

HOUSE FINANCE COMMITTEE
FIRST SPECIAL SESSION
June 7, 2017
1:34 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Scott Kawasaki
Representative Jason Grenn

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Representative Andy Josephson; Representative Justin Parish; Representative Charisse Millett; Representative Chuck Kopp; Representative Dan Saddler; Representative Dave Talerico; Representative Ivy Spohnholz; Representative Sam Kito; Representative Geran Tarr.

SUMMARY

PRESENTATION: OIL & GAS TAX FISCAL OVERVIEW RELATED TO HB 111 (OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS): FISCAL IMPACT COMPARISON BY THE DEPARTMENT OF REVENUE

[NOTE: The following presentation contains content relating to HB 111. The bill was no longer in the House Finance Committee's possession.]

^PRESENTATION: OIL & GAS TAX FISCAL OVERVIEW RELATED TO HB 111: FISCAL IMPACT COMPARISON BY THE DEPARTMENT OF REVENUE

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#hb111

HOUSE BILL NO. 111

OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

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Co-Chair Foster reviewed the meeting agenda.

Representative Wilson noted it was unusual to hear a presentation related to a bill that had been reported out of the committee and was currently in conference committee.

Co-Chair Foster replied the intent was to let the public know about the differences in the bill.

Vice-Chair Gara thought it was important to correct any misapprehension legislators may have about the content of both bill versions.

Representative Wilson had no problem with receiving extra information. She wanted the public to understand any changes to the bill would occur in conference committee. She referred to back up in the committee's folder and remarked that the data was from the spring forecast. She requested updated information. She referenced Caelus Energy and asked whether the commissioner could address their concerns.

Co-Chair Foster underscored that the meeting was purely informational.

Co-Chair Seaton confirmed that no changes were being proposed in the committee, as those were the purpose of the conference committee. The meeting will help the legislature understand the parameters of the different bill versions. The committee would not be discussing any negotiations or

changes that would be addressed by the conference committee.

Co-Chair Foster added that the presentation consisted of 17 slides.

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Representative Pruitt noted that all of the committee members had dealt with the bill previously. He was concerned that conference committee had not yet met and the finance committee was having a discussion about the content of the conference committee. He added that no committee members were part of the conference committee.

Co-Chair Foster acknowledged Representatives Sam Kito, Andy Josephson, Justin Parish, Dave Talerico, Chuck Kopp, Charisse Millett, Ivy Spohnholz, and Dan Saddler in the audience.

Representative Guttenberg had been told the Senate had made considerable changes to HB 111, but he had not read that bill version. He hoped to gain a better understanding of the changes and believed the current meeting would be educational.

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Representative Wilson wanted to ensure the public realized that the legislators had voted to concur or not concur with the Senate's version. She believed the majority of the legislators had made sure they knew the facts about the bill before voting on the House floor.

Vice-Chair Gara agreed that the hope was all legislators had read the bill. However, he had learned that all legislators did not know about the reduction in oil tax or the added \$1.4 billion in credits in the Senate version.

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, clarified the presentation predated a recent compromise proposed by the governor. The department had been asked to do a comparison between the House and Senate versions of the legislation. The administration intended to avoid policy discussions, which were under the purview of the conference committee. The presentation would simply present the technical details of both bill versions.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, provided a PowerPoint presentation titled "New Sustainable Alaska Plan, Pulling Together to Build Our Future: HB 111 Oil and Gas Production Tax/Tax Credits Comparison of House and Senate Versions" dated June 2, 2017 (copy on file). He outlined that there were two sections of the presentation; one detailing the fiscal impacts and the second the differences between the two versions. He stated there were three main things to focus on when examining the changes in the legislation versions. The first change regarded the actual taxes paid to the state, the second the state's obligations to credit payments, and the third change was the concept of carried forward value. He provided a summary of fiscal impacts on slide 3 "Summary of Fiscal Impacts: Comparative Fiscal Note Analysis - Tax."

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Mr. Alper indicated the chart showed a side-by-side comparison of the House and Senate bill versions of HB 111. The bills were most different in how they treated revenue, primarily because the Senate version did not substantially modify the underlying SB 21 [oil and gas production tax, 28th Legislature] tax system, whereas the House version changed the base tax rate from 35 percent to 25 percent and eliminated the sliding scale credit. The graph showed forecasts for FY 19, FY 22, and FY 25, tied to assumptions from the spring revenue forecast on price and production. There were some small negative numbers shown related to the Senate bill, but he cautioned not to get too fixated on those numbers. He detailed that those represented the elimination of cash credits. He provided an example of a small oil project (Mustang) coming into production in 2022, under the Senate bill they would have a suite of carry forwards that would be used to offset taxes, and that would appear on the fiscal note as a small reduction in tax revenue for the state, however, it was more than counter matched on the state's outlay that was not paid out. The House numbers showed positive revenue which had to do with getting rid of the per barrel credit which brought everything to the 25 percent base tax rate. The effect tax rate below \$100 per barrel was below 25 percent once the sliding scale per barrel credit was accounted for.

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Mr. Alper turned to slide 4: "Summary of Fiscal Impacts: Effective Tax Rates - 'Legacy' Oil." The red line represented the status quo which was ACES, and also the Senate bill which did not change ACES. The line went up to 35 percent at the end, showing the effective tax rate at very high prices when the sliding scale went to zero. As the per barrel credit went from \$1 to \$8 to eight, the stair step of the effective tax rate steps down to around ten percent at the \$70 to \$80 per barrel price. At lower prices the minimum tax kicked in and the four percent floor would become a higher and higher percentage of profits, and the effective tax rate would get higher. The dotted red line represented the net operating loss (NOL) or carry forward loss rate of status quo. Regardless of the tax rate companies were paying, they received 35 percent benefit for losses with which to offset taxes. The per barrel credit was eliminated in the House bill. There was no dotted blue line, only the solid blue line. The effective tax rate remained 25 percent until the progressive tax feature of the House version for profits of greater than \$60 per barrel, or \$100 per barrel oil prices, were reached. The triangle-shaped area between the red and blue lines between \$50 and \$100 per barrel reflected the tax increase in the House version of the bill.

Vice-Chair Gara referred to the red line and asked whether it represented the percentage of profits paid by a company in production tax.

Mr. Alper replied in the affirmative.

Vice-Chair Gara stated that current prices were about \$50 per barrel, but below \$70 per barrel the state was only getting 4 percent tax because the profits tax rate was so low.

Mr. Alper answered in the affirmative. He detailed the actual tax calculation was two calculations in parallel. One was the 35 percent tax minus the per barrel credit (\$8 at low prices), if that number is less than gross value, then four percent of gross value was what was paid.

Vice-Chair Gara referred to mention of a 35 percent tax that would not be paid until oil reached \$160 per barrel, which had never been reached to date.

Mr. Alper answered in the affirmative, that the tax calculation was 35 percent, but was reduced by the per barrel credit that lead to an actual tax rate that was always less than 35 percent except at very high prices.

Vice-Chair Gara spoke to the revenue in taxes. He noted that the Senate version would reduce production tax revenue compared to current law by \$15 million by 2020. He asked for verification and a reason why this would be the case.

Mr. Alper replied that the small negative numbers in the Senate bill had to do with reclassifying of spending which would have been paid as credits. A small portion of that would be used by companies to offset their own taxes. The savings to the state of not paying out those credits in the Senate version was greater than the tax decrease, but it did show up as a small tax decrease.

Vice-Chair Gara stated this regarded legacy oil and the higher tax rates. He noted there was a lower tax rate for other fields. Under the Senate proposal, for the higher tax rate there is nothing beyond the 4 percent minimum on an average North Slope field until around \$72 per barrel.

Mr. Alper replied that the Senate version did not change the status quo. The current crossover between the minimum tax and the net profits tax was around \$73 per barrel.

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Representative Wilson thanked Representative Saddler for providing her with a question. She asked what the graph on slide 4 would look like if the companies were represented. Currently the companies kept less than what the state took. She wondered how much more of a profit the state would be taking.

Mr. Alper answered that it was important to remember that production tax was only one of four state tax mechanisms that the state received from oil companies. Currently companies would have to pay the state royalty, the production tax, corporate income tax, property tax, and the

federal corporate income tax. The company percentage tended to increase as the price went up. The government take was greater than 50 percent and certainly what the companies were keeping was less than half the profits.

Representative Wilson referred to slide 3 and asked which prices were referred to in 2019, 2022 or 2025.

Mr. Alper replied that he did not have precise numbers on hand; by order of magnitude the forecast for FY 19 was around \$55, FY 22 looked at prices of \$60 and FY 25 at \$70. He referred to the graph on slide 4 shows the maximum gap between the two versions. The tax increase embedded in the House version hit its maximum around the \$70 oil price.

Representative Wilson asked if they just discussed price, not volume forecasts.

Mr. Alper replied that the forecast volume decline was approximately four percent. Slow steady decline in production was predicted in the forecast. By 2025 it was in the low 400,000 barrel volume area. None of the proposed large projects were built into the forecast at present.

Representative Wilson noted the discussion had occurred in the past. She remarked that in the past two years they had not seen the 4 percent decrease, but an increase. She asked how the numbers on slide 3 would change if actuals were used for 2017.

Commissioner Hoffbeck answered that the average price for FY 17 was currently running about \$0.50 less per barrel than the forecast. It was expected the fiscal year would end up there. Production was currently 5,000 to 6,000 barrels per day above the forecast. However, currently they were seeing standard seasonal declining production. It was expected to be slightly higher than forecast, by around 3,000 to 5,000 barrel a day.

Representative Wilson asked whether production was around 544,000 barrels per day currently. Commissioner Hoffbeck answered it would be close to that figure in the current month.

Representative Wilson stated it was not 4 percent less than what they had. She understood using forecasts but felt

using specific numbers was helpful. She liked presentations to reflect both.

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Representative Ortiz referred to slide 4 and to the price drop to \$70 barrels followed by a slight increase with the hardening of the floor.

Mr. Alper replied it was the existence of a floor rather than its hardening or not.

Representative Ortiz asked if the tax floor was equally hardened by both versions of the bill.

Mr. Alper replied in the affirmative. The NOL credit would be eliminated; it would become simply carried forward losses. NOL credits can be used in certain circumstances to reduce tax payments below the minimum tax. They were earned one year and used in the following year. Due to the elimination, companies would be compelled to pay the minimum tax under either version of the bill that they would not under the status quo. Under either version of the bill, the floor would be hardened.

Representative Pruitt referred to slides 4 and 5 that addressed tax rates. He discussed a conversation about credits. He asked for verification that the only reason the slides were included were due to the House version of the bill. He clarified that the Senate version of the bill pertained to oil and gas credits, whereas the House version also related to taxes.

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Mr. Alper believed the statement was reasonable. He had referred to three types of impacts embedded in the bill: tax, credit, and carry-forward impacts. The tax impacts were concentrated in the House version of the bill. He would not go as far as to say the Senate version included no tax impacts. It included minor changes related to interest rates and hardening the floor. For the most part the presentation was to present contrasts to the status quo, which was the Senate version of the bill.

Vice-Chair Gara asked Commissioner Hoffbeck whether his projection was that prices would be slightly lower than

forecast. He asked whether he was saying there was a 4 percent decline.

Commissioner Hoffbeck clarified that he had not brought up the 4 percent. He elaborated that a 3 percent to 4 percent decline was embedded in the forecast, but May [2017], the most recent completed month, was currently three percent higher than the previous year. A downturn was about to begin. Additionally, a maintenance turnaround had not occurred the preceding year. There would most likely be one in the current year, which would mean substantially less production in the early months of the following fiscal year. Large fields, once they peaked, usually presented a fairly predictable decline. There was no assumption in the forecast that the fields had bottomed out. The fields would continue to decline.

Vice-Chair Gara observed that the blue line on slide 4 represented the House version of the bill. He asked for confirmation that the 25 percent tax rate was only on profits.

Mr. Alper replied that the 25 percent was on profits. He pointed to a hook on the graph at the end at the \$50 point. It indicated where the minimum tax would kick in. In the House bill the cross-over point between minimum tax and net tax moved from \$73 or \$74 to about \$50 per barrel. The state's 4 percent piece would still be there, but only at very low prices.

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Vice-Chair Gara stated that a number of legislators had agreed that in the former tax system, Alaska's Clear and Equitable Share (ACES), the 25 percent tax rate jumped quickly to a higher tax rate. He asked whether the House version stayed at 25 percent for the first \$50 or \$60 of profit. He asked how that compared to the current system.

Mr. Alper responded that the House bill had a 15 percent bracket of surtax above \$60 per barrel profit production tax value. The House and Senate bills were essentially revenue neutral to each other at high prices. The tax increase in the House version was concentrated on the lower price points, between \$50 and \$100 per barrel. The greatest impact was at \$70 or \$80 per barrel. ACES would appear below 25 percent. At lower prices, the effective tax rate

of ACES included 20 percent capital credit, so it would be represented by a diagonal curve from below 25 percent, crossing over the blue line to \$80 dollar range, then would go up above the blue line to show a higher effective tax rate at higher prices.

Co-Chair Seaton asked about the relative impact on revenue, [between the two bills] at \$73 per barrel, of the carry forward rate identical to the effective tax rate [in the House version], compared to the Senate version in which the carry forward rate is so much higher than the effective tax rate.

Mr. Alper replied that he would address the carry forwards in later slides. The House and Senate versions had different tax rates. When it came time to count them, the House version would have a lower value, which impacted the conversion of carry forwards to future tax value. He would address the issue in later slides.

Representative Wilson asked why the analysis began at \$50 per barrel prices rather than at zero, given that the bill came about due to low prices.

Mr. Alper replied that below break-even, or about \$40 per barrel, the effective tax rate became greater than 100 percent and the information became hard to graph once the vertical line went off the chart.

Representative Wilson asked whether there was a point at which companies did not pay anything.

Mr. Alper replied that a 4 percent minimum tax was the governing calculation at those lower prices. The larger companies could not get those if they produced more than 50,000 barrels per day. They would carry their NOLs forward. Companies could reduce their payments to zero with the use of credits in certain circumstances.

Representative Wilson stated that the biggest concern seemed to be the cashable credits.

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Mr. Alper agreed that cashable credits were still the primary focus of the legislation. The fact that the state owed a lot in obligations and was trying to avoid paying

for those credits into the future was one of the core reasons the bill was introduced.

Mr. Hoffbeck reiterated that they did not want to get into policy discussions. The presentation was aimed at laying out the details and differences of the two versions only.

Representative Wilson disagreed. She elaborated that it would be hard to compare without discussing policy in the two versions. She stated it would be hard to discuss the differences without addressing the current legislation as well as past legislation.

Representative Pruitt stated that it was a policy call, and did not see how discussion of policy could be avoided. He believed there were some things the governor wanted to see. He remarked that the governor had spoken out about policy in the days leading up to the present meeting. He asked if that influenced the conversation. He thought if the two bodies came to agreement but the governor was not in agreement, the whole process would have to start over. He asked whether the thoughts of the governor should be heard in the meeting.

Commissioner Hoffbeck respectfully disagreed with the statements. He clarified the policy issues would be addressed in conference committee and the straight layout of the nuts and bolts comparison of the legislation was the focus of the presentation.

Representative Pruitt agreed that the conference committee should be having the conversation.

Vice-Chair Gara wanted to clarify that his intention for the bill had been to get a fairer tax for the people of Alaska.

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Mr. Alper summarized that both versions of the bill were more or less revenue neutral at higher prices and moved to slide 5: "Summary of Fiscal Impacts: Effective Tax Rates - 'New' Oil." New oil was eligible for the gross value reduction (GVR). The red line showed status quo, not impacted by the Senate version. It showed the 35 percent tax as impacted by the GVR reduction and then further reduced by the flat tax credit of \$5. As there was no hard

floor on GVR oil, the tax rate was effectively zero below around \$70 per barrel. The tax rate never gets close to 35 percent as there was always the \$5 credit which did not decline to zero. The red dotted line was the carry forward rate for GVR oil. In status quo there was still the 35 percent benefit for losses or incremental spending. The House bill was the blue line. The House bill hardened the floor for GVR oil, which was not something in current law. The House bill hardened the floor to 3.2 percent, which is why it looked like a tax increase at the lower price points below \$70 per barrel. There were two different inflection points at \$90 and \$110, which have to do with keeping the \$5 barrel credit. The House bill eliminated sliding scale credit for old oil, did not remove \$5 credit on new oil, but did reduce the base tax from 35 percent to 25 percent. The combination resulted in a tax decrease on GVR oil, which is why the blue line is below the red line at higher prices and was above red line at lower price points. The effective tax rates are in fact decreased on GVR oil in the House bill at a variety of price points.

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Representative Wilson used Caelus as an example of new oil. She asked what the differences under the two versions could mean for producers of new oil.

Mr. Alper explained the basic principle of the GVR. He gave the example of a small field with \$100 million in gross value. If it were old oil, its profits would be taxed at 35 percent and it would receive the per barrel credit. Gross value reduction means that the first 20 percent is taken off the top, so rather than \$100 million, it would be taxed on \$80 million plus any subtractions from that. New oil was not held to the minimum tax, and could go to zero. The current legislation stated that there was time limit to receiving those benefits, sometime between three and seven years. The Senate version made no changes. In the House version, the floor was hardened. Beyond where minimum tax is a factor, there was the change in the tax rate from 35 percent to 25 percent, resulting in a tax cut which appeared on the graph as above and below the line.

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Representative Wilson spoke to an announcement from Caelus about production. She asked if the numbers changed for 2019 and 2022.

Mr. Alper answered the Caelus had announced that it would not be drilling the follow up project in Smith Bay. The company had drilled two wells and thought it would produce several billion dollars' worth of oil. The well that was intended for the following winter would not be drilled. No production from that field had been built into the ten-year forecast. Potential credits or tax offsets the company would earn as it would be deferring the project from 2018 to 2019, but no modifications in production were within the forecast.

Representative Wilson thought there were only a few companies currently moving forward in finding new oil. She asked whether what was happening in statute would impact current production.

Commissioner Hoffbeck stated that the department was not prepared to discuss Caelus's decision. Nothing had changed since the bill was before the committee early in the year.

Representative Wilson felt that things had changed. While she understood the commissioner was trying to keep policy out of the discussion, she felt that changes were being made to the voter initiative on SB 21.

Mr. Alper responded that both versions would be making changes to SB 21 that the voters voted for. It was reasonable to state that the House version made more significant changes, however both made changes to the original initiative SB 21. He wanted to make one comment about Caelus' announcement. He suggested that the bigger concern was the uncertainty rather than specific changes to policy.

Representative Wilson stated her concern that whatever was done in committee during the current meeting might impact future production.

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Representative Ortiz referred to slide 5 of the presentation. He wondered whether, if the price of oil

remained below \$70 per barrel, there would not be any effective tax in the Senate's version.

Mr. Alper responded in the affirmative. He added that it really meant that it remained status quo. The big change was that after several years, it changed back to legacy oil, so that benefit would not go on indefinitely.

Representative Ortiz asked if by several years he meant three years. Mr. Alper replied that he meant several as in between three and seven years, depending on the price of oil.

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Vice-Chair Gara asked if the Senate version and current law allowed for zero production taxes, as long as oil prices remained below \$70 per barrel, for seven years.

Mr. Alper did not believe Vice-Chair Gara had specified that he was referring to new GVR oil, but assuming that, the answer was yes.

Vice-Chair Gara asked if possible reserves in Arctic National Wildlife Refuge (ANWR) would be considered new oil under the Senate version, and were it to open, it too would present zero production tax for seven years.

Mr. Alper responded that he was correct. He added that anything that happened there in the future would automatically fall into the category of new oil.

Vice-Chair Gara wanted people to understand which fields would fall under the GVR field categories. He mentioned Ooguruk and Nikaitchuq as well as Point Thomson.

Mr. Alper responded that it was not a good idea to mention specific fields. He indicated that Point Thomson was a field that was created after 2011. They would benefit from the GVR statutes as well.

Vice-Chair Gara asked about the blue line that went to 3.25 percent minimum tax on new oil.

Mr. Alper responded that it was the 4 percent that could be reduced by 20 percent, to 3.2 percent.

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Vice-Chair Gara mentioned that Mr. Alper had heard a lot of questions about Caelus. It was his understanding that only two wells had been drilled there, not enough to know how much oil was producible or how much oil might be there.

Mr. Alper did not have very much expertise on the project. It was a good 100 miles from any infrastructure. If the project was as large as it seemed, it would be a large, expensive project that would employ a lot of people, but would not see production for some years.

Vice-Chair Gara thought it was an exaggeration to state there were 200,000 barrels per day. It was not even delineated enough to be an SEC [Securities and Exchange Commission] bookable reserve.

Commissioner Hoffbeck stated he would leave it up to Caelus to respond to questions about its field.

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Representative Pruitt asked what percentage of the total was new oil that fell under the rate on slide 5.

Mr. Alper answered that there was a table showing that information in the Revenue Sources Book. The table had changed dramatically after HB 247 [oil and gas tax legislation passed in 29th Legislature]. Currently 7 to 10 percent was eligible for GVR. The trend had been towards an increase, but now that production tended to fall off after three to seven years, the forecast showed a decrease of new oil qualifying as new by 2025. That could change if one of the large projects began producing. He could provide the chart to the committee.

Representative Pruitt mentioned being aware of a slight change in total price. He asked if it was estimated that there would be a tax increase based on the current estimate for any new oil, or 7 to 10 percent, for around six years.

Commissioner Hoffbeck responded that the only forecast that had changed was for the current year.

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Co-Chair Foster reminded the committee to stick to the presentation and to avoid policy discussions.

Mr. Alper continued to slide 6: "Summary of Fiscal Impacts: Comparative Fiscal Note Analysis - Budget":

- Because both bills effectively eliminate cash credits, they are very similar in the way they reduce the future demand for state spending
- The slight differences have to do mostly with the Senate also eliminating cash for Middle Earth credits
- The long term figure of \$150 million per year reflects the forecast assumption for credit cash demand
 - This number could be substantially higher if one or more large projects is sanctioned
 - In that case, either bill would have a much greater budget impact.

Mr. Alper stated that as the current credits were earned, they appeared as a budget item, as an expected demand on state appropriations. Both bills eliminated cash credits, so that future demand decreases at similar rates. The Senate version eliminated credits for Middle Earth while the House version retained them. The number was relatively small, around \$10 million. The long-term estimate was that about \$150 million worth of cash credits would be earned in future years. However, if a large project like Smith Bay were to move forward, that number would increase. If the state was getting out of the business of cash credits, that meant reducing the budget by \$150 million per year into the future. For the North Slope, both bills were eliminating cash credits for operating losses. Likewise, status quo had already eliminated cash credits for Cook Inlet in the bill that passed the legislature in the previous year [HB 247]. That left the difference between the two bills in the Middle Earth regime.

Vice-Chair Gara suggested that cash credits could be eliminated and replaced with a brand new credit that cost just as much money to the people of the State of Alaska. He asked for confirmation that \$150 million was the cost of cash credits in the estimate going forward, and that \$145 million per year with carry forward credits over the next ten years was what was proposed in the Senate version.

Mr. Alper replied that the next slide looked at the issue as alluding to the counting of the carry forward value, but the Senate bill was maintaining the same tax rate structure, the same idea of valuing spending in terms of its tax offset value. Whatever was not being paid in a credit was simply getting converted into a future offset against taxes. The numbers were, by their nature, going to be very similar. The number that appeared as a carry forward value in the Senate was very similar to the amount being offset in credits not being paid. It was a major difference because it concerned the time-value of money - the state would not be paying that or getting those offsets from taxes until some future year, as opposed to the present. Generally speaking, the state did not expect to see it until that company was paying taxes, meaning it will be an offset from taxes rather than a cash appropriation made by the legislature.

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Vice-Chair Gara queried whether the Senate bill would replace cash credits of \$1.5 billion with carry forward credits of \$1.45 billion over the next ten years. Mr. Alper replied in the affirmative.

Vice-Chair Gara stated that he personally considered the current cash credit system sort of a pig and saw the above-mentioned proposal as lipstick on a pig.

Mr. Alper advanced to slide 7: "Summary of Fiscal Impacts: Comparative Fiscal Note Analysis - Impact of Carried Forward Liability":

With the elimination of cash credits, an important variable is the future impact of carried forward losses

These are listed as a "tax equivalent," as they will be used to offset future taxes outside the fiscal note period

Tax Value of Carry-Forwards in Fiscal Year 2027

House is \$610 million; Senate is \$1,445 million

The difference is primarily driven by four factors:

1. Senate includes Middle Earth carry forwards (~\$60 million)

2. House requires using carry forward lease expenditures to zero PTV while still paying minimum tax (~\$60 million)
3. Tax value of carry forwards is 35% in Senate bill vs. 25% in House bill (~\$400 million)
4. House bill reduces value of carry forwards after 7 years (~\$300 million)

Mr. Alper stated the House version was still paying for Middle Earth, while the Senate version was not. The other issue had to do with how they were used. In the House version, a company could use \$100 million in carry forwards to reduce the profits to some small number and it would be the equivalent of paying the minimum tax; however, it would take \$200 million to bring the value to zero. The House version would state that companies could use the whole \$200 million to drive the value to zero but would they still pay the minimum tax which would result in a certain loss of carry forward credits. The Senate version stated specifically that the companies did not have to waste the credits and therefore got to save more to carry them forward to use against a future year. It made a small difference in the fiscal note, but could grow to a large number, of around \$60 million between the two bills, in the future. The big dollar differences had to do with the taxes themselves. He used an example about an oil company with \$1 billion in carry forward losses. In the Senate version, that was worth \$350 million as it reduced profits by \$1 billion. The House bill had a 25 percent calculation so the \$1 billion would be worth \$250 million, as they are multiplied by what the tax rate is.

Mr. Alper highlighted that the biggest difference between the two versions was that the Senate valued carry forwards at 35 percent, and the House at 25 percent. This element was worth about \$400 million difference between the two versions of the bill. The other large component related to an erosion of value. The Senate version says they can be used indefinitely. The House says the value gets reduced by 10 percent after seven years, which would sunset the value of carry forwards, while the Senate version says they can be held indefinitely. The House version says that if they cannot be used within seven years, they lose 10 percent in value per year starting in year eight. That was a cumulative reduction in value that begins to appear in some of the fiscal analysis in the House version, making \$300 million difference in the two bills. If one added \$60

million plus \$60 million plus \$400 million plus \$300 million, it gets close to the \$800 million total difference between the two versions.

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Vice-Chair Gara surmised that the House bill followed the normal process that other countries do for profits taxes in that deduction percentage is roughly the same as the tax percentage - 25 percent tax means a 25 percent deduction.

Mr. Alper did not want to opine on the word "normal." He stated House version tax rate was aligned with the value given to spending.

Vice-Chair Gara referred to chart seen in February, showing 13 percent profits tax rate at \$80 per barrel for North Slope oil. Under the Senate version, companies would pay a 13 percent profits tax rate but get a 35 percent deduction, or triple the effective tax paid.

Mr. Alper answered that the chart in the memo showed the same data set in the graph in slide 4. The effective tax rate 13 percent at \$80 oil, and the value of the losses was 35 percent, so what he was saying was correct.

Vice-Chair Gara asked whether the Senate version included a 9 percent tax rate at \$75 per barrel prices, and a 35 percent deduction, while the House version there was only a 25 percent tax rate and a 25 percent deduction.

Mr. Alper replied in the affirmative. He elaborated House bill did not have a gap between tax rate and deduction rate.

Representative Wilson referred to testimony by Rich Ruggiero [Castle Gap, legislative consultants] in which he stated that all regimes allowed companies to recover all of their costs.

Mr. Alper replied in the affirmative. It was fundamental tenet of a profits based system that companies get to deduct all expenses. The devil was in the details. There was a difference between the statutory tax rate of 35 percent and the effective tax rate due to the per barrel credit. Mr. Ruggiero had not really addressed this, but had spoken about 100 percent carry forward.

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Representative Wilson believed Mr. Ruggiero had made it pretty clear that a company should be allowed to put that money back into their activities. She found it hard to understand only considering the production tax, but not the other taxes involved.

Co-Chair Seaton requested to return to the topic at hand.

Representative Wilson clarified that she was not asking the presenters to respond on the other taxes she had mentioned. She wanted to ensure the public realized the production tax only represented a small portion of what the state received from companies.

Representative Pruitt referred to the term "carry forward." He asked for verification that carry forwards were a portion of the cost of doing business. He asked if any companies did not allow for the opportunity to recoup some portion of their costs.

2:55:10 PM

Mr. Alper answered that the carry forward was all of the spending that exceeds revenue, or the sum total of losses. In the current law, they were turning the losses into credits. The House and Senate bill versions had different tax rates, but both bills allowed for 100 percent carry forward use. The 100 percent carry forward was calculated at a different tax rate. The House version reduced the value of the carry forward after seven years. He agreed that it could lead to a circumstance where a company did not recoup 100 percent of the value in the future.

Co-Chair Seaton added that the carry forward was intended to be an incentive to bring a field into production in the nearer term rather than sitting on it for an extended period. The policy basis for that item was developed on the incentive to bring a field into production in order to receive the full value of carry forwards. He pointed out that if a company paid a 20 percent tax rate to the federal government and could write off expenses, it would get 20 percent utilization of that money. If it paid 35 percent tax rate it would get 35 percent utilization. The difference between the two bills was that one said a

company got 100 percent utilization at the effective tax rate. The other says the company got 35 percent regardless of the tax rate paid.

[2:58:07 PM](#)

Representative Pruitt referred to point 4 on slide 7. He asked if \$100 million is invested into a field, and the time value erodes, why would a company sit on it for seven years, then put it into production. It will erode on its own. It would not affect the state so much as the company's own shareholders. He queried whether the company should be determining their own timeframe if the money had been invested. There was no reason for the shareholder not to get a return sooner than later. He did not think point 4 brought things on early, only that the company could use all of the credit.

Co-Chair Seaton replied that the discussion could be had on policy outside the present meeting.

Vice-Chair Gara referred to a statement that a company should be entitled to sit on a field for as long as it determined. He disagreed with that as Exxon had sat on the Point Thomson field for 30 years and the field ended up being a zero percent tax field.

Representative Pruitt thought the statement was misleading. He clarified that Point Thomson did not sit on the field awaiting changes in policy, but changes had been made in the timeframe. It was also part of the leases, however they were not talking about leases. He stated once investment had been made and a loss was incurred, it was carried forward.

[3:01:57 PM](#)

Mr. Alper moved to slide 9: "Differences between House and Senate Credit Issues: Treatment of Carried Forward losses":

- Both bills eliminate the NOL credit for the North Slope and replace it with a structure of carried forward lease expenditures
- Both bills allow for 100% of carry-forward, without any "uplift" (interest)
- House bill has provision where carry-forward balances lose 10% of their value per year after

seven years

- Senate bill also eliminates the NOL credit for Middle Earth, and repeals the underlying NOL credit statute AS 43.55.023(b)

Mr. Alper explained that the black, blue, and red text on the next group of slides indicated items which were in both versions, the House version, and the Senate version, respectively.

[3:04:21 PM](#)

Mr. Alper advanced to slide 10: "Differences between House and Senate Credit Issues: Use of Carry Forward Losses: Ringfence Issues":

Ringfence Issue

- Both bills have no restriction if the producer does not have an overall loss in the year the costs are incurred; spending on a new project can offset current taxes
- House bill requires carry forwards to only be used to offset value from the property where originally incurred
- Senate bill allows carry forwards to be used off lease

Minimize Loss of Credits Issue

- House bill requires carry-forwards to be used to zero production tax value, while producer still pays minimum tax
- Senate bill allows taxpayer to use only as much as they want / need to protect use of per-barrel credits so that no carry forwards are "lost"

Mr. Alper stated that neither bill had any limitation if spending was done by a company that had other production in the state that it could be offset from, such as Conoco's Willow project. The difference was that Conoco could develop the field while still operating Kuparuk and own a substantial interest in Prudhoe Bay. Conoco could be spending profits in real time on the new field. If it did not put the company in a loss circumstance, no carry forward would be issued. The spending from the new field could offset profits from the new field. This was current law and neither version changed that in any way. The House bill put in the restriction that if a loss occurred, it

could only be used to offset production from that particular field. That could happen if the price of oil was low enough or spending was so high that it more than offset their profits. The loss would be tied to that field and would also impact the Armstrong project. The Senate language did not include the restriction. If a company had other production or sells a fraction of the project to another company and that company has projects in Alaska, the issue was establishing which controls were on the migration of the losses from the original project to offset some other currently producing field. He spoke to minimizing the loss of credits. The House version stated that the company had to use carry forwards to get to zero and there may still be the minimum production tax. The amount resulting in the 4 percent had no tax value to the company. The Senate version says the taxpayer can conserve carry forwards and only use what was needed to result in the minimum tax payment without losing any of the benefit they may have coming to them.

[3:08:03 PM](#)

Representative Guttenberg spoke to the carry forwards in the Senate bill which allowed them to be used "off lease." He asked how far off lease the carry forwards could be used.

Mr. Alper replied that this regarded a segment in the regulations, and they could be used anywhere on the North Slope.

Representative Guttenberg asked whether it could be used anywhere, for any purpose, as long as it was on the North Slope.

Mr. Alper answered that if a company was holding carry forwards from one field on the North Slope, they could be used to offset taxes on another field.

Representative Guttenberg asked if the audit requirements for both locations got looked at in the same way.

Mr. Alper was unsure what Representative Guttenberg meant by audit requirements. He detailed the value of the carry forward loss was established in the year in which it was accrued. It did pose the question of a lease expenditure accrued in 2018 and put against production in 2023. There

was not currently a statute of limitations and it would need to be looked at. There would be the same level of scrutiny on carry forwards as was currently on current year expenses.

[3:10:25 PM](#)

Representative Guttenberg asked whether, if a company was working on a lease and had a wellhead expenditure and took it off lease, it did not matter if there was work on a wellhead on an off-lease project but was the value of the credit that migrated.

Mr. Alper responded in the legislation there was not talk of credits. They were now known as lease expenditures. Subsequently, the definition was broadened to include prior year spending that had been carried forward. It did not matter what type of activity it was used for.

[3:11:36 PM](#)

Mr. Alper turned to slide 11: "Differences between House and Senate Credit Issues: Use of Carry Forward Losses: Middle Earth Issues." The term Middle Earth had been developed during the petroleum production tax (PPT) debates and referred to everything in Alaska that was not North Slope or Cook Inlet. There was a separate range of taxes for Middle Earth.

- House bill made no changes to existing Middle Earth credits (15% NOL; 10% Capital; 20% Well) plus the 40% Exploration credit (through 2021)
- Remaining credits remain eligible for cash refund
- Senate bill eliminates the 15% NOL credit for Middle Earth, in effect reducing state support from between 25%-55% to between 10%-40%
- Senate bill makes remaining Middle Earth credits ineligible for cash refund
- Senate bill allows ME Exploration Credits to offset the company's corporate income tax
 - o Provisional (unusable) certificates awarded at time of application in order to preserve place in line
 - o Seismic Exploration credits repealed in 2018

[3:15:51 PM](#)

Representative Guttenberg asked when the seismic exploration credits ended. He asked whether they were cut off in the middle of a project, or after the project ended. For example, if there was a two-year exploration program in 2017 and had to end the second part of project in 2018. He asked whether, once a program was approved for credits, it would be allowed to continue until it was done.

Mr. Alper answered that the sunset dates related to the date the work was done. Work had to be completed by the sunset date. In the current law for Middle Earth that was January 1, 2022. A 2021 program would be covered, but a 2022 program would not be. The Senate version of the bill meant it would occur in 2018. Any seismic work done before January 1, 2018, but anything beyond that date would not.

Representative Guttenberg thought it would be frustrating for numerous people working on a multi-year program.

Vice-Chair Gara thought the difference was small in terms of dollars. He asked what Middle Earth credits were expected to cost in the current and following fiscal years.

Mr. Alper answered the numbers were quite small, almost all regarded Middle Earth, and was estimated to be plus or minus \$10 million. The spending was not currently in the forecast.

Vice-Chair Gara referred to the fiscal note on the Senate version showing a cost of \$1.45 billion and asked whether it factored in the Middle Earth provision.

Mr. Alper answered that the second subtotal on the fiscal note tables called "total budget impact" shows the reduction in the state's anticipated appropriation. The Senate bill was slightly larger by \$5 million to \$10 million per year in the out years. The difference was that the Senate eliminated the Middle Earth credits but the House did not. That appears as a \$5 million to \$10 million gap between the two bills.

Vice-Chair Gara asked if the carry forward numbers factored in Middle Earth and the North Slope.

Mr. Alper pointed to slide 7 and the four points. The Senate version was taking credits the House would still be

paying cash for and turning them into carry forwards. The total across ten years was \$60 million.

Vice-Chair Gara spoke to the cost of the Senate version of \$1.444 million versus the House version of the bill \$610 million. He asked whether that included Middle Earth and North Slope.

[3:21:30 PM](#)

Mr. Alper answered that the number was all-inclusive across the entire state. The Senate figure includes Middle Earth. The figure did not appear in the House as it was not making changes to Middle Earth.

Mr. Alper discussed slide 12: "Differences between House and Senate Credit Issues: Purchasable Credits and Tax Credit Fund":

- Both bills retain ability to get cash for remaining "corporate income tax" (refinery, LNG storage) credits which will all be sunset by 2020
- House bill retains the tax credit fund structure, primarily due to the continuation of Middle Earth credits
- Senate bill repeals the tax credit fund once all outstanding credits are paid off, or in 2022, whichever is later

Mr. Alper elaborated the fund in AS 43.55.028 would cover the obligation of the state prior to the effective date of the bill. On the later date between January 1 after all credits are paid or January 1, 2022 [whichever is later], the Senate bill would repeal "the .028 fund section."

[3:23:57 PM](#)

Mr. Alper scrolled to slide 14: "Differences between House and Senate Tax Issues: Tax Rates and Production Credits":

- House bill reduces the base tax rate from 35% of Production Tax Value to 25%, and eliminates the \$0 to \$8 sliding scale per barrel credit
- House bill has a "surtax" of 15% of that portion of PTV greater than \$60

- Net effect is a tax increase of \$100 to \$300 million at oil prices between \$50 and \$100 with the greatest impact in the \$60-\$80 range. Revenue neutral at higher oil prices
- Senate bill retains all major SB21 features, so that it is essentially neutral from a revenue perspective

Mr. Alper detailed slide 15: "Differences between House and Senate Tax Issues: Minimum Tax 'Floor' and GVR 'New Oil'":

- Both bills retain the 4% "floor tax rate
- Both bills, by eliminating the North Slope NOL credit, effectively harden the floor against major producer losses
 - Only a material impact at oil prices of about \$40 or below
- House bill hardens the minimum tax for GVR-eligible "new" oil, preventing the \$5 per-barrel credit from being used below the floor.
 - House adds a modified 3.2% minimum tax for GVR, based on a 20% reduction below the base 4% tax rate
- House bill eliminates the 30% GVR for high royalty fields
- Senate bill makes no changes to either issue

Mr. Alper elaborated that there was another provision in existing state law specifying that if the land was all state leases with royalty of greater than 12.5 percent, then the company received an extra benefit of 10 percent. That provision was removed in the House version and all new oil would only get 20 percent GVR.

[3:27:31 PM](#)

Vice-Chair Gara referred to discussion about the GVR. He asked for verification that there was not a 30 percent reduction in the tax rate.

Mr. Alper responded it excluded 20 percent from the volume from taxation. The baseline is 20 percent or 30 percent lower and the same costs could be subtracted from it, so it tended to multiply the impacts. For a 20 percent GVR, the reduction in tax would be some number greater than 20 percent.

Vice-Chair Gara queried whether at very low prices the low floor was the same in both bills and in the status quo.

Mr. Alper answered that it got to 4 percent at an average annual price greater than \$25 per barrel. Should the price drop that much, there would eventually be one percent minimum tax, and zero at \$15 and less.

Co-Chair Seaton asked for an explanation of the difference between royalty and GVR.

Mr. Alper replied that GVR would eventually be subject to the 35 percent tax rate. A 20 percent GVR equated to a 7 percent reduction in gross tax rates. Twenty percent of the value is no longer subject to that 35 percent tax and 35 percent of 20 percent is 7. By adding an extra 10 percent gross reduction, it created a tax benefit that was the equivalent of an addition 3.5 percent of the gross, or 10.5 percent. In regards to how that related to high royalty structures, the typical state share was 1/8th or 16 2/3 percent, which was being targeted by the provision. By giving a 3.5 percent additional gross benefit, the 30 percent GVR clawed back a fairly substantial portion of the incremental royalty between 12.5 and the 16 2/3.

[3:31:51 PM](#)

Co-Chair Seaton asked whether the 10 percent additional for the high royalty fields was equivalent to a reduction of 3.5 percent royalty.

Mr. Alper responded in the affirmative and that a 16.6 becomes equivalent to 13.1 percent royalty.

Co-Chair Seaton spoke to sliding scales royalties that were bid terms. He asked whether the state could be giving up more of the royalty and going down below 12.5 percent royalty.

Mr. Alper responded that he had recently received a regulatory clarification and that any additional royalty payment for the net profit share would not count towards the greater than 12.5 percent and only the baseline would have to be greater than 12.5 percent to trigger the incremental feature.

Co-Chair Seaton asked whether that was also true for sliding scale royalty.

Mr. Alper was not prepared to answer the question. He suggested speaking with the Department of Natural Resources.

[3:33:35 PM](#)

Mr. Alper scrolled to slide 16: "Differences between House and Senate Tax Issues: Interest on Delinquent Taxes":

- Both bills eliminate the "three years then zero" interest provision for Oil and Gas Production Tax as passed by HB247 in 2016
- House bill retains the 7% plus federal reserve rate, compounding for Oil and Gas Production Tax
- House bill retains the 3% plus federal reserve rate, simple interest, for all other taxes
- Senate bill recombines all taxes under the same interest structure, as it was before 2017
- Senate bill has 3% plus federal reserve, compounding, for all taxes

Mr. Alper highlighted that the House version retained a bifurcated system, whereas the Senate version aligned all bills, and this was something that needed to be addressed in conference committee.

[3:35:43 PM](#)

Representative Wilson asked how much money was really being discussed.

Mr. Alper indicated that the amount was indeterminate in the fiscal note. The number depended on how large the audit assessment was to be in a few years. The difference of compound interest became a very big part. Three years ago, when ACES-era interest was compounding, 60 percent of the total was interest, and only 40 percent was principle. Whereas in the newer audits in which three years of the lower interest rate of SB 21, more like one-third interest and two-thirds principle. A big difference accrued over a number of years. It was a question of synergy between different taxes. From the state's point of view, there was a certain opportunity cost if a company does not pay its

taxes, as the money would have to come out of state savings. The expected rate of return on savings was 7 percent. He reiterated that these were policy decisions that should be made in conference committee.

3:37:30 PM

Representative Wilson was not talking about the policy call, she was talking about what had happened in the past. She was looking for interest collected for FY 15 and FY 16. She asked whether there was some line in the budget that showed interest collected for those years, at the end of the six-year audit cycle.

Mr. Alper responded that there was a firm grasp of oil tax as it involved relatively limited audits and they were released on an annual cycle. He could provide the communications back and forth about what portion was interest and what was principle. It was important to note that the money went to the Constitutional Budget Reserve (CBR) and was not General Fund money. He was sure interest was tracked separately. He did not have the total at hand.

Representative Wilson stated companies paid what they thought their taxes should be. The audit addressed what the department determined rather than the companies. Companies were not going six years without paying any production tax at all.

Mr. Alper indicated that certainly what she was saying was true. What she was describing was not the end of the process. There was an appeals process and a settlement or decision which usually fell somewhere in the middle.

3:40:01 PM

Representative Wilson was curious about the figure. She did not want to argue about a small amount. She would like to know interest over last couple of years.

Mr. Alper would provide numbers for the last three audit cycles.

3:40:51 PM

Representative Pruitt asked whether over the prior two years there had been an instance in which those audits were completed before the six year statutory maximum timeline.

Mr. Alper relayed that the extension of the audits to six years was part of the ACES bill. It first affected 2007 taxes. The department had stayed close to the statutory timeline. The previous March was the deadline for 2010 taxes. Those for 2011 were nearing completion. By the following spring the department would have 2012 and in following fall those for 2013. The division was on target to meet the deadlines.

Representative Pruitt was glad to hear Mr. Alper's response. He asked if there had been interest that the state had to pay during Mr. Alper's tenure. He asked whether taxes were accruing due to things being found in the audits.

Mr. Alper responded in the affirmative. He suggested there could be a situation in which an audit assessment was triggered and a company would choose to pay the entire assessment in order to forestall additional interest and then go through the appeals process which could go on for a couple of years. In that the scenario the state was paying the company back the difference plus all of the interest. Vice-Chair Gara referred to a deficit in auditors at the department.

[3:44:39 PM](#)

AT EASE

[3:44:53 PM](#)

RECONVENED

Mr. Alper replied that he was very proud of the department's audit team. He was not advocating for more or fewer auditors.

[3:45:58 PM](#)

AT EASE

[3:46:03 PM](#)

RECONVENED

Mr. Alper addressed slide 17: "Differences between House and Senate Tax Issues: Other Miscellaneous Issues":

House

- Prevents Gross Value at the Point of Production from going below zero for a particular property
- Eliminates the ability assign tax credit certificate payments to a third party financier
- Adds transparency / public reporting related to credits and lease expenditures held by companies
- Adds a new legislative working group to look at Cook Inlet and Middle Earth taxes

Senate

- In certain circumstances allows use of purchased credit certificates against prior-year tax liabilities, including penalties and interest

Mr. Alper spoke to a recent report of which companies had been paid cash credits for a total of around \$73 million. The House version would expand upon that transparency feature. The Senate version would allow a certificate to be used against prior-year taxes with certain limitations, specifically having to do with the CBR. Article 9, Section 17 states that if there is an administrative proceeding, the results of that have to go to the CBR. The Senate bill was not trying to circumvent the provision but additional liabilities from past years could be offset with credit certificates.

[3:49:19 PM](#)

Co-Chair Foster referenced the complex issues in the bills. He asked Mr. Alper to provide a very broad explanation of the differences between the two bills.

Mr. Alper complied. At the broadest level, both versions eliminated the idea that the state was going to be writing checks to oil companies for tax credits based on work being done. Both versions changed it to a structure in which companies would use the carry forwards to offset future taxes. Both bills maintained a net profit-based tax which means that company spending is an integral part of the tax calculation. All of the spending that was no longer turning into credits would be turned to offsets later. Beyond that, the House version made certain formula changes to the tax itself that lead to a tax increase of a couple of hundred million dollars per year that the Senate version did not make. Otherwise the differences were relatively technical

and not big-dollar items but which certainly merited further discussion in conference committee.

Co-Chair Foster added that both House and Senate versions eliminate cashable credits, the Senate version does not raise additional revenue whereas the House version does.

Mr. Alper replied that the statement included the fundamental differences and similarities of the bill versions. He added that his contact information was available on the presentation if people wanted to follow up.

Co-Chair Seaton noted that the synopsis did not really cover the future liability difference of \$800 million between the two bill versions.

Mr. Alper answered that what he had described was part of changing the tax rate. He stated that it was counterintuitive that the House version raised more revenue by lowering the tax rate, but that was what happened. It also eliminated the per barrel credit. A major difference was because the House had a lower rate, the House version lowered the value of the spending against taxes. Essentially there was no longer such a thing as a credit, instead it was carrying forward losses, which did not get value until they were used. The state's obligation in terms of future tax offsets was lowered.

Vice-Chair Gara referred to statements that the Senate bill eliminated \$1.50 billion in cash credits, however, it was replaced by \$1.45 billion in carry forward credits. He hoped people understood that this meant it was nearly net zero.

[3:55:23 PM](#)

Mr. Alper answered it was a net profits tax. The companies are spending money and net profits tax means that the company gets that value back somehow in the future. The Senate bill made many fewer changes to how the things were valued and the net result was a revenue neutral change over the long-term. It was different in that the payments were no longer in the budget; there was no longer an appropriation battle over how much to spend on tax credits in a given year. It was seen passively as a reduction from future taxes. The House bill also had that - there was

still a large number in the future that would be used to offset taxes, but conceptually it was the same thing. Companies were losing money, they were carrying those losses into the future, and they would use those losses against future taxes.

Co-Chair Seaton asked for clarification on the use of loss carry forwards down to zero.

Mr. Alper responded that the House version was requiring the use of carry forwards and then paying the minimum tax, and the Senate was only requiring the amount used down to the minimum tax. This showed up in the analysis in two different places. In both circumstances, the tax payer was paying a minimum tax. In the Senate version there was a slightly larger carry forward number because they could be conserved for a future year. They also appeared in the analysis of the life cycle of project field analysis. New fields accrue the same lease expenditures. For the first few years, they would pay minimum tax even at high prices. In the Senate bill, six or eight years on they would still be paying the minimum tax as they were using carry forwards. In year seven and eight, in the House version, there was higher revenue. It appeared in the lifecycle analysis mid field life as one or two years of higher revenue in the House version.

[3:58:35 PM](#)

Co-Chair Seaton asked if applying to zero and stopping at the minimum tax was a difference between status quo and the Senate version of the bill. He asked if more carry forward occurred for legacy fields in the Senate bill but not in the status quo.

Mr. Alper replied that it was important to distinguish between current year and carry forwards when discussing status quo. Within the current year, the company did not get a loss until it went below zero. A company could be forced to pay the minimum tax while earning small or zero profit then certain lease expenditures would be lost as they are only allowed to get credits or the carry forward to the amount below zero. With carry forwards, there was discussion of the hard floor and other restrictions. Under current law there was generally not any loss of the value. There were restrictions on what could be used and if the credits could not be used, they could be carried forward.

There were use them or lose them credits within a single year, such as the small producer credit or the \$5 per barrel credit. That was status quo. In both versions of the bill, the going to zero within a year was unchanged. The only difference was in the carry forward scenario. House carry forwards go to zero and then they would pay minimum tax, whereas in the Senate version companies could use only as much as want to in order to pay the minimum tax.

Co-Chair Seaton referred to slide 10 related to the use of carry forward losses. He spoke to the protection of the use of per barrel credits.

Mr. Alper answered that it was a change between the version that passed the Senate Resources Committee and what passed the Senate. The committee had said that the company only needed to use the amount to get to the minimum tax calculation, but that calculation assumed zero per barrel credits. He spoke to chart showing how much per barrel credits were earned and used at different price points. It was visible how much it stepped up from zero to \$8 as the price got lower until about \$90 per barrel. Once the minimum tax was reached, more and more of the per barrel credits would be unusable. By the time \$50 per barrel, only about a dollar in credit could be used. At around \$55 per barrel, a company might be able to use \$2 per barrel credit. The Senate Resources version would have eliminated that credit for them. The way it was re-worded in the Senate Finance language, the company would use only the amount necessary to arrive at a calculation in which they would receive the same benefit as the \$2 credit. This meant the company would be using less of the carry forwards and able to use them to carry into a future year.

[4:02:52 PM](#)

Co-Chair Seaton referred to status quo where expenditures were used up. He surmised that the Senate version currently says they can be carried forward to offset future taxes.

Mr. Alper answered that status quo was based on current year taxes, then applying carry forwards to that amount. The Senate version said that a company should not lose any current year credits and should therefore be able to protect the carry forwards to use in a subsequent year.

Vice-Chair Gara referenced slide 7 and asked about credit provisions in the bill versions. He clarified that the Senate version was for \$1.45 billion over the next ten years, whereas the House version was \$610 million over the next ten years.

Mr. Alper replied that \$610 million was originally \$640 million in early April. The department had refigured the fiscal note based on the spring forecast to have an apples-to-apples comparison. It may not have been attached the House version.

[4:04:58 PM](#)

Vice-Chair Gara clarified that no member on the current committee had tried to keep down the number of auditors in DOR.

Representative Wilson asked about number 3 on slide 7. She asked for clarification on the tax value of carry forwards in each of the versions.

Mr. Alper spoke about losses. There was a certain forecast for company spending that would result in a loss of about \$4 billion over the next ten years. Lease expenditures in Alaska are generally around \$4 billion per year but mostly from major producers and were used to offset revenue. There was also \$4 billion in losses, either due to lack of production or high spending. Four billion dollars was in company hands and that would be used in some way to offset future tax. In SB 21 the tax was calculated at 35 percent, so \$1.4 billion was tax offset value of the carry forward. The House version reduced the rate to 25 percent. The \$4 billion would be used to offset at the 25 percent level or \$1.0 billion. The calculation of turning the \$4 billion into a tax benefit was the difference between \$1.4 billion and \$1.0 billion, which was the \$400 million shown in the slide.

Representative Wilson asked whether there would be \$400 million that the company would not be able to get back under the analogy.

Mr. Alper replied in the negative. He explained that companies were getting the \$4 billion in losses at whatever the tax rate was. If the tax rate was increased, the value of the carry forward would increase. If the tax rate was

reduced 10 percent then the \$4 billion would only be worth \$400 million, but it would still be the value of the \$4 billion but it would be used at whatever the tax rate was when it came to be used.

4:08:02 PM

Representative Wilson asked for verification that under either bill, companies would get \$400 million but it would be calculated differently. She was trying to determine how the number became larger in the Senate version.

Mr. Alper answered the difference was that companies would get the \$4 billion calculated against the tax rate. The \$4 billion subtracted from profits and taxed at 35 percent was more than at 25 percent. It was the same \$4 billion, but because the tax rates were different, the impact of the tax calculation would be different.

Representative Wilson referred to point 3 on slide 7 and asked for verification it spoke to only the tax rate not the investment.

Mr. Alper answered they were speaking to the \$4 billion figure. Much of that money was being accrued in 2018 and 2019, but if they were not in production and therefore the money would not be used until 2026 or 2027, the 10 percent subtraction would start to kick in. In this way, instead of \$4 billion, under the House version it would be \$3.5 billion and that, with the further addition of the tax calculation, was another \$300 million between the two versions.

Representative Wilson noted it related to the life cycle Mr. Alper had mentioned earlier. She asked whether he was using the life cycle to show that a company would not see that deduction until year 8, 9, or 10.

Mr. Alper answered that the lifecycle analysis was theoretical and abstract. The \$300 million was the actual number in the ten-year forecast of what was believed would be spent and how much of that money would lead to actual production within the fiscal note period. It was money being spent that the state do not see coming into production in the following ten years.

4:11:06 PM

Representative Wilson stated that in the House version companies were penalized if there was nothing to write it off against.

Mr. Alper replied the numbers showed as money that had not been used. The money existed on the companies' books to be spent from 2028 and beyond on taxes. On the House side some value had been lost so that by 2027 the number had gone down to \$600 million.

Representative Wilson asserted that regardless of position, she believed everyone wanted to see an increase in production on the North Slope. She thought that was the issue ultimately.

Commissioner Hoffbeck replied that he believed that both the House and Senate did what they thought was in the best interest of both industry and the state. He believed a compromise was needed.

Representative Wilson supported compromise, but not if it decreased production.

[4:13:19 PM](#)

Representative Ortiz referred to the \$800 million difference in carry forward value between the two bill versions. He asked if that was separate from the added revenue in the House version of up to \$200 million.

Mr. Alper responded it was separate. He referenced companies holding carry forward credits and detailed that slide 7 depicted what the numbers would be and what they were worth in 2027. It was completely separate from the tax calculation.

Representative Ortiz asked about the ultimate difference in revenue between the two versions.

Mr. Alper replied that the House bill included \$200 million per year in tax. On the budget side, the Senate bill eliminated roughly \$1.5 billion in cash credits and replaced them with about \$1.5 billion in offsets in the future. The House version eliminated the cash credits and replaced them with a smaller number of offsets for the

future. That was a second place in which the total grand value was larger on the House side.

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Representative Ortiz asked about the total value difference between the two bills by 2025.

Mr. Alper provided the caveat that this assumed ten years of forecasts and prices and production. He stated sum total of revenue in the House version was about \$1.5 billion over ten years. The sum total of the difference between the two bills in tax carry forwards was another \$800 million and there was a grand total of about \$2 billion difference between the two bills.

Representative Pruitt referred to number 1 on slide 7. He suggested that carry forwards or NOLs were not credits but a reduction. Saying there was an additional \$60 million in carry forwards failed to recognize that if it was not a carry forward it would be cash that the state needed to pay out. It did not recognize that those would have to be paid in cash at some point in the future.

Mr. Alper agreed and added that both bills were fully eliminating cash credits. The House version was keeping them in Middle Earth. The sum total of the Senate bill was about \$80 million higher over the ten-year period. That \$80 million almost matches \$60 million in additional carry forwards in the Senate version. It was net zero between the two bills for the particular line item.

Representative Pruitt stated that the goal in HB 247 was to protect the NOL credits "as essential playing fields levelers between incumbent producers and newcomers" ["Key Goals and Features of HB 247 - Governor's Oil and Gas Tax Credit Reform Bill", dated January 20, 2016]. He asked if point 4 on slide 7 was eroding the ability for smaller companies with less money to compete with bigger players.

Commissioner Hoffbeck answered that it had all been part of the total fiscal package. The fiscal package had morphed and there were provisions that were and were not in the original package. They were currently in a position where everyone needed to compromise.

Representative Pruitt spoke to a less capitalized company. He asked if there was potential to lose some smaller companies if they are not as capitalized as others, since they could not place deductions going past the seven years, based on how long it took to recoup their costs.

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Commissioner Hoffbeck answered there was nothing the state could do that would match paying cash for the credits. It had been a substantial benefit that was not paid in other locations and the state could no longer afford. It would certainly be a lesser benefit. The impact was still to be seen.

Representative Pruitt referred to allowing companies to carry liability forward. He agreed that cash was an incentive but he was concerned that cost write-offs and caps could reduce the perspective of smaller companies.

Commissioner Hoffbeck answered that the severance taxes were a separate area. The rules put in place are different by jurisdiction. He believed the House and Senate had crafted bills that they believed were in the best interest of the state and of industry. He did not know whether it would have an impact.

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Mr. Alper discussed making major changes and stated if there were any change in industry behavior, the reduction in value and loss of cashable credits would be large determiners in that.

Vice-Chair Gara spoke to the difference between not getting as much revenue, because companies deduct their carry forward credits from the revenue they give the state, and cash credits which the state paid out. He surmised that having \$150 million in payouts and getting \$150 million less in revenue, from a budgeting stand point for the legislature, was the same thing.

Mr. Alper replied in the affirmative but underlined that earlier he had mentioned that there was a time issue as well. The cash obligation was in real time and a lot of the carry forward obligations were many years in the future.

Vice-Chair Gara stated he would argue that given the level of credits, since the state was not paying them on an annual basis, there was time value to that as well. The state was not paying that \$1 billion of credits every year, but over many years. He asked for verification that the Senate version contained \$1.445 billion in liability to the state, and the House version \$610 million. He asked whether that was roughly an average of about \$84 million a year difference between the two versions.

Mr. Alper replied in the affirmative, stating that the first year or two were immaterial.

Vice-Chair Gara stated that the Senate version cost an extra \$84 million a year that would have to be covered somehow. He thought it was notable that the amount was similar to what the Senate had proposed cutting from budget for the University and K-12. He thought it was similar to the governor's fuel tax and that the legislature could adopt the fuel tax to pay for that \$80 million difference which would go straight to cash credits. He did not feel like it was making progress, whereas they had come up with a fair credit system for the oil industry.

[4:26:15 PM](#)

Commissioner Hoffbeck thanked the committee for the opportunity to put the information out there. He stressed the need for compromise. The administration thoroughly believed all parties had put forward what they believed was in the best interest of the state, but it was time for a compromise.

Co-Chair Seaton thanked the presenters.

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ADJOURNMENT

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The meeting was adjourned at 4:27 p.m.