HOUSE FINANCE COMMITTEE
April 26, 2018
2:03 p.m.

2:03:38 PM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 2:03 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Jason Grenn

ALSO PRESENT

Elizabeth Diament, Staff, Representative Paul Seaton; Ken Alper, Director, Tax Division, Department of Revenue; Representative Geran Tarr, Chair, Legislative Working Group on Oil and Gas; Representative Geran Tarr.

PRESENT VIA TELECONFERENCE

Doug Gardner, Director, Legislative Legal Services.

SUMMARY

HB 411 OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITSW

Co-Chair Foster relayed the agenda for the day.

#hb411

HOUSE BILL NO. 411

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

2:04:54 PM

Co-Chair Seaton MOVED to ADOPT Amendment 1 (copy on file).

Page 2, line 2:
Delete "July 1, 2018"
Insert "January 1, 2019"

Page 2, line 5:
Delete "July 1, 2018"
Insert "January 1, 2019"

Page 2, line 8:
Delete "25"
Insert "10"

Page 2, line 15:
Delete "25"
Insert "10"

Page 3, line 11. through page 4, line 11:
Delete all material and insert:

"(2) on or after January 1, 2019, and before January 1, 2022, for each month for which the producer's average monthly production tax value under AS 43.55.160(a)(2) of a BTU equivalent barrel of the taxable oil and gas is more than $101 the tax amount is the sum of the following:

(A) the difference between the monthly production tax value of a BTU equivalent barrel and $10 multiplied by the volume of oil and gas produced by the producer for the month multiplied by five percent;

(B) if applicable, the difference between the monthly production tax value of a BTU equivalent barrel and $15 multiplied by the volume of oil and gas produced by the producer for the month multiplied by five percent;

(C) if applicable, the difference between the monthly production tax value of a BTU equivalent barrel and $20 multiplied by the volume of oil and gas produced by the producer for the month multiplied by five percent;
(D) if applicable, the difference between the monthly production tax value of a BTU equivalent barrel and $30 multiplied by the volume of oil and gas produced by the producer for the month multiplied by 10 percent;
(E) if applicable, the difference between the monthly production tax value of a BTU equivalent barrel and $50 multiplied by the volume of oil and gas produced by the producer for the month multiplied by 10 percent;
(F) if applicable, the difference between the monthly production tax value of a BTU equivalent barrel and $70 multiplied by the volume of oil and gas produced by the producer for the month multiplied by five percent;

(3) on or after January 1, 2022, for each month for which the producer's average monthly production tax value under AS 43.55.160(a}(2) of a barrel of taxable oil is more than $10, the tax amount is the sum of the following:

(A) the difference between the monthly production tax value of a barrel of taxable oil and $10 multiplied by the volume of oil produced by the producer for the month multiplied by five percent;
(B) if applicable, the difference between the monthly production tax value of a barrel of taxable oil and $15 multiplied by the volume of oil produced by the producer for the month multiplied by five percent;
(C) if applicable, the difference between the monthly production tax value of a barrel of taxable oil and $20 multiplied by the volume of oil produced by the producer for the month multiplied by five percent;
(D) if applicable, the difference between the monthly production tax value of a barrel of taxable oil and $30 multiplied by the volume of

oil produced by the producer for the month multiplied by 10 percent;
(E) if applicable, the difference between the monthly production tax value of a barrel of taxable oil and $50 multiplied by the volume of oil produced by the producer for the month multiplied by 10 percent;
(F) if applicable, the difference between the monthly production tax value of a barrel of taxable oil and $70 multiplied by the volume of oil produced by the producer for the month multiplied by five percent."

Page 7, line 13:
Delete "July 1, 2018"
Insert "January 1, 2019"

Page 9, line 10:
Delete "July 1, 2018"
Insert "January 1, 2019"

Page 9, line 25:
Delete "25"
Insert "10"

Page 10, line 9:
Delete "25"
Insert "10"

Page 10, line 23:
Delete "25"
Insert "10"

Page 11, line 2:

Delete "25"
Insert "10"

Page 12, line 9:

Delete "25"
Insert "10"

Page 12, line 26:

Delete "25"
Insert "10"

Page 13, line 6:

Delete "25"
Insert "10"

Page 13, line 22:

Delete "25"
Insert "10"

Page 14, line 7:

Delete "25"
Insert "10"

Page 19, line I:

Delete "July 1, 2018"
Insert "January 1, 2019"

Page 26, line 2:

Delete "July 1, 2018"
Insert "January 1, 2019"

Representative Wilson OBJECTED for discussion.

Co-Chair Seaton asked his staff to explain the amendment.

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ELIZABETH DIAMENT, STAFF, REPRESENTATIVE PAUL SEATON, explained the amendment. She related that the amendment was offered in response to industry testimony. She indicated that the amendment changed the effective date from July 1, 2018 to January 1, 2019, which aligned with the tax calendar year. The bill also lowered the base tax rate from 25 percent to 10 percent of production tax value (PTV). The base tax was raised through six supplemental tax brackets rather than the three previous brackets. She reviewed the tax brackets. The first bracket was 10 percent up to $10, at $10 an additional 5 percent, an additional 5 percent at $15, an additional 5 percent at $20, and at $30 the tax bracket stepped up 10 percent and at $50 the tax rose another 10 percent and finally at $70 another 10 percent tax was assessed which brought the tax to 50 percent. The last major change was a technical clarification that

specified that after 2022 the PTV would be based only on oil when the gas and oil taxes were split in 2022. The provision was omitted in the previous version by a drafting error.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, introduced himself and indicated he had been asked by the sponsor to perform modeling on the amendment. He indicated that the charts projected on the screen were titled "Fiscal Note Table and Tax Model" (copy on file). He explained that the chart on the first and second slides depicted the effective production tax rates comparison - Non-GVR and GVR Oil, FY 2019 and was a high-level aggregate model allowing comparison of status quo production tax structure to an alternate configuration for typical non-GVR and GVR oil fields. The green line represented amendment 1, the blue line represented the current tax structure, and the red line was what Alaska's Clear and Equitable Share (ACES) effective production tax rates would be in 2019. He reminded the committee that the amendment reflected the consultant's, Rich Ruggerio, In3Energy, suggestion to lower the base rate and add more brackets to the tax structure.

Representative Wilson asked whether any of the three lines reflected the current bill and how the amendment changed the bill. Mr. Alper answered that a slide from the sponsors original presentation included a chart depicting the original 25 percent base rate. He described that the chart had a horizontal green line at 25 percent through $70 per barrel and flared up with progressivity. He stated that the previous chart was not included because the comparison was not requested. He noted that the current green line was located lower at the 10 percent effective tax rate at lower oil prices. He noted that the chart he was referring to was placed on the screen titled "Effective Production Tax Rates Comparison Model - Non-GVR Oil, FY 2019" which was slide 12 on the presentation titled "HB 411 An Act relating to the Oil and Gas Production tax, tax payments, and credits; and providing for an effective date." (copy on file)[presented on April 10, 2018]. He deduced that the intent was to start the tax at a lower amount and increase the rate in multiple steps. The current tax rate increased more gradually and was lower than in the previous version of the bill.

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Representative Wilson asked whether the amendment was a tax increase compared to the original version of HB 411 or versus the present tax regime or both. Mr. Alper responded that the amendment was a tax increase against the status quo represented as the gap between the green line and the blue line. He restated that the increase was smaller at oil prices below $90 per barrel. He did not know how the tax compared at higher prices. Representative Wilson asked Mr. Alper to compare the tax at higher prices for both bill versions. Mr. Alper compared the charts side by side and deduced that the amendment reflected a smaller tax increase up to roughly $120 per barrel and above the amount the taxes were slightly higher than the original version of the bill.

Vice-Chair Gara recalled that at $60 per barrel the original bill would generate approximately $550 million and the amendment generated no additional revenue at $60 per barrel compared to the status quo. He asked whether he was correct. Mr. Alper relayed that there were two different analyses. The slides under discussion based on the average barrel and average cost showed a $220 million increase at $60 per barrel and the equivalent analysis of the original version of HB 411 was a $600 million tax increase. The analysis on the third slide that contained a table and bar graph included on the fiscal notes indicated a tax increase of about $200 million at $60 per barrel based on actuals. He furthered that the analysis was more specific to the oil companies and their cost structures. The analysis used their confidential data and was amalgamated to make a single estimate. Vice-Chair Gara asked how the original version of HB 111 compared to the amendment at $50 with no additional revenue and $297 million in additional revenue at $70 per barrel. Mr. Alper suggested that the issue was at what price the minimum tax was applicable. He noted that under the status quo the minimum tax applied at roughly $65 per barrel versus the original version of HB 411 at $40 per barrel. The amendment applied the minimum tax at $50 per barrel. He delineated that where the green line and the blue line was identical no change occurred because of the 4 percent minimum tax. The tax increase began at approximately $50 per barrel and rose to $200 million at $60 per barrel, $300 million at $70 per barrel, and slightly decreased until $150 per barrel increasing to $600 million.

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Vice-Chair Gara asked what the numbers were at $50 and $70 per barrel for the original version of HB 411. He recalled the numbers were much higher. Mr. Alper replied that at $50 per barrel the additional revenue was $292 million, at $60 per barrel it was $605 million, and at $70 per barrel the increase was $677 million. The original version of the bill had a much higher tax increase than the amendment.

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Co-Chair Seaton referred to the bar chart and table on the third slide that represented the 25 percent flat tax. He elaborated that if companies paid lower taxes under a lower tax rate they would offset their expenses against the lower tax rate. He wanted to make sure that everyone considered the complete system and not only the tax rate.

Representative Wilson asked if the change would work the same for all companies. She wanted to understand the intent of the amendment. She wondered whether the sponsor was attempting to reach middle ground from the status quo or was it dependent on other deductions a company took.

Co-Chair Seaton replied that he attempted to take a balanced approach, so the goal was the percentage of taxes paid was balanced by the percentage of deductions. He believed that it was currently problematic; the tax credit was 35 percent, but the tax was only 5 or 8 percent. He noted that changing to the 25 percent tax rate had two implications: 1) taxes were less at lower prices because the tax rate was less; 2) if expenses offset taxes, the tax rate indicated how much a company would save. The intention was to have the legislative working group examine the issues further. He voiced that more analysis was necessary than only determining a tax rate to truly discern the implications to the state. He relayed that Mr. Ruggerio informed the committee that the cost of services as the price of oil changed could greatly impact how the tax worked. Since the tax was a "profits tax" high expenses impacted the tax. The net fiscal impact included lower deductions for a lower tax rate. He emphasized the necessity to consider all factors to measure impacts to the companies and the state. He wanted all the factors discussed at the same time.

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Representative Wilson expressed concern that the amendment was not a proposal that would be discussed by the working group later but was currently under consideration. She understood that the amendment was positive for some companies but possibly not all companies. She inquired whether the statement was fair. Co-Chair Seaton reported that he wanted further analysis to understand the full impact on industry. He reiterated that the impacts factored in all elements of a tax policy and not just the basic tax rate that required a complete analysis.

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Representative Wilson wondered whether a general assumption of the amendment would be that taxes were lower compared to the original version of HB 411 but higher than the status quo. Mr. Alper indicated that across the board the tax increase would be smaller than the original version. He pointed to the table on the third slide and noted that the tax increase was highlighted in yellow and the number below the line was the impact of the carry-forward lease expenditures and credits which reflected the impact on producers in the future. He recalled that HB 111-Oil & Gas Production Tax;Payments;Credits, (CHAPTER 3 SSSLA 17-07/27/2017) adopted the previous session eliminated cash credits and allowed costs to be carried forward that would be used to offset future taxes. The future values of the carry forwards were unknown. He noted that accounted for the big gaps between the before and after lines at the bottom of the table.

Representative Wilson WITHDREW her OBJECTION.

Amendment 1 was ADOPTED.

2:25:24 PM

Vice-Chair Gara MOVED to ADOPT Amendment 2 (copy on file).

Page 1, line 1, following "Act":
Insert "relating to the Alaska Net Income Tax Act;"

Page 1, following line 3:
Insert new bill sections to read:

"* Section 1. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year on [UPON] the entire taxable income of every corporation or oil or gas producer derived from sources within the state a tax computed as follows:

If the taxable income is	Then the tax is:
Less than $25,000	zero
$25,000 but less than $49,000	2 percent of the taxable income over $25,000
$49,000 but less than $74,000	$480 plus 3 percent of the taxable income over $49,000
$74,000 but less than $99,000	$1,230 plus 4 percent of the taxable income over $74,000
$99,000 but less than $124,000	$2,230 plus 5 percent of the taxable income over $99,000
$124,000 but less than $148,000	$3,480 plus 6 percent of the taxable income over $124,000
$148,000 but less than $173,000	$4,920 plus 7 percent of the taxable income over $148,000
$173,000 but less than $198,000	$6,670 plus 8 percent of the taxable income over $173,000
$198,000 but less than $222,000	$8,670 plus 9 percent of the taxable income over $198,000
$222,000 or more	$10,830 plus 9.4 percent of the taxable income over $222,000.

* Sec. 2. AS 43.20.012(a) is amended to read:
(a) Except as provided in (e) of this section, the [THE] tax imposed by this chapter does not

(1) apply to an individual;
(2) apply to a fiduciary;
(3) for a tax year beginning after December 31, 2012, apply to an Alaska corporation that is a qualified small business and that meets the active business requirement in 26 U.S.C. 1202(e) as that subsection read on January 1, 2012; or
(4) for a tax year beginning after June 30, 2007, apply to the income received by a regional association qualified under AS 16.10.380 or nonprofit corporation holding a hatchery permit under AS 16.10.400 from the sale of salmon or salmon eggs under AS 16.10.450 or from a cost recovery fishery under AS 16.10.455.

* Sec. 3. AS 43.20.012(a), as repealed and reenacted by sec. 2, ch. 55, SLA 2013, is amended to read:

(a) Except as provided in (e) of this section, the [THE] tax imposed by this chapter does not apply to

(1) an individual;
(2) a fiduciary; or
(3) the income received by a regional association qualified under AS 16.10.380 or nonprofit corporation holding a hatchery permit under AS 16.10.400 from the sale of salmon or salmon eggs under AS 16.10.450 or from a cost recovery fishery under AS 16.10.455.

* Sec. 4. AS 43.20.012 is amended by adding a new subsection to read:
(e) The limitations in (a) of this section do not apply to an oil or gas producer.

* Sec. 5. AS 43.20.021(c) is amended to read:
(c) For a corporation or oil or gas producer, for [FOR] purposes of calculating the alternative tax on capital gains provided for in the provisions of 26 U.S.C. 1201 (Internal Revenue Code), the rate is 4.5 percent [FOR CORPORATIONS].

* Sec. 6. AS 43.20.021(d) is amended to read:
(d) For a corporation or oil or gas producer, where [WHERE] a credit allowed under the Internal Revenue Code is also allowed in computing Alaska income tax, it is limited to 18 percent [FOR CORPORATIONS] of the amount of credit determined for federal income tax purposes that [WHICH] is attributable to Alaska. This limitation does not apply to a special industrial incentive tax credit under AS 43.20.042.

* Sec. 7. AS 43.20.021(f) is amended to read:
(f) For a corporation or oil or gas producer, for [FOR] the purpose of calculating the alternative minimum tax on tax preferences provided for in 26 U.S.C. 55 - 59 (Internal Revenue Code), the tax is 18 percent [FOR CORPORATIONS] of the applicable alternative minimum federal tax.

* Sec. 8. AS 43.20.030(a) is amended to read:

(a) If a corporation, an oil or gas producer, or a partnership that has a corporation as a partner, is required to make a return under the provisions of the Internal Revenue Code, it shall file with the

department, within 30 days after the federal return is required to be filed, a return setting out

(1) the amount of tax due under this chapter, less credits claimed against the tax; and
(2) other information for the purpose of carrying out the provisions of this chapter that the department requires.

* Sec. 9. AS 43.20.144(h)(2) is amended to read:
(2) "consolidated business" means a corporation or oil or gas producer or group of corporations or oil or gas producers, or both, having more than 50 percent common ownership, direct or indirect, or a group of corporations in which there is common control, either direct or indirect, as evidenced by any arrangement, contract, or agreement; the requirements of this chapter apply whether or not the taxpayer is the parent or controlling corporation;

* Sec. 10. AS 43.20.340 is amended by adding a new paragraph to read:
(11) "oil or gas producer" means an individual, sole proprietorship, partnership, join venture, association, trust, estate, business trust, an S corporation that has elected to file federal tax returns under 26 U.S.C. 1361 - 1379 (Internal Revenue Code), or other similar entity or organization that
(A) is engaged in the production of oil or gas from a lease or property in the state; and
(B) during the taxable year, was subject to tax under AS 43.55."

Page 1, line 4:
Delete "Section 1"
Insert "Sec. 11"
Renumber the following bill sections accordingly.

Page 25, following line 9:
Insert a new bill section to read:

"* Sec. 24. The uncodified law of the State of Alaska is amended by adding a new section to read:
APPLICABILITY. AS 43.20.011(e), as amended by sec. 1 of this Act, AS 43.20.012(a), as amended by sec. 2 of this Act, AS 43.20.012(e) enacted by sec. 4 of this Act, AS 43.20.021(c), as amended by sec. 5 of this

Act, AS 43.20.021(d), as amended by sec. 6 of this Act, AS 43.20.021(f), as amended by sec. 7 of this Act, AS 43.20.030(a), as amended by sec. 8 of this Act, AS 43.20.144(h)(2), as amended by sec. 9 of this Act, and AS 43.20.340(11), enacted by sec. 10 of this Act, apply to an oil or gas producer filing a return for a taxable year beginning on or after the effective date of secs. 1, 2, and 4 - 10 of this Act. In this section, "oil or gas producer" has the meaning given in AS 43.20.340(11), enacted by sec. 10 of this Act."

Renumber the following bill sections accordingly.

Page 25, line 13:
Delete "secs. 4 - 8"
Insert "secs. 14 - 18"

Page 25, line 15:
Delete "secs. 4 - 8"
Insert "secs. 14 - 18"

Page 25, lines 16 - 17:
Delete "secs. 4 - 8"
Insert "secs. 14 - 18"

Page 25, line 19:
Delete "secs. 4 - 8"
Insert "secs. 14 - 18"

Page 25, line 20:
Delete "secs. 4 - 8"
Insert "secs. 14 - 18"

Page 26, line 1:
Delete "Section 15"
Insert "Section 26"
Page 26, following line 1:
Insert a new bill section to read:

"* Sec. 28. Section 3 of this Act takes effect on the effective date of sec. 2, ch. 55, SLA 2013."

Renumber the following bill section accordingly.

Page 26, line 2:
Delete "sec. 16"
Insert "secs. 27 and 28"

Representative Wilson OBJECTED for discussion.

Vice-Chair Gara reviewed Amendment 2. He explained that the amendment closed an inequity in the oil and gas tax law. Currently, the only producers that paid corporate tax to the state were C corporations and native corporations. However, S Corporations or other entities did not pay any corporate tax. The current tax was modest at approximately 7 percent. The amendment imposed taxes on S Corporations and other entities. He believed that the amendment was "fair and equitable."

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Representative Pruitt asked if Alaska Gasline Development Corporation (AGDC) would pay a tax under the amendment. Vice-Chair Gara was uncertain and deferred the question to Mr. Alper.

Mr. Alper replied that he could not imagine AGDC being a tax payer. He explained that the amendment amended AS 43.20 related to Alaska corporate income tax and was not related to oil tax statutes. The intent of the amendment was to extend the corporate tax to all producers of oil and gas. He understood that AGDC would purchase the gas at the input into the future gasline and not from the field. The companies remained the producers of gas. He pointed to the definition on page 4 of the amendment that defined an oil and gas producer. He related that a producer was any company engaged in the production of oil and gas from a lease or a property of the state. Unless AGDC purchased leases and began producing gas, he could not imagine that AGDC fit the definition of producer.

Representative Pruitt indicated that if taxes were increased on oil and gas producers the impact would "shave into" AGDC's share. He asked Mr. Alper to comment. Mr. Alper replied that he was not involved into the gasline project and was reticent to make any assumptions. He reported that the vast number of oil and gas producers on the North Slope were C Corporations. Any entities that were not C Corporations and would sell gas to the gas project would be subject to the 9.4 percent tax at over $200 thousand. The corporate income tax was attached to federal income tax. The oil and gas companies were taxed based on the Alaska portion of their worldwide income. Typically, for most companies it reduced a company's effective tax

rate to below 9.4 percent. A small Alaskan company with no other projects outside of Alaska would be subject to the 9.4 percent rate. Representative Pruitt asked for the names of companies that the tax would apply to. Mr. Alper felt "awkward" to identify names. He mentioned that the three major producers; Exxon, BP, and ConocoPhillips were multi-national C corporations. The number 4 producer was Hill Corp and was a type S Corporation. Many other of the smaller companies such as Caelus and Bluecrest were currently organized as partnerships. They would be subject to the tax. The tax would impact the smaller producers.

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Representative Pruitt asked how much oil was produced by the entities the amendment would impact. Mr. Alper warned that an answer would be a "wild guess". He suggested that approximately 10 to 12 percent or 60 thousand to 70 thousand barrels of oil per day would be impacted. Representative Pruitt conveyed that currently a bond proposal for tax credits was being debated by the legislature and the amendment would further impact the smaller producers. The amendment would specifically target the smaller producers. He wondered how the tax would be perceived outside of Alaska. Mr. Alper did not want to speculate. He understood that taxes were generally unfavored. He relayed that the intent of the amendment was to equalize the tax base. He stated that the tax was not being applied differently - it was merely an opportunity to equalize the corporate tax system for the oil and gas industry. He related that he had heard of the issue over the years. He informed the committee that most states tax the profits of S corporations and partnerships through individual income tax and were considered "pass-through entities". He explained that for accounting purposes pass through entities' profits belonged to the owners of the companies and used a K-1 form to report income. The profits of the non C corporation oil and gas producers would be taxed if Alaska had an income tax. Representative Pruitt believed that under ACES the concept of equity was to tax the large producers at a higher rate and offer credits to the smaller producers. He suggested that "equity" made the statement that all producers paid the same amount in taxes. He wondered whether the scenario created a "difficult challenge" for encouraging oil development in the state and was a "huge shift" in how the state defined equity for producers. Mr. Alper replied that the question was "largely

rhetorical." He surmised that the tax was bracketed and did not reach the maximum rate until profits amounted to $222 thousand, which rarely occurred for small producers. There would be a higher effective tax rate paid by the larger companies because they earned multi-million dollars in profits and were taxed at the maximum rate.

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Representative Thompson asked for clarification relating to page 1, line 8 of amendment 2 and referred to the words "every corporation". He asked whether the amendment would tax every S corporation. Mr. Alper explained that the amendment added the words "or oil and gas producer" to existing statute. He furthered that AS 43.20 related to taxes on corporations. In addition to corporations, the amendment expanded the brackets to oil and gas producers and included a legal definition of oil and gas producer on page 4. Representative Thompson asked if S corporations were currently taxed. Mr. Alper responded that a tax waiver existed elsewhere in statute because of their pass-through nature.

Representative Wilson asked if any other industry in the state that was a non-C corporation did not pay the corporate income tax. Mr. Alper responded that the corporate income tax only taxed C corporations. Representative Wilson restated her question. Mr. Alper replied that no other exception was built into the corporate tax law and state corporate income tax was paid by C corporations. Representative Wilson thought the tax only targeted one sector of industry. Mr. Alper commented that the intent of the amendment was to ensure that all oil and gas producers paid the equivalent of the corporate income tax. The oil and gas industry were the largest component of Alaska's corporate income tax. Representative Wilson thought that the tax was not a way to reward the largest industry in the state. She asked if the amendment was a back-door way to impose an income tax. Mr. Alper did not agree with the assessment. He believed that the amendment was a way to increase tax on a specific industry. He stated that if a state income tax was adopted the provision would need to be reconsidered to avoid a double taxation scenario.

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Representative Ortiz commented that HB 411 would be sent to the working group for further analysis rather than currently changing policy.

Co-Chair Seaton clarified a previous statement that the smaller companies enjoyed a greater tax advantage through the tax credits that were disproportionate to the larger companies. He remarked that large companies had the same tax advantage using net operating loss credits that were valued at 35 percent and were subtracted from its taxes. He noted that currently both large and small producers were carrying losses forward. Mr. Alper appreciated the clarification. He voiced that the bulk of the cashable credits were operating loss credits and reduced every dollar in taxes by $0.35; the 35 percent statutory tax rate. He confirmed that the idea of tax credit equity was included for companies who were not profitable through production but gained value for spending like producers through tax reductions. The cashable credit was included to offer equal treatment to the smaller producers.

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Representative Tilton asked whether DOR had an analysis for amendment 2 and if he could provide it to the committee. She asked for the dollar value of the tax increase imposed by the amendment. Mr. Alper conveyed that the division had written a white paper on the potential taxation of all S corporations in the state. He recalled that the revenue would be in the range of $30 million to $60 million per year when assessed at the corporate rate. He guessed that if exclusively oil and gas producer S corporations or other types of non-C corporate entities were taxed, the revenue impact would be approximately $50 million.

Vice-Chair Gara deduced that the corporate income tax was only imposed on profits and was based on a smaller percentage of profits. He asked whether the producers could deduct production taxes from the corporate income tax. Mr. Alper replied in the affirmative and expounded that state and local taxes were a deduction for federal income tax and the state corporate income tax was based on federal taxable income. He also distinguished between the production tax and corporate tax. He instructed that both were a profits-based tax. The production tax was considered a tax flow tax where expenses were subtracted in real time. The corporate

income tax included depreciation on capital spending that was deducted over time.

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Representative Guttenberg asked whether the profit was divided by the shareholders after deductions for S corporations. He asked who was paying the tax on S corporations. Mr. Alper answered that the tax was paid by the entity and was paid before the profits were distributed to shareholders.

Representative Wilson MAINTAINED her OBJECTION.

Representative Pruitt clarified that he would not be supporting the amendment because of the message it sent to the companies. He cautioned that the messages sent by the legislature resonated throughout the state, nation, and world. He recalled that previously the state was attempting to incentivize investment in Alaska but went too far by "paying out cash". He felt that "giving out cash was very different" than the establishment of a tax regime that allowed for a lower tax rate for certain companies that did not have the same capacity as larger ones. He did not want to send the message that Alaska was not trying to attract new investment. He wanted to create an inviting business climate for other companies interested in investing in Alaska. He emphasized his opposition to the amendment because he disagreed with the message that the state was increasing taxes on companies that invested in the state.

Representative Guttenberg supported the amendment. He believed that it was the legislature's duty to examine all sides of the issue. He hoped the bill was forwarded to the working group to discuss the ideas further. He was concerned with the idea that it was inappropriate to discuss taxation. He appreciated the amendment and the opportunity it provided to discuss and analyze the ideas and formulate a conclusion. He discerned that the most important message sent to potential investors was that the ideas and conclusions were well vetted.

Representative Wilson argued that the bill was focused on one industry. She maintained that the working group was tasked with examining every aspect of oil taxation and passing a bill out of committee meant the issues were already decided. She opined that the true discussion was

"doing business in the state of Alaska as a business." She stressed that the legislature kept messaging to the oil industry that they were never contributing enough. She was distressed by the amendment because a business chose how it would organize itself based on the tax structure in a state. She stated her concern over the messaging and wanted to vote on the bill.

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Vice-Chair Gara suggested that the bill kept the "welcome mat out" for oil and gas producers because the state was a stable place to do business and had the lowest oil taxes of any of the major oil and gas producing states in the nation and one of the lowest when compared internationally. He thought the current corporate tax structure was "arbitrary." He believed that the amendment provided a fair way to treat companies engaged in the same industry regardless of how they filed with the SEC (Security and Exchange Commission) or state tax division. He stated that the amendment did not include all S corporations because it would violate the single subject rule. The bill addresses a "very generous loophole" in the oil and gas production tax for producers that did not pay any of the state's corporate tax no matter the size of their profits. He opined that the loophole was wrong.

A roll call vote was taken on the motion.

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

OPPOSED: Pruitt, Thompson, Tilton, Wilson

The MOTION PASSED (7/4).

2:58:38 PM

Co-Chair Seaton MOVED to ADOPT the Letter of Intent (copy on file):

> It is the intent of the House Finance Committee that this proposed legislation be forwarded to the Legislative Oil & Gas Working Group that was established with the passage of HB 111 during the 30th legislature for its consideration. The Legislative Oil & Gas Working Group is requested to utilize all three

> consultants available to the legislature to obtain an array of perspectives. By January 1, 2019 the group is requested to submit a report and proposed legislation for an effective long-term tax regime for the State of Alaska to the presiding officers of both bodies and the Co-Chairs of the Resources and Finance Committees. We request the working group consider HB 411 as a basis for a proposed taxation system and consider separation of oil and gas for expense and tax calculation.

Representative Wilson OBJECTED.

Co-Chair Seaton read the letter into the record.

Co-Chair Seaton reasoned that a thorough analysis of the tax proposals and the interplay of external and internal factors was imperative to develop an appropriate tax system. He explained that the bill should reside with the House Finance Committee until the working group finished examining the issues.

3:02:43 PM
AT EASE

3:03:12 PM
RECONVNENED

Representative Wilson read passages from a legal opinion from Legislative Legal Services (LAA) (copy on file):

> In Summary, the letter of intent set out above may be offered for adoption at the time the bill is passed from committee or passed on the floor. A letter of intent is a document recognized in the Manual of Legislative Drafting that is to accompany a bill. A letter of intent that does not accompany a bill is not, in my view, provided for in the Manual of Legislative Drafting. …
>
> This office warns, in certain circumstances as set out below, that a letter of intent should not be used in place of a directive that should be in the language of the bill itself.
>
> Please note that in HB 111, ch. 3, SLA 17, the Legislative Oil and Gas Working Group was directed to

> prepare the analysis and report contemplated by the above letter of intent for consideration by the legislature during the second regular session of the 30th Alaska State Legislature. The letter of intent provides a different deadline for submission of the working group's report of January 1, 2019, is really and amendment of existing uncodified law and might be better addressed by amending the law. …

Representative Wilson voiced that LAA had never heard of adopting a Letter of Intent without also moving the bill. She preferred that the Co-Chairs wrote the letter versus the Letter of Intent as a committee document. She thought that the action was setting an ill-advised precedence and was opposed to the motion. She wanted the language inserted in the bill and voted on by both bodies. She understood that the motion would pass in committee regardless of her vote. She wondered whether the path was one that members wanted to set. She suggested that the chair read the letter of intent on the floor or send it directly to the working group.

3:06:45 PM

Co-Chair Seaton responded that the letter was the Letter of Intent by the House Finance Committee and a vote to adopt would be necessary on the House floor. He was trying to get to a point where industry and the public was made aware of what the legislature was intending and to embark on further analysis by the group that the industry endorsed. He elucidated that the legislative working group had not yet generated a report but had until January of 2019 to act. He noted that the legislature had access to three consultants and hoped the group would begin meeting in a timely manner and utilized all three consultants to obtain a broad perspective for moving forward. He believed the letter of intent was directed to the working group and was the best approach under the circumstances.

3:10:29 PM

Representative Thompson opposed the Letter of Intent. He believed that the letter would be interpreted as the entire legislature endorsing the provisions in HB 411 and was asking them to only consider the provisions in the bill. He emphatically stated that the message was wrong, and he

did not like the idea. He wanted the working group to consider all issues regarding the oil tax regime.

Representative Pruitt read the intent of the working group that was adopted in the prior session. He noted that it was uncodified law. He read the following from page 20, lines 10 through 14 of HB 111:

> LEGISLATIVE WORKING GROUP. (a) A legislative working group is established to analyze the state's fiscal regime for oil and gas, review the state's tax structure for and rates on oil and gas produced in the state, recommend changes to the legislature for consideration during the Second Regular Session of the Thirtieth Alaska State Legislature, and develop terms for a comprehensive fiscal regime.

Representative Pruitt emphasized that the language already provided instructions to the working group in uncodified law that was better than a Letter of Intent. He thought it set a bad precedent and was leading the group in a certain direction. He thought it was problematic and characterized the action as a "work around" because he believed the bill would not be passed.

3:13:48 PM

Co-Chair Foster asked Representative Wilson to clarify what she had read from legal services.

Representative Wilson reported that she had requested a legal opinion asking whether a Letter of Intent was adopted without reporting the bill out of committee. She clarified that she received a legal memo from Legislative Legal Services in response. She summarized the contents of the memo and stressed that the action was not prohibited but cautioned that the action was setting the precedent.

Co-Chair Foster invited Doug Gardner, Director, Legislative Legal Services to comment.

3:15:05 PM

DOUG GARDNER, DIRECTOR, LEGISLATIVE LEGAL SERVICES (via teleconference), thought the situation was unique in one respect; the drafting manual provided that a Letter of Intent should accompany legislation. He believed the

process was logical and addressed any ambiguity in a bill. In addition, the drafting manual also stated that a Letter of Intent should not be a substitute for drafting a bill or adopting an incomplete bill. He described the action as "unusual" and viewed the Letter of Intent as providing guidance from the House Finance Committee to an existing legislative working group. He would have "a very dim view" and a "very different view" of providing a "floater Letter of Intent" not accompanying a bill that targeted a previously passed bill or another piece of legislation that affected the judicial or executive branches. He qualified that in this scenario the letter was guidance for an internal legislative committee and felt that it was an unusual situation that would likely not happen again. He did not want the current discussion to be an interpretation for the next situation in the future. He asked Representative Wilson if she wanted him to address some of the specific points in the memo.

Representative Wilson responded in the affirmative.

Mr. Gardner relayed that the critical focus was that there was already a law in place in HB 111 where it outlined what the legislature wanted the legislative working group to do in uncodified law in Chapter 3 SLA 17. He generally cautioned that the traditional path forward was to pass a bill that amended the uncodified law. He assumed that both House and Senate members were seated on the group and a bill provided unified instruction. He deduced that if the House Finance Committee passed the Letter of Intent on to the House floor he supposed that action could be taken under "unfinished business," which was unconventional. He was uncertain what actions the Senate would take if it received the Letter of Intent. He summarized that a critical view of the Letter of Intent process was that the guidance should be part of an amendment to the uncodified law which was a "direct and clean manner." However, because it was offering guidance to an internal legislative working group, acting in this manner could be considered. He did not think it would have a significant amount of influence on precedence. He thought it was preferable for the guidance to be in the form of a bill voted on by both bodies. The Letter of Intent alone was a non-binding statement and offered very little guidance value if it was not adopted by the House and Senate or if only adopted by the House and not adopted in the Senate, he thought the working group would have a lopsided directive that could

pose a logistical problem. He did not think there was an easy yes or no answer. He had contacted the Chief Clerk's office who related that they did not recall it ever happening before and he was not certain that a similar action happened in the past.

3:22:19 PM

Representative Guttenberg appreciated hearing the functioning directives of the working group. He related that there was frustration that the working group never met. He stated that the Letter of Intent was an internal memo. He suggested that if the letter only passed in committee or did not pass both bodies it was merely a letter to the working group but would not supersede the working group's directive by statute. He asked whether he was correct. Mr. Gardner agreed that Representative Guttenberg's statement was accurate. He was not trying to be dismissive of a Letter of Intent but thought that it did not have to be acted on especially if it was only endorsed by the House Finance Committee or by one body. He believed that the letter only carried limited weight, especially under the circumstances.

Co-Chair Foster mentioned that the floor acted on motions such as the Sense of the House. He wanted to make a comparison between the sense of the House or Letters of Intent attached to budget bills. He asked whether the current situation was substantially different. Mr. Gardner agreed with the similarities. He detailed that the Sense of the House was a non-binding statement that was not legally binding. He thought if the Letter of Intent was similar in terms of the weight that it carried.

Representative Wilson thought intent language within a bill was very different than a Letter of Intent outside of a bill. She asked whether she was correct. Mr. Gardner answered that he directed his previous comments exclusively to a Sense of the House and would not equate the current situation with a budgetary Letter of Intent.

3:27:59 PM

Vice-Chair Gara thought that the co-chairs were trying to do something different than they intended. He relayed a story from personal experience. He suggested that the letter of intent was offered as an olive branch to other

members of the legislature to resolve the budget and differences that remained in the current session in a timely manner and not forward the bill to the floor. The other option was to move the bill from committee and having a multi-day debate on the floor that had the potential to extend session approaching a government shutdown date. He thought that the letter was a "graceful" gesture and acknowledgement that agreement between members and bodies would be difficult to achieve in a timely manner and agree on items that were attainable. He remarked that the letter "was an olive branch and not a sword".

3:30:40 PM

Representative Wilson commented that the letter was divisive and there would be a fight on the floor. She agreed that the working group should have met and accomplished the directive. She read from the letter of Intent:

> We request the working group consider HB 411 as a basis for a proposed taxation system and consider separation of oil and gas for expense and tax calculation.

Representative Wilson pointed out that the letter was changing the directive in HB 111 and would be the divisive issue. She did not think that was what industry was asking the legislature to do, which was analyze the current system and not use HB 411 as the base.

3:33:02 PM

Representative Pruitt appreciated that Co-Chair Seaton had alerted members of the Letter of Intent in advance. He agreed with Representative Wilson's point of view. He wished that the working group had acted however, he did not want to lay the burden entirely on the group because of the lack of time. He would agree to a letter that requested the group act but not to a letter that changed the mandate. He did not agree with forwarding the letter. He believed that the Senate would not endorse the letter. He opined that the letter could impede the working group's progress by confusing the directives. He thanked the Co-Chair for the effort but was not supportive of the Letter of Intent.

Co-Chair Foster suggested there were three possible ways to proceed; vote on the Letter of Intent, set it aside, or vote on the bill.

3:36:17 PM

Vice-Chair Gara favored the co-chairs approach. He viewed the bill to start a discussion but would also prefer changes.

Co-Chair Foster also offered a 4th option which was to set the bill aside.

Co-Chair Seaton voiced that industry had an expectation for the working group to accomplish something. He suggested that nothing got done because the original mandate was too broad. He thought that the established consensus was to proceed with a profits tax versus a gross tax. He indicated that the bill attempted to work with industry and provided a profits tax developed with the assistance of one of the consultants. He viewed the bill as a starting point that offered parameters for analysis; changes could be made from the starting point.

3:40:36 PM
AT EASE

3:41:51 PM
RECONVENED

Co-Chair Foster asked Co-Chair Seaton if his intent was for the letter to be voted on the floor. Co-Chair Seaton suggested to forward the letter directly to the working group since the intent was directed to the group from the House Finance Committee.

Representative Wilson opined that the process "made absolutely no sense" to her. She did not understand why the bill and Letter of Intent was not reported out of committee. She felt that supporting the letter translated to supporting HB 411. She did not understand how the Letter Intent would make a difference. She agreed that it was difficult for the working group to have met last year with the length of legislative sessions. She suggested the Letter of Intent merely request that the working group begin meeting on the original mandate and would support the letter. She felt that if she supported the letter as

proposed she would be supporting HB 411. She wanted to set the letter aside and ask the working group to begin its process.

3:45:32 PM

Representative Pruitt highlighted that the letter asked for a report and proposed legislation. The working group had originally been directed to review the current tax regime and develop terms. He did not feel like a change was needed. He suggested that along with the Letter of Intent a tally of the committee vote should be included to show that some members had concerns. Otherwise, a simple letter to request that the working group begin discussions under the original mandate would garner full committee support.

Co-Chair Foster noted that the committee had been joined by Representative Geran Tarr.

Co-Chair Foster surmised that although reporting out a Letter of Intent was unusual nothing prohibited such action. He felt that the committee members had expressed their views.

3:49:08 PM
AT EASE

3:51:47 PM
RECONVENED

Co-Chair Seaton WITHDREW the MOTION to ADOPT the Letter of Intent for HB 411.

3:52:17 PM

REPRESENTATIVE GERAN TARR, CHAIR, LEGISLATIVE WORKING GROUP ON OIL AND GAS, provided a verbal report of the progress of the legislative working group that was established to analyze the state's fiscal regime for oil and gas. She indicated HB 111 was not adopted until late July. She commended Senator Giessel for developing and organizing the "Oil and Gas 101" training with the consultant Rich Ruggiero, IN3Energy. She reported that over 100 people attended that included representatives from industry, Department of Revenue (DOR), legislative staff, and legislators. The group's progress was hampered by the fall special session on the crime bill. The group held "a

couple" of meetings in December and met with the Competiveness Review Board to develop a working relationship with the board after it was determined that the board, established in SB 21 - Oil and Gas Production Tax [CHAPTER 10 SLA 13 - 05/21/2013] played a meaningful role. The working group was mandated to disband at the end of 2017, but Senator Giessel felt the group should continue to meet. The group published a report and delivered it to the Senate President and Speaker of the House. The group met again in early January with the Competiveness Review Board and had no intention to meet during the current legislative session. She noted that comments were made questioning whether the group should continue, which caused the group's members to question their involvement. She relayed that the intention of the group was not to evaluate specific proposals but to make broad evaluations not restricted by topic. she emphasized that comprehensive analysis was expected. Some of the proposals in HB 411 were identified as areas of interest but so were other wide-ranging topics. She exemplified that the A Star project and other infrastructure improvements could be a better way to partner with industry instead of the credit program that was not as beneficial to the state. She felt the group wanted to explore a more comprehensive approach other than just analyzing the tax structure or provisions in HB 411. She hoped the group would convene very soon. She welcomed as much involvement by individuals outside of the group. She maintained that the group offered a way to address differences in a bicameral process and bipartisan way rather than something in the context of a bill. She related that the working group was receiving mixed signals about whether to proceed and she would like a clear vision on whether or how to proceed.

3:57:35 PM

Representative Wilson thanked the representative and apologized for any mixed signals. She hoped the group would continue in the exact manner they established. She favored the broad approach.

Vice-Chair Gara thanked Representative Tarr. He clarified he had never been critical of the working group during committee discussion.

3:58:35 PM

Co-Chair Seaton explained that the industry wanted the working group to examine taxation specifically. He noted that the broader approach was not the expectation of industry and the purpose of the Letter of Intent was to narrow the focus to the concerns of industry. He hoped that all three consultants would be utilized to develop a proposal related to changes to the tax structure. He wanted the broad approach to include a detailed review of the tax structure that resolved specific issues. He indicated that the Letter of Intent requested that the working group analyze the provisions in HB 411. He stated that if the request was beyond the parameters of the group's mandate, it would be beneficial to advise industry that a detailed analysis of a tax proposal should come from House and Senate committees. He expressed confusion regarding the duties of the working group and would appreciate a delineation of its responsibilities.

Representative Tarr added that she agreed with his statements and shared that her concerns focused on the discussions regarding whether the working group had met or accomplished anything. She wanted to avoid a false characterization about the group. She relayed the difficulty with meeting during legislative session.

Co-Chair Foster relayed the agenda for the following day. He recessed the meeting to a call of the chair [note: the meeting never reconvened].

#
ADJOURNMENT

4:03:16 PM

The meeting was adjourned at 4:03 p.m.