

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

February 1, 2017

6:01 p.m.

**MEMBERS PRESENT**

Representative Andy Josephson, Co-Chair  
Representative Geran Tarr, Co-Chair  
Representative Dean Westlake, Vice Chair  
Representative Harriet Drummond  
Representative Justin Parish  
Representative Chris Birch  
Representative DeLena Johnson  
Representative George Rauscher  
Representative David Talerico

**MEMBERS ABSENT**

Representative Chris Tuck (alternate)

**COMMITTEE CALENDAR**

PRESENTATION(S): UPDATE: STATUS OF THE OIL AND GAS TAX REGIME

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

PAT GALVIN, Chief Commercial Officer/General Counsel  
Great Bear Petroleum  
Anchorage, Alaska

**POSITION STATEMENT:** Testified during the hearing of the status of the oil and tax regime in Alaska, and answered questions.

DAVID WILKINS, Senior Vice President  
Hilcorp Energy Company  
Anchorage, Alaska

**POSITION STATEMENT:** Testified during the hearing of the status of the oil and gas tax regime in Alaska, and answered questions.

BENJAMIN JOHNSON, President/CEO  
BlueCrest Energy, Inc.

Anchorage, Alaska

**POSITION STATEMENT:** Testified during the hearing of the status of the oil and gas tax regime in Alaska, and answered questions.

KEN ALPER, Director  
Tax Division  
Department of Revenue  
Juneau, Alaska

**POSITION STATEMENT:** Continued a PowerPoint presentation begun during the meeting of 1/30/17 entitled, "Alaska Oil and Gas Taxation - Status Report" dated 1/30/17, and answered questions.

#### **ACTION NARRATIVE**

[6:01:55 PM](#)

**CO-CHAIR GERAN TARR** called the House Resources Standing Committee meeting to order at 6:01 p.m. Representatives Tarr, Birch, Drummond, Johnson, Parish, Rauscher, Talerico, Westlake, and Josephson were present at the call to order.

#### **PRESENTATION(S): UPDATE: STATUS OF THE OIL AND GAS TAX REGIME**

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CO-CHAIR TARR announced that the only order of business would be an update on the status of the state's oil and gas tax regime.

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PAT GALVIN, Chief Commercial Officer and General Counsel, Great Bear Petroleum, informed the committee Great Bear Petroleum is an exploration company on the North Slope that holds 590,000 acres of state oil and gas leases located directly south of Prudhoe Bay and Kuparuk River Unit fields, but not in the Foothills. Great Bear has completed five years of 3D seismic acquisition - covering its approximately 1,000 square miles of leases - and has drilled three wells, two that targeted shale intervals; however, due to economics, the company has turned its attention to conventional fields. Great Bear utilized seismic data to identify six conventional oil prospects that will be explored with three wells and that have the potential to produce billions of barrels of oil. Further, Great Bear has spent almost \$250 million in drilling and seismic acquisition, and has earned about \$140 million in reimbursable tax credits, a large portion of which remain unpaid by the state. Mr. Galvin

provided a brief personal background. Turning to the status of Alaska's oil and gas tax system, he advised that the oil tax system is very complicated because it has developed over time and through a number of adjustments, and cautioned that under these circumstances policymakers may fail to see all of the ramifications of their actions. It is very important to develop a set of principles or objectives to follow in order to avoid unintended consequences. One of the driving principles of the state's oil and gas policy over the past 20 years has been a recognition of the need for competition on the North Slope; new companies as explorers and developers, and then as producers, create a different market with more activity and competition. He opined the aforementioned principle ensures economic equity between the incumbents and new companies, so that investment dollars hold the same economic value. Mr. Galvin cautioned against a return to a tax credit system that is more beneficial to an incumbent. Firstly, the existing reimbursable tax credit system ensures that new companies receive the same economic value as incumbents because incumbents immediately deduct their expenses and reduce their taxes, and reimbursable cash payments are equivalent to the value of an incumbent's tax savings; thus if the state fails to make payments, the investment value shifts back to the incumbent. Secondly, net operating loss credits are part of the tax system that allow a company with no revenue to deduct expenditures from zero and convert them to a credit. However, a current producer with no revenue would deduct expenses and generate net operating losses. He clarified that losses are not credits and can be carried forward into a subsequent year; the difference between credits and net operating losses must be recognized and understood.

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REPRESENTATIVE BIRCH asked what other investments have been made by Great Bear Petroleum.

MR. GALVIN said the company's focus is solely on Alaska and the North Slope; Great Bear was created by investors to pursue the "Shell play" in 2010. Subsequently, the company partnered with a new managing partner, and he provided a brief background on its new CEO. All of Great Bear's employees live in Anchorage.

REPRESENTATIVE PARISH surmised from Mr. Galvin's remarks that the state's current tax structure puts larger firms at a competitive advantage.

MR. GALVIN clarified that he is worried that the state is "definitely moving in that direction."

REPRESENTATIVE PARISH observed that it is imprudent for the state to pay statutorily recommended amounts of tax credit liabilities, given the state's financial difficulties.

MR. GALVIN remarked:

... I was there writing the statute that dealt with the reimbursable fund, and that is not intended to be a statutorily recommended amount. That was intended to be strictly a mechanism to establish the fund and to ensure that there was a way in which the fund would automatically receive a calculated amount, but it was always intended, and was from day one up until ... present, fully funded to the expected amount of the reimbursable credits that were supplied; in fact, it was written into the budget that it would be funded at whatever was necessary to cover the credits up until the governor vetoed that language a year ago. The legislature has always funded it completely, and that statute was never intended to be a limit or a recommended amount ....

REPRESENTATIVE PARISH posed the analogy of a person who spends \$100 at a market and receives a coupon worth \$60 off their next purchase. The state has created an unwise expectation that its coupon will be immediately repurchased, which is unfair to industry. He questioned how to restructure the current tax regime to level the playing field, because now the majors have an unfair advantage.

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MR. GALVIN disagreed with the foregoing analogy. For example, the state has advertised that exploration companies get \$0.60 back for each \$1 spent, and that current producers get \$0.60 off. He described the present situation, and said the state has "changed [its] mind." Mr. Galvin could not say how to fix the situation; the question is not whether the state can afford to pay, but that in order for all to participate, the state has to treat all of the industry the same. He questioned the administration's "fix" by having companies sell their credits to incumbents who then pay less, because the state pays out the same amount: the fix is an attempt to hide the cost on the "revenue side" for political expediency. Mr. Galvin said the

state should not create a profit center for one company and a disincentive for another, and urged for fairness.

CO-CHAIR JOSEPHSON acknowledged there is - or is an appearance of - a "promise" made by the state through the credit regime. He surmised Mr. Galvin's concern about a tax holiday in the initial years after production begins, "is that you couldn't get to production."

MR. GALVIN said that exploration is different from development and production in that it holds significant risk that there may be no return, thus a company cannot borrow against an exploration play. In Alaska there is a long lead time between exploration and production, so the expectation is that the return will be much higher; in fact, the cost of capital for an exploration company is that a five- to ten-year wait between expenditure and "a certain amount of cash" means nothing in value. For an exploration company there is a degrading of the economic value of a payment "way out in the first few years of production ...."

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CO-CHAIR JOSEPHSON questioned whether the state and the people of the state are entitled to a system that has the Department of Natural Resources (DNR) evaluate the financing and geology of a project, and establish a priority list based on merits, but not on the status of a company.

MR. GALVIN opined the public discussion that companies are making money off of the tax credit program without making good economic decisions is a fallacy. Great Bear's investors may invest between \$15 million and \$25 million to drill an exploration well in Alaska; after credits, the cost remains between \$9 million and \$15 million. An identical well in Texas would cost \$2 million to \$3 million. With this amount of money at risk, Great Bear does not need DNR's guidance. He recalled that when the tax credit program was established it was debated whether state oversight was needed, but Mr. Galvin's experience is that the industry is better equipped than DNR to assess risk.

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DAVID WILKINS, Senior Vice President, Hilcorp Energy Company, paraphrased from the following written statement [original punctuation provided]:

Good evening Co-Chairs Josephsen and Tarr, My name is Dave Wilkins and I'm the Senior Vice President for Hilcorp Alaska. I appreciate the opportunity to speak with the resources committee today and to take part in a discussion that is very important to me personally, it's important to my company and to our State. Hilcorp, founded in 1989, is one of the largest privately-held oil and natural gas exploration and production companies in the United States. Headquartered in Houston, TX, Hilcorp has nearly 1,500 employees in multiple operating areas including the Gulf Coast of Texas and Louisiana, Wyoming, the Northeast United States, and Alaska's Cook Inlet and North Slope. Here in Alaska, Hilcorp operates in both Cook Inlet and on the North Slope. Just over 500 full-time employees support our operations in Alaska and I'm proud to say that nearly 90% are Alaskan residents. I'm also proud to say that we've worked very hard to build efficiencies over the last several months. We were successful in doing so, and because of that I'm happy to report Hilcorp has had zero layoffs during this unpredicted drop in oil price. The support industry's willingness to help us weather the storm should not go unmentioned. While they have seen job losses overall, Hilcorp's activity, on average, employs approximately 400 full-time contractor positions and hundreds more part time contractor positions. Again, these are hard-working Alaskans helping us develop the State's resources safely and responsibly and are a major part of Alaska's overall economy. Hilcorp operates approximately 53,000 gross barrels of oil per day and 150 million cubic feet of gross gas sales per day from approximately 500 producing wells, for a total net production to Hilcorp of approximately 57,000 barrels of oil equivalent per day. Keep in mind we did not come to Alaska until 2012, so this represents a tremendous investment in Alaska in a very short time period. Before I go any further, and I realize you've heard this from earlier testimony, but it's worth saying again, from our point of view the system is working. I'm proud to say that we had a role in last year's historic increase in North Slope production. It's quite a feat for an operator that's only been on the Slope since late 2014. It's also important to note that we have worked very hard and invested hundreds of millions of dollars in the Cook Inlet basin as well. Our activity has

increased both oil and gas production- increasing revenues for paid to the state and providing long-term energy security for Alaska's largest population hub. SB21 was in place when Hilcorp made the decision to expand our operations in Alaska to the North Slope. It was a significant investment at a time when prices were significantly higher than they are today. It's worth mentioning that despite the economic and logistical challenges, Hilcorp continues to invest and works hard to move the needle on oil and gas production. We've made great progress in all three producing fields we operate on the Slope - Northstar, Milne Point and Endicott. We continue to invest time and money in the Liberty Development. It's a project that could add an additional 70,000 barrels a day down the pipeline. We also recently built a new drilling rig for those fields. We call it the Innovation rig, it's a state of the art rig that is already bringing more production online at Milne Point. If the legislature decides to change tax policy again, we will evaluate the economic impact to our company and adjust our spending accordingly.. We believe that the passage of SB21 was a good policy decision, and one that has yielded the results it intended. And as I watch the new legislative session take shape, I'm encouraged to hear that folks are recognizing the value of stability. Production from new exploration plays can take several years and hundreds of millions of dollars to bring online; maintaining and growing production from existing/aging fields requires significant and continual investments. I urge you to foster stability let good policy continue to benefit the state in the way it was intended and as a result we will continue to invest our capital in Alaska. We want to keep Alaskans employed. We want to put more oil in the pipeline, and so I'll close with this...Policy matters, the current system is working. Let's continue to work together, to provide stability not only for the industry but for the State. Thank you.

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CO-CHAIR TARR inquired as to tax credits for which Hilcorp was eligible in Cook Inlet.

MR. WILKINS said Hilcorp was eligible for credits and invested its credits into activity in Cook Inlet; five years ago there was concern that natural gas supplies in Cook Inlet were depleted, and importing natural gas may become necessary. Because of [Alaska oil and gas tax regime policies] Hilcorp made investments and earned credits by drilling over 50 wells in the Cook Inlet basin, which doubled oil production and stabilized the gas market. At this time, Hilcorp can no longer exercise cashable credits, but he opined that the tax credit policy was successful for Alaska.

CO-CHAIR TARR, as an aside, stated that if a company produces over 50,000 barrels of oil per day it is eligible to deduct net operating loss against tax liability, but not for cashable credits.

REPRESENTATIVE RAUSCHER asked where the Hilcorp rigs are located.

MR. WILKINS answered on the North Slope, the Kenai Peninsula, and offshore on the King Salmon platform.

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BENJAMIN JOHNSON, President/CEO, BlueCrest Energy, Inc. (BlueCrest), informed the committee that he supports the previous testimony by other members of the industry and stressed the importance of fostering an environment that brings Alaska's resources to development and value to its residents. Policy matters here, and positive changes to the state's tax system have stemmed the natural decline of oil through TAPS, fostered a rebirth of oil fields in Cook Inlet, and ensured that large new fields such as BlueCrest Cosmopolitan are under development. Further, new large oil finds have just been announced, which will require time and a lot of money to reach production, and begin a new era of productivity and wealth for Alaska. Also, BlueCrest is developing a smaller field in Cook Inlet which has the potential to deliver oil and natural gas within a short period of time and for years to come. In Cook Inlet, BlueCrest is utilizing an extended reach drilling (ERD) rig specifically designed to finish a new well that should be in production this summer, and a second new well may be producing by late fall. Mr. Johnson advised that the foregoing activities were commenced based on the belief that the state will stand behind its commitments concerning incentives to invest in Alaska. He acknowledged that the incentive plan may change, but urged that the state honor its commitments for the amounts that have

already been earned. Mr. Johnson provided brief personal background information. Now, as a manager representing global private investors, he must ensure the highest returns possible from assets; he restated that the oil business is a competition for investment dollars and the money follows the promise of highest return. In its search for investment opportunities, BlueCrest knew that Alaska has resources, but its high cost of development did not compete with the Lower 48 until the incentives offered by the state were sufficient to offset the higher cost. He stressed that BlueCrest would not be developing Cosmopolitan except for its trust in the state to follow through on its promises. At the time BlueCrest was evaluating the Cosmopolitan project, it relied on the "one-of-a-kind opportunity" announced by the state and based its plan on that a portion of the investment funds would be covered by the state tax credit. BlueCrest has successfully proved-up Cosmopolitan, completed a production facility, and built a large drilling rig which is drilling wells. Furthermore, BlueCrest has invested almost \$400 million in a project that will require \$500 million to reach the point of positive cash flow, and has earned the tax credits for the remaining, which should have been paid. Without confidence that the tax credits will be paid as due, in a timely manner, BlueCrest may lack the ability to continue unimpeded development; the results to the state are tangible, and BlueCrest may be forced to slow or stop drilling new wells that will provide large returns to the state. He recalled his previous testimony that the tax credits are a good investment for Alaska and represent a return of several hundred percent on the state's tax credit investment. In addition to oil reserves, BlueCrest also has a large proven gas field offshore in Cook Inlet that could provide energy security to Southcentral, but has stopped gas well drilling due to the uncertainty of the future of the tax credit program. Mr. Johnson urged that the committee work with industry to wisely develop Alaska's wealth.

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CO-CHAIR TARR inquired as to which credits benefit BlueCrest.

MR. JOHNSON responded that BlueCrest utilizes credits for intangible and tangible well lease expenditures and net operating loss; House Bill 247 cut the earned credits in half, and after calendar year 2017, there will be no further credits available in Cook Inlet.

REPRESENTATIVE BIRCH asked for the magnitude of BlueCrest's tax credit liability against its total investment in Cook Inlet.

MR. JOHNSON stated that BlueCrest has invested \$400 million and has received \$26 million in total tax credit payments to date. By the end of this year, BlueCrest will have an additional \$100 million due, which is approximately 25-30 percent of its total investment.

REPRESENTATIVE BIRCH asked for the range of the ERD rig.

MR. JOHNSON said 30,000 feet is reasonable; the well underway will be 22,000 feet.

REPRESENTATIVE RAUSCHER questioned how far the rig could reach horizontally.

MR. JOHNSON explained that the horizontal reach is a function of depth; for example, the wells underway are about three miles out and about one and one-half miles deep.

REPRESENTATIVE PARISH inquired as to BlueCrest's experience selling tax credit certificates.

MR. JOHNSON answered that BlueCrest has no experience selling tax credit certificates to a major company.

REPRESENTATIVE PARISH asked for BlueCrest's average return on equity, exclusive of Cook Inlet exploration.

MR. JOHNSON advised that BlueCrest is entirely focused on Cook Inlet, and has no return on equity for investors so far.

REPRESENTATIVE RAUSCHER asked for the cost of drilling a well in Cook Inlet.

MR. JOHNSON stated that an offshore well drilled in 2013 cost \$45 million; the ERD wells underway cost between \$40 million and \$45 million each. Compared to wells in the Gulf of Mexico, the same well in Alaska is three times more expensive.

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KEN ALPER, Director, Tax Division, Department of Revenue, continued an update begun during the meeting of 1/30/17 entitled, "Alaska Oil and Gas Taxation - Status Report" dated 1/30/17. Mr. Alper acknowledged that the industry was very unhappy with [Alaska's Clear and Equitable Share (ACES) passed in the 25th Alaska State Legislature] tax system because of high marginal rates, especially at high prices, and the windfall

profits tax; however, industry strongly supported Senate Bill 21 because of its effects at different price points and a perception that it more strongly favors investment. He explained that with multi-year developments it is hard to determine at what point a tax change impacts a decision, investment, or production. Mr. Alper opined large investments were driven by high prices and the state's generous system of cashable credits that was financed by state surplus revenue; neither of which were tied to the tax system in place at that time. The ACES tax system incentivized capital spending and Senate Bill 21 [passed in the 28th Alaska State Legislature] incentivized the production of lower cost oil (slide 42). He provided a "looking backwards" graph that estimated what production tax would have been under the tax regimes of [the Petroleum Production Tax (PPT), passed in the 24th Alaska State Legislature], ACES, and Senate Bill 21 for the years FY 07 through FY 18. At high prices Senate Bill 21 generates less revenue, although he questioned whether the foregoing is "the essential issue before the legislature right now ...." (slide 43).

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REPRESENTATIVE BIRCH characterized tax credits not as a gift but, in a manner similar to a child care tax credit, as an offset on one's taxes. He asked whether tax credits are an integral part of what the government levies in its tax program.

MR. ALPER explained tax credits that are deducted against liability are an integral part of the tax system and are related to the tax rate set by legislation; however, cash credits are unique to Alaska and no matter their definition, they are part of an incentive program to encourage desired behavior. He advised at this point, the cost benefit of the incentive program in the future must be evaluated. In response to an earlier question, he directed attention to slide 43 and pointed out that in FY 16 and FY 17 projected revenue from ACES is zero because the 20 percent capital credit not bound by the minimum tax floor would have offset any taxes due from producers.

CO-CHAIR JOSEPHSON referred to modeling for ACES and Senate Bill 21 and opined the legislature "did not adequately consider this sort of marketplace ...."

MR. ALPER recalled the Senate Bill 21 model was bound by an \$80-\$120 per barrel of oil expected price range. The ACES model looked at the \$40-\$80 per barrel of oil price range; however, in

2007, spending was about \$20 per barrel and now it is \$40, which creates a big difference when calculating a net profits tax, thus ACES did not consider very low prices either. He said:

... the minimum tax was a stopgap, something of an emergency tax. The fact that we've been exclusively living under it for the last three years and ... it's our primary production tax for the foreseeable future, is probably outside the expectations of the bill.

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REPRESENTATIVE PARISH returned attention to slide 43 and said all things being equal, the state would be about \$10 billion poorer if under the Senate Bill 21 tax regime since FY 07.

MR. ALPER pointed out that other factors, such as budgeting and savings, impact the estimated revenue. In response to Representative Parish's repeated question, he said yes.

REPRESENTATIVE TALERICO remarked:

... we talk about the \$10 billion, that's under the assumption that capital spending and investment in all of our oil industry would have remained at the level it did, had the tax regime stayed there under ACES and the capital was not actually available to the companies to invest. So I think an assumption that that would actually be available might, might be kind of tough for us to [arrive] at.

MR. ALPER agreed. In response to Co-Chair Tarr, he said for a period in FY 08, oil prices were over \$130 per barrel thus the state received the ACES greater-than-50-percent tax rate for a period of two months; further, the progressive tax rate changed every month based on average profits, which capitalized on the industry's windfall.

REPRESENTATIVE BIRCH recalled the legislature significantly increased the amount originally proposed by former Governor Palin in ACES legislation.

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MR. ALPER said yes, and added that the tax base rate of ACES was 25 percent, which was an increase from PPT; in addition, the slope of progressivity as profits go up was increased from 0.2

percent per dollar to 0.4 percent per dollar. He stressed that the original bill also provided for a 10 percent minimum tax on certain large legacy fields, which was removed in response to industry objections, thus the higher percent "was a tradeoff for the other."

REPRESENTATIVE BIRCH observed that Senate Bill 21 incorporates a floor of 4 percent.

MR. ALPER advised the 4 percent floor remains unchanged since PPT; however, the degree to which certain credits can offset the minimum tax have changed. For example, in ACES the 20 percent capital credit could lower beneath the floor, but Senate Bill 21, with the exception of certain factors, holds the legacy fields to 4 percent of the gross value of oil.

REPRESENTATIVE BIRCH observed Senate Bill 21 is "saving the day for us here ... under the current price regime."

MR. ALPER questioned whether Senate Bill 21 or ACES adequately determine state revenue in a very low-price environment.

CO-CHAIR TARR discussed the three ways of "hardening the floor" included in Senate Bill 21.

MR. ALPER explained that credits that can be used to go below the minimum tax would be any refundable exploration credits, which have now expired; the small producer credit; the \$5 per barrel credit for new, gross value reduction (GVR) eligible oil; and any net operating loss (NOL) credits. He elaborated that although the exploration credits, other than for [non-North Slope, non-Cook Inlet areas of the state known as Middle Earth], have expired, and the small producer credit eligibility has expired, those that have qualified can receive credits for nine consecutive years. Mr. Alper then presented two graphs that compared ACES and Senate Bill 21 in a range of oil prices based on the Department of Revenue (DOR) fall 2016 forecast models, not including and including the impact of repurchased tax credits (slides 44 and 45).

CO-CHAIR TARR referred to the representation of the per barrel credit on slides 44 and 45.

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MR. ALPER noted different proposed versions of Senate Bill 21 called for a flat \$5 per barrel credit or one based on a sliding

scale. The sliding scale found in the final version, creates "odd marginal tax impacts as one gains or loses right at the margin ... [thus] the oddity of the stair step." He continued to "looming problems" (slide 46). One issue is not enough revenue now and possibly in the future. The state's net profit system is not a pure net profit system but is a hybrid; for example, income tax is based on profit and royalty is tied to gross. He provided details on how the production tax system is also a hybrid (slide 47). He expressed DOR's concern that cashable credits of reasonable amounts that were intended to support small exploration companies and diversify the North Slope, are being earned by large discoveries and will lead to huge payments the state cannot afford. Furthermore, if the credits are not paid, the situation is detrimental to companies that have made investments.

MR. ALPER, in response to Co-Chair Josephson, clarified that state revenue from oil and gas and restricted and unrestricted funds in FY 16 was approximately \$1.6 billion, and is forecast at \$1.4 billion in FY 17.

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CO-CHAIR JOSEPHSON acknowledged that the state will recoup its investment over the life of a successful oil field, however, he questioned why the industry would not see that the current outlay for a large project is not possible, even though the state may seek to do so.

MR. ALPER, presuming that Caelus' model is accurate and its field is successful, said a tax credit of \$3.5 billion is a reasonable contribution from the state: the foundational difference is the state offsetting Caelus' future taxes when due, versus writing Caelus a check sometime in the next five years.

CO-CHAIR JOSEPHSON referred to other testimony that production will not happen without state assistance now.

MR. ALPER agreed that if the state goes too far reducing tax credits, it will "tip that playing field." He pointed out that an existing producer, such as ConocoPhillips Alaska, Inc., can develop a large, new find under an economic structure different from that of a small explorer because it is already producing oil in Alaska and has profits. This is possible because, for tax purposes, the North Slope is a single entity, and every company has a unified tax return for all of its North Slope

operations thus spending money on development can be offset by credits against taxes on its profit; however, Caelus, for example, is in a different situation, and large expenditures could force it to sell its assets to a major producer, which is counter to the legislature's and the administration's efforts to diversify the North Slope and create competition.

REPRESENTATIVE BIRCH referred to a previous chart [chart not identified] which indicated that the state receives about \$1 billion per year when oil is priced at \$30 per barrel; he concluded the state's interest is best served by producing oil.

MR. ALPER agreed that the intent of Senate Bill 21 was that total government take should remain relatively the same across a range of oil prices. However, a portion of the state's share is royalty, and royalty is a fixed number: 12.5 percent of gross. He gave an example of gross at 30, and 12 percent of that is \$4, and the net profit is \$1, so that is a 400 percent tax.

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REPRESENTATIVE TALERICO expressed his understanding that there is a limit on refundable credits per company, at \$70 million per year, with the intent to allow the state to defer cash payments.

MR. ALPER said yes, a provision of House Bill 247 set a limit of \$70 million per company. However, if a company has partners, the limit is multiplied by the number of its partners, thus the maximum remains unknown.

CO-CHAIR JOSEPHSON added that the \$70 million limit is applied per year and overages will accrue for a future liability.

MR. ALPER agreed that there is no cap on the amount of tax credits that a company earns in one year; hopefully, production will ensue quickly, followed by a tax liability.

CO-CHAIR TARR questioned whether total government share typically includes the royalty share, noting that in the Lower 48, royalty - the ownership share - is paid to private landowners.

MR. ALPER explained that DOR analyses of total government take include royalty; in fact, in an "apples to apples" comparison, one should look at the total non-producer share.

CO-CHAIR TARR questioned whether corporate income tax paid to the state is deductible against federal corporate income tax.

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MR. ALPER explained that production tax is deductible from state corporate income tax, and what remains is subject to federal income tax; net loss credits on federal income tax can be carried forward to future years. He returned attention to slide 47, and informed the committee the floor in Senate Bill 21 is permeable to potential loss credits, and could reduce taxes to zero if the price of oil is at \$40 per barrel. "Hardening the floor" refers to making the minimum tax "solid" so that credits can't be used, but that raises the equity issue. He opined the minimum tax is broader than originally intended; in fact, the minimum tax is in effect up to \$80 per barrel because of higher per barrel spending and the \$8 per barrel credit which impacts the minimum. Also, under the Senate Bill 21 system, there is no mechanism to replenish the state's savings if there is a return to high oil prices. Further, a net profits tax system is more complex to administer (slide 47).

REPRESENTATIVE PARISH questioned whether a gross tax system would level the playing field between newcomers and larger producers.

MR. ALPER said a pure gross system would. He recalled that during the construction of Prudhoe Bay, the producers spent a lot of money without credits and made money once the oil was flowing. However, a gross tax does not encourage the development of challenged resource fields, and pays the state less when oil prices are high. He concluded that a gross system is a simple way to "fix the equity question." In further response to Representative Parish, he suggested other means are to lower the operating loss credit, or set time limits on the credits.

MR. ALPER returned to the presentation and said in July 2016, during a special session to address a fiscal plan, the governor introduced House Bill/Senate Bill 5005 that eliminated all North Slope net operating loss credits (slide 48).

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REPRESENTATIVE RAUSCHER asked whether the aforementioned changes were modeled.

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MR. ALPER stated that a fiscal note was introduced with the bill and initial modeling was presented at its first hearing. In further response to Representative Rauscher, he advised the bill would have negatively affected some projects, as a company would have had to make back all of its investment from future profits. He then described "Fiscal Note" modeling DOR will provide to explain the line item impacts of any of the various components incorporated in proposed legislation (slide 50). He provided details of "Life Cycle" modeling that will reveal the various impacts of proposed legislation to a specific project or oil field (slide 51). Lastly, he described "Long term scenario modeling" which revealed the impacts of hypothetical production from the Arctic National Wildlife Refuge (ANWR) fields (slide 52).

REPRESENTATIVE BIRCH asked whether there is a private [land]owner component in ANWR.

MR. ALPER responded ANWR is considered federal land, however, the federal government would get 10 percent royalty, and the state would get 90 percent royalty and production tax. Turning to the topic of tax audits, he advised that production tax audits of oil and gas companies are complex tasks involving very large companies. Tax audit assessments, like the results of a legal action, are Constitutional Budget Reserve Fund (CBRF) revenue. Currently, the statute of limitations for production tax audits is six years, and Tax Division staff has adapted to regulations for ACES, new software, and increases in tax credit applications (slide 54). The 2007 audit was not released until 2014, and the total assessments for 2007 were \$387.3 million. The 2008 audit was completed in 2015, and the total assessments were \$264.4 million. He explained that Senate Bill 21 reduced the interest rate on assessments from 11 percent compounded quarterly to 3 percent or 3.5 percent simple interest. In 2009, the total assessments were \$132 million. Most of the foregoing assessments have been paid, settled, or appealed (slide 55). Upcoming audits for 2010 should be done in February 2017, and 2011 audits should be done in spring, 2017. Mr. Alper pointed out that audits for 2010-2013 are very important because they cover years of high revenue and high progressivity (slide 56).

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REPRESENTATIVE PARISH questioned whether from 2007 to 2009 the state was underpaid in taxes in the amount of over \$300 million.

MR. ALPER acknowledged the state claimed underpayment of tax, but the appeals process gleans follow-up and missing information; by a multi-stage process, adjustments are usually made and agreement is found "somewhere in the middle."

REPRESENTATIVE BIRCH observed that the state has well exceeded former Governor Jay Hammond's admonition of "one-third, one-third, one-third," and reached 40-50 percent.

MR. ALPER offered to provide further information on shared net profits, gross value at the point of production of wellhead value, and the percentage of market value. He agreed that total government take at this time is in the "mid-60s."

CO-CHAIR JOSEPHSON relayed that industry does not have the resources to pay 35 percent, not including royalty, at this oil price.

MR. ALPER directed attention to slide 19 and said in a gross system it is easier to predict the percentage of revenue because the tax stays nearly the same. These are questions of public policy and how much the legislature is willing to accept in matters of risk, liquidity, and volatility from the oil and gas tax system.

REPRESENTATIVE TALERICO pointed out that a statement related to selling credits at \$0.70 on the dollar was erroneously attributed to a previous testifier.

MR. ALPER clarified that DOR is aware when credits change hands, but is unaware of their value. In 2006, there was anecdotal information that PPT credits were selling in a 70 percent range.

REPRESENTATIVE TALERICO restated that the previous testifier provided an example.

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#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 8:02 p.m.