

Alaska Oil and Gas Association



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FINAL

November 19, 2009

Mr. John Larsen, Audit Master
Alaska Dept. of Revenue, Tax Division
550 West 7th Avenue, Suite 500
Anchorage, AK 99501

Re: AS 43.55 Regulations Proposed 10/15/2009

Dear Mr. Larsen:

The Alaska Oil and Gas Association ("AOGA") welcomes the opportunity to submit the following comments regarding the regulations (the "Proposed Regulations") under AS 43.55 proposed in the public notice of October 15, 2009. AOGA is a private, nonprofit trade association for the oil and gas industry in Alaska, and our 15 members account for the majority of oil and gas exploration, development, production, refining and shipping activities in the state. In keeping with historic practice, these comments have been developed and approved by the AOGA Tax Committee without dissent.

The Proposed Regulations address three specific aspects of the tax under AS 43.55. One is the matter of making adjustments ("§170 Adjustments") under AS 43.55.170 to a producer's otherwise deductible lease expenditures under AS 43.55.165, which is addressed in proposed 15 AAC 55.280(b) – (g). Second is the tax credits allowed under AS 43.55.023(a) – (b), which proposed 15 AAC 55.320(c) addresses. Finally, there is the matter of determining the heating-value of gas production for purposes of converting a physical volume of gas into BTU equivalent barrels ("BOE") as defined in AS 43.55.900(3). Our comments are divided into four parts or chapters, one for each of these subjects being addressed by the Proposed Regulations plus a final part about a transition rule for any additional tax under AS 43.55 that may become payable as a result of adopting these regulations and applying them retroactively to prior tax periods.

PART 1. §170 ADJUSTMENTS — PROPOSED 15 AAC 55.280(b)–(g)

A. Initial Observations. We would like to begin our substantive comments by acknowledging that, overall, 15 AAC 55.280(b) – (g) of the Proposed Regulations is a material improvement from the previous July 17th discussion draft regarding §170 Adjustments, in two important respects. First, the Department clearly has listened to and taken to heart the comments that individual companies made on the July 17th draft. This is reflected, for instance, in the way the

present Proposed Regulations specifically employ and interpret the specific language in AS 43.55.170(a)(1) – (3) about the situations that can trigger a §170 Adjustment, rather than saying the statute “does not apply” as the discussion draft did.

Second, in interpreting AS 43.55.170(a)(1)* in these Proposed Regulations, the Department has determined that a payment by a facility-using producer to a producer owning the facility is not necessarily “for ... the use ... of [that] production facility” merely because that payment is made pursuant to the terms of an agreement or contract providing for the use of the facility. Instead, to trigger a §170 Adjustment under (a)(1) of the statute, the payment must actually be “for” the use of that facility, and not merely in conjunction with that use. This is best illustrated in proposed 15 AAC 55.280(b)(5), wherein the clear and unconditional expression of its rule refutes the notion that a payment “for” the use of a production facility under (a)(1) of the statute includes any and all kinds of payment from a user to an owner that might be made in conjunction with that use.

Third, we applaud the iterative process the Department has followed in developing these regulations and others in which it has offered its preliminary thoughts up for public comment (including industry’s) and has then used that feedback to revise and improve its drafts, which it then offered for further public comment. This consultative or collaborative public process is both prudent and wise. But because this takes more time than rule-making by simple fiat, it is important to recognize that the more difficult path the Department has chosen for developing the ACES regulations has resulted in improvements to the earliest drafts that justify the greater time and effort that have been required. There is an old quip about never having enough time to do something right, but always time to do it over. Here the Department has avoided falling into this quip, which is no small feat and deserves recognition.

B. O&M Costs for a Shared Facility: Proposed 15 AAC 55.280(b)(1) and (c).

(i) *Summary of the proposal.* Under proposed 15 AAC 55.280(b)(1), a payment to a producer by another person that “defrays” a “fraction of the producer’s costs [“O&M Costs”] to operate and maintain [a] production facility that is attributable to the other person’s use of [that] facility” would not trigger a §170 Adjustment unless the producer includes that fraction of the O&M Costs as its own lease expenditures. The amount of “fraction” for this purpose is determined under proposed 15 AAC 55.280(c)(2), while (c)(1) clarifies that O&M Costs for these purposes do not include any capital costs.

(ii) *Problems in determining the “fraction” under (c)(2).* Paragraph (c)(2) sets the “fraction” as “the other person’s share” of the facility’s O&M Costs as “provide[d] for” in “the facility use agreement ... unless the department determines that the amount is unreasonable[.]” Paragraph (c)(2) immediately continues, “otherwise, the department will determine that fraction using a method of allocation that is based on relative quantities of produced fluids processed by

* AS 43.55.170(a)(1) calls for §170 Adjustments to reduce a producer’s otherwise deductible lease expenditures under AS 43.55.165 for “payments ... received by the producer ... for (1) the use by another person of a production facility in which the producer has an ownership interest[.]”

the facility or other characteristics of the produced fluids that are reasonably related to the costs to operate and maintain the facility.”

The substantive problem with (c)(2) is the proposed ability of the Department to set aside as “unreasonable” the share of a facility’s O&M Costs that the parties themselves have agreed upon as appropriate for the user to “defray” — without any objective standard upon which the Department would base such a determination of “unreasonable[ness.]” Our concern here arises primarily from the need for clarity in order for the ACES tax to work as intended in terms of keeping Alaska competitive for investments in exploration, development and production. If there is no objective standard for judging what share of O&M Costs is reasonable or not, neither the facility-user nor the facility-owner can be confident that the share they have agreed upon — which, one must not forget, is what actually changes hands between them — will not be set aside by the Department, perhaps many years after the fact.

AOGA believes (c)(2) should respect whatever share the parties actually agree upon at arm’s length as the share of a facility’s O&M Costs that the user of it will “defray[.]” By “arm’s length” we mean any situation where either the would-be user or users of a facility do not have any ownership interest at all in that facility, or where one or more of them do own interests in it but there are other owners of it as well who have a right or power individually or collectively to veto the agreement for the use of that facility. This would be an objective standard. Even in a situation where one or more entities will be both users and owners of a facility, the Department needs only to read the terms of the operating agreement among the owners of the facility to see whether such a veto power exists for the facility-owners that do not have such a dual role regarding its use. Only in the absence of such a veto power would the Department revert to allocation on relative volumes of produced fluids or other characteristics of those fluids affecting the O&M Costs to run them through that facility.

Alternatively, if the Department is unwilling to accept the parties’ own allocation of a facility’s O&M Costs when it is at arm’s length, (c)(2) should establish a procedure pursuant to which the Department would gather the facts, hear the parties’ views and make its determination of whether the parties’ allocation of O&M Costs is reasonable or not. There is useful precedent for the Department to establish such a quasi-adjudicatory procedure.*

(iii) *Technical drafting problem in (b)(1) and (c).* There is a technical drafting problem in the use of “and” between “operate” and “maintain” in 15 AAC 55.280(b)(1) and (c). The term “operating and maintenance costs” is generally understood to include both the costs to operate something and the costs to maintain it. But specific items of cost are often only for one or the other — that is, they are either to operate a facility, or to maintain it, but not both. By using “and” between the verbs “operate” and “maintain”, (b)(1) and (c) are susceptible to being interpreted as applying only to the subset of O&M Costs that individually are for both operating a facility and maintaining it. We know that “and” may be read as meaning “or” in appropriate

* See former 15 AAC 55.027 regarding procedures for rulings by the Department not to aggregate for oil ELF purposes lease or properties that are sharing production facilities.

situations. But reading it that way is discretionary. Our concern isn't that it could not be read to mean "or" when appropriate, but that someone in the Department years from now might choose not to read it that way.

To prevent such an unintended narrow reading, either (b)(1) and (c) should be rewritten so that the standard term "operating and maintenance costs" is used instead of "costs to operate and maintain", or the word "and" should be replaced with "or" each time the phrase "operate and maintain" is used in (b)(1) and (c).

(iv) Technical drafting problem in (c)(2). As it is used after the semicolon in the middle of (c)(2), the word "otherwise" is ambiguous. Other than what? Other than situations where the facility use agreement provides for an identifiable amount representing the other party's share of facility O&M Costs? Other than situations where the Department has determined that amount to be unreasonable? Instead of "otherwise" after the semicolon, the regulation should use "in situations where ..." and then continue by describing what those situations are — e.g., if our first recommendation is followed, the phrase "in situations where there is no arm's length agreement" would appear where "otherwise" currently appears. Alternatively, if the Department does not change the portion of (c)(2) before the semicolon, "otherwise" should be replaced by "in situations where the facility use agreement does not provide for an identifiable amount of a fee representing the other person's share of those costs, or where the department determines that amount to be unreasonable".

C. Appropriate vs. Inappropriate Symmetry between a User and an Owner of a Production Facility: Proposed 15 AAC 55.280(b)(2) and (3). We acknowledge the basic intent and function of AS 43.55.170(a)(1) and (2) are to establish and maintain a kind of symmetry between the user of a production facility and the owner of it so that, between the two of them, costs or expenditures for that facility are not recognized and deducted twice for AS 43.55 purposes. However, such symmetry should not exist in situations where there won't be a double recognition and deduction of costs or expenditures for the production facility. Indeed, the contrary is true. Yet proposed 15 AAC 55.280(b)(2) and (3) would establish precisely such an inappropriate symmetry.

(i) Inappropriate symmetry under 15 AAC 55.280(b)(2). Paragraph (b)(2) pertains to a "fee or other consideration" (a "Backout Payment") that "compensates the producer [i.e., the facility owner in this context] for the deferral or loss of ... production[.]" It provides that payment of such a fee or other consideration to the facility owner will not trigger a §170 Adjustment for that owner "except to the extent the [facility user] treats the fee or other consideration as its own lease expenditure." This creates a symmetry between the user and owner under which, if the user claims part or all of the Backout Payment as a deductible lease expenditure, then the owner has its own otherwise deductible lease expenditures reduced by the same amount through a §170 Adjustment. Such a symmetry is inappropriate for the following reasons.

First, the facility owner's own lease expenditures for its production running through the facility are unchanged whether it receives a Backout Payment from the user or not. This is fun-

damentally different from the situation where symmetry under the statute is appropriate in order to prevent double-counting of lease expenditures.*

Second, the question of whether the facility-user may or should claim Backout Payments as lease expenditures is not a subject addressed by AS 43.55.170, but by AS 43.55.165 which defines lease expenditures. In other words, the question of whether or not a Backout Payment triggers a §170 Adjustment is completely unrelated to the question of whether that payment qualifies as a “lease expenditure” under AS 43.55.165 for the user paying it. It is therefore inappropriate for these regulations to try to create a linkage between the two questions.

Third, from the point of view of the facility-user, a Backout Payment is part of its costs of getting its oil “produced” in the sense of being recovered from the ground and put into “a condition of pipeline quality[.]”[†] It is a cost the non-facility-owner/producer faces for its production economics. The State stands to benefit substantially from a new field’s decision to use an existing production facility instead of building a new one. Thus, far from creating an economic disincentive against a new field’s use of an existing facility instead of building a new one,[‡] we would have expected the Department to be proposing regulations to create incentives for that choice.

Finally, in situations where a Backout Payment is made in kind with physical oil or gas, there is an analogy to deals where unequal volumes are exchanged to account for differences in quality, location or value of the respective oil or gas being exchanged. If, for instance, a producer receives 1.1 barrels of oil back for each barrel it trades away in such an exchange, the volume differential affects the “full consideration”[§] the producer receives in the exchange, but not costs for getting that producer’s oil to the delivery point in that exchange. A Backout Payment in kind, from the facility-user’s perspective, is not unlike an exchange with a volume differential, except that the exchange is to keep the facility-owner’s oil in the ground. It is, in other words, not unlike an exchange in which the received oil is delivered to a third-party instead of the user/producer, and that third party in turn conveys a benefit back to the user/producer.

(ii) *Inappropriate symmetry under 15 AAC 55.280(b)(3)*. Paragraph (b)(3) pertains to

* In response to this point, one might argue that the State “loses” tax revenue from the deferral or loss of the owner’s production, just as it “loses” tax revenue from counting the same lease expenditures twice, once by the user and again by the owner, and consequently such symmetry is appropriate after all. Such a response, however, shortsightedly ignores the fact that the State stands to receive tax and royalties for the user’s production, which is greater in volume than the facility owner’s lost or deferred production. In addition, the greater volume due to the user’s production lowers transportation costs on a per-BOE basis, thereby increasing the netback value for all production subject to state tax, royalties or net-profits sharing. The higher netback value also improves the economics of prospective new developments and exploration.

† AS 43.55.900(20)(A) (defining “point of production” for oil).

‡ One should bear in mind that the deductibility of the costs for such a new facility would not be in question, while the deductibility of the user’s out-of-pocket costs associated with using an existing facility would be questionable, if not eliminated, under (b)(2) as proposed.

§ 15 AAC 55.161.

a payment (a “Tax Hold-Harmless Payment”) that “reimburses the producer for its additional tax liability resulting from the receipt of fees or other consideration in connection with the other person’s use of the production facility[.]” Like (b)(2), paragraph (b)(3) provides that payment of such a fee or other consideration to the facility owner will not trigger a §170 Adjustment for that owner “except to the extent the [facility user] treats the amount of the reimbursement as its own lease expenditure.” This creates a symmetry between the user and owner under which, if the user claims part or all of the Tax Hold-Harmless Payment as a deductible lease expenditure, then the owner has its own otherwise deductible lease expenditures reduced by the same amount through a §170 Adjustment.

Such a symmetry is inappropriate for two reasons. First, for a facility-owner, the tax it pays under AS 43.55 cannot be a lease expenditure,^{*} and therefore there is no possibility of a double deduction regarding a Tax Hold-Harmless Payment. Second, the question of whether the facility-user may or should claim a Tax Hold-Harmless Payment as a lease expenditure is not a subject addressed by AS 43.55.170, but by AS 43.55.165 which defines lease expenditures. In other words, the question of whether or not a Tax Hold-Harmless Payment triggers a §170 Adjustment is unrelated to the question of whether that payment qualifies as a “lease expenditure” under AS 43.55.165 for the user paying it. It is therefore inappropriate for these regulations to try to create a linkage between the two questions.

D. Impossibility of Administration and Enforcement: Proposed 15 AAC 55.280(b)(2) and (3). It will not be possible for the Department to administer and enforce paragraphs (b)(2) and (3) of the proposed regulation, because of the confidentiality of tax information. The mere fact that the Department notifies a facility-owner of a §170 Adjustment under either paragraph will necessarily disclose to that owner that the facility-user has claimed the payment in question as a lease expenditure. Consequently, the very act of making a §170 Adjustment on either ground would violate AS 43.05.230(a): “It is unlawful for a current or former officer, employee, or agent of the state to divulge ... the particulars set out or disclosed in a report or return made under this title[.]”

E. Technical Comment: Proposed 15 AAC 55.280(b)(4). In the “except” clause at the end of paragraph (b)(4), we recommend deleting the word “that “ in “that share” and replacing it with “more than its own[.]” The last part of the paragraph would thus read, “except to the extent the producer treats more than its own share of the capital investment as its own lease expenditure; or[.]” This avoids ambiguity about which share the paragraph refers to.

F. Payment with Respect to Capital Invested before 4/1/2006: Proposed 15 AAC 55.280(b)(5) and (d). These proposed regulations would prevent a §170 Adjustment for a payment that “represents a charge for use of capital invested in [a] production facility before April 1, 2006.” This 2006 date is the effective date when the new “net” tax replaced the former ELF-based tax under AS 43.55. We have one technical comment to offer regarding this.

^{*} AS 43.55.165(e)(14) (“For purposes of this section, lease expenditures do not include ... (14) a tax levied under AS 43.55.011”).

The word “represents” at the beginning of (b)(5) should be replaced either with “is” or “constitutes”, and “under (d) of this section” should be inserted between “charge” and “for[.]” The paragraph would read, “(5) is [or “constitutes”] a charge under (d) of this section for use of capital invested in the production facility before April 1, 2006.” We believe a cross-reference to (d) in (b)(5) would be helpful to clarify or strengthen the linkage between these two parts of the regulation.

G. Proposed 15 AAC 55.280(e) – (g). We have no comments to offer regarding subsections (e) – (g) of the proposed regulations, except for one technical comment about (f). In the phrase “constitute a reimbursement or other payment that offsets the producer’s lease expenditures” in the third and fourth lines of proposed subsection (f), the proposal is using the same language as the underlying statute AS 43.55.170(a)(2) except that the proposal uses “other” before the phrase “payment that offsets the producer’s lease expenditures” while the statute uses the word “similar” in that phrase. The regulation should use “similar” too, in order to parallel the statute and be completely clear that it is interpreting the statutory language.

PART 2. TAX CREDITS UNDER AS 43.55.023(a) OR (b) — PROPOSED 15 AAC 55.-320(c)

The new subsection (c) proposed to be added to 15 AAC 55.320 would apply to —
a tax credit claimed under AS 43.55.023(a) or (b) [that] is based on an expenditure for an asset or other item that is intended to be used in, or in support of, oil or gas exploration, development, or production in the state but has not yet been placed in service for that use at the time the application is made for a transferable tax credit certificate[.]

For such a tax credit, (c) would require the applicant for the tax credit certificate to provide “assurance that the item will in fact be placed in service for the intended use within a reasonable period of time” and “proof of financial security to assure repayment” of the credit if the item is not placed in service within such a reasonable time.

Proposed subsection (c) — to the extent it would apply to tax credits under AS 43.55.-023(a) for qualified capital expenditures (“QCEs”) — addresses a threat or concern that AOGA believes does not exist. Moreover, the proposed “solution” to this perceived “problem” is unworkable and inappropriate. And to the extent subsection (c) would apply to tax credits under AS 43.55.023(b) for a carried-forward annual loss, it is also overbroad in its scope.

The concern about an asset not being placed into service is misplaced with respect to QCEs because it is highly unlikely a taxpayer is going to invest deliberately in a capital item and then not place it into service as soon as it can. This is because, for federal income tax purposes, the taxpayer stands to get no tax depreciation for its expenditure unless and until it places the item into service. This essentially eliminates the reason for concern, unless one expects an explorer or producer to invest in a capital item for use in Alaska and then divert that

item for use somewhere else before it is ever placed in service here. * Never, to our knowledge, has a producer had a production module or similar facility made for Alaska use and then diverted it for use elsewhere. Even for trucks and similar equipment (as opposed to facilities) of a capital nature, we are not aware of a case where a producer bought a vehicle for use in Alaska and then sent it Outside to be used before ever placing it in service here. Therefore, we believe this “problem” is not real or, at most, *de minimis*.

The “solution” being proposed in (c) is unworkable because the requirement to provide “adequate” assurance that an item “will in fact be placed in service for the intended use within a reasonable period of time” is subjective. How much time is “reasonable” for placing an asset in service? What kinds of evidence are appropriate and what must be shown in order to provide “adequate” assurance? How is *force majeure* to be dealt with in providing “adequate” assurance of placement into service within a reasonable time?

The proposed “solution” is inappropriate because, for any company without enough production to have a current tax liability of its own under AS 43.55 that it can apply its tax credits against, the proposed regulation would unnecessarily complicate the process for obtaining a tax credit certificate that it can then sell to someone having current tax liability to apply the certificate’s credit against. And it threatens to delay the issuance of certificates for QCEs much longer than need be. Moreover, the subjectivity of the conditions in (c) could allow the Department to avoid ever giving a tax credit certificate for a QCE before the asset or item is actually placed in service. But the very point of providing for such tax credits at all is the incentives they provide for investing for oil and gas here instead of somewhere else.

Additionally, there are many cases where QCEs are incurred for something that can never be placed in service — dry holes, for instance, and geophysical data. Similarly, there are other common cases where QCEs are incurred for safe and prudent operations, but it is impossible to tell beforehand when, or even whether, they will end up being placed in service. A good example of this is “capital spares” — specialized spare parts stored on the North Slope whose costs are capitalized. Having them on hand and ready to be used as soon as a part in operation breaks avoids the risks to people and property, as well as the potential cut back or curtailment of operations, that might otherwise occur if replacement of the failed part had to be delayed while a new part can be fabricated, shipped to the Slope and installed.

Finally, proposed subsection (c) is overbroad in applying to certificates for tax credits under AS 43.55.023(b) for a carried-forward annual loss. This is because it is possible to have O&M Costs that create such a loss all by themselves, even when there are no QCEs to deduct for that year. In such a situation it is meaningless to talk about placing anything in service, but the proposal makes no allowance for this possibility.

For all these reasons, we recommend that the Department not adopt proposed 15 AAC

* We note that the situation where a capital item is placed in service in Alaska and subsequently sent outside the state for use is addressed and dealt with by AS 43.55.170(a)(3)(A).

55.320(c) at this time, and instead continue to work on it through the public workshop process until the need for something like it can be established, and a way to make it workable can be found.

PART 3. HEATING VALUE OF GAS — PROPOSED 15 AAC 55.810(d) AND -.811

The proposed addition of subsection (d) to existing 15 AAC 55.810 would cut off the applicability of the present regulation for determining gas heating value when the amendment takes effect. Starting as of that date, the proposed new regulation 15 AAC 55.811 would apply for purposes of determining the heating value.

On the face of it, subsection (a) of the proposed new regulation seems to have much more specific and detailed provisions than the present regulation regarding the methodologies to be used for taking gas samples, for determining the water vapor content of a sample, and for calculating the gross heating value of the sampled gas. Our primary concern about this high degree of specificity arises from the possibility, or even likelihood, that the existing gas-sampling and measurement equipment for producing fields may not have been designed for these presumably state-of-the-art methods and might not be capable of meeting them. To change out the existing equipment for new equipment capable of meeting these standards would not be easy or inexpensive.

AS 43.55.900(3) defines “BTU equivalent barrel” to be one barrel of crude oil or “the amount of gas that has a heating value of 6,000,000 British thermal units[.]” In other words, this statutory definition assumes irrebuttably that crude oil has a heating value of 6 million Btu per barrel. In fact, however, the empirically measured heating value of crude oil, on average, is 5.8 million Btu per barrel.* This means that, in terms of its heating value, a BTU equivalent barrel for natural gas is 3.44% greater than one for crude oil.

In light of this inherent 3.44% inaccuracy in converting natural gas production volumes into BTU equivalent barrels under the statute, it seems incongruous to require by regulation the determination of the heating value of the gas to a significantly higher degree of accuracy — within a mere fraction, apparently, of one percentage point. In terms of the degree of error in a calculation, it is the parameter with the greatest error that sets the limit on the meaningful degree of accuracy that the result of that calculation can have. Certainly whatever degree of overall accuracy might be obtained under the proposed regulation, the inaccuracy of the result will be greater than the inherent 3.44% inaccuracy built into AS 43.55.900(3).† This, we submit, is

* U.S. Energy Information Administration, *Monthly Energy Review* (Nov. 2002), Appendix A. “Thermal conversion factors,” Table A2, “Approximate Heat Content of Crude Oil, Crude Oil and Products, and Natural Gas Plant Liquids” (online at http://findarticles.com/p/articles/mi_m2744/is_11_2002/ai_95916397/pg_7/?tag=content;coll).

† This point is shown by the following example. Suppose the calculation involves multiplying to empirically measured parameters, of which *A* has an error of 5% and *B* only 0.001 percent. This means that *A* can actually be as low as 95% of its mean value and as high as 105% of it, while these figures for *B* are 99.999% and 100.001% respectively. The range of error in the product of *A* × *B* is found by multiplying the lowest values of *A* and *B* within their respective ranges of error and then their highest values. In other words, the range of error in *A* × *B* is from 95%

simply not enough to justify the likely disruption and expense to replace gas sampling and testing equipment for producing fields across the state.*

Proposed 15 AAC 55.811(b) would require “composite sampling or continuous analysis” whenever gas production for a lease or property exceeds 1,000 Mcf a day, and “spot sampling at least once per month” otherwise. Again, our concern with what is being proposed is that the existing equipment may not be well-suited for sampling and gas analysis at this frequency.

We would add that the AOGA Tax Committee does not have among its members the technical engineering knowledge and expertise to speak authoritatively and in detail on either of the preceding concerns. Consequently, we hope that the operators of producing fields will submit technical comments to the Department regarding proposed 15 AAC 55.811 and its feasibility and appropriateness in actual practice. But should it turn out that they do not comment on it, we would urge the Department to contact the operators to discuss this regulation with them before adopting it.

Certainly, at this stage in the process, it seems more prudent to us for the Department to leave the present regulations in place for determining the heating value of gas. We are not aware of any problems in their implementation or compliance, and it certainly seems to be a likely possibility that there will be such problems or issues if the Department adopts 15 AAC 55.811 as currently proposed.

PART 4. TRANSITIONAL PROVISION — NOT IN THE PROPOSED REGULATIONS

The transitional provisions in the 2007 ACES legislation give the Department statutory authority to adopt regulations to implement the substantive tax law enacted under that legislation retroactively to the respective effective date of the change in substantive tax law.[†] It seems to us that the Department is not planning to use this transitional statutory authority to adopt proposed 15 AAC 55.811 retroactively. It also does not seem that proposed 15 AAC 55.320(c) will be retroactive, although this is less clear to us. But it does seem to us to be reasonably likely that the Department intends to adopt the proposed regulations on §170 Adjustments (15 AAC 55.280(b) – (g)) retroactively at least to July 1, 2007, the effective date of the amendment to AS 43.55.170 under the ACES legislation.[‡] If so, then it seems likely that there could be

× 99.999% or 94.99905%, to 105% × 100.001% or 105.00105 percent. The error in the result is 5.000950% at the low end of the range and 5.001050% at the high end, both of which are greater than the degree of error in either *A* or *B*. This illustrates that the accuracy in the result of a calculation cannot be better than the accuracy of the parameter in that calculation with the highest degree of error.

* Because it is the Alaska Oil and Gas Conservation Commission, not the Department, that exercises the State’s police power to regulate the operations of oil and gas fields in this state and the terms and conditions for measuring the production from them (*see* AS 31.05), there may be a legal difficulty for the Department if it sought to require for tax administration the installation of equipment or the adoption of procedures that are not required by the AOGCC or might even conflict with what the AOGCC does require.

[†] §§ 72(1) and 73 ch 1 SSSLA 2007.

[‡] The effective date of the amendment is July 1, 2007. *See* § 63 (making the amendment) and § 74(d) (making

§170 Adjustments resulting in additional tax for past tax periods to which 15 AAC 55.280(b) – (g) would retroactively apply.

In light of this possible retroactivity and the possibility of additional tax becoming due as a result of that retroactivity, we believe it would be prudent, fair and appropriate for the Department to adopt a transitional regulation that sets a prospective due date — that is, one that occurs some prescribed, reasonable time after the effective date of the regulation (before taking retroactivity into account) — for paying additional tax on production during prior tax periods that arises as a result of the adoption of a regulation that is retroactive to those tax periods.

The effect of such a transitional regulation would be to prevent the accrual of interest under AS 43.05.225(1) from the original due date for the tax under AS 43.55 for each prior month's production to which the 15 AAC 55.280 amendments would retroactively apply. Otherwise, the statutory interest would be calculated, at a minimum, at a punitively high 11% APR compounded at the end of each calendar quarter. While AS 43.05.060 and 43.05.070 allow the Department to "compromise" a tax or a penalty, there is no corresponding provision to compromise interest. But interest does not begin to accrue until the "tax ... becomes delinquent[.]"* Clearly, then, if the additional tax for past periods under a retroactive regulation does not become due until a date after that regulation is adopted and becomes effective, there would be no delinquency — and hence no accrual of interest — unless the additional tax is not paid by that due date.

As the Department is well aware, the questions about the validity of a retroactive tax law or regulation under Due Process become graver the farther back a retroactive provision goes. In addition, a different question is presented under the constitutional prohibition against *ex post facto* laws[†] if the effect of retroactivity is to punish conduct that was not culpable or improper at the time it occurred.

We mention these constitutional matters not as any kind of saber-rattling, but because the present Proposed Regulations are not likely to be the only ACES regulations adopted retroactively by the Department. Indeed, the Department has already presented and held public workshops on discussion-drafts of ACES regulations that we expect to be adopted retroactively.

§ 63 retroactive to July 1, 2007), ch 1 SSSLA 2007. AS 43.55.170 was originally enacted by § 24 ch 2 TSSLA 2006 and made applicable to oil and gas produced on or after April 1, 2006 by § 35(a) ch2 TSSLA 2006. Sec. 37 ch 2 TSSLA 2006 gave the Department statutory authority to adopt regulations to implement § 24 and other sections of that Act retroactively to April 1, 2006.

* AS 43.05.225.

[†] U.S. Const., Art. I, sec. 10, cl. 1; Alaska Const., Art. I, sec. 15. An *ex post facto* law is "a civil or criminal law with retroactive effect; especially : a law that retroactively alters a defendant's rights esp. by criminalizing and imposing punishment for an act that was not criminal or punishable at the time it was committed, by increasing the severity of a crime from its level at the time the crime was committed, by increasing the punishment for a crime from the punishment imposed at the time the crime was committed, or by taking away from the protections (as evidentiary protection) afforded the defendant by the law as it existed when the act was committed" (emphasis by underscoring added, italics in original). See "ex post facto law," *Merriam-Webster's Dictionary of Law*, Merriam-Webster, Inc. 10 Nov. 2009. <Dictionary.com <http://dictionary.reference.com/browse/ex+post+facto+law>>.

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Accordingly, we believe it would be timely and appropriate to use the present occasion of adopting the Proposed Regulations and amend 15 AAC 55.800 (“Retroactive application of regulations”) and/or 15 AAC 55.830 (“Interest”) so as to establish the rule that additional tax from a retroactive regulation for past tax periods that it retroactively applies to will not become due until some reasonable date after that regulation is adopted. This rule would initially apply to those of the present Proposed Regulations that are adopted retroactively. But, as additional retroactive ACES regulations are adopted in the future, this rule would be amended in conjunction with the adoption of those other retroactive ACES regulations so it applies to them as well.

This concludes our comments on the Proposed Regulations. Thank you for this opportunity to share them with you.

Very truly yours,

A handwritten signature in cursive script that reads "Marilyn Crockett".

Marilyn Crockett
Executive Director