

HOUSE FINANCE COMMITTEE

April 8, 2017

1:59 p.m.

1:59:35 PM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:59 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

Ken Alper, Director, Tax Division, Department of Revenue;
Representative Charisse Millet; Representative Chris Birch;
Representative Dan Saddler, Representative Colleen
Sullivan-Leonard; Representative DeLana Johnson;
Representative Gary Knopp; Representative Gary Knopp;
Representative Dave Talerico; Representative Jennifer
Johnston; Representative George Rauscher; Representative
Louise Stutes; Representative Lora Reinbold; Representative
David Eastman; Representative Dean Westlake; Representative
Mike Chenault.

PRESENT VIA TELECONFERENCE

Susie Shutts, Legislative Legal Services, Juneau; Rich
Ruggiero, Consultant, Castle Gap, Houston, TX.

SUMMARY

HB 111 OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

CASHB 111 (FIN) was REPORTED OUT of committee with 4 "do pass" recommendations, 4 "do not pass" recommendations, 2 "no recommendation" recommendations, 1 "amend" recommendation, and with a new fiscal impact note by the Department of Revenue.

SB 26 APPROP LIMIT & PER FUND:DIVIDEND;EARNINGS

CSSB 26 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the agenda for the day.

#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."

2:00:29 PM

Representative Pruitt informed the committee that the consultant [Rich Ruggiero, Consultant, Castle Gap Advisors, LLC;] was available to answer questions during the meeting.

Vice-Chair Gara commented that the consultant had been available since mid-March for every member to contact at any time. He voiced that he had never been given the same courtesy in the past as a longtime member of the committee. He noted that the committee had previously held 8 hearings on the bill starting on March 20, 2017 and Mr. Ruggiero was available a week prior to the stated date.

Co-Chair Foster relayed a list of legislators in the audience. [See above under "Also Present"]

Representative Wilson appreciated the expert testimony for prior meetings. She was not looking to slow the bill down but felt that the bill had changed dramatically and wanted additional clarification.

[2:05:24 PM](#)

Co-Chair Foster commented that he intended to discuss the two amendments and then proceed to questions for the consultant.

Representative Pruitt appreciated the accommodation. He noted that the Legislative Budget and Audit Committee (LBA) approved his request for Mr. Ruggiero to consult with the committee during the meeting.

^AMENDMENTS

[2:07:21 PM](#)

Co-Chair Seaton MOVED to ADOPT Amendment 1.

1 Page 31, lines 5 - 28:
2 Delete all material and insert:
3 "{2) AS 43.55.011{g){3), the monthly production
tax value of oil
4 taxable under AS 43.55.011{e) produced by a
producer during a month
5 CA) from leases or properties in the state that
include land
6 north of 68 degrees North latitude is the gross
value at the point of
7 production of that oil, less 1/12 the producer's
lease expenditures under
8 AS 43.55.165 for the calendar year incurred to
emlore for, develop, or
9 produce oil and gas deposits located in the state
north of 68 degrees North
10 latitude or located in leases or properties in
the state that include land
11 north of 68 degrees North latitude, as adjusted
under AS 43.55.170;
12 CB> in a calendar year that is before or during
the last
13 calendar year under AS 43.55.024(b) for which the
producer could take a
14 tax credit under AS 43.55.024Cal. from leases or
properties in the state
15 outside the Cook Inlet sedimentary basin, no part
of which is north of 68
16 degrees North latitude, other than leases or
properties subject to

17 AS 43.55.011Cpl. is the gross value at the point
of production of that oil,
18 less 1/12 the producer's lease expenditures under
AS 43.55.165 for the
19 calendar year incurred to explore for, develop,
or produce oil and gas
20 deposits located in the state outside the Cook
Inlet sedimentary basin and
21 south of 68 degrees North latitude, other than
oil and gas deposits located
22 in a lease or property that includes land north
of 68 degrees North latitude
23 or that is subject to AS 43.55.011Cpl or, before
January 1, 2027, from

1 which commercial production has not
begun. as adjusted under
2 AS 43.55.170;
3 CC) from leases or properties subject to AS
43.55.011(p) is
4 the gross value at the point of production of
that oil, less 1/12 the
5 producer's lease expenditures under AS 43.55.165
for the calendar year
6 incurred to explore for develop or produce oil
and gas deposits located in
7 leases or properties subject to AS 43.55.011Cp)
or, before January 1, 2027,
8 located in leases or properties in the state
outside the Cook Inlet
9 sedimentary basin, no part of which is north of
68 degrees North latitude
10 from which commercial production has not begun,
as adjusted under
11 AS 43.55.170;
12 (D) from leases or properties in the state no
part of which is
13 north of 68 degrees North latitude, other than
leases or properties subject
14 to CB) or CC) of this paragraph is the gross
value at the point of?
15 production of that oil less 1/12 the producer's
lease expenditures under
16 AS 43.55.165 for the calendar year incurred to
explore for, develop, or
17 produce oil and gas deposits located in the state
south of 68 degrees North

18 latitude, other than oil and gas deposits located
19 in a lease or property in
20 the state that includes land north of 68 degrees
21 North latitude, and
22 excluding lease expenditures that are deductible
23 under (B) or (C) of this
24 paragraph or would be deductible under CB> or CC)
25 of this paragraph if
26 not prohibited by (bl of this section, as
27 adjusted under AS 43.55.170; a
28 separate monthly production tax value shall be
29 calculated for
30 (i) oil produced from each lease or property in
31 the
32 Cook Inlet sedimentary basin;
33 (ii) oil produced from each lease or property
34 outside
35 the Cook Inlet sedimentary basin, no part of
36 which is north of 68
37 degrees North latitude, other than leases or
38 properties subject to
39 CQ of this paragraph [(3) OF THIS SUBSECTION]."

Representative Wilson OBJECTED.

Co-Chair Seaton spoke to the technical amendment. He indicated that the original bill mistakenly omitted AS 43.22.160 (h) (2) in section 25 of the bill. He explained that under current law, oil and gas were taxed separately after 2022, but lease expenditures for both oil and gas were able to be deducted against the tax on oil. The amendment ensured that the deduction continued by adding back the language regarding the expenditures for gas in the calculation of production tax value, which matched the language in current statute.

Representative Pruitt thought the amendment was more than a technical amendment. He wanted verification.

[2:09:18 PM](#)

AT EASE

[2:11:56 PM](#)

RECONVENED

[2:12:27 PM](#)

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, wanted the committee to understand what would happen in 2022. He noted that the provision was part of the AKLNG legislation that passed in 2014 [SB 138 (Gas Pipeline; AGDC; Oil & Gas Prod. Tax) [Chapter 14 SLA 14 - Enacted 05/08/2014]]. He indicated that in 2022 the state transitioned to a gross gas tax. The tax was part of the state accepting payment in kind for gas in lieu of taxes and royalties for the state's share of throughput into the pipeline that the state partially owned. He furthered that a lot of technical and conforming language was necessary in statute beginning in 2022. In January 1, 2022, the net tax was only on oil but the expenses from oil and gas were subtracted from the tax on oil. The amendment amended the section to describe the tax calculation, not only for the base 25 percent tax but also on the new 15 percent surcharge on the amount of profits above \$60 per barrel. The Committee Substitute (CS) did not delineate that both the oil and gas expenditures were counted against the oil value for calculating the tax. He revealed that the Department of Law (DOL) attorney, Mary Gramling, discovered the oversight and brought the issue to Co-Chair Seaton's attention. The amendment language was written by a Legislative Legal Services attorney, which he agreed, was in accordance with the bill's intent. The amendment included language regarding how the amendment affected the Middle Earth tax cap and Cook Inlet, which he felt was irrelevant. He detailed that the relevant change was in subsection (a) that stated oil and gas expenditures were counted against oil value.

[2:15:01 PM](#)

Representative Pruitt reiterated his question regarding whether the amendment "truly" was technical in nature.

SUSIE SHUTTS, LEGISLATIVE LEGAL SERVICES, JUNEAU (via teleconference), introduced herself. She provided a brief overview of AS.43.55.160. The statute determined the production tax value of oil and gas that was broken down in subsection (a) as follows: "for oil and gas produced before January 1, 2022" and in subsection (H), "for oil after 2022." She elucidated that subsection (h) paragraph 1, dealt with the production tax value for the purposes of subsection (e) and paragraph 2, dealt with the production tax value calculations for the purposes of subsection (g) which was the new subsection added to AS 43.55.01 (g) (3),

for the additional surcharge tax calculated at certain price points. She relayed that the changes in the amendment added oil and gas lease expenditures and broke down the calculation to the same that existed in AS 43.55.160 (h) and would be under subsection (h) (1) in an amended bill.

[2:17:35 PM](#)

Representative Pruitt asked why the provision was missed in the initial CS version. Ms. Shutts responded that the production tax value could be calculated differently for the purposes of (g) versus (e). She indicated that the amendment calculated the production tax for the purposes of (g) the same as for (e); the break down was the same and the lease expenditures for oil and gas was deducted. The calculations could be done several different ways, but the amendment specified the break down and the same type of lease expenditure deducted in the calculation of production tax value. Representative Pruitt asked whether the amendment was a substantial change in policy. He surmised that the "ability to break down and separate the two [oil and gas] was hampered because the gas was being pumped back into the ground." The ability to write off anything related to gas was limited. He asked whether his understanding of the amendment was correct. Ms. Shutts encouraged him to direct his policy question to the sponsor of the amendment in terms of intent. She offered that the amendment change was in line with paragraph 1, subsection (m). The decision was whether the committee wanted to deviate from the existing statute for the purposes of the calculation under subsection (g).

Vice-Chair Gara explained the purpose of the amendment. He recounted that the legislature had made a policy call to encourage a future gas pipeline by allowing certain gas expenses to be deducted from oil taxes. He indicated that one provision in the current CS failed to include the word "gas" which created uncertainty over whether the previous policy was included in the CS. He noted that the policy was not wholly embraced and might be debated again in a future legislature. However, Amendment 1 maintained the policy that future gas expenses were an allowable deduction from oil production taxes. Mr. Alper clarified that in current statute, oil and gas were taxed together establishing a single tax on the North Slope. Beginning in 2022, by existing law, gas tax changed to a gross tax. He drew the committee's attention to page 29 of the CS, subsection (h)

[AS 43.55.160 (h)] line 16, relating to oil produced after January 1, 2022, and the words, "oil produced." He noted that the words were changed from "oil and gas" in subsection (a) of the previous CS. He pointed to line 24 that referred to the costs to produce oil and gas deposits, and commented the calculation against oil revenues applied in 2022 according to a provision adopted by the 28th legislature in 2014. He referred to page 31, subsection ii [line 1] and reported that the language contained the same structure for calculating taxable value for the purposes of the new 15 percent progressivity bracket. He cited the language, "applicable to the oil" on lines 12 and 20 [page 31], and pointed out that the references to gas were missing and brought it to the Co-Chair's attention. He restated that when correcting the bill, the drafters went further and applied the changes to Middle Earth and Cook Inlet in subsections (b), (c), and (d). He emphasized that the main concern was how oil and gas were taxed, which was specified on line 9 of the amendment. He opined that subsection (b) was most likely unnecessary because the Middle Earth credit had never been used. He furthered clarified that subsection (c) related to oil that was subject to the Middle Earth 4 percent gross tax cap through 2027 and subsection (d) referenced the Cook Inlet tax. He focused attention to subsection (a) that specifically addressed the relevant issue.

[2:24:13 PM](#)

Representative Pruitt asked whether the intent of the change meant that the new 15 percent tax would remain the same beyond 2022. Mr. Alper answered in the affirmative. He explained that the 25 percent tax applied to the net; gas and oil costs were deducted. The amendment enabled subtraction of gas costs to the base tax. He maintained that the amendment was not merely a correction, but more of a policy amendment. He felt that the amendment kept the new tax policy beyond the 2022 timeframe and was a substantial change.

Representative Wilson MAINTAINED her OBJECTION.

A roll call vote was taken on the motion.

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

OPPOSED: Pruitt, Thompson, Tilton, Wilson.

The MOTION to ADOPT Amendment 1 PASSED (7/4).

Representative Wilson wondered whether her Amendment 2 "was on the right track."

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Representative Wilson commented that the CS was much different from the original proposal. She understood that it was very similar to Alaska's Clear and Equitable Share (ACES) when applied to the lower oil price ranges of \$55 to \$90 versus \$100. She asked for comments.

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RICH RUGGIERO, CONSULTANT, CASTLE GAP, HOUSTON, TX (via teleconference), commented that her question contained many questions. He deduced that the CS was not the same as ACES. The CS changed to a progressive net tax with a much different form of progressivity. He delineated that the progressivity was much more favorable to issues regarding marginal tax rates and only applied to dollars and volumes above a certain point, instead of being retroactive to all volumes and profits. He offered a high-level view regarding the bill. He discerned that Alaska had a very complex tax system and the complexity could be removed through a tax system that started taxing at a low rate and increased as the profitability increased versus the existing high base rate with per barrel credits, which was a form of negative progressivity. He had recommended an alternative structure and advised that members review the "compendium" of his former presentations. He advised utilizing "more than two levels" for a net progressive tax system. He indicated that the way the CS was crafted, heavy oil and Cook Inlet was not included but believed they should be included as a "multi-step net system" versus a two-step system. He recommended eliminating Middle Earth, Cook Inlet, North Slope, gas and heavy oil distinctions and utilize one tax system. In his tax scenario, the decisions focused on how much the legislature thought a fair tax rate was at low profitability and how high a tax should increase as profitability improved. He recounted previously discussing achieving two goals simultaneously: one was addressing the taxable credits issue and the other was to maintain oil throughput. He thought that the legislation solved some of the cashable credit issues by removing some of the state's financial burden. In terms of increasing the amount of oil

in the pipeline, he felt that at least one more progressivity step was necessary to account for the lower unit profitability in Cook Inlet and other areas to boil it down to one tax system. He judged that the more the tax system was combined into one simpler system the less other elements like oil versus gas expenses, state and federal land issues, etc. needed to be factored in separately.

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Representative Wilson provided a hypothetical example regarding non-transferrable credits between exploration companies and development companies. She expressed concern regarding the consequences of the bill being antithetical to the main goal of incentivizing more oil production. Mr. Ruggiero responded that the way to meet the goal of more oil in the pipeline was to ensure development lead to production. He heard concerns about companies merely using the credits as deductions against income; where companies purchased credits and did not develop fields. He concluded that the goal of increased production was not met in that scenario. He warned that allowing a third-party to purchase credits from an explorer needed a system that ensured the credits were used in the production of new oil and not current oil. Representative Wilson agreed and shared the concern. She asked about the provision that began to expire lease expenditures after 7 years. She asked whether that would deter developers that anticipated unforeseen project delays. Mr. Ruggiero answered that Representative Wilson raised a valid concern regarding the "forces outside a company's control" that can influence how quickly a project was completed. He was unclear whether the seven-year timeframe was adequate. He thought that data regarding companies' actual experiences should be accessed. He deduced that the amount of the total development costs that were spent until the time of the delay was encountered might need to be considered, but felt that most of the projects costs were not incurred until after the problem was solved and development ramped up. He favored a cutoff date because it forced the discovery into a production stage.

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Representative Wilson mentioned competitiveness. She wondered whether the bill made Alaska competitive. Mr. Ruggiero surmised that the provision to move from 50

percent NOLs (net operating losses) to 100 percent NOLs was beneficial because it allowed companies to recover costs and kept the state in a competitive position. He stated that the tax rates in the CS were less than many other countries' tax rates. He furthered that timing and minimizing the risk of cost recovery played an important role in investment. He indicated that the CS allowed for deductions as soon as revenues were realized, which kept Alaska in a "very good competitive position." He noted the necessity to factor in other elements of the tax system for a complete assessment of competitiveness. He provided an example by questioning when and how an NOL could be used in a scenario where a company did not incur enough revenue to cover current expenses and carry forwards. The NOLs could be reduced or eliminated, if current expenses were required to be deducted first. He counseled that allowing NOL deductions first provided a more beneficial outcome for the company. He advised that the "nuts and bolts" of how the tax worked determined the competitiveness of the system.

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Representative Pruitt asked whether the provisions in the CS was more complex or easier to administer than the current system. Mr. Ruggiero believed the system was moving in a more streamlined direction. Representative Pruitt recalled a chart from previous testimony that showed increases and decreases in tax systems over the last 10 years. He asked whether the CS included a tax increase and where the state fit in on the chart. Mr. Ruggiero believed he was referencing the "IHS" chart on fiscal regime changes that was plotted against the price of oil and had green boxes denoting more favorable fiscal terms by government and orange boxes for less favorable terms [found in Castle Gap Advisors presentation titled: "Petroleum Fiscal Design HB 111" March 23, 2017 slides 18 through 20 (copy on file).] He suspected that by simply looking at the tax rates payable over a range of taxes and expected unit profitability the CS increased taxes, but when looking at the overall package, he would have to examine the bill further to discover whether the effects were net positive or negative.

Co-Chair Foster recognized Representative David Eastman in the audience.

Representative Pruitt asked about the issue of ring fencing for a company currently producing on the North Slope.

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Mr. Ruggiero answered that ring fencing by project was prevalent worldwide. Secondly, he referred to AS 43.55.160 (a) (1) and reported that the tax system already included 7 different ring fencing options. How it impacted the traditional 3 legacy producers on the North Slope versus the new producers coming in required analysis of new projects versus the legacy production and the ability to write off expenses on new items against existing production. He defined that a ring fence moved the deduction out in time. The deduction was still allowed, and he viewed the effect as a time value loss that depended on the amount of time to determine whether it was a "major issue." Representative Pruitt commented that the committee had had two days to review the bill. He wondered whether the bill needed more time for review or whether two days was enough. Mr. Ruggiero opined that he would need more time but understood the legislative process.

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Representative Pruitt asked how Mr. Ruggiero viewed how the bill would impact North Slope investment. Mr. Ruggiero urged members to look at likely fields to come into production within the next 5 years. Alaska only had limited types of projects. He suggested obtaining data from the Department of Natural Resources (DNR) and producers to identify the projects and assess the tax system against the projects. He communicated that until the state analyzed projects likely to come online it was impossible to determine how taxes would affect new production. Representative Pruitt used the Armstrong Energy, LLC. and Repsol oil find as an example. He communicated that Repsol was an international company with investment dollars and Armstrong owned the leases but were not producers. He wondered how the CS affected such companies moving forward with production. Mr. Ruggiero indicated that every company used a set of criteria to determine where to invest and the best use its resources. He observed that a benefit for Alaska was that energy projects had a long life; industry tended to invest in new technology on long life fields to increase extraction. He reported that the benefits of switching from NOL credits to NOL carry-forwards for 7

years then reducing them 10 percent each year was currently unknown. He reiterated his belief that each project should be measured against the tax system to determine the impact on overall profitability and the timing for investment returns. He was unable to offer an opinion without performing calculations for each project. Representative Pruitt referenced information from Mr. Ruggiero's initial presentation [cited earlier in the meeting] regarding "long-term drivers and short-term drivers" that highlighted two things that helped to fill the pipeline: "more from legacy fields and new big North Slope fields developed" [slide 9]. He questioned whether the legislation would result in more production in the legacy fields. Mr. Ruggiero responded that the CS raised taxes which lowered the producer's share of revenue. He guessed that due to the lower profitability environment, companies would view the CS negatively.

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Representative Pruitt inquired whether the legislation was representative of a slight increase or a "substantial" increase in taxes, relative to the current price of oil. Mr. Ruggiero recounted that he had cautioned against using "averaged" data when raising taxes. He restated that the impact depended on the "overall profitability" of the specific field and its cost structure. He ascertained that the per-barrel credit was based on market price and the current tax was based on unit profitability. He discerned that in terms of averages, average field costs and a \$30 per-barrel cost structure; fields that were currently accruing 7 percent to 15 percent effective tax rates paid the base rate of 25 percent under the legislation. Representative Pruitt asked how Mr. Ruggiero viewed the legislation's effect on new investment in Alaska. He asked whether the tax would be a deterrent for new entrants. Mr. Ruggiero answered that "overall" many oil regimes attracted "significant investment" that enacted multiple changes to their fiscal systems. He qualified that the changes moved in the "right direction;" higher state take with higher oil prices and lower taxes at lower oil prices. He remarked that the unit costs were high, and the project lead time was long in Alaska along with other places in the world. A new entrant assessed the two factors against the risk of profitable investment returns. He perceived that Alaska was "still attractive to new entrants" because it allowed investment cost recovery as quickly as production and the

market price allowed. He stated that "players that would come to the Alaska North Slope were not players that were in it for the short-term." He added that short-term developers were not the type of companies the state would want on the North Slope. Representative Pruitt asked that in terms of stability, whether the structure in the CS was a concern for long-term entrants considering operating on the North Slope. Mr. Ruggiero felt that producers would view the legislation unfavorably, but producers understood the economic reality in the state and that it was not uncommon for heavily oil dependent regimes to engage in tax changes during fiscally challenging times.

[3:03:07 PM](#)

Vice-Chair Gara recalled Mr. Ruggiero's term "bracketed" when referring to the surcharge at \$60 in profits. He asked how the overall tax rate increases compared to the previous two profits based tax systems. Mr. Ruggiero compared the CS progressivity to the progressivity under Petroleum Production Tax (PPT) and ACES. He explained that under PPT and ACES "as the profit per barrel increased the tax rate increased and the tax rate was applied against the entire production tax value." He compared a bracketed tax to a wedding cake. The 25 percent was an overall base rate, but the next layer up was smaller; the 15 percent surcharge only applied above the \$60 price and unlike PPT and ACES was not applicable back to the first dollar of profit. Vice-Chair Gara asked whether a bracketed profits tax was more favorable to industry. Mr. Ruggiero replied that he would "no-brainer" choose the current CS versus ACES if his choice was the way brackets were handled under both systems. Vice-Chair Gara referred to "a law" that reduced the payment from industry if a company proved the reduction "made the field economic." He asked how a royalty relief statute calculated into the decision to invest. Mr. Ruggiero was not familiar with requests for relief in Alaska. He believed that the option was available for producers in Alaska. Vice-Chair Gara asked whether Mr. Ruggiero thought royalty relief was favorable for high cost fields. Mr. Ruggiero answered in the affirmative but recommended a much lower tax rate on "a first bracket," therefore, low profitability due to high costs garnered a lower tax. Vice-Chair Gara wished the CS addressed the low tax situation in Cook Inlet. He inquired whether Mr. Ruggiero had an opinion on the matter. Mr. Ruggiero responded that the amount of changes to the tax structure

was the committee's decision. He reiterated his recommendation to include more than two brackets in the CS.

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Representative Thompson asked whether the loss carry forwards and the ring fencing provisions combined discourage new independents and their ability to find investors. Mr. Ruggiero responded that what Alaska had in comparison was not different from other regimes. He voiced that one concern was that the ring fencing provided less options for cashing in or selling out and the costs remained with the project, which was the practice "across the world." Representative Thompson expressed some confusion about ring fencing. Mr. Ruggiero relayed from personal experience working in the United Kingdom with two different types of fields in the North Sea; one highly profitable and the other with high costs. The ability to "cross deduct one versus the other" was not available; therefore, one field paid high taxes while the other field covered the loss. He was aware of the situation prior to investing and did not view it negatively. He worked harder to increase production and made use of carry forward losses.

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Representative Tilton referred to Mr. Ruggiero statements regarding moving towards a simpler system. She asked whether the CS reflected his recommendations. Mr. Ruggiero responded that he had offered more recommendations that were not included. He voiced that in the end, he was not the decision maker. He noted that if changes outside of his recommendations were made he would offer further suggestions to avoid potential "pitfalls and unintended consequences" from the decisions. Representative Tilton mentioned prior discussions regarding increasing taxes at a lower per-barrel price point, which was the opposite compared to other regimes. She wanted to encourage competition and wondered how higher taxes at lower prices per-barrel helped Alaska. Mr. Ruggiero reiterated that the whole tax system required consideration and he used Norway as an example. He articulated that two of the big oil companies that operated in Alaska were major investors in Norway and every dollar of production tax value (PTV) was taxed at 78 percent by a combination of petroleum and corporate taxes. He observed that both companies were not

deterred from investing in Norway. Norway had extremely favorable terms for investment recovery. He believed that the favorable terms on investment returns was the reason investment occurred in high tax regimes. He cautioned against focusing on any one aspect and encouraged an evaluation of the tax as part of a whole package. Representative Tilton asked whether two days was enough time to assess how all the tax elements worked together. Mr. Ruggiero was uncertain about whether enough time was allotted and attributed the issue to "the workings of the legislature." He addressed her question regarding the interplay of the tax provisions. He believed that the bracketed tax, removing the per-barrel credits, and NOL provisions contained in the CS "fixed" many of the issues he had identified in the old system and the prior CS from the House Resources Committee version.

Vice-Chair Gara asked Mr. Ruggiero to elaborate on his comments concerning the improvements in the current CS. Mr. Ruggiero cited his assessment of NOLs in the document previously provided to the committee titled "Understanding the Impact of NOLs" dated March 29, 2017 (copy on file). He relayed that his analysis discovered that where a producer expected to recover costs through deductions and not paying tax during cost recovery, that the combination of per-barrel credits, Gross Value Reductions (GVR), floors etc. reduced NOLs to approximately 30 percent or 60 percent or an amount lower than their full value. He added that he could not model a situation where an NOL was above 80 percent of its value. He reasoned that the cause was due to the interaction with the per-barrel credits more than the minimum tax. He pointed out that through elimination of per-barrel credits (based on market price) and basing the tax on unit profitability, the focus of the taxation was on profitability. He stated that the NOLs offered more cost recovery and were more useful to the producers.

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Vice-Chair Gara remarked that in the House Resources Committee version the minimum tax was raised to 5 percent and the CS eliminated the increase on the gross tax. In addition, the House Resources CS eliminated the decreasing gross tax from zero to 4 percent and adjusted the tax to a minimum of 4 percent. The current CS reinstated the decreasing gross tax. He asked how Mr. Ruggiero viewed the changes. Mr. Ruggiero restated that an evaluation of the

impact on the entire tax system on different operators at different prices was preferable. He deemed that eliminating the 5 percent to 4 percent on the top grossing amount lowered taxes and the 25 percent tax at the first barrel of profitability represented an increase in taxes. The reinstatement of the decreasing tax was based on very low prices that were highly unlikely. He doubted that the tax had any effect at all; positive or negative.

Representative Wilson recounted that SB 21 was brought to a public vote. She remarked that since that taxation system went into effect oil production increased. She referenced Mr. Ruggiero's remarks from previous testimony that a more equitable way to deal with cashable credits was to add interest to NOLs to maintain their value. She asked whether her interpretation was correct. Mr. Ruggiero responded that he thought it would be fair to eliminate the ability to use an expense as a cashable credit and receive cash immediately. However, he favored some "uplift" with the expectation that expenses were recovered from production, in consideration of the time value of money between when the expenses occurred and when the costs were recovered. Representative Wilson asked Mr. Ruggiero if he was aware of any location in the world where a system appeared to work and was changed in a period of low profitability. Mr. Ruggiero referred to the IHS chart he previously discussed. He noted that many changes were instituted in many regimes. He emphasized that the scenario was not the first time an increase happened in a low-price environment by a government that heavily relied on oil revenue for its existence.

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Representative Wilson remarked that he had stated the legislation had many moving parts. She anticipated that the oil producers would "react" to the changes. She wondered whether the legislature should have a better understanding of how the bill worked to avoid revisiting the issue next year. Mr. Ruggiero restated that issue was the legislature's decision. He thought that small changes were easier to adopt; the consequences would be discovered by the actions of the producers. He voiced that major changes necessitated more time. Representative Wilson asked if he thought the CS was a major change or a moderate change. Mr. Ruggiero assessed that the changes in the CS were "very small or moderate." He recommended eliminating the 7

different categories of taxes currently in statute (AS 43.55.160), Middle Earth, Cook Inlet, and North Slope distinctions and employ a bracketed system with 4 to 5 brackets to simplify the tax system for all. The simplified system provided incentives to small new entities or high cost projects and appropriately taxed large companies and profitable projects. Representative Wilson opined that the simplified system would not incentivize more oil production in the state.

[3:29:04 PM](#)

Representative Wilson MOVED to ADOPT Amendment 2.

Page I, lines I- 9:

2 Delete all material and insert:

3 "An Act relating to the interest applicable to
4 delinquent oil and gas production
5 tax; relating to the net operating loss credit
6 against the oil and gas production tax;
7 relating to lease expenditures; and providing for
8 an effective date." "

6

7 Page I, line 11, through page 2, line 16:

8 Delete all material. 9

10 Page 2, line 17:

11 Delete "Sec. 3"

12 Insert "Section 1"

13

14 Renumber the following bill sections accordingly.

15

16 Page 3, line 12, through page 21, line 28:

17 Delete all material. 18

19 Renumber the following bill sections accordingly.

20

21 Page 22, line 29:

22 Delete "[OR (g)]"

23 Insert "or (g)"

2 Page 23, line 1, through page 27, line 24:

3 Delete all material. 4

5 Renumber the following bill sections accordingly.

6

7 Page 27, line 28:

8 Delete "(h) (1) [(h)]"

9 Insert "(h)"

10

11 Page 28, line 5:

12 Delete "(h) (1) (C) [(h) (3)]"
13 Insert "(h) (3)" 14
15 Page 28, line 15, through page 31, line 28:
16 Delete all material. 17
18 Renumber the following bill sections accordingly.
19
20 Page 32, lines 21 - 30:
21 Delete all material and insert:
22 "(3) lease expenditures, as adjusted under (m) of
this section, that
23 (A) met the requirements of AS 43.55.160(e) in
the year that
24 the lease expenditures were incurred;
25 (B) were deductible in the
immediately preceding 10
26 calendar years, not counting the year in which
the expenditure was
27 incurred;
28 (C) have not been deducted in the determination
of the
29 production tax value of oil and gas under AS
43.55.160(a) in a previous
30 calendar year;
31 (D) were not the basis of a credit under this
title; and
1 (E) were incurred to explore for, develop, or
produce an oil
2 or gas deposit located north of 68 degrees North
latitude."
3
4 Page 32, line 31, through page 33, line 10:
5 Delete all material and insert:
6 "* Sec. 5. AS 43.55.165 is amended by adding a
new subsection to read:
7 (m) A loss carried forward under (a) (3) of this
section shall increase in value
8 at a rate of 10 percent, compounded annually. An
increase in value under this
9 subsection begins to accrue on January 1 of the
calendar year immediately following
10 the calendar year in which the loss was
accrued and no longer accrues on
11 December 31 of the calendar year immediately
preceding the calendar year in which a
12 carried-forward annual loss is applied. The
increase in value accrued under this

13 subsection has no value except as applied in this
14 section. An increase in value may not
15 accrue
16 (I) for a partial calendar year;
17 (2) for more than 10 calendar years, consecutive
18 or nonconsecutive; or
19 (3) on a loss carried forward by a producer whose
20 average amount of
21 oil and gas produced a day and taxable under AS
22 43.55.011 (e) is more than 50,000
23 BTU equivalent barrels during the calendar year
24 that the loss was accrued." 20
25 Page 33, line 11, through page 38, line 4:
26 Delete all material and insert:
27 "* Sec. 6. The uncodified law of the State of
28 Alaska is amended by adding a new section to
29 read:
30 APPLICABILITY. (a) AS 43.55.023(b), as amended by
31 sec. 2 of this Act, applies to
32 lease expenditures incurred on or after the
33 effective date of sec. 2 of this Act.
34 (b) AS 43.55.165(a) (3) and 43.55.165(m), added
35 by secs. 4 and 5 of this Act, apply to
36 a lease expenditure incurred on or after the
37 effective date of secs. 4 and 5 of this Act." 29
38 Renumber the following bill sections accordingly.
39 Page 38, line 14:
40 Delete "Section 3"
41 Insert "Section 1" 4
42 Page 38, line 15:
43 Delete "Sections 3, 30, 36, and 37"
44 Insert "Sections 1, 7, and 8" 8
45 Page 38, line 17:
46 Delete "Section 26"
47 Insert "Section 4" 12
48 Page 38, line 19:
49 Delete "secs. 38 and 39"
50 Insert "secs. 9 and 10"

Co-Chair Seaton OBJECTED.

Representative Wilson explained the amendment. She remarked that the goal was to address the state's liability from cashable credits. She explained that the amendment deleted most of the bill, converted the cashable credits into NOLs that accrued interest to protect their initial value, and only applied to the smaller companies that currently

received the credits. In addition, the lease expenditures were extended to 10 years and would end without any decrease in value over time. She believed that the extension would address unanticipated project delays and would offer a tax benefit.

Co-Chair Seaton MAINTAINED his OBJECTION.

A roll call vote was taken on the motion.

IN FAVOR: Pruitt, Thompson, Tilton, Wilson.

OPPOSED: Grenn, Guttenberg, Kawasaki, Gara, Seaton, Foster.

The MOTION to adopt Amendment 2 FAILED (4/7).

Vice-Chair Gara reviewed the new Department of Revenue (DOR) fiscal note allocated to the Tax Division. He pointed to page 4 of the fiscal note analysis, which included a chart that reported the bill's revenue impact. He relayed that the impacts were \$20 million in FY 18, \$85 million in FY 19, \$90 million in FY 20, \$100 million in FY 21, \$145 million in FY 22, and \$190 million in FY 23. He noted that the increases were based on forecasted rising oil prices. He reported a capital cost of \$1.2 million.

[3:34:00 PM](#)

Representative Wilson remarked that DOR testified in prior testimony that the price of oil was not expected to increase soon. She wondered whether any other factors were taken into consideration when predicting the bill's revenue impact. Mr. Alper responded that the numbers built into the fiscal note were predicated on the Fall 2016 revenue forecast. The numbers reflected a situation where as the price of oil rose above \$50 to \$55 it initiated significant change in the use of the per-barrel credit. He delineated that the reason total revenue did not also change dramatically was due to the 4 percent minimum tax floor. A company only used a small portion of its per-barrel credit at \$50 to \$52 oil before the credit bumped against the floor, as the price increased more of the per-barrel credit was used before the minimum tax was reached. He noted that the amount of per-barrel credit offset on line 5, of the chart grew significantly larger as more use of the per-barrel credit was used to achieve the minimum tax floor. Representative Wilson asked whether the calculations

included volume. Mr. Alper replied in the affirmative. Representative Wilson asked whether the expected increase in oil production was based on the tax structure in SB 21. Mr. Alper responded that future oil production projections were based on "a number of things including what was known about company investments." He did not attribute the forecast to "any particular law." Representative Wilson queried whether Mr. Alper was suggesting that no matter how much a company was taxed its behavior remained the same. Mr. Alper responded that it was reasonable to say that significant changes to a tax system would change companies' behavior. Representative Wilson asked whether it was accurate to say that the state had not seen the amount of increased production in the last 14 years since the inception of SB 21. Mr. Alper reported that the production of oil increased last year over the year prior and was the first increase since 2001. He agreed that her statement was correct. Representative Wilson asked how Mr. Alper made the analogy considering the production increases because the state taxed companies fairly under SB 21. She asked what kind of response the state should expect under increased taxes. Mr. Alper responded that he thought it was a matter of opinion and speculation and he could not accurately answer the question. Representative Wilson disagreed with the fiscal note and commented that fiscal note information should be accurate.

Mr. Alper directed member's attention to the note included on page 4 of the fiscal note. He read the following:

Note: The fiscal impact of this proposal is an estimate based on the Fall 2016 revenue forecast. Estimates shown here are draft/preliminary data based on our interpretation of possible changes, and do not include any changes in company behavior as a result of the proposal. We reserve the right to make modifications to estimates for any forthcoming fiscal notes.

Mr. Alper shared that the department was not trying to interpret any changes in company behavior, investment, or production.

[3:40:36 PM](#)

Representative Guttenberg voiced the difficulty for Mr. Alper to speculate on activity that took place in

boardrooms full of local, national, and international corporations. He believed that it was DOR's job to present the best facts and not forecast based on assumptions that were impossible to predict. He stressed that "things that happened during the time SB 21 was in place did not mean they were the result of SB 21." Mr. Alper added that the fiscal note was mostly a "mathematical exercise" based on a model.

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Co-Chair Seaton MOVED to report CSHB 111 (FIN) out of Committee with individual recommendations and the accompanying fiscal note.

Representative Wilson OBJECTED.

Representative Wilson spoke to her objection and stated that "Alaskans would be the true losers." She spoke to job losses on the North Slope. She agreed that cashable credits were problematic. She suggested addressing the situation with adding interest to NOLs. She described provisions in the CS she felt were damaging to the state: the elimination of the utilization of cashable credits as collateral, and transferrable credits. She declared that the citizenry spoke when they voted for SB 21. She suggested that SB 21 was working, and more fields were coming online. She anticipated that company behaviors would likely change and continued to argue against the CS. She believed that the oil industry "paid the bills for the state" and was being penalized for making a profit. She believed that the bill would stop exploration and increase oil job losses. She believed that Alaska was owed a good portion of revenue for its resources, but the state received a lot of revenue from royalties and corporate taxes. She was thankful for the oil companies and predicted a loss in state revenues. She apologized to the oil companies for the legislation that she could not stop.

Representative Thompson compared the bill to his property tax at home. The bill was tripling the tax and negatively impacted production, jobs, and investment. He strongly opposed the bill.

Co-Chair Foster acknowledged Representative Chenault in the room.

[3:48:33 PM](#)

Vice-Chair Gara relayed that Mr. Ruggiero stated that Alaska was still attractive to new entrants under the bill. He elaborated that many fields paid no production tax to the state; the CS raised taxes above zero. He reported that as new production took the place of older field production, the state would have more and more fields in the future that had a zero percent production rate up to \$70 per-barrel for the first seven years of production. He thought the public was right in wanting to balance the public's interest and treat producers fairly. He thought zero was out of balance. He thought the public wanted to know that if they were being asked to "chip in," the oil companies were also expected to chip in. He noted that Conoco Phillips had made a profit in the previous year in Alaska at \$41 per-barrel, but lost revenue elsewhere in the world. He thought the tax was fair and was raised or lowered according to profits. He related that the bill established a "modest profits tax rate of 25 percent." He reported that if a field was not profitable, a company was not charged the 25 percent profit tax and only paid the 3 or 4 percent gross tax. He reminded the committee that under Alaska law, a royalty relief reduction was available under proven "uneconomic" circumstances. The relief offset the 3 or 4 percent gross tax by 7 to 13 percent in royalty reduction, which he believed was more generous and erased the gross tax. He mentioned three previous cases of royalty relief. He believed the bill balanced both the state's and industry's interest. He cited Mr. Ruggiero statement regarding the modest nature of the tax change. He characterized the bill as instituting a "modest profits tax." In addition, the bill offered NOLs and carry forwards on losses. He felt that the bill was fair and balanced.

[3:54:44 PM](#)

Representative Pruitt declared that he ascertained that the bill increased taxes. He reported that BP lost \$87 million and paid \$822 million in royalties and taxes over the last two years according to the Alaska Journal of Commerce. He highlighted how difficult it was to get royalty relief. He reported from the Petroleum News, December 2014 that only 8 cases were submitted to the Department of Natural Resources (DNR) for royalty relief since 1995, and only two resulted in royalty relief. He stated that royalty relief was not "prevalent." He read from BP talking points that called the

CS a "rig killer" for the North Slope legacy fields. He believed that the oil companies would reduce spending resulting in job loss and reduced throughput. In addition, lower property tax values were a possible "ancillary effect." He disagreed with increasing taxes when the industry was "struggling" and felt the action sent the wrong message to business. He acknowledged that cashable credits needed changing but thought the bill went too far. He spoke of people crying when he last campaigned going door to door and hearing from constituents who had lost their jobs because of the low oil price. He felt that current job losses were caused by the "inability of the legislature to control its own budget." He cautioned against supporting the legislation.

[3:59:53 PM](#)

Representative Kawasaki remarked that he did not want to see anyone cry. He relayed that BP had just published its annual report for 2016. The report noted that BP made \$115 million worldwide and \$85 million of the total was profit from Alaska. He did not believe the bill would decrease or cease production in the state. He would be voting in favor of the bill.

Co-Chair Foster acknowledged Representative Zach Fansler in the audience.

Co-Chair Seaton commented on the remarks regarding having to revisit the issue next session due to unintended consequences. He thought that if the CS was not adopted the legislature would have to deal with another oil tax bill next year. He believed that industry was aware that the current tax system was unworkable and was not designed for the low oil price environment. Solving the matter now ensured that a bill was not necessary next session. He offered that the tax was based on profits and was what the industry had wanted for many years. In response to industry testimony, the bill only applied to profitable fields and at over \$60 PTV per-barrel a 15 percent surcharge kicked in, but only on the amount over and above \$60. He added that the bill eliminated detrimental cash credits, but offered carry forward NOLs at 100 percent for 7 years. He reasoned that the 7-year limit incentivized production but offered time sensitivity for non-production. He noted that ring fencing on net operating losses primarily applied to new fields where companies were producing or exploring. The

NOL's were not transferrable for legacy fields that were operating and profitable and left new field undeveloped. He believed that transferring NOLs to offset profitable legacy field taxes as a way to increase oil production "made no sense". He maintained that ring fencing NOLs would "push" project development. He felt that the bill was balanced, and supported the legislation.

Representative Wilson MAINTAINED her OBJECTION.

A roll call vote was taken on the motion.

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

The MOTION to REPORT OUT CSHB 111 (FIN) PASSED (6/5).

CSHB 111 (FIN) was REPORTED OUT of committee with 4 "do pass" recommendations, 4 "do not pass" recommendations, 2 "no recommendation" recommendations, 1 "amend" recommendation, and with a new fiscal impact note by the Department of Revenue.

Co-Chair Foster reviewed the agenda for the following meeting.

Co-Chair Foster recessed the meeting to a Call of the Chair [Note: the meeting never reconvened].

ADJOURNMENT

4:07:04 PM

The meeting was adjourned at 4:07 p.m.