

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 13, 2017

1:47 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 Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 111

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

- HEARD AND HELD

HOUSE BILL NO. 87

"An Act relating to participation in matters before the Board of Fisheries and the Board of Game by the members of the respective boards; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

HOUSE JOINT RESOLUTION NO. 12

Opposing the United States Food and Drug Administration's approval of AquaBounty AquAdvantage genetically engineered salmon; and urging the United States Congress to enact legislation that requires prominently labeling genetically engineered products with the words "Genetically Modified" on the product's packaging.

- SCHEDULED BUT NOT HEARD

HOUSE BILL NO. 32

"An Act relating to the labeling of food; relating to the misbranding of food; requiring labeling of food produced with genetic engineering; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 111

SHORT TITLE: OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

SPONSOR(s): RESOURCES

02/08/17	(H)	READ THE FIRST TIME - REFERRALS
02/08/17	(H)	RES, FIN
02/08/17	(H)	TALERICO OBJECTED TO INTRODUCTION
02/08/17	(H)	INTRODUCTION RULED IN ORDER
02/08/17	(H)	SUSTAINED RULING OF CHAIR Y23 N15 E2
02/08/17	(H)	RES AT 1:00 PM BARNES 124
02/08/17	(H)	Heard & Held
02/08/17	(H)	MINUTE(RES)
02/13/17	(H)	RES AT 1:00 PM BARNES 124
02/13/17	(H)	Heard & Held
02/13/17	(H)	MINUTE(RES)
02/17/17	(H)	RES AT 1:00 PM BARNES 124
02/17/17	(H)	Heard & Held
02/17/17	(H)	MINUTE(RES)
02/20/17	(H)	RES AT 1:00 PM BARNES 124
02/20/17	(H)	Heard & Held
02/20/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 1:00 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 6:30 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/24/17	(H)	RES AT 1:00 PM BARNES 124
02/24/17	(H)	Heard & Held
02/24/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 1:00 PM BARNES 124
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 7:00 PM CAPITOL 106
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)

03/01/17 (H) RES AT 1:00 PM BARNES 124
03/01/17 (H) Heard & Held
03/01/17 (H) MINUTE(RES)
03/01/17 (H) RES AT 6:00 PM BARNES 124
03/01/17 (H) Heard & Held
03/01/17 (H) MINUTE(RES)
03/06/17 (H) RES AT 1:00 PM BARNES 124
03/06/17 (H) Scheduled but Not Heard
03/06/17 (H) RES AT 6:30 PM BARNES 124
03/06/17 (H) Heard & Held
03/06/17 (H) MINUTE(RES)
03/08/17 (H) RES AT 1:00 PM BARNES 124
03/08/17 (H) Heard & Held
03/08/17 (H) MINUTE(RES)
03/08/17 (H) RES AT 6:00 PM BARNES 124
03/08/17 (H) Heard & Held
03/08/17 (H) MINUTE(RES)
03/09/17 (H) RES AT 5:00 PM BARNES 124
03/09/17 (H) -- MEETING CANCELED --
03/10/17 (H) RES AT 1:00 PM BARNES 124
03/10/17 (H) Heard & Held
03/10/17 (H) MINUTE(RES)
03/11/17 (H) RES AT 12:00 AM BARNES 124
03/11/17 (H) -- MEETING CANCELED --
03/13/17 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

ED KING, Legislative Liaison
Office of the Commissioner
Department of Natural Resources
Juneau, Alaska

POSITION STATEMENT: Provided information regarding a forthcoming Department of Natural Resources fiscal note during the hearing of HB 111.

ACTION NARRATIVE

[1:47:17 PM](#)

CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 1:47 p.m. Representatives Tarr, Birch, Parish, Talerico, Rauscher, Drummond, Johnson, Westlake, and Josephson were present at the call to order.

HB 111-OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

[1:48:41 PM](#)

CO-CHAIR TARR announced that the first order of business would be HOUSE BILL NO. 111, "An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date." [Before the committee was the committee substitute (CS) for HB 111, Version 30-LS0450\N, Nauman, 3/10/17, adopted as a working document during the 3/10/17 House Resources Standing Committee meeting.]

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CO-CHAIR TARR informed the committee that although the committee substitute (CS) for HB 111, Version N, was reviewed at the meeting on 3/10/17, two issues require further review, one of which is how the concept of uplift is approached in the bill. She recalled Richard Ruggiero, Managing Partner, Castle Gap Advisors, Castle Gap Energy Partners, [consultant to the Legislative Budget and Audit Committee] had advised that because the state is considering eliminating cash credits in favor of [net operating loss (NOL)] deductions, uplift is a concept that would level the playing field for non-producers. Currently, producers generally use their losses within the year in which they are earned because they have a tax liability, which enables them to use 100 percent of their losses against their tax liability. However, for non-producers, from exploration to the start of production - which is an average of seven years - non-producers just accumulate losses, thus the state is seeking to "offer [non-producers] something that's attractive," she said.

CO-CHAIR TARR directed attention to a document entitled, "Comparison of CSHB 111 with Rauscher Amendment N.1 and N.2," dated 3/9/17. She remarked:

With a 50 percent carry forward [of net operating losses (NOLs), and] with the 8 percent interest ... by year seven, those individuals have recovered ... basically 85 percent of the cost. So, it's not [100 percent] but ... we have to keep in mind that what we also offer is the GVR provision, and so these individuals, who are not in production, after year seven, not only will they get to carry forward all of those losses, but then starting in year one, from when they become producers, they also have the GVR provision.

CO-CHAIR TARR cautioned that if the state is too generous, the value [of state revenue] will be eroded; for example, [Amendment N.1] allows 100 percent of the losses to go forward with 10 percent interest, which equates to giving 200 percent of the value by year seven. That, plus GVR provisions and the per barrel credit, would result in total erosion of value to the state. She reminded the committee that Mr. Ruggiero had recommended a bracketed tax based on profit, along with the elimination of both the per barrel credit and the GVR provisions. However, Version N does not eliminate the per barrel credit or GVR, but has made modest modifications on the per barrel credit. Further, she warned of "how all of these sort of stack up against each other and so that is why we felt like this is [an] appropriate way to apply this uplift, because we're not, at the same time, doing away with the GVR provisions that apply once they become a producer."

[1:51:57 PM](#)

CO-CHAIR TARR, continuing to changes made in Version N to the sliding scale of per barrel credit, directed attention to a slide provided by the Tax Division, Department of Revenue (DOR), entitled, "A Net Profits Tax is very Volatile to Price" [included in the committee packet] that showed the current tax rate is 35 percent, but the effective tax rate is much lower. Version N recognizes that as oil price falls below \$50, a 4 percent tax with a hard floor would ensure the state retains some value, and as oil prices rise above \$50, Version N increases the minimum tax to 5 percent that would ensure some value to the state when oil prices range from about \$50 to \$70 per barrel. She provided an example based on production of 500,000 barrels per day, wherein a 12.5 percent royalty share is subtracted to arrive at 437,000 barrels, and that number is multiplied by 365 days to equal 160 million barrels produced annually. Based on this scenario the minimum tax, at 4 percent, with an oil price of about \$55, results in the state receiving \$1.80 per barrel:

- \$55 less \$10 for transportation = \$45 gross value at point of production (GVPP)
- \$45 less \$30.88 for lease expenditures = \$14.12 for production tax value (PTV)
- 35 percent tax on \$14.12 = \$4.94
- subtract \$8 per barrel credit = minimum tax zone.

CO-CHAIR TARR opined the current tax of between 9-13 percent is too low. Because oil prices are now consistently in the "mid-

price range," raising the minimum tax to 5 percent of production tax value, although a modest change, is crucial at the mid-price range per barrel; in fact, at an oil price of about \$65, the effective tax rate would be about 10-15 percent.

CO-CHAIR TARR, recalling suggestions from the consultant and others, said, "One of the ways that we can be a little more generous on the low side is if we take a little bit more on the high side." She pointed out under the current tax system a per barrel credit is available when oil prices are \$160 per barrel and above; however, oil prices have never exceeded \$147 per barrel, thus Version N lowers the "windfall" price to \$120 per barrel, and the state would collect higher revenues [because per barrel credits would no longer apply] when oil prices are around \$120 and more. She urged the committee to compute the modeling equations on their own, pointing out that the mathematics are not complicated, and offered to provide modeling of lease expenditures at varying price levels. Lease expenditures are expected to increase with the price of oil as companies will begin to recover from layoffs, and in fact, lease expenditures have decreased from \$53-\$54 per barrel in 2015 to \$40.12 in 2016.

CO-CHAIR TARR said an understanding of the economics of oilfield operations provides a clear understanding of why a discovery like Smith Bay will not be developed - until oil price per barrel increases substantially to offset the cost of development. She concluded that the changes made in Version N are modest and address the current low oil price environment. Further, although infrastructure depreciates, Version N allows 100 percent of the value of a loss to be carried forward, without depreciation, thus there is generosity built into the proposed legislation.

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REPRESENTATIVE JOHNSON referred to the recent Armstrong/Repsol discovery and asked whether its announcement is a positive indication of how the current tax policy is working. She said, "Did that change your view on [HB 111] at all?"

CO-CHAIR TARR urged further discussion about the amount of loss the proposed legislation allows to be carried forward and how much of the value would be recovered. She stressed that [carry forward losses] are allowed for the first seven years of development, and GVR provisions extend further to seven years of production, therefore, during the first fourteen years of work,

the state would be providing very attractive opportunities. And so, if the state is more generous, announcements of new finds will not generate "much of excitement for the state." The consultant suggested if the state allows 100 percent carry forward losses, it should eliminate GVR and per barrel credit because without eliminating GVR and per barrel credit, the tax system leads to "stackable credits"; for example, at Smith Bay, stackable credits have meant that the state will cover 85 percent of the work conducted thus far at Smith Bay - a generosity she opined the state can no longer afford. The preapproval provision of the bill will also allow the state to have a better handle on costs. Co-Chair Tarr stressed that the proposed legislation does not change from a net profits system, and will continue to recognize the recovery of costs through net profits, as well as carry forward losses, GVR, and per barrel credits, a system which she characterized as generosity on the part of the state and/or opportunities for the industry. She compared the find at Smith Bay, which is distant from existing infrastructure, to the Point Thomson development, noting a larger diameter pipeline transporting oil 124 miles to the Trans-Alaska Pipeline System (TAPS) would be prohibitive at an oil price of \$55 per barrel, and said, "If the state is going to be sort of a co-investor by allowing these expenses to be deducted, I think we want to be as strategic as possible [with] the dollars that the state invests."

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REPRESENTATIVE RAUSCHER, referred to [Version N, Section 26 subsection (n)] that directs the Department of Natural Resources (DNR) to preapprove costs that will generate a carry forward annual loss, and asked how that provision will work.

CO-CHAIR TARR responded that currently a plan of development and a plan of production are submitted to DNR, albeit late in the process of developing a project. The proposed bill directs DNR to prepare draft regulations [for a preapproval process], on which the public, stakeholders, and industry would have an opportunity to comment. She acknowledged industry is well-suited to participate in the adoption of said regulations. Testimony by Mr. Ruggiero touted the benefit to all parties of multiple and timely contacts with the governmental regime, in order to offer incentives and provide oversight to ensure every dollar is spent in a strategic manner.

REPRESENTATIVE RAUSCHER pointed out this is not a role DNR has accepted in the past.

CO-CHAIR TARR reported that representatives of DNR have expressed interest in having better oversight because the state has no ability to "turn down the work once it has happened." For example, if a project does not stay on schedule due to poor management, the project may be delayed. If DNR participates earlier in the development of a project, a delay may be avoided and additional expenses - to the state as co-investor - avoided also. Further, DNR may choose to prioritize nearer-term projects over distant projects.

REPRESENTATIVE RAUSCHER suggested that the committee should have an opportunity to question DNR directly on this provision; furthermore, if DNR is going to accept this responsibility, then an additional fiscal note from DNR may be warranted. He cautioned there would be costs borne by DNR and the Department of Revenue (DOR).

CO-CHAIR TARR said DOR would continue to receive tax payments from industry, but the review process would be the responsibility of DNR. She restated when the draft regulations related to the review process go out for public comment, the industry will have an opportunity to comment on how specific companies are affected. Additional staffing at DNR was not discussed, she recalled, and she agreed that it would be good to have the department respond to Representative Rauscher's question.

REPRESENTATIVE RAUSCHER further questioned whether DOR or DNR has control over the allowable lease expenses.

CO-CHAIR TARR responded that currently, nobody has control over allowable lease expenditures. In further response to Representative Rauscher, she said Version N would direct DNR to develop regulations and create a standard system of review for all companies to follow. She suggested the review could be informal or not, and guided by industry.

REPRESENTATIVE RAUSCHER asked whether a taxpayer would be required to submit an annual lease expenditure estimate on January 1, of each year, to get preapproval.

CO-CHAIR TARR said that has not been determined yet because the bill directs DNR to develop regulations through the established public process, which would involve industry participation.

REPRESENTATIVE RAUSCHER queried what the consequences would be if the taxpayers erred in their estimates.

CO-CHAIR TARR stated the bill does not propose punitive action; however, the provision may provide DNR the opportunity to identify and correct overspending.

REPRESENTATIVE RAUSCHER predicted that auditing procedures may be challenging, duplicative, and expensive.

CO-CHAIR TARR clarified that DOR is involved in a project "after the spending has taken place," at taxpayer filing, and this provision under discussion would provide an earlier and better understanding of a project.

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The committee took an at-ease from 2:14 p.m. to 2:19 p.m.

[2:19:34 PM](#)

CO-CHAIR JOSEPHSON commented that when Senate Bill 21 [passed in the Twenty-Eighth Alaska State Legislature] was enacted there was the belief that the legislation created a 4 percent hard floor; in fact, that does not exist.

[Due to technical difficulties the remainder of Co-Chair Josephson's comments were not recorded and the committee took an at-ease from 2:20 p.m. to 2:34 p.m. to relocate to Room 106.]

[2:34:17 PM](#)

CO-CHAIR TARR called the House Resources Standing Committee back to order.

CO-CHAIR JOSEPHSON recalled that in early February of last year the legislature learned that the credits, particularly when stacked - and in a low-price environment - could bring the taxable value beneath zero, which was cause for concern. Further, media accounts at the time suggested that this consequence of Senate Bill 21 was neither well-understood by all, nor had it been sufficiently vetted by either chamber in 2013. He acknowledged this concern was somewhat remedied in House Bill 247 [passed in the Twenty-Ninth Alaska State Legislature]. The proposed provision directing DNR's involvement [by preapproval of an oil and gas project] is in response to the belief that the public is entitled to more

information about the investments Alaska has made. Although under Version N, those investments would no longer be cash investments, the public is still entitled to be informed because deductions are taken against tax liability, and there are net operating losses [both resulting in the reduction of state revenue]. Co-Chair Josephson opined, due to the aforementioned circumstances, preapproval by DNR is warranted. In addition, when operators make a decision to invest in an oilfield, they have already achieved their company's internal approval, and the public is entitled to know and understand said investments through their elected officials. This is particularly appropriate to ensure against ring fencing, when a company uses a single unprofitable location to make itself unprofitable in toto.

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REPRESENTATIVE BIRCH posed the question of whether the proposed legislation would attract investment and exploration in order to put more oil in TAPS. He asserted that a [page from the fiscal note, titled "Provisions in CSHB 111 (RES)\N and their Estimated Fiscal Impact based on Fall 2016 Forecast (\$millions) - Fall 2016 FC PRICE," revised 3/13/17 by DOR, included in the committee packet] attached to [Version N] shows \$190 million added in expense to the industry by fiscal year 2020 (FY 20). Furthermore, state royalty share has been "lost in the discussion," and more information is also needed from DNR related to Version N. Representative Birch noted [the recently announced discovery in the Pikka and Horseshoe units by Armstrong and Repsol that is projected to produce] 120,000 barrels per day, at a one-sixth royalty share, would yield about 20,000 barrels of oil per day for Alaska; at \$50 per barrel, this one discovery would bring the state about \$1 million per day - and between \$300 million and \$400 million per year - in royalty. He cautioned against legislators dismissing royalty share, but instead to do what they can to attract investment, put oil in TAPS, and fulfill their fiduciary responsibility to the favorable development of Alaska's resources. Representative Birch said, "I think we need to take a real hard look at, if adding another couple hundred million a year in cost is going to attract the kind of investment that we need to realize our oil and gas potential in this state."

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REPRESENTATIVE PARISH declared that before he became an 85 percent investor, he would need to know the nature of the

investment and the likelihood of it paying off in the near or distant future. He opined that under the current system, legislators do not have that assurance or the necessary level of oversight on their investments; in fact, subsidizing behavior at 85 percent skews behavior and encourages behaviors which may not be economical or rational in the absence of a generous subsidy. He expressed his hope that through the proposed legislation, DNR would provide the needed oversight. Representative Parish expressed his support for the bill, and reminded the committee that the initial development of the North Slope oilfields was not subsidized.

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REPRESENTATIVE TALERICO questioned accuracy of the 85 percent figure mentioned by Representative Parish, except in regard to the tax system currently in place in Cook Inlet, which will be reduced by 50 percent on July 1, and eliminated completely on July 1, 2018, as a result of House Bill 247; on the North Slope, the state's level of investment does not reach 85 percent. He stated his biggest concern is regarding throughput: in January throughput was about 554,000 barrels per day, and in February, was about 553,000 barrels per day. Even with low prices, this year and last, Alaska has seen an increase in throughput, and the trend is for throughput to continue to rise. He said, "... I think [it's] really important that we've had this increased throughput which, of course, is good for the coffers of the State of Alaska, because we do ... well off of royalty, royalty is a thing that ... we obviously felt that we needed and we've always been able to collect, and the more throughput there is the more oil there is for the State of Alaska." He turned to the issue of tax credits, and said last year the legislature recognized that Cook Inlet tax credits represented about \$411 million of the total \$648 million in tax credits, and since Alaska's take from Cook Inlet is nothing like that from the North Slope, the legislature addressed the Cook Inlet credits through House Bill 247. The provisions of House Bill 247 affect some companies adversely, yet it provides a transitional period so that companies can adjust to the new provisions. He stressed that although provisions in House Bill 247 have yet to take effect, the legislature is discussing more changes to the tax regime. Representative Talerico referred to a graph - presented during testimony on other proposed legislation related to production tax - which showed that an increase in production tax would result in a \$25 million deficit; however, projections for House Bill 247 indicate that the following year there would be production tax revenue in the amount of \$110 million, increasing

to \$136 million the next year [document not provided]. He opined House Bill 247 has put Alaska on the right track for more production and revenue - and industry agrees - as evidenced by more production. He cautioned legislative actions that unnecessarily decrease throughput would be a disservice to Alaska. Throughput in TAPS is key, and he reiterated that House Bill 247 should be allowed to take effect - the current system will work. He observed that it is a matter of record that a few more people oppose the proposed legislation than support it, and restated his concerns about losing both increased production through TAPS and the current [improved] investment climate.

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CO-CHAIR TARR agreed that Alaska wants to remain an attractive place for investment and to increase the amount of oil flowing into TAPS. She said Version N does not address Cook Inlet - in part because House Bill 247 does so - but it would establish a Cook Inlet working group to adjust the provisions of House Bill 247 that are related to oil tax, as more information becomes available. Further, establishing the working group now would ensure that the opportunity for recovering costs is addressed.

CO-CHAIR TARR, in response to Representative Birch's previous comment on the aforementioned fiscal note, directed attention to line D, under "Total Revenue Impact," which read "Budget impact of no cash repurchase for net NOL credits earned after 1/1/18." She said that the fiscal note shows that after 1/1/18, credits owed by the state would not be paid by a check, but are "just being shifted to the ... revenue side of things, when those people become producers, and will have reduced revenue." Thus the state's investment is "realized on the other side of the equation." For example, the only benefit to the state was shown on line 3 of the fiscal note, under "Description of Provision," which read "Minimum tax increased to 5% of GVPP at prices of \$50 and above ...," and for FY 18 the benefit would be \$20 million, which is a reduction from the original version of the bill.

REPRESENTATIVE BIRCH returned attention to the aforementioned fiscal note on the line "Total Fiscal Impact - (does not include potential changes in investment)" and said the impact for FY 20 is \$190 million. He asked if the \$190 million signifies \$190 million more [emphasis on "more"] that the state would take.

CO-CHAIR TARR answered that on the aforementioned fiscal note, the amount for FY 20 on line "Total Revenue Impact" is added to the amount for FY 20 on the line "Total Budget Impact": \$60

million plus \$130 million equals \$190 million, therefore, the substantial portion of the \$190 million comes in "Total Budget Impact." She continued as follows:

And so, a big portion of that ... where we save money is by not writing the checks. So, we won't be writing the checks; however, when they become producers ..., it'll become reflected in reduced revenue to the state, as is the case with the big three right now, that, as taxpayers generally use their losses in the same year that they were earned.

REPRESENTATIVE BIRCH pointed out the fiscal note shows an upward trend to a total fiscal impact of \$260 million in 2027. He asked for confirmation that this would be additional revenue to the state over and above existing revenue.

CO-CHAIR TARR answered, "Yes and no." She explained that the revenue - new money coming into the state - is shown in the upper portion of the fiscal note [Description of Provision]; the bottom half [Total Revenue Impact] shows "the budget impact of us not paying out money." She continued as follows:

It's just a little bit different, in that we're not writing a check; we're saying: "Carry forward your losses. Once you become a producer, that money will be deducted from your taxes." So ... whenever those companies become producers, we'll see that dollar amount shown as a reduction in their tax liability to the state. So, not new dollars coming in, but us not paying dollars out.

CO-CHAIR TARR invited amendments for consideration.

[2:52:11 PM](#)

REPRESENTATIVE RAUSCHER moved to adopt Amendment 1, labeled 30-LS0450\N.3, Shutts/Nauman, 3/13/17, which read:

Page 1, lines 1 - 7:

Delete all material and insert:

"An Act relating to the interest applicable to delinquent oil and gas production tax; relating to the net operating loss credit against the oil and gas production tax; relating to lease expenditures; creating a credit against the oil and gas production

tax for certain exploration activity; and providing for an effective date."

Page 1, lines 9 - 13:
Delete all material.

Page 2, line 2:
Delete "**Sec. 2**"
Insert "**Section 1**"

Renumber the following bill sections accordingly.

Page 2, line 27, through page 15, line 31:
Delete all material.

Renumber the following bill sections accordingly.

Page 17, line 4, through page 19, line 17:
Delete all material.

Renumber the following bill sections accordingly.

Page 19, lines 22 - 30:
Delete all material.

Renumber the following bill sections accordingly.

Page 20, line 13, through page 23, line 31:
Delete all material.

Renumber the following bill sections accordingly.

Page 24, line 24, through page 25, line 2:
Delete all material and insert:

"(3) lease expenditures, as adjusted under (m) of this section, that
(A) met the requirements of AS 43.55.160(e) in the year that the lease expenditures were incurred;
(B) were deductible in the immediately preceding 10 calendar years, not counting the year in which the expenditure was incurred;
(C) have not been deducted in the determination of the production tax value of oil and gas under AS 43.55.160(a) in a previous calendar year;
(D) were not the basis of a credit under this title; and

(E) were incurred to explore for, develop, or produce an oil or gas deposit located north of 68 degrees North latitude."

Page 25, lines 3 - 23:

Delete all material and insert:

"* **Sec. 6.** AS 43.55.165 is amended by adding a new subsection to read:

(m) A loss carried forward under (a)(3) of this section shall increase in value at a rate of 10 percent, compounded annually. An increase in value under this subsection begins to accrue on January 1 of the calendar year immediately following the calendar year in which the loss was accrued and no longer accrues on December 31 of the calendar year immediately preceding the calendar year in which a carried-forward annual loss is applied. The increase in value accrued under this subsection has no value except as applied in this section. An increase in value may not accrue

(1) for a partial calendar year;

(2) for more than 10 calendar years, consecutive or nonconsecutive; or

(3) on a loss carried forward by a producer whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is more than 50,000 BTU equivalent barrels during the calendar year that the loss was accrued."

Page 25, line 24:

Delete "and 43.55.029 are"

Insert "is"

Page 25, line 25, through page 28, line 12:

Delete all material and insert:

"* **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to read:

APPLICABILITY. (a) AS 43.55.023(b), as amended by sec. 2 of this Act, applies to lease expenditures incurred on or after the effective date of sec. 2 of this Act.

(b) AS 43.55.165(a)(3) and 43.55.165(m), added by secs. 5 and 6 of this Act, apply to a lease expenditure incurred on or after the effective date of secs. 5 and 6 of this Act."

Renumber the following bill sections accordingly.

Page 28, line 15:
Delete "Section 2"
Insert "Section 1"

Page 28, line 16:
Delete "Sections 1, 2, 28, and 33"
Insert "Sections 1 and 9"

Page 28, line 18:
Delete "sec. 34"
Insert "sec. 10"

[2:52:16 PM](#)

CO-CHAIR TARR objected for discussion purposes.

REPRESENTATIVE RAUSCHER spoke to Amendment 1. He reiterated that there has been an increase in activity on the North Slope, which has led to finds; there has also been an increase in exploration. Further, there has been greater trust in the State of Alaska by producers who are putting a considerable amount of money into finding and extracting oil. A concern is that the new trust and momentum could be lost. He said the proposed bill, as written, is not friendly to producers, so Amendment 1 would delete "the lion's share of the bill," leaving the sections that address dry hole credits and carry forward losses - the former unchanged and the latter changed from 50 percent as proposed in Version N to 100 percent. He recalled the state's consultant, Rich Ruggiero, said that unless the state allows for 100 percent of the development costs to be recovered, Alaska would be "at the bottom of the list globally, in this regard," and it would be irresponsible for the legislature to allow that to happen. The amendment also changes uplift from 7 percent to 10 percent, extends the period of carry forwards and uplift from seven to ten years, and leaves in place the portion of the current tax structure that is working and that has resulted in greater investment, major new discoveries, and increased throughput in TAPS. Representative Rauscher said he did not understand how 50 percent carry forward losses and 7 percent uplift could equal a 100 percent return on loss, because he calculated only 80 percent. He urged the committee to support Amendment 1.

CO-CHAIR TARR responded:

It is about 85 percent, and that's what the left-hand column of the [comparison] shows that ... the reason we used that amount for the uplift is that is linked to the interest rate associated with delinquent taxes that either the state would pay if the taxpayer overpaid, or that we would charge if the taxpayer underpaid, so for consistency purposes on that [the sponsors set the interest rate].

CO-CHAIR TARR restated that Mr. Ruggiero had also suggested eliminating the GVR and the per barrel credit. Considering all three suggestions, she stated concern about "how many years ... these opportunities can be in place." For example: after seven years of carry forward losses, the taxpayer becomes a producer and uses their accumulated losses against tax liability, along with a GVR 20 percent reduction, and a \$5 per barrel credit; by the time all that is combined, much of the value is eroded, which is the reason she cannot support Amendment 1.

[2:57:53 PM](#)

CO-CHAIR JOSEPHSON expressed concern that offering 100 percent carry forward deductions "would be more impactful to the state than current law." Further, if a dry hole credit were added, along with uplift - particularly at 10 percent - the problem would be compounded. He opined Amendment 1 would put the state in a [fiscal] position more precarious than its current one.

REPRESENTATIVE BIRCH expressed his support of Amendment 1. He said Mr. Ruggiero informed the committee that virtually every business in the oil and gas industry is entitled - by its governing regime - to recover its costs, and Amendment 1 "sets that out," is reasonable, and "would encourage that option."

REPRESENTATIVE PARISH stated that businesses typically recover costs by making a profit off of their product, which has been done by the oil industry for a long time. He said he supported providing a subsidy in the form of a write-off on industry's taxes, providing a generous 8 percent rate of return for seven years. However, a 100 percent carry forward loss deduction with 10 percent interest may encourage companies to drill a dry hole and be confident that in seven years, their investment would have doubled in the form of liabilities, thereby enabling them to sell out to a larger company that is seeing a profit, and transfer nearly twice the value of the initial investment to that other company, resulting in a profit. He stated, "It's a recipe for disaster and for really perverse market incentives."

We should not be interfering ... this intensely and setting us, ourselves up for this level of failure. I do not support the amendment."

[3:01:06 PM](#)

REPRESENTATIVE JOHNSON said she would feel better about moving Version N out of committee if Amendment 1 is adopted, because Amendment 1 at least attempts to change the bill in response to the public testimony and the many concerns that have been brought forth. She said she does not think the committee has had time to address Version N, but she supports Amendment 1.

REPRESENTATIVE RAUSCHER said:

... I understand where [the] Representative from District 17 was going there, but I think each one effect[s] different ... sections at different times; they're really -- get a full grasp of what we're saying there. And I don't know whether, you know, if you're not really excited about 100 percent [of NOLs], I think somewhere in between the 50 percent you're leaving them short.

REPRESENTATIVE RAUSCHER expressed his understanding that the Internal Revenue Service (IRS) allows people to use their costs incurred, and he is not certain whether [the State of Alaska] is letting [oil companies] use their entire costs. He said as a result, he is not certain the companies will be incentivized to "dig in, go forward, [and] spend money."

[3:03:00 PM](#)

A roll call vote was taken. Representatives Birch, Johnson, Rauscher, and Talerico voted in favor of Amendment 1. Representatives Drummond, Parish, Westlake, Josephson, and Tarr voted against it. Therefore, Amendment 1 failed to be adopted by a vote of 4-5.

[3:03:52 PM](#)

REPRESENTATIVE RAUSCHER moved to adopt Amendment 2, labeled 30-LS0450\N.4, Shutts/Nauman, 3/13/17, which read:

Page 24, line 24, through page 25, line 23:
Delete all material and insert:

"(3) lease expenditures, as adjusted under (m) of this section, that

(A) met the requirements of AS 43.55.160(e) in the year that the lease expenditures were incurred;

(B) were deductible in the immediately preceding 10 calendar years, not counting the year in which the expenditure was incurred;

(C) have not been deducted in the determination of the production tax value of oil and gas under AS 43.55.160(a) in a previous calendar year;

(D) were not the basis of a credit under this title; and

(E) were incurred to explore for, develop, or produce an oil or gas deposit located north of 68 degrees North latitude.

* **Sec. 26.** AS 43.55.165 is amended by adding a new subsection to read:

(m) A loss carried forward under (a)(3) of this section shall increase in value at a rate of 10 percent, compounded annually. An increase in value under this subsection begins to accrue on January 1 of the calendar year immediately following the calendar year in which the loss was accrued and no longer accrues on December 31 of the calendar year immediately preceding the calendar year in which a carried-forward annual loss is applied. The increase in value accrued under this subsection has no value except as applied in this section. An increase in value may not accrue

(1) for a partial calendar year;

(2) for more than 10 calendar years, consecutive or nonconsecutive; or

(3) on a loss carried forward by a producer whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is more than 50,000 BTU equivalent barrels during the calendar year that the loss was accrued."

Page 27, line 23:

Delete "and (n)"

[3:03:54 PM](#)

REPRESENTATIVE TARR objected for the discussion purposes.

REPRESENTATIVE RAUSCHER spoke to Amendment 2. He maintained that HB 111 would not incentivize producers whereas plans the

state has put in place in the past have inspired oil companies to do business with the state. Furthermore, the changes proposed by HB 111 are too severe, expect "a little bit too much from our partners," and will make them leery about the future. He observed that every year brings another change and disappointment for the industry, yet companies continue to work with the state; in fact, it is very important to keep the companies as partners and to work hand-in-hand. Representative Rauscher said Amendment 2 would increase the carry forward [loss deduction] from 50 percent as proposed in Version N to 100 percent. He reiterated Mr. Ruggiero's caution that industry should recover 100 percent of its development costs. He said Amendment 2 would also change the uplift from 7 percent to 10 percent and would expand the life of the carry forward deductions from seven years to ten years. He urged the committee to support Amendment 2.

REPRESENTATIVE BIRCH stated support for Amendment 2. He said Alaska is an expensive place in which to do business, and long lead times created by permitting delays have affected even such an established area as that in which ConocoPhillips Alaska, Inc. operates. He said he thinks Amendment 2 is "on track," and that the state needs to provide the opportunity for oil and gas exploration companies to recover their costs.

CO-CHAIR TARR said carrying forward losses is a typical feature of an income tax, and she stressed that companies are able to recover 100 percent of their carry forward losses on their corporate income tax; furthermore, production tax is deducted against corporate income tax, and corporate income tax is a deduction against federal taxes. Thus there are several places where losses are recovered, and Version N would make no adjustments in that respect. One of the challenges of the Alaska severance tax is that it is a combination of gross tax and net profits tax, and behaves in some ways like a corporate income tax. She opined that the combination of tax systems does not work well and the state is overcommitted [by its obligations to pay tax credits]. Because the accumulation of credits are obligations the state cannot meet, and payments have been vetoed by the governor, she expressed her view that the tax credit program, "even if it's scaled back a little bit, but we always meet that obligation, that would be beneficial to the industry, more than having something that ... potentially is supposed to be available, and then is not available." Co-Chair Tarr cautioned that while the legislature has the power to make appropriations, the governor will always have the ability to veto any line items in the budget; therefore, if [the

legislature and governor] are not in alignment, then "that puts the whole system at risk." She explained that she cannot support [Amendment 2], because she does not want the legislature "to be overcommitted to something that puts us in a position where we have to react again." She stated the intent of Version N is to provide more stability to the system.

REPRESENTATIVE RAUSCHER said Amendment 2 would take care of cashable credits, which he agrees need to be reevaluated. He recalled previous testimony by the consultant and others has consistently pointed out that tax systems must be revisited, and characterized Co-Chair Tarr's remarks about not wanting [to react again] as being an excuse. He stated his belief that Amendment 2 is good, tame, not large-scale, and garners no repeated analyzation or reaction, and he urged everyone to support it.

[A roll call vote was taken, and was subsequently voided for being incomplete.]

[3:11:58 PM](#)

The committee took an at-ease from 3:12 p.m. to 3:13 p.m.

[3:13:18 PM](#)

CO-CHAIR TARR announced that the roll call vote on Amendment 2, taken before the at-ease, would be voided, because one member had not been called.

[3:13:25 PM](#)

A roll call vote was taken. Representatives Talerico, Birch, Johnson, and Rauscher voted in favor of Amendment 2. Representatives Westlake, Drummond, Parish, Josephson, and Tarr voted against it. Therefore, Amendment 2 failed to be adopted by a vote of 4-5.

[3:14:11 PM](#)

ED KING, Legislative Liaison, Office of the Commissioner, DNR, informed the committee the department needs additional time to determine the fiscal impacts of [HB 111, Version N] on DNR. In response to Co-Chair Tarr, he said he anticipated a forthcoming positive fiscal note, because Version N would require of the department tasks that are outside the scope of its normal function, and would require the expansion of its accounting

section. In response to a question from Representative Birch about the timing of the new information requested under Version N, and how it would impact the oil and gas industry, he said it is typical for a regulation packet to take about one year to be implemented; therefore, he speculated there may be a period of uncertainty that could "drive differences in behavior." He proffered the question would be best asked of the industry.

REPRESENTATIVE BIRCH said he is keenly interested in the issue and would like an assessment by [DNR] - as a leaseholder "managing that relationship" - of the significant impacts of the proposed legislation.

CO-CHAIR TARR asked for clarification concerning the amount of time Mr. King thought the department would need to complete its fiscal note.

MR. KING said staff at the Division of Oil and Gas, DNR, is currently working on [a fiscal note] and making sure regulations could be written in a way that would not impede the ability of auditors in DOR to audit the tax returns after the preapproval process happens through DNR. He anticipated the process will take at least through today, and he said he would get a fiscal note to the committee as soon as possible.

[3:17:16 PM](#)

The committee took an at-ease from 3:17 p.m. to 3:18 p.m.

[3:18:46 PM](#)

CO-CHAIR TARR said she would allow DNR to the end of the day to work up some preliminary information [pertaining to a forthcoming fiscal note].

REPRESENTATIVE WESTLAKE surmised that [Version N] would increase the workload of those in accounting, who are currently years behind. He said, "I'd hate to set a precedent where we're doing exactly the same thing, where ... we've made a ruling here, and the State of Alaska, through no fault of industry, is years behind on this thing." He asked if there is a way the legislature can address this issue.

MR. KING said he was unsure; however, he did confirm that [Version N] would require an accounting process different from that which the department currently has in place, and it would take time to implement such a process. He said DNR would seek

to combine efforts with DOR, and avoid duplications and overlap, to meet the objectives of the proposed legislation; DNR is not interested in expanding its [accounting] department unless absolutely necessary.

CO-CHAIR TARR said she had not anticipated the challenge the provision created in terms of a fiscal note from DNR, and appreciated the opportunity to work through that provision of the bill.

[HB 111 was held over.]

[3:21:05 PM](#)

ADJOURNMENT

The House Resources Standing Committee meeting was recessed at 3:21 p.m. to a call of the chair. [The meeting reconvened at 3:20 p.m. on 3/14/17].