

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 30, 2018

2:34 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative John Lincoln, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson

MEMBERS ABSENT

Representative George Rauscher
Representative David Talerico
Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 331

"An Act establishing the Alaska Tax Credit Certificate Bond Corporation; relating to purchases of tax credit certificates; relating to overriding royalty interest agreements; and providing for an effective date."

- HEARD & HELD

HOUSE BILL NO. 288

"An Act relating to the minimum tax imposed on oil and gas produced from leases or properties that include land north of 68 degrees North latitude; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

HOUSE BILL NO. 399

"An Act disallowing a federal tax credit as a credit against the corporate net income tax; repealing a provision allowing the exclusion of certain royalties accrued or received from foreign corporations for purposes of the corporate net income tax; repealing the reduced rate for the alternative tax on capital gains for corporations; repealing an exemption from filing a return under the corporate net income tax for a corporation

engaged in a contract under the Alaska Stranded Gas Development Act; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 331

SHORT TITLE: TAX CREDIT CERT. BOND CORP; ROYALTIES

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/07/18	(H)	READ THE FIRST TIME - REFERRALS
02/07/18	(H)	RES, FIN
03/30/18	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

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

POSITION STATEMENT: Co-provided a PowerPoint presentation entitled, "State of Alaska Department of Revenue HB331: Oil & Gas Tax Credit Bond Proposal" dated 3/30/18 and answered questions during the hearing of HB 331.

MIKE BARNHILL, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Co-provided a PowerPoint presentation entitled, "State of Alaska Department of Revenue HB331: Oil & Gas Tax Credit Bond Proposal" dated 3/30/18 and answered questions during the hearing of HB 331.

ACTION NARRATIVE

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CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 2:34 p.m. Representatives Tarr, Birch, Parish, Drummond, Lincoln, and Josephson were present at the call to order. Representatives Drummond and Johnson arrived as the meeting was in progress.

HB 331-TAX CREDIT CERT. BOND CORP; ROYALTIES

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CO-CHAIR TARR announced that the only order of business would be HOUSE BILL NO. 331, "An Act establishing the Alaska Tax Credit Certificate Bond Corporation; relating to purchases of tax credit certificates; relating to overriding royalty interest agreements; and providing for an effective date."

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KEN ALPER, Director, Tax Division, Department of Revenue, reported that House Bill 111 had ended the Alaska system of cashable tax credits, even though there were still "a substantial amount of them still on the books at some point needing to be either used by tax payers to offset taxes, sold to other taxpayers, or purchased by the state pending funding." He relayed that there was about \$800 million outstanding with another \$150 million in process before the final tax credits were eligible for cash re-purchase. He declared that "we're looking at a recession in Alaska, private sector jobs are down." He mused that one aspect of the proposed bill was to give a boost to the Alaska economy, which had been a component of the Governor's stimulus package introduced at the beginning of the legislative session, slide 2. He reported that Alaska had lost many jobs since the price of oil started to drop in the later months of 2014; the private sector jobs had dropped about 3.8 percent, 9,200 jobs, and the oil and gas sector jobs had dropped over 30 percent, according to the Department of Labor & Workforce Development. He shared the ISER (Institute of Social and Economic Research) forecast for 2018 indicating an additional small drop, and not a recovery. He declared that proposed HB 331 was intended to provide a boost of funding to help resolve some of the uncertainty for the oil and gas industry relating to the not full payment of the earned tax credits in the manner to which they had been paid in prior years. He explained that this uncertainty meant that companies were unable to plan their next round of investment. He stated that the proposed bill would provide about \$700 million to the oil and gas sector and into the economy by incentivizing new spending in Alaska.

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MIKE BARNHILL, Deputy Commissioner, Office of the Commissioner, Department of Revenue, directed attention to slide 3, "Bill is Structured to Balance Competing Interests." He pointed out that the legislature resolved one issue with respect to the oil and

gas tax credits in the previous session by sunseting the tax credit program, even though it left an issue with outstanding tax credits of \$700 million to \$1 billion. He declared that the proposed bill was an attempt to balance competing interests through financing. He explained that the state could not afford to tap into the state savings to pay all of this today, so it was being proposed to borrow and pay this off over time through debt service. He noted that the tax credit program had been calculated, and actively marketed, to attract investment into the state from new and small oil and gas exploration companies. He shared a story of marketing these slide shows to investors and pointed out that this program was about reliance. He added that any litigation against the state would include evidence for the role of the Department of Revenue in trying to attract investment from outside entities.

CO-CHAIR TARR asked, as the program for repayment had been created in statute, how it was advertised to companies. She questioned that companies would not request the details and potentials for pitfalls included in the statutory formula for repayment.

MR. BARNHILL offered to share the slide show for marketing to investors. He referred to the anxiety in 2010 in the Cook Inlet region regarding a shortage of gas to generate electricity. He stated that, as there was considerable enthusiasm for this program, this was reflected in the marketing. He pointed out that, regardless of any due diligence by the investors, there had been investment and the state had paid a considerable amount of money for some period when the credits were tendered. The state had stopped making payments when the price of oil "bottomed out." He pointed out that the state had made statements and actions which would be weighed along with the enacted statutory language in determining resolution for this. He reiterated that the committee should be aware of the enthusiasm for which the program was marketed.

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MR. ALPER noted that the statutory formula language had "found its way in in 2007 and was largely forgotten." He pointed out that eight consecutive years of budgets had ignored this, and that language had been written in every year to fully fund the amount of credits requested. It was not until the fiscal crisis, when it was realized that the state could not afford to do this, that the language was brought back to light.

CO-CHAIR Tarr offered her belief that the risk assessment by a company should have included a very careful review of the statute, and the corresponding payment schedule.

REPRESENTATIVE PARISH offered an example of a contract offer and asked if there was an obligation to continue with that anti-market practice.

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MR. BARNHILL said that, ultimately, a court would have to decide the obligation. He stated that he was just trying to offer the committee a better understanding of "the various factors the courts would weigh in evaluating that." He suggested that a business, which made representations to the public and then suddenly changed those or changed their practice, could not expect but that the customers would be frustrated with that sudden change of practice. He declared that the reputation and the stability of the business was important. He opined that state credibility was a similar concept and that the current administration wanted to emphasize that, as the state was in a recession, that the state's business arrangements were viewed as credible and stable, and that the state was a good place to invest.

REPRESENTATIVE PARISH stated that he would rather the state be recognized for its honoring of contracts and statutes instead of the word of a character, Mr. Moose, in a marketing program. He expressed his dissatisfaction that the previous administration had "put us on hook and put Mr. Moose's good name at risk."

REPRESENTATIVE BIRCH declared that this was a "huge issue, talks about state credibility," and he demanded that the committee "roll through this presentation and ..."

CHAIR TARR cut off Representative Birch, reminded him that she was the chair of the committee and affirmed: "I will run the committee as I see fit, and I will allow you to ask questions. Everyone is an equal member of this committee. Everyone will have an opportunity to ask questions." She asserted that there would not be any continued conversation for how she was running the committee meeting.

REPRESENTATIVE BIRCH asked if the chair planned to adjourn the meeting at 3:05 p.m. as stated at the outset.

CHAIR TARR replied, "yes we are."

REPRESENTATIVE BIRCH offered his encouragement to finish the presentation.

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MR. BARNHILL offered to meet with members of the committee individually. He stated that slide 4, "Oil & Gas Tax Credit Background," was a timeline and that those credits had achieved their purpose. He acknowledged that there could have been better ways to do it and that it cost a lot of money. He pointed out that, as there were gas shortages in the Railbelt, the tax credit program had been created to solve that problem. He pointed out that the tax credits had succeeded in bringing new, small gas explorers to the state to create the opportunities for new development and new production. He shared that the hope had been for investment through the tax credit program to create a "virtuous cycle" of state investment in development and exploration of new fields for new royalties and new production taxes to pay for all the important programs, slide 5. He stated that slide 6, "State-purchased credits through the FY2018," offered a background for the \$3.6 billion total cash purchases which had produced real production for the future, with 175 million barrels of oil produced to date. He reported that there was a current balance of \$807 million of unpaid tax credits, of which \$514 million was from the North Slope and about \$300 million was not from the North Slope.

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MR. ALPER, in response to Chair Tarr, explained that the \$807 million had been offered into the bonding program should the bill pass, and that about \$750 million would be paid, with this reinvestment into the economy described on an earlier slide. He noted that the \$130 - \$180 million was in addition to the \$807 million for credits that had not yet been issued. He reported that the structure of the bill and the bonding would call for a second and third round of bonds issued for these smaller amounts.

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MR. BARNHILL continued with slide 7, "Forecasted Production Helped by Known Credits," and shared the forecasted production for the fields financed by the State of Alaska investments through the tax credit program, about 106 million barrels from fields currently producing on the North Slope, an additional 23

million barrels from fields not yet producing, for a total of 215 million barrels financed by the tax credits. He reported that Cook Inlet now had a large amount of gas to meet the needs of the Railbelt region, an estimate of 90 billion cubic feet per year, an equivalent of 15 million barrels of oil. He reported that the total past and future production in the Cook Inlet region was almost 300 million barrels of oil equivalent.

REPRESENTATIVE PARISH asked how much production would have taken place in absence of the tax credit program.

MR. BARNHILL offered his belief that prior to the tax credit program, with respect to the Cook Inlet exploration, there was not any plan for additional exploration in that region, even as there was "serious concern about brown-outs and what not."

REPRESENTATIVE PARISH asked about the North Slope.

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MR. ALPER stated, "we honestly don't know." He shared that there had always been a certain exploratory interest, and part of the perception in the industry about the North Slope was that it was somewhat controlled by three large companies. He added that an intangible part of the program was to "help draw new blood to the oil patch because it was generally understood that the oil that remained to be found out there was not elephant fields but were fields in the 25 - 100 million barrel size... that's simply too small for the BPs of the world to invest their time and effort seeking." He stated that the large international companies in Alaska "looked to do large things." He pointed out that, as the barriers to entry included isolation, transportation, and logistical issues, the tax credits were intended to ease the path into Alaska for the new entities. He said that it was hard to determine what would have happened in the absence of any credits, noting that a lot of these credits were operating loss credits. He explained that, after the transition from a gross based tax to a net profits-based tax in 2006, for the companies which were producing and selling oil for profit, every dollar they spent came off the bottom line and reduced the tax burden. He pointed out that a company that spent money without production did not get an immediate tax value for those expenditures. He explained that, although there were several ways to do this, House Bill 111 allowed the companies to carry over and hold until production. He stated that a lot of these credits were instead taking losses and monetizing them in real time, instead of forcing the company

to wait a certain number of years. He opined that this made it easier for some companies to enter Alaska, although "how much would or would not have happened without them, I think it's impossible to say for sure."

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MR. BARNHILL moved on to "The Challenge," slide 8, which he explained was the background for the current bill. He reported that from FY08 - FY15 the state had paid all the tax credits in the year that they were presented. Beginning in FY16, the state had been unable to make the payments, as the governor had vetoed the tax credits for two consecutive years. After that, the tax credits were paid pursuant to a statutory calculation: at a projected oil price of \$60 or higher, the formula was 10 percent of the gross production tax under AS 43.55.011, and if the oil price was less than \$60, the formula was 15 percent of the gross production tax. He said that the current forecast for the price of oil had been updated to \$63 per barrel. He shared slide 9, which projected the annual statutory appropriation for the estimated payment from FY19 - FY24.

REPRESENTATIVE BIRCH asked if there had been an interpretation for a significantly smaller calculation.

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MR. ALPER replied that the tax under AS 43.55.011 had been interpreted to mean a tax on 35 percent of the net profit. He said that the per barrel credit could be subtracted from this, per AS 42.55.024. This formula, 10 or 15 percent of the gross amount, was not explicit in the statute and others had interpreted it to say "the amount of revenue actually received under [AS 43.55.]011, which would be the net of that tax calculation minus the credits." He said that the amount in the operating budget, \$49 million, reflected the net-based mechanism to make the same calculation.

CO-CHAIR TARR asked if the difference in the calculation was the per barrel credit.

MR. ALPER replied that the difference was almost entirely the per barrel credit. He said that the per barrel credit increased as the price of oil went down, although it would then decrease as the price of oil continued to go lower and went into a minimum tax environment. There was no per barrel credit for prices below \$40. He added that, as the price of oil had moved

up into the \$50s and the \$60s per barrel, companies had increased use of the per barrel credit to almost the entire \$8 credit per barrel allowed in statute. He noted that this had created a wider gap between the plausible ways of making the calculation. He pointed out that, this year, the delta for the difference was about \$130 - \$140 million.

REPRESENTATIVE PARISH mused that the difference between the tax amounts was "pretty enormous" and asked why the State of Alaska was "erring on the side which costs the state more money."

MR. ALPER explained that the calculation was a continuation of the past practice from 2015 and had been made as an assumption for a certain way. He stated that it had not been contemplated to be controversial or be such a large gap, as it was "simply being consistent in our own interpretation." He offered his belief that, from the industry point of view, there was an expectation that the funding would be less. He pointed out that, as the funding from the past two years had been based on the formula outlined on slide 8, this was the expectation. There was now some anxiety and uncertainty regarding a revisit to the formula.

REPRESENTATIVE BIRCH asked if the administration supported the historical interpretation for the appropriation.

MR. BARNHILL replied, "yes."

MR. ALPER reported that the proposed bill had to contain a mechanism to project what a company would have received if the appropriations had been as the statutory formula, in order to calculate the offered buy-out.

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MR. BARNHILL returned to slide 9 and stated that the state would appropriate \$184 million; in lieu of this, under the proposed bill, the governor's budget listed an amount sufficient to pay debt service. He concluded that the impact of reducing payments from the total amount of tax credits presented in any year to the statutory schedule had been material, as exploration and development on the North Slope had, in some cases, been halted. He said that [DOR] had reached out to speak with some banks providing financing to the companies, as the banks were not lending due to this issue. He stated that a primary purpose for the proposed bill was to create economic stimulus, to unfreeze

credit markets, and to restore some normalcy to the oil and gas sector in Alaska.

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MR. ALPER moved on to slide 10, "Proposed Solution:" and said that conceptually there was an offer to buy back the credits at less than face value. He explained that the mechanism was to ask the company when they expected payment given their pro-rata share of the annual statutory formula, and then, based on that schedule, the discount could be implemented. He directed attention to the chart on slide 10 and offered an example for the value of the payment schedule versus the offer for immediate payoff. He noted that the proposed bill offered two different discount rates, and he shared examples of the payouts using a 10 percent discount and a 5.1 percent discount.

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[HB 331 was held over]

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:15 p.m.