until the state knew it was going towards producing oil in the location the benefit was being received. He did not know all the ways to accomplish the goal; there were many sophisticated and modern ways to incentivize new oil, but Alaska was not a production sharing, contract jurisdiction - it was not doing a full field ring fence. The ring fence was a relatively mild version of a separation from field to field, but it would force a company to get a field into production if they wanted to get their value back.

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Representative Wilson referred to the DOR fall revenue forecast and the increase in oil production that had occurred since the passage of SB 21. She believed everyone understood there were issues with the cashable credits because the state had not paid them on time like it was supposed to. She remarked that the state now owed a debt. She believed it appeared the "sweet spot" had been located given the increased oil production. She thought it made sense to take care of the major problem - the cashable credits - before making any more changes that could cause production to decrease again by around 3 percent annually. She believed it was the first time in a long time where production had increased.

Mr. Alper was not advocating for any bill or what needed to be included. He observed that getting out of the cashable credit business appeared to be a near consensus priority.

At that point it came down to how to implement the change - there were certain questions that arose, such as what happened to carry forwards, who could use them, whether they were transferable, and what they should be valued at. There were pro and con policy reasons for many of the questions. He referred to the progressivity in the tax code that created lower effective tax rates than statutory tax rates so carry forwards were worth 35 percent when the tax was less. He stated that the questions did not need to get resolved at present, but they could be. He did not know whether the items would damage the state's standing as a competitive entity versus some other change. He understood the concern and agreed it was an important debate to have. He continued that once the one problem was solved, the next problem was evident. The question was whether to address the next problem at present or save it until later. He reasoned that if the problem was saved until later the state would get accused of changing oil taxes eight times instead of seven times.

Representative Wilson countered that the current system was working. She remarked that someone may disagree with her statement. She noted that DOR compiled the revenue book and assumed it was honest in its depiction of the increase in oil production. She elaborated it was about 100,000 barrels off compared to actual production. She stated it was a fact that there was more oil currently coming down the pipeline. She underscored there had been substantial concern about a decrease in oil production when SB 21 was implemented. She believed everyone could agree on the goal of increased oil production. She referred to the current issue that needed solving. She acknowledged there may or may not be other problems. However, she stressed that oil was the number one income provider to the state. She supported taking care of the one issue. She agreed that the legislature may have to consider the tax system again anyway because the bill may result in a 3 percent decrease in production. She asked if the scenario was a possibility.

Mr. Alper replied that he did not want to downplay the importance of the increase in production. He stated it was important to recognize that when the debate had started over PPT (11 years earlier), production had been about 800,000 barrels per day and there had been a steady decline since that time. He furthered that a couple of new fields had come online. Additionally, there were some smaller new fields actively under development that could hopefully

offset the natural decline of the other fields. There were also the bigger discoveries such as Conoco's Royale, Armstrong's Pikka, and Caelus's Smith Bay. The bigger discoveries would be the ones to reverse the direction of the North Slope. He explained that if the state were to continue to pay 75 percent of companies' costs it could probably guarantee a lot of that production, but the state would not be receiving any value for it. He recognized that production was essential, but the state also needed to receive revenue. He remarked that it was not merely a jobs program - the state required revenue to operate. The balance was to produce revenue for the state and not drive producers away. The goal was to ensure that what the state spent on the industry was in line with the benefit it hoped to receive at the back end. He did not know whether there was a specific sweet spot and whether it existed at present. He reasoned that if the cost of the flattening was billions of dollars of future liability, a correction probably needed to occur. He did not have sufficient detail to conclude for certain. He noted that everyone had a different opinion.

Representative Wilson agreed that everyone had an opinion on what should or should not be done; however, she emphasized that production was up at present and changes made by the legislature in the next several weeks could change that. She believed it was important to include in the discussion. She wanted the public to understand there was a way to take care of the cashable credits, while keeping SB 21 intact, and to keep development moving in an upward direction. She opined that if changes (other than the elimination of the cashable credits) were made in the legislation, some projects may not come online. She did not want to lose sight of how much the state had gained. She did not want to get greedy - the state received revenue from production tax and royalties that went into the Permanent Fund.

Mr. Alper responded that the status quo was unsustainable, which he believed everyone accepted. It was important to recognize that companies working in Alaska also knew that the status quo was unsustainable. He furthered that the companies the state hoped would move forward and produce large fields knew that the 35 percent and higher cash credits were not viable [for the state]. He stressed that the companies needed to know what the system would be to make investments in good conscience. He stated that the

companies could not invest under the belief that the status quo would be in place for the next 10 years, because it would not be; the state could not afford it. He recommended settling on a decision for companies to make their decisions.

Representative Wilson thought companies would appreciate it because the state had yet to be able to settle on a decision.

Vice-Chair Gara asked for DOR to come prepared the following day to address the issue of fields that had come online since the passage of SB 21. He remarked that legislators had differing opinions about when the investment had begun. He was interested in the Point Thomson and CD5 fields specifically. He believed the commitments on the two fields had occurred prior to SB 21.

Mr. Alper answered that CD5 had been in the works for a long time; there had been some delays related to federal permitting. The Point Thomson settlement had been in 2012. He elaborated that producers that know the issue well had testified to the committee that they had made commitments to the projects since the passage of SB 21. He remarked that it was hard to say - the internal process of all companies was different and took multiple years. He believed companies had been hoping for a tax reduction package and once it happened they wanted to show their satisfaction. He stated there was no way to determine absolutely "what is because of something else." He hoped to be only a spectator during the meeting the following day.

Representative Pruitt asked if Mr. Ruggiero would be available to testify the following day.

Co-Chair Foster replied that staff had contacted Mr. Ruggiero who had replied that he was not prepared to testify.

[Note: power outage caused computer shutdown. The meeting recessed until the following day at 1:00 p.m.]

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

Co-Chair Foster relayed the meeting would recess until the following day when the committee would hear amendments to HB 111 [see April 8, 2017 1:00 p.m. minutes for detail].

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