ALASKA STATE LEGISLATURE
JOINT MEETING
SENATE RESOURCES STANDING COMMITTEE
SENATE FINANCE COMMITTEE
January 19, 2018
9:01 a.m.

MEMBERS PRESENT

SENATE FINANCE

Senator Lyman Hoffman, Co-Chair
Senator Anna MacKinnon, Co-Chair
Senator Click Bishop, Vice-Chair
Senator Donny Olson
Senator Gary Stevens
Senator Natasha von Imhof

SENATE RESOURCES

Senator Cathy Giessel, Chair
Senator John Coghill, Vice-Chair
Senator Natasha von Imhof
Senator Kevin Meyer
Senator Bill Wielechowski
Senator Click Bishop

MEMBERS ABSENT

SENATE FINANCE

Senator Peter Micciche

SENATE RESOURCES

Senator Bert Stedman

OTHER LEGISALTORS PRESENT

Representative Dave Talerico
Representative Andy Josephson

COMMITTEE CALENDAR

OVERVIEW: REGULATIONS PACKAGE FOR HOUSE BILL 111 (CHAPTER 3 SSLA 17)

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

Ken Alper, Director
Tax Division
Department of Revenue
POSITION STATEMENT: Provided overview of regulations package for HB 111.

John Larsen, Audit Master
Tax Division
Department of Revenue
POSITION STATEMENT: Participated in overview of regulations package for HB 111.

Mary Hunter Gramling, Assistant Attorney General
Department of Law
POSITION STATEMENT: Participated in overview of regulations package for HB 111.

ACTION NARRATIVE

9:01:50 AM
CHAIR GIESSEL called the Joint Senate Resources and Finance Committee meeting to order at 9:01 a.m. Resources Committee members present at the call to order were Senators Bishop, Meyer, von Imhof, Wielechowski, Coghill, and Chair Giessel. Senator Stedman was excused.

CO-CHAIR MACKINNON, Senate Finance Committee, introduced the Senate Finance Committee members present at the call to order: Senators Olson, von Imhof, Stevens, Bishop, Co-chair Hoffman and Co-chair MacKinnon. Senator Micciche was excused.

CHAIR GIESSEL also welcomed Representatives Talerico and Josephson, who serve with her on the HB 111 Working Group.

OVERVIEW: REGULATIONS PACKAGE FOR HOUSE BILL 111 (CHAPTER 3 SSLA 17)

9:03:09 AM

CHAIR GIESSEL recounted that the legislature had passed HB 111 months previously, which affected tax credits. Those laws are passed on to departments where bureaucrats (def: ruling from the desk) write rules, which have the force of law. She wanted to ensure that the rules match the laws that were passed and intended by the legislature. Legislators spend a lot of time deliberating; hear facts from experts, debate issues, and wrestle those facts to the ground and write laws. She reiterated that she wants to make sure those rules that are written to enforce those laws are accurate.

Today they would examine one regulation package that is almost complete. A second package, which members have a copy of, is out for public comment now and she understands that a third package of rules will be coming out later. She welcomed the "chief maker of rules," Department of Revenue, (DOR) Tax Director, Ken Alper, and his Audit Master, John Larsen, to the table.

9:05:32 AM
KEN ALPER, Director, Tax Division, Department of Revenue (DOR), clarified that the HB 111 legislation has two packages of regulations. One of them is complete and has been signed and now has the force of law. The second package is in its process now, which means he can't talk about some of the details.

He introduced John Larsen, who is not new to the state but might be new to committee members. He is an Audit Master, one of the subject matter experts and one of the production tax specialist positions that was created when Alaska switched to the net profits-based tax. Mr. Larsen had been with the department for 10 years and had the primary role of leading the regulations drafting process for the last several oil and gas tax bills that have passed the legislature.

9:07:24 AM
MR. ALPER said the Department of Law (DOL) asked him to read a brief disclaimer about the current process, and turned to slide 2, "Statement on Process:"

> "We have been asked to present on recent regulations from a process standpoint. Importantly, DOR has one set of regulations that are currently noticed for public comment. This legislative hearing is not part

of the public comment process for the adoption of regulations. The committee members, as well as any member of the public who is listening who wishes to comment on the regulations should comment as provided in the public notice. The notice as well as the full text of the proposed regulations are available on the department's website.... The public comment period closes next Friday, January 26.

For the pending regulations, we cannot discuss how they would be applied. Testimony today should not be construed as any pre-determination of any final regulations. Our presentation today is focused on factual information about the DOR's recent and ongoing regulations process."

9:08:31 AM
JOHN LARSEN, Audit Master, Tax Division, Department of Revenue, Juneau, Alaska, introduced himself for the record.

MR. ALPER said in the last two legislative sessions two major bills have passed that both fit into this realm of tax credit reform, a ramping back from the more generous historic program of providing direct support to exploration and development, and he wanted to recap the content of the bills as follows:

HB 247 passed in June 2016
- Phased out Cook Inlet tax credits and reduced the Middle Earth tax credits. Tax credits are still being offered in Middle Earth.
- Extended Cook Inlet gas tax cap. It was scheduled to sunset in 2022 and a new tax of $1/bbl cap was added to Cook Inlet oil.
- Added sunset provisions, referred to as "graduation provisions" to the North Slope gross value reduction (GVR), the new oil reduced tax treatment that was originally passed to be indefinite and is now somewhere between 3 and 7 years depending on the price of oil. That treatment will go away, and the oil will "graduate" and begin to be taxed as legacy oil after that point.
- Inserted an annual cap on cash through the credit system that a company could receive per-company, per-year.
- Created a resident-hire priority for allocating cash payments in times of restricted revenues.

- Added limited transparency with an annual report to the public of how much cash was received by each company in aggregate over the course of the year. The first of those reports came out in April 2017 based on 2016 information.
- Increased the interest rate to just the production tax for a period of three years, and then reduced it to zero.
- Cleaned up technical provision remnants from old laws or things that weren't working properly that were also passed with HB 247.
- Adopted a regulation package that went through the same process he is about to describe today for HB 111 and those regulations became effective January 2017.

9:11:24 AM

MR. ALPER said that HB 111 was in many ways more aggressive, because it eliminated the regime of the state buying cash tax credits:

HB 111 passed in July 2017

- Most credits were no longer eligible for state repurchase after July 1, 2017, with the exception of the refinery and LNG storage credits that have their own built-in sunset in the next couple years.
- The Net Operating Loss (NOL) (formerly known as the carried-forward annual loss credit) credit (by far the largest component of the cash credit program) was repealed effective January 1, 2018.
- It was replaced with a new system of carried-forward lease expenditures. A large portion of the bill detailed the treatment of how those carried forward losses were to be calculated and eventually how they were to be recaptured when a company brought their field into production. One key provision was known as the "ring-fence," the idea that these carried forward losses can't be used until the underlying leases come into production. Flexibility was given where the taxpayer could choose how much they did or didn't want to use in a given year to maximize their flexibility to use any other tax credits or reductions they might have available to them. Limitations specified that the carried forwards could be used to reduce taxes below the minimum tax.
- A new provision was added to say that if they are not used for 10 years, they begin to start to lose

value on a graduated scale referred to as a "down lift."

9:13:28 AM

- Because of the carving out of production tax versus other taxes, interest rates were aligned among all tax types administered by the Department of Revenue and no sunsetting of the interest, which continues for as long as the delinquency remains or an appeal, which can go on for 10 years.
- A new provision was added that credits can be carried-back and used by the originator of the credit or by the purchaser of the credit against a prior year tax liability including offsetting interest and penalties associated with past year liabilities. The key limitation is the Alaska Constitution. The Constitutional Budget Reserve Fund (CBRF) says the tax liabilities related from an administrative proceeding or a settlement for certain lawsuits must go to the CBRF. That cannot be superseded by law. So, any past year liabilities that fit the CBRF definition cannot be offset with tax credits.
- Conditional exploration tax credits became a new provision, because they often take a long time to review for a variety of reasons, and once time and money became issues, they were falling behind in the queue in the line to receive cash payments. These credits would allow a company to reserve its place in line in advance of getting the final review and awarding of those tax credits for exploration.
- The seismic credit on the North Slope and Cook Inlet had previously sunset before last year, but it remains in Middle Earth and that was repealed January 1, 2018.
- Exploration credits in Middle Earth can now be used to offset the explorer’s corporate income tax. For perspective, there is no production of oil and gas from Middle Earth, yet. The hope is that someone finds it and develops it. The companies that are doing that work tend to be the regional Native corporations like Ahtna. The exploration tax credits they are earning on that work can be used to offset those companies' corporate income tax liability.
- Because the tax credit fund is no longer going to be needed after the last credit is paid, which could be any time between next year and 2026, a delayed repealer is built in.
- Established the Legislative working group.

9:16:50 AM
MR. ALPER stated that the Governor signed it into law on July 28 and the DOR realized it was too big to implement in one set of regulations, in part because certain things needed to be done relatively fast. The rules needed to be in place by January 1 for a variety of reasons related to the interest or the idea of carried back. But the carried forward lease expenditures were very complicated and very sensitive and needed more time to be developed, and frankly didn't need to be entirely pinned down by January 1, because no one was going to try to use them until the end of the 2018. So, they split the package in half; the first package was the carry-back of credits against a prior year, interest rates, and most changes other than the new carry-forward loss structure.

The second package was related to the carry forward lease expenditures and related issues - how they are earned, calculated, and allocated, and most importantly how they are used once the field comes into production.

MR. ALPER explained that before either package was written a pre-regulation scoping workshop was held. It was designed to get input from the affected parties, primarily industry, as to what they expected to see in the regulations, what their understanding of the laws that passed was, and what the hot button issues might be that needed more attention. It had 22 attendees from industry, plus those on the phone, and DOR staff. Comments were accepted after the workshop, and the deadline was extended because the Alaska Oil and Gas Association (AOGA) members have offices in Houston and were impacted by Hurricane Harvey last summer. They received comments from eight different parties, including Senator Giessel and Representative Seaton.

9:19:15 AM
CHAIR GIESSEL said she appreciated the pre-regulation scoping workshop, because it is a complex subject.

MR. ALPER stated the meetings were helpful but not required. They like to have them when possible. Sometimes, a ticking clock that makes it harder. In this case, the bill passed with retroactive regulatory authority. Well, they can't go backwards to 2010, but should the regulations take effect because of all the process after the effective date of the bill, January 1, 2018, the regulations can be

taken back to the effective date of the bill. This is the important authority that gives them the leeway to spend an extra few weeks in process. He pointed out that bills don't usually pass in July; they usually pass in April or May and that couple of months makes a big difference.

9:20:27 AM
Slide 7: "Initial Regulation Process to Implement HB 111"

MR. ALPER said the scoping workshop identified key issues to be addressed in drafting the regulations. Examples include:

1. Defining exploration expenditures in the context of the "ring fence." When the expenditures developing a field are ring-fenced you know those expenses are tied to that field. But what if you are exploring: drilling multiple exploration wells and only one of them finds something, is there a mechanism for the company to be able to regain value from the failed exploration wells? The language provided was "reasonably related" to a lease or property, and that had to be fleshed out.

2. Another issue was determination of what the ring fence is. The triggering provision for the use of carried forwards was when a field came into "regular production." That is an Alaska Oil and Gas Conservation Commission (AOGCC) definition - not from the tax statutes - and the idea that HB 111 talked about regular production from a lease or property needed to be aligned with the AOGCC reference to production from an "individual well."

3. Determining and allocating the amount of carried-forward lease expenditures when a producer has both producing and nonproducing properties and/or exploration expenditures that might put them into a loss situation for the overall year and making sure that only the amount of the loss was tied up in the ring fence and not the entirety of the expenditure on the new development.

4. Another interesting concern was with gas used in-state (GUIS). They use the term "segment," which is a taxable area; for instance, North Slope oil and gas is a segment. In other words, the taxes are calculated differently for each segment and lease expenditures get allocated for each segment. Gas used in-state is a separate segment and pays tax at the Cook Inlet gas tax cap rate of 17 cents. But

because of that, the lease expenditures have to get allocated to the gas used in state. That became a little complex and industry wanted to know more about how that was done.

5. Finally, the retroactive regulation question: he thanked them for giving DOR that authority to allow a more interactive drafting process. They are still not done, presuming they get to the public comment deadline and redraft the regulations, then the DOL does its review, then it goes to the Lieutenant Governor, and finally they get filed and made official 30 days after they are signed. It will be somewhere in March before they are done, but these regulations will have the effect of law on January 1 because of that retroactive authority.

9:23:51 AM
Slide 8: "Necessary Steps in the Regulations Process"

MR. ALPER said the regulations process "is a lot of statute and a little bit of custom." An administrative order (AO) recommended these workshops but did not mandate them, as well as a discussion of the pre-official draft. That AO was used to say let's have a workshop.

The second step was publication of draft language for packet two. The draft language has a tightly prescribed series of steps: published in a newspaper of general circulation, posted on the Alaska Online Public Notice System, furnished to the department's interested parties list and the Department of Law, furnished electronically to all state legislators and the Legislative Affairs Agency, chairs of the standing committees with jurisdiction over the subject, the Administrative Regulation Review Committee, and Legislative Council. Approximately 140 people are signed up for the Department of Revenue's "Interested Parties" list.

9:25:11 AM
Slide 9: "Necessary Steps in the Regulations Process"

The Administrative Procedures Act, AS 44.62.190, requires a minimum 30 days of public notice before the adoption, amendment, or repeal of a regulation. Although not mandatory, the department typically holds a public hearing for regulations on oil and gas production taxes. Ideally that is done somewhere in the middle of the public comment

period, which provides an opportunity for interested parties to evaluate and incorporate information from the public hearing into their written comments. After the public comment deadline, all comments received are published on the department's website.

9:26:26 AM
CO-CHAIR HOFFMAN asked if the public record includes who made the comments.

MR. ALPER answered in the affirmative.

MR. ALPER continued discussing slide 9. He said prior to drafting final regulations, the Administrative Procedures Act requires that the department must consider all public comments received and to keep a record of its use or rejection of them. The document is called "Affidavit of Agency Record of Public Comment" and is submitted along with the final adopted regulations.

9:27:38 AM
Slide 10: "Necessary Steps in the Regulations Process"

MR. ALPER said the draft is revised into a final regulation proposal and adopted and signed by the DOR Commissioner and then it goes to the DOL to ensure that the proposal is within the authority conferred by the department by the law, itself, that it's not conflicting with other statutes, not repeating any statutes, and making sure the regulations are not over-reaching. That usually takes a couple of weeks.

The legislature is informed of pending regulations and has the option to review. Typically, the Department of Law makes technical revisions to language and then the final version is presented to the Lieutenant Governor for signature. Then they are officially law 30 days after that unless another date is specified.

9:29:08 AM
Slide 11: "Regulations Packet 1"

MR. ALPER said package 1 is everything except carry forwards with the carry back provisions being the most complex. These were signed by the Lieutenant Governor and published, and by January 1, they were the law of the land.

He said the clear legislative intent was to strengthen the secondary market, the ability of companies that are holding cashable tax credits, where the state might not have cash available, to be able to sell these credits to another company who could then use them to offset their taxes. For a variety of reasons, that market had not been used, primarily because the state had been buying all that were presented for about eight years, and there was no need for it.

Once the demand was there, there wasn't very much market, primarily because of low oil prices, and the potential buyers of those credits, Alaska's major oil and gas producers, didn't have enough tax liability to be able to buy credits to further reduce them. But the intent of the legislature was to strengthen that secondary market.

This is important, the typical past year tax liability is in an audit. It is clearly an administrative proceeding - the court has said - and that money goes to the Constitutional Budge Reserve (CBRF). However, a major settlement is still being finalized on the Trans Alaska Pipeline System (TAPS) tariffs going back to about 2010/11. The Attorney General has said that is not litigation related to tax; it is related tariffs, and the fact there are more taxes is a secondary impact of it. If you can imagine, the allowable tariffs were being reduced for oil through the pipeline and that means the value of the oil up at the well head is a little bit higher. That higher value translates through as a larger royalty liability and a larger tax liability. That tax liability did not have to go to the CBRF, therefore creating a little bit of a window for a secondary market where companies who might owe that tax could purchase tax credits to offset that liability, an estimated $165 million for 2011/12/13 they hope will be used to absorb some of the hanging tax credit balances that are out there.

MR. ALPER stated that some changes were made prior to the regulations being final. The conditional exploration certificates were issued right away. The department had close to $100 million worth of exploration applications sitting in the work pool, and all of those were able to be 2017 tax credit certificates.

As they are ranked for cash, the process is to first pay off all of the 2016 originating certificates, then pay off

all the 2017s, and all of the 2018s. Within the 2017s is where the local hire rank order will come in, but the first and most important rank order is by year of origin.

9:34:02 AM
CHAIR GIESSEL asked if it was possible for the division to deny a conditional credit.

MR. ALPER replied that the guidance per HB 111 is that the conditional credit is given when it's requested, so there is no review initially. But the conditional credit cannot be sold or cashed. It's simply a place holder. They can't get any money until the department has issued it. The audit process will kick in between the issuing of the credit and the finalizing of it, and that is where some adjustment is made or perhaps denying them outright if for some reason the applicant is not eligible. Up until that point, the conditional certificate is for 100 percent of the amount requested.

CHAIR GIESSEL asked the likelihood of a conditional application being denied.

MR. ALPER replied it is very rare for a conditional application to be denied. He explained to qualify for the exploration credit expenditures have to be from outside of a unit boundary; sometimes an application is a hybrid for, for instance, a seismic shoot where some of it is inside a unit and some of it is outside, and the acreage inside the unit has to qualify for the operating loss credit or something similar. So, they have to be reallocated.

A reserve fee for a rig that never got used during the year can't be credited in that year, but if the rig is used in a subsequent year, those costs can be brought forward and claimed then. Adjustments can always be made, but the auditors are much deeper into those details. He could say that it would be very unusually for a credit to be rejected outright.

9:36:36 AM
CHAIR GIESSEL asked if the conditional credit was accepted with the adjustments.

MR. ALPER replied that once the adjustments are made, it is no longer a conditional application. For instance, for a $10 million credit application, the department will give

them a $10 million conditional credit to reserve their place in line. It's worth only a $9.5 million but now it's a real credit and it's eligible for cash.

CHAIR GIESSEL asked now that real credit that has been reviewed goes into the queue in priority, is it possible they moved from slot 4 to slot 10.

MR. ALPER recalled that DOR gave out 12 conditional credits in August. Of those 12, 7 were finalized before December 31, anyway. So, it wouldn't have mattered, but for the other 5 who won't be getting their final certificate until sometime in 2018, they are reserving their identical spot in the 2017 pool.

No 2017 certificates have been purchased yet and there are about $400 million worth of 2016 certificates on the books. The next $400 million appropriated by the legislature will pay off those 2016 certificates before getting to any of the 2017 certificates. The caveat is that the administration will possibly bond for this and pay them off in a different manner.

MR. ALPER stated that hypothetically, if the legislature appropriated $500 million in the coming budget cycle towards tax credits, that would entirely pay off the 2016 pool and the first $100 million of the 2017 pool. Then they would get to the rank order question. Under the current rules, the priority among the 2017 pool would go to those with the highest Alaska resident hire.

CHAIR GIESSEL said she appreciated the clear explanation.

9:39:21 AM
SENATOR BISHOP wondered if he had ever seen a positive adjustment for conditional credits.

MR. ALPER answered yes, although it's less common, and not just for exploration credits. All credit applications are reviewed and occasionally a company has made an error in the state's favor and the state will correct it.

CO-CHAIR MACKINNON asked if Mr. Alper was at liberty to share the legal opinion from the Attorney General on the department's ability to divert money from the CBRF to pay tax credits.

MR. ALPER replied that he did not know if he could share the actual document, but he had shared the content of it a couple slides ago.

9:40:46 AM
MARY HUNTER GRAMLING, Assistant Attorney General, Natural Resources Section, Department of Law, commented that she didn't have authority today to say whether they would be able to provide that document to the committee. She could say that it was in part based on a recent Alaska court decision in Wielechowski versus State where the state took the position that the Permanent Fund as a dedicated fund should be construed narrowly. When they were factoring a dedicated fund analysis into HB 111, the CBRF is also a dedicated fund and should be construed narrowly, as well, just to be consistent. The bill passed, and the decision came down on another dedicated constitutional fund, and DOL took another look at it.

CO-CHAIR MACKINNON said she could only speak for herself regarding the use of the CBRF and moving funds away from deposit, that the legislature has tried to pay tax credits two times through the CBRF and the Governor has chosen to veto them. So, she needed to see that legal opinion to see if it's consistent with the case she is referring to.

MS. GRAMLING stated that sections 9, 11, and maybe 16 of HB 111 incorporate some CBRF language and that is why that interpretation was required to implement this bill. That carry back concept was not a suggestion by the administration. Mr. Alper said it had to be in there, but she didn't know if that is necessarily true. It is the law now that carry backs can't divert money that would otherwise go to the CBRF. As a matter of law, she didn't know if that restriction could be deleted.

CO-CHAIR MACKINNON clarified that she wanted to pay back the tax credits and wants to be legally consistent with how funds are deposited into the CBRF.

9:44:09 AM
SENATOR BISHOP said what got his attention on this was the TransAlaska Pipeline System (TAPS) valuation that drove the $165 million and it sounds like a tariff is not a tax. He needed some clarification on that.

MR. ALPER stated that a tariff is not a tax; it is a commercial transaction paid from the company shipping oil to the company that owns the pipeline. The CBRF receives revenue resulting from an administrative proceeding or settlement of litigation and a whole series of clauses, related to tax. Because the tariff isn't a tax, the guts of this AG's opinion was they didn't pay enough taxes, and those lawsuits definitely go to the CBRF. But because it's really a tariff issue, the tax indirectly impacted the tariff calculation and there wasn't a hard requirement to divert that money to the CBRF.

9:45:48 AM
Slide 12: "Regulations Packet 2"

MR. ALPER said this is the regulations packet that is in the public review period right now. The "carried forward annual losses" had some issues: the allocation among properties and segments, application of the "ringfence," and taxpayer flexibility on use.

One provision that evolved working through the legislative process had to do with: ok, I've spent a billion dollars and I'm holding this, and now my oil field is in production. How do I use that billion dollars per year? One version of the bill said it could be used to get down to the minimum tax level, but the problem with that is what if that means I can't use my per barrel credits. What if my tax liability per the tax calculation is $500 million, but my actual tax owed is only $100 million. So, I'm going to have $400 million worth of per barrel credits. The way that provision was written they would have lost the ability to use that $400 million. So, by allowing maximum flexibility for the taxpayer, they get to preserve their ability to carry those lease expenditures forward into future years and not potentially lose that value.

He said that Mr. Ruggiero, the LB&A consultant, frequently testified about maximizing the ability to use carry forwards, because cost recovery is an essential tenet in a net profits-based system. And the legislature went to the maximum degree to preserve the ability for cost recovery in the final language. That is in AS 43.55.165(m) or (n), the new subsections that were added to the lease expenditure sections of law.

MR. ALPER said the "downlift" calculation is interesting in what triggers it: if lease expenditures are not used for 10 years, they begin to lose value at 10 percent of that amount per year. But the syntax of that was subjected to competing ideas: is it 10 percent of the entire value that is lost every year or 10 percent of the remaining value? For example, if you have 100 and you lose 10 percent, the next year you have 90. If you still haven't used them the year after that do you go down to 80 or do you use 10 percent of the 90 and go down to 81? Given the way the section was written, the answer was 81, but some preferred 80. So, the regulations were written to assure the 81 definition.

Also, a fair amount of time was spent on the idea of "reasonably related." The regulation package made available to the committee is long and a lot of the pages in it are examples for illustrative purposes to interpret the intent, and in many ways are the most helpful part of the regulations package. The department is trying to appropriately interpret the will of the legislature in the guidance they gave to through the bill, itself.

Where are we in the process? Mr. Alper answered that the discussion draft went out. This package has already had two drafts, a preliminary draft went out on November 18th, and because it wasn't an official public notice, they could talk freely with companies about it, and get their input, and that was very helpful in cleaning up the public notice of the official draft package 2 which didn't happen until December 21. Mr. Alper said they decided to have the hearing during the holidays because it was important to get it done. They apologized to industry and the legislature, but they ran out of calendar and wanted to get it done before the session. The public comment period closes in one week.

9:51:00 AM
CHAIR GIESSEL considered the statement from the Department of Law and said that the regulation package 2 actually is not something the committee could comment on today, because it is still out, and this is not official public testimony.

MR. ALPER responded that she could comment on anything she wants, but she might not be satisfied with the depth to which they could respond to them.

CHAIR GIESSEL asked if they were free as citizens to submit written comments to him on that package.

MR. ALPER answered yes.

SENATOR VON IMHOF referenced slide 11 and the language, "additional tax liability due to the recent TAPS settlement is not required to go to the CBR," and asked if the TAPS settlement going into the CBR generated any interest, because she sees regular additions into the CBR financial statements.

MR. ALPER answered that ultimately the settlement changed tariff calculations and reduced the allowable amount of transportation expenditure for the oil that was shipped in the affected years. That reduced transportation cost filtered its way through the tax calculation and lead to an additional tax liability. Then, yes, interest is charged on that tax liability.

He explained that the authority granted by the bill that passed last year stated not just the tax but the associated intertest could be offset by transferred tax credits. If for example, company X owed $20 million in taxes and turns into $30 million with all of that compounded interest, they could go out and buy $30 million worth of tax credits from another company for, maybe, $25 million and use that to offset the full $30 million obligation.

9:54:29 AM
CHAIR GIESSEL asked about regulation language relating to sections 6, 9, and 16 in HB 111 that refers to the carry-back tax credit being applied to satisfy a tax interest penalty, fee, or other charge; yet the regulations have much more limited language that refers only to the tax interest and/or penalty and left out "fee or other charge" in various places in section 305(c). She asked Mr. Alper when the department writes the actual language if they focus on extracting the actual language from the bill that passed the legislature. In HB 111 it was in Section 6 AS 43.55.023(c)).

MR. LARSEN answered that the language reads: "[3) may, regardless of when the credit was earned, be used to satisfy a tax, interest, penalty, fee, or other charge that" and prohibitions follow under paragraphs (A) and (B). Paragraph (A) says, "[except for] a surcharge under AS

43.55.201 - 43.55.299 or 43.55.300...." He explained that the reason the language was proposed and adopted as it was is that the department is not aware of any additional fees other than the principal portion, the interest, and the penalty. The penalty would be considered to be a part of the administrative proceeding because it normally falls out from the issuance of a letter from the department for something like a late filing. However, the language of the regulation says if someone self-reports a penalty - for example, if they knew they misfiled or filed late - and thereby avoid the administrative proceeding (letter from the audit department) they can use the carry-back credit to pay that portion of the penalty.

9:58:32 AM
CHAIR GIESSEL said her fundamental understanding of that was the rationale for leaving out the "fee or other charges" is at this point the tax division doesn't charge any other fees or other charges.

MR. ALPER clarified that Mr. Larsen said in the reference to AS 43.55.200-300 that the surcharge is the nickel a barrel conservation surcharge that goes to the Spill Cleanup and Response Fund that could be construed as a fee, but that was specifically carved out from this. So, the chair is correct, the department doesn't have any other fees.

CHAIR GIESSEL said if the department were to impose any other fees at some point in the future, the legislative intent is the application of the statute in that case for future fees to be offset by credits, but the word "fee" isn't in the regulations.

MR. LARSEN added that he was unsure under what authority the department would impose any other fees. If fees were added, at that point in time, that "fee or other charges" language would probably be added to the regulation. In working on language with the DOR and DOL the consensus was that since there are no other fees that it was appropriate to not include that language in the regulation now.

MR. ALPER added that if another fee was added, it would be through legislation, and the appropriate regulation would be added at that time.

10:01:00 AM

SENATOR VON IMHOF asked if the original intent of HB 111 was to disallow a carry-back tax credit from being used to create a tax overpayment over a claim for a refund or was the carry forward just going to be used a little bit each year and then kicked forward until it was used up. She recalled that the legislature didn't want to create that restriction.

MR. ALPER answered the circumstance he was concerned about and brought to the Senate Finance Committee's attention was what if someone has paid their 2011 taxes in full but was going to buy a tax credit and apply it to the 2011 taxes that would now be overpaid, the cash refund being a possible workaround to the limitation on cash through the Tax Credit Fund. He had not perceived that as the will of the committee, and in fact, Co-Chair MacKinnon read a statement saying that was not the intent of the bill and the department felt like it had clear guidance to make sure to not create the opportunity for a purposeful overpayment leading to a cash refund and implemented the regulations that way.

SENATOR VON IMHOF said she understood the example of taxes being closed and paid but what about taxes that are still open? She remembers that six years of back taxes were still under review. She asked if a company could apply a credit to a tax audit that is still open.

MR. ALPER replied companies typically refile taxes multiple times over the years because something changes. This TAPS settlement is one example. What will actually happen in practice - 2011/12/13 were high tax years and companies were paying the state billions of dollars - is company X thought it owed $1.1 billion and now they owe $1.2 billion. The thinking would be to buy credits to pay that $100 million of incremental tax. If the tax account is open because it is being audited, that audit is in the CBRF restriction. It's offset-able anyway and it falls out the carry back. If there had been a refile of some other sort that leads to a tax liability, that tax liability can be offset with these carry-backs. The department wants to make sure if there is no refile and no indication of a tax liability, disputed or otherwise, that the tax credits could be applied to overpay something that doesn't exist. He added that he might need a little more clarity on her envisioned circumstance.

SENATOR VON IMHOF said he answered it. She believes that it makes sense if due to a refile there is a subsequent liability, yes, they ought to be able to use the tax credits to offset that.

MR. ALPER responded that is he understood it; there has to be liability, some justification in the math, that says the liability exists.

SENATOR VON IMHOF said she understood and thanked him.

10:04:47 AM
CO-CHAIR MACKINNON asked if it is illegal to purposely overpay taxes.

MR. ALPER answered not to his knowledge, but he wanted Mr. Larson to answer that.

MR. LARSEN said he agreed with Mr. Alper.

CHAIR GIESSEL thanked the presenters for the overview. She pointed out that the Administrative Regulation Review Committee no longer exists, and that review is a function being performed by the joint meeting today. She thanked the committees for their time.

10:06:39 AM
CHAIR GIESSEL, finding no further comments, adjourned the meeting at 10:06 a.m.