

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 3, 2016

1:01 p.m.

DRAFT

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Mike Hawker, Vice Chair
Representative Bob Herron
Representative Craig Johnson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr

MEMBERS ABSENT

Representative Kurt Olson

COMMITTEE CALENDAR

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing

oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 247

SHORT TITLE: TAX;CREDITS;INTEREST;REFUNDS;O & G

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/03/16	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

RANDALL HOFFBECK, Commissioner
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: On behalf of the governor, assisted in introducing HB 247.

MR. KEN ALPER, Director
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: On behalf of the governor, provided a PowerPoint presentation to introduce HB 247.

ACTION NARRATIVE

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CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 1:01 p.m. Representatives Nageak, Talerico, Josephson, Seaton, Johnson, and Hawker were present at

the call to order. Representatives Tarr and Herron arrived as the meeting was in progress.

HB 247-TAX;CREDITS;INTEREST;REFUNDS;O & G

[1:02:38 PM](#)

CO-CHAIR NAGEAK announced that the only order of business is HOUSE BILL NO. 247, "An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

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RANDALL HOFFBECK, Commissioner, Department of Revenue (DOR), explained that Governor Walker's New Sustainable Alaska Plan has three major components to it: 1) earnings - the use of the state's existing wealth, which are primarily earnings from the

permanent fund but also from other investments as well; 2) reductions in spending; and 3) increases in revenues, the majority of them being an increase in rates to existing taxes, as well as a personal income tax. The bill hits in two places: 1) it reduces the sizes of the credits that the State pays out, so it is a cut in expenditures of about \$400 million, and 2) it has a component that raises the minimum tax on producing properties from 4 percent to 5 percent. The increase in minimum tax, as well as hardening the floor, would result in about \$100 million in new revenue.

COMMISSIONER HOFFBECK walked the committee through events between when the budget was signed last year to today. He said the governor's line-item veto of a portion of the budget actually limited the amount of credits that the State could pay in fiscal year (FY) 2016 to \$500 million instead of the more open-ended language that was in the original budget. That had a bit of a ripple effect through the oil and gas industry, particularly as it related to the smaller companies that were exploring and developing the fields. Essentially, the folks that had loaned money against the credits refused to loan, saying they were uncertain that these credits would now be paid. They pulled back and this created a liquidity crisis within these smaller developers. So, [the administration] spent the first few months putting that package back together, assuring those that were loaning the money that in fact the State would pay the credits; that there would be some timing changes, but the credits would still all be paid.

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COMMISSIONER HOFFBECK explained that it then set off a whole series of meetings with the industry representatives and with folks in the financial community to get their feel for what would be a package that would work going forward. It was the opinion of the administration, which he thought was very valid, that the State just couldn't afford the level of credits that it was paying. That was not a critique on whether it was a good idea to have credits in the first place, but just simply that the size of the credit program didn't match the State's ability to pay the credits any more. "We worked diligently with these companies and with the financial community," he said, "and came up with a plan that we thought would resolve the majority of the issues." Senator Giessel also held a series of workshops throughout the summer and [the administration] testified at three of them and [Senator Giessel's work group] came up with a plan. Today Mr. Alper will present [the administration's] idea

of what the comparison is between the plans. Commissioner Hoffbeck said he thinks the results are fairly similar, although [the administration] feels a bit more urgency in the timing of what needs to be done and when. It was a collaborative effort and as many issues as possible were addressed. There are still going to be areas where certain companies have a different idea of what the best solution is, he continued, and he expects that those companies will be happy to express that. Commissioner Hoffbeck offered his appreciation for the openness that the companies had in meeting with [the administration] and walking [the administration] through the significant pinch points in this issue. It was good government, it was very participatory, and the discussions were open book rather than people posturing for positions.

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REPRESENTATIVE HAWKER stated it all began with the \$200 million veto of last year. He inquired whether he is correct that the governor has made absolute assurance to industry that those credits that were vetoed will be honored.

COMMISSIONER HOFFBECK replied correct.

REPRESENTATIVE HAWKER asked whether he has missed something because he has not seen an appropriation request in the budgets that were submitted by the governor. Yesterday was the deadline to produce the supplemental appropriation for FY 2016 and he has not seen a request for that funding.

MR. KEN ALPER, Director, Anchorage Office, Tax Division, Department of Revenue (DOR), responded that HB 247 contains a fiscal note [Identifier: HB247-DOR-OGTCF-1-27-16] that includes an appropriation to the Oil and Gas Tax Credit Fund in the amount of about \$926 million. Of that, it supplements the approximately \$73 million that is in the governor's operating budget for FY 2017 to make the \$1 billion of what [the administration] is calling "transition appropriation" to kind of carry the existing program, including any overhanging credits, through to the effective date of the proposed legislation.

REPRESENTATIVE HAWKER inquired which fiscal note that might be.

MR. ALPER answered that two fiscal notes were written. One of them is Tax Division which talks about the implementation of the bill. The other one is called "fund caps" in its title [Identifier: HB247-DOR-OGTCF-1-27-16] and it shows a relatively

large upfront cost and that is the one that incorporates the reductions in expenditures in the out years.

REPRESENTATIVE HAWKER said the fiscal notes that he has taken off the internet have apparently been superseded.

MR. ALPER replied he noticed on BASIS this morning when looking over this bill the documents in question are in the document area but not in the fiscal notes section.

REPRESENTATIVE HAWKER maintained it is not a fiscal note and presumed there is a new fiscal note then.

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MR. ALPER began his PowerPoint introduction of HB 247, "Oil and Gas Tax Credit Reform HB247." Turning to slide 2, "Bill Title," he apologized for the title containing 273 words, but said a lot of different pieces of statute are touched upon in the bill and it does a lot of things within the broader tax credit universe. Moving to slide 3, "Suggested Informal Short Title," he said he hopes to informally refer to the bill as "An Act reforming oil and gas tax credits and strengthening the minimum oil and gas production tax."

MR. ALPER drew attention to slide 4, "Work Done Since Last Session." Reiterating some of the recent history stated by Commissioner Hoffbeck, he said the governor's line-item veto capped FY 2016 spending at \$500 million. That \$500 million has not yet been spent. The total credits claimed and refunded to date in FY 2016 is about \$472-\$475 million and a number of credits are in process. "There isn't going to be that much actual delay in the actual buying back of tax credits before we get to what happens in the current budget cycle," he continued. Hopefully the liquidity crisis has been resolved and will continue to stay resolved. The three presentations that [the administration] made to Senator Giessel's working group as well as a presentation that many committee members were at in Kenai in June are all on BASIS. The legislation before the committee has been developed gradually over the last six to seven months.

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REPRESENTATIVE SEATON recalled that when the estimate of \$700 million was being considered last year there was discussion of statutory requirement that 10 percent of production tax be paid, which was about \$91 million. However, the governor obviously

arrived at \$500 million. He asked what amount the statutory requirement is anticipated to be for this coming fiscal year.

MR. ALPER responded that the formula in AS 43.55.028(c) is tied to the price of oil. It would be 15 percent of production taxes before the application of any credits. If the price of oil is expected to be below \$60, which it is, then the answer is \$73.4 million. That comports with what the governor put in the operating budget for FY 2017.

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MR. ALPER resumed his presentation, turning to slides 5-11 to review the history of oil and gas production tax credits. Addressing slide 5 he said the "modern" world of oil and gas tax credits began in 2003 with the Alternative Credit for Exploration [AS 43.55.025], which was a percentage of qualified expenditures and it could be taken against what was then a gross-based tax known as the Economic Limit Factor (ELF). The bulk of the credit system was put in place with the Petroleum Production Tax (PPT). The PPT bill was the switch to the net profits-based tax and that is where credits were started to be seen for operating losses, credits for capital expenditures, and so forth. The PPT bill also included the Cook Inlet tax caps, the maximum taxes that Cook Inlet producers currently enjoy. It also added the possibility of the State repurchasing credits. Prior to that the credits had to be held and used against the tax liability. The PPT system was modified and expanded upon with the passage of Alaska's Clear and Equitable Share (ACES) bill in a fall 2007 special session. Credit wise, the most interesting point in ACES was that the repurchase provision was made open ended - there were no more caps on it - and it set up a specific fund to which the legislature appropriates money every year and from which the Department of Revenue (DOR) repurchases tax credits. Many of the credits were expanded upon or added in 2010 with Representative Hawker's bill, the Cook Inlet Recovery Act, House Bill 280, and some companion legislation in the other body. To encourage additional exploration and development in Cook Inlet, House Bill 280 added, among other things, the 40 percent Well Lease Expenditure Credit, as well as a bunch of other more subtle and technical treatment issues as to how credits were calculated. That bill has led certainly to a lot of activity and in many ways the pushing back of the concerns about supply anxiety that were driving the conversation at that moment in history. In 2012 the legislature passed the Frontier Basin bill, which added a lot of new benefits, new credits in the previously underdeveloped areas

of the state in the Interior. This bill was in some ways modeled after the Cook Inlet Recovery Act. Senate Bill 21 was passed in 2013. Primarily an oil tax overhaul, Senate Bill 21 on the North Slope eliminated the "spending credits," the 20 percent capital credit, and replaced it with what is now known as the Per-Taxable-Barrel Credit, the sliding-scale credit tied to production.

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REPRESENTATIVE HAWKER returned to his earlier question about the fiscal note [Identifier: HB247-DOR-OGTCF-1-27-16]. He expressed his concern about living up to the promises made to producers to whom the State of Alaska owes \$200 million. That is an unconditional obligation at this point, he said. The legislature could retroactively repeal that if it chooses. He inquired whether this is really the intention of [the administration]. He observed from the fiscal note that the appropriation that Mr. Alper said contains that money is contingent upon passage of a version of this bill. He inquired whether this a "hostage provision" and that those producer tax credits will not be paid if the legislature does not pass a version of the bill for [the administration].

COMMISSIONER HOFFBECK answered "no, those are liabilities of the State that will be honored." If this particular package doesn't pass, then some modification will be needed in order to have the appropriation to pay the credits.

MR. ALPER added that the tax credit is a two-step process. When a company does the desired activity and submits the application, the company earns a credit certification, which is a paper asset. That asset is subject to the statute and does not change regardless of what's in any budget. The repurchasing of those certificates is the fact that's limited by the appropriation. Should nothing happen other than last year's veto, there will be about \$200 million of outstanding certificates that are owned by companies and that have not yet been purchased by the State. "And what we're looking at," he said, "is providing the means to repurchase those certificates."

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MR. ALPER resumed his discussion of the history of oil and gas production tax credits. Moving to slide 6 he noted that credits were done to encourage or incentivize a desired behavior. The State wanted companies to come in and make investments that they

weren't otherwise making. There was anxiety about declining production, desire to diversify the oil field, and in Cook Inlet to create some supply certainty. Later on the credits were built in to the net profits tax system. What does that really mean? A certain minimum amount of credits is anticipated just because it is known that a certain amount of money, say, is going to be spent or certain number of oil is produced, so a relatively high tax rate was established that was offset by a robust credit system and that all got built into an expected revenue. However, as credits got added over time they were layered with each other. "We" started getting the same behavior receiving multiple credits and some unanticipated circumstances, and very high levels of State support at times. He reiterated that credits can either be used against tax liability, meaning subtracted from a company's tax bill if it owes taxes, and if not, then the credits can be cashed out and repurchased by the State subject to appropriation. A specific provision in current law says that large producers, those producing more than 50,000 barrels a day, are not eligible to get cash for their credits, to have their credits repurchased. In those cases, a company without a tax liability would have to carry its credits forward into a future tax year and then use them against the company's taxes.

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REPRESENTATIVE HERRON asked what the current balance is in regard to the original \$700 million credit balance that the governor reduced to \$500 million.

MR. ALPER replied that right now the amount in the tax credit fund is \$25 or \$28 million. The \$500 million was transferred into the fund early in the fiscal year and the last time he checked the State had repurchased approximately \$472 million, leaving around \$28 million left in the fund for the rest of FY 2016. He added that there is an inherent "front-loadedness" in the fiscal year for repurchasing tax credits. This is because most of the applications come with the tax filings of the major oil producers and the smaller oil companies. The due date for the production tax is the end of March [for] the previous calendar year. The State has a statutory obligation to issue certificates in 120 days; so, for the most part the credit certificates are given in July and many of them get turned around right away the next day to request repurchase. It may take several weeks to get the bank accounts worked out and transfer the money, but by the end of August or into September

usually two-thirds of the year's credit money has already been spent.

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REPRESENTATIVE HERRON surmised the tax credit situation would be self-correcting given the current oil price situation; he therefore inquired why this legislation is needed.

COMMISSIONER HOFFBECK responded that a transition is being seen within the credit package. When oil prices are low, capital is constrained and less actual work is being done that can be claimed, but more losses are seen in companies and so a growth is seen in the Net Operating Loss Credits. The hope was that it would self-correct, but it didn't; essentially the credits have moved more towards the net operating loss side of the ledger.

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MR. ALPER continued with addressing the history of oil and gas production tax credits. Displaying slide 7 he delineated the major credits on the books right now. He explained that the focus is on the first three credits listed on slide 7 because the fourth and fifth credits will at least partially sunset in the near future. Under the Net Operating Loss Credit [AS 43.55.023(b)], the State pays companies back for a percentage of their losses; it varies by time period and area of the state. That credit is notably stackable, meaning that credit can be earned as well as one of the other credits, and that is where some of these very large rates of State participation have come in. The Per-Taxable Barrel Credit [AS 43.55.024(i & j)] is the North Slope Production Credit added by Senate Bill 21. This credit ranges between \$0 and \$8 for legacy oil and is a flat \$5 for new oil. It can only be used against tax liability, so is one of the so-called "use-it-or-lose-it" credits. The Capital or Well Lease Expenditure Credit [AS 43.55.023(a and l)], the 20-40 percent credit, does not exist on the North Slope. In other areas of the state these are credits based on company qualified expenditures. They are generally refunded and can be stacked with the Net Operating Loss Credit. The Exploration Credit [AS 43.55.025(var)] can be used in place of the Capital Credit if a company qualifies. These credits are a little bit larger, have a little bit different rules, and they have data submission requirements for the Department of Natural Resources. Most of these credits are expiring this July, although certain ones have been extended in the Interior areas that are known as the Frontier or Middle Earth areas.

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REPRESENTATIVE HAWKER questioned Mr. Alper's characterization of AS 43.55.024(i and j) as a credit. That element, he maintained, operates as a component of establishing the base tax rate. The result of that element is not a credit that is taken against the payment of a tax; rather, it is part of the calculus of developing the tax rate at which a company pays. That item was put into the legislation specifically to create a progressive effective tax rate. He said he is therefore curious as to why it is being characterized as a credit along with these other elements which have a completely different economic operation.

MR. ALPER answered, "We agree wholeheartedly with your characterization of the Per-Barrel Credit, it is very much a component of the tax system." Had that not existed it is likely the legislature would have come around to a lower tax rate. The same can also be said about the 20 percent Capital Credit in the ACES era, which was primarily a major offset that lowered the tax rate and was built in. He continued:

For accounting purposes, for reporting purposes, we consider it a credit, it is described in statute as a credit. But, in all of our reporting we refer to it clearly as a credit used against liability, which has a different character and ... really a different series of policy decisions that we're looking at as opposed to those credits that are refunded by the State.

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REPRESENTATIVE HAWKER said his question was not answered. He asked why it is being characterized in this document and in this public report and before this legislature as a credit, comparable with the same economic character as the others.

MR. ALPER replied:

We are listing comprehensively in this slide all of the different credits. As we get deeper into the proposal and the bill itself you will see that we're not intending to do anything to that credit. We're aware of it ... it is called a credit in statute and we are trying to comprehensively describe all the credits that are in statute.

REPRESENTATIVE HAWKER said his recall is that it is characterized as a gross value reduction.

MR. ALPER responded that the statutes can be looked at later on to define it at the appropriate time.

REPRESENTATIVE HAWKER maintained that [AS 43.55.024(i & j)] operates completely different than every one of these other true credits being considered. He said it is critical to understand that difference.

MR. ALPER replied:

That credit in a very low price environment is unusual in that it is truly a use-it-or-lose-it credit or deduction, whatever we choose to call it. In fiscal year 16, where prices are expected to be very low for the entirety of the year, only \$28 million worth of that credit are going to be used. Basically that's the amount of subtraction the companies can take before they bump up against the minimum tax and then they lose the rest of it. In a year with higher oil prices we could see five, six, seven, over a billion dollars in that offset. But ... that offset tends to decrease to zero in a low price environment, it is not a major component of the credit cost to the State ... in this low price era.

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MR. ALPER returned to slide 7, stating that the Small Producer Credit [AS 43.55.024(c)], a component of the PPT bill, provides up to \$12 million off of a company's taxes if it meets certain small production criteria. Per statute, applicants will no longer be accepted after May 2016. However, it is what is called a slow sunset - once a company is inside the small producer credit regime, it could receive the credit for up to nine years. Consequently the State will be paying at least some Small Producer Credits until about 2024.

MR. ALPER displayed slide 8 noting that through 2015, depending on what is counted, \$7.4 billion has been spent on credits or taken in credits against liability, which gets to what Representative Hawker said earlier. Of that number, \$4.3 billion were credits against liability on the North Slope which, for the most part, are offsets to the tax regime - either the

Per-Taxable Barrel Credit in Senate Bill 21 or the 20 percent Capital Credit in ACES - and [DOR] does characterize those very differently than the other roughly \$3 billion worth of refunded credits. On the North Slope, \$2.1 billion was refunded in credits; these were from the new producers and explorers that were developing new fields. Outside the North Slope there was about \$1 billion in credits. Of that, only about \$100 million was used against liability; that's largely because there isn't very much tax liability in Cook Inlet because of the tax caps that were put in place in the PPT bill. He said [DOR] has attempted to calculate that through the end of 2013, and somewhere between \$500 and \$800 million is the value of those tax caps, the tax reductions in statute. In addition, there has been \$900 million in refunded credits through end of FY 2015 and the great bulk of that has been in the last three or four years, since the Cook Inlet credit regime was opened up and a lot more activity was drawn into the inlet.

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REPRESENTATIVE HAWKER observed on slide 8 the subheading, "FY 2007 thru 2015, \$7.4 Billion in Credits." He said legislation passed by the legislature has resulted in \$7.4 billion in tax credits. He asked how much the State has collected from the oil and gas industry during this same time period of 2007 to 2015.

MR. ALPER answered he thinks the production tax number is a year old through 2014 and the number he has in his head is \$27 billion. Corporate income tax and the royalty would need to be added to that, so it is probably a number in the neighborhood of \$40 billion.

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MR. ALPER resumed his presentation, drawing attention to slide 9 and explaining that the graph shows the regional breakdown of the refunded tax credits, the approximately \$3 billion in historic refunded credits between the North Slope and the non-North Slope area. Tax credits have been claimed for the Middle Earth, or Interior, areas of the state. However, because these are so few, [DOR] is not able to discuss them without violating taxpayer confidentiality. So, [DOR] has commingled them with the Cook Inlet and called it non-North Slope, but the figure is almost entirely Cook Inlet with a small amount of the Interior exploration work that has been ongoing. An increase in the relative share of Cook Inlet credits can be seen, with it now being greater than 50 percent over the last couple of years.

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REPRESENTATIVE SEATON said [the legislature] established a system to stimulate, which has successfully stimulated exploration. He expressed his concern on what the Net Present Value is to the State and whether over the lifespan of the fields it is projected that the State is going to have to institute an income tax or a sales tax to generate revenue to pay more because there will be a Net Present Value loss from some of these very big tax credits that have been given. He requested that when tax credits, and the value of those tax credits, are being talked about that it be in relationship to the Net Present Value to the State of the entire 30-year life of a field. When the State invests the money and when it gets the payback and whether at the end of a 30-year lifespan, depending on different prices, whether in the future the State is actually having to tax citizens individually to pay for some of these investments that are being encouraged. He said he wants to ensure that the legislature looks at this holistically.

MR. ALPER responded that over the last several years more field lifecycle modeling is being seen, such as that from [the consulting firm] enalytica. Professor Goldsmith did some lifecycle modeling in some of his analysis and the DOR Tax Division has been trying to replicate that and would like very much to bring some sort of field examples. Some of it was discussed before this committee last spring when potential development of the Arctic National Wildlife Refuge (ANWR) was talked about. There was a lot of credit cost in the upfront part and then the revenue comes later. It's important to have a conversation about the time value of money and whether the State actually sees its money back at the backend when it is spending a lot of money in the upfront. It is an important conversation and [the administration] looks forward to talking about it more later on in the session.

1:34:00 PM

MR. ALPER moved to slide 10 and continued discussing the history of oil and gas production tax credits. He said that, setting aside the large credits used against liability that were a core component of the tax system, the State has paid and refunded about \$3 billion in credits through the end of FY 2015. In looking at that number, so much of the line-item specific information is confidential that [DOR] cannot talk about specific products. [The department] has tried its best to put

it in a format where order of magnitude can be discussed. Of that \$3 billion a bit less than \$1.5 billion went to six North Slope projects that are currently in production, fields that were in development and are now producing. About \$650 million went to 13 other [North Slope] projects, some of which are expected to be produced and some of which were exploration or pre-development projects that never came to fruition. On the non-North Slope or Cook Inlet plus area, it has been about 50:50. There are six projects that are in production that received about \$450 million in credits and eight other projects that do not yet have any production, although it is expected that the bulk of those will eventually produce oil or gas.

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REPRESENTATIVE HAWKER noted that when the \$650 and \$450 million are added together, the State under current statutes has given a little over \$1 billion to companies that have had no production, no contribution to the State apparently. He asked whether Mr. Alper thinks that was a good idea.

MR. ALPER replied he doesn't know that he wants to answer a flat yes or no to that question, it was part of a large policy direction. [The State] is paying companies essentially on activity and without necessarily a guarantee; the bulk of the money is turning into production. He said he thinks this analysis might be easier to do in a few years when it can be seen what really does lead to production; for example, analyzing how many dollars per barrel in increased production did the State spend. [The department] has struggled with trying to do that analysis and has been unable to come up with any meaningful results to say how much the State is really spending and how much new activity has it led to. It's a big question mark; it's hard to know exactly what would have happened if these credits didn't exist.

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REPRESENTATIVE HAWKER said these credits resulted from a policy call in the legislature, a contentions policy call actually, from folks who said that the State of Alaska really needed to provide substantial funding and put explorers on equal footing with the larger companies that were having significant production. That was an argument made on the floor and made in this committee. Some legislators agreed with it, some didn't. He said he is "wondering if we are really starting to question whether the State ought be supporting non-producing entities or

whether we should only be supporting producing entities." He requested that the answer to his question be in the context of the bill that [DOR] indicates in its fiscal is contingent and wrapped up in this, which is the new Alaska Industrial Development and Export Authority (AIDEA) bill that says a big part of getting rid of all these credits is replacing them with a loan system that only companies with proven reserves will be receiving. He asked whether the administration has made a policy call that the State is not going to support non-producers and will only be supporting those that have already proven up their reserves in the future.

COMMISSIONER HOFFBECK answered:

No, it isn't. Because we left the Net Operating Loss Credit in place we are still supporting exploration activities and pre-development activities. ... Not at the level that we have in the past, but we would still be supporting at a 25 or 35 percent level, depending whether you're in Cook Inlet or on the North Slope.

REPRESENTATIVE HAWKER concluded it is adjusting the levels.

COMMISSIONER HOFFBECK replied right. He continued:

That Net Operating Loss Credit is one of the more difficult ones for us to control as far as ... what the value of that credit is. But it's one that became very clear in our discussions ... with the companies over the summer that that was the critical credit ... in the picnic basket of credits.

[1:38:31 PM](#)

REPRESENTATIVE JOSEPHSON assumed that part of the reason it is hard to gauge the efficacy of the credits now is because there are all these variables that are difficult to fit into any calculus, such as finding more oil or gas than was thought might be, or price that is out of one's control.

MR. ALPER responded:

Yes, absolutely. We simply can't know what would have happened in the negative, if we weren't doing these things. Frankly, some of the larger projects that are currently in production on the North Slope were in the pre-development or development process prior to the passage of the PPT bill

in 2006, yet were, by the nature of their projects, eligible for a certain amount of credits. So it's hard to say what maintained them, what stopped them from being stopped, what encouraged them to develop more. It's a very, very difficult analysis to do. And if I could say one more word on Operating Loss Credits ... to follow what Commissioner Hoffbeck said. The Operating Loss Credit is in many ways, especially on the North Slope, a playing field leveler. It's a net profits tax, which means if you're an incumbent producer, if you have a tax liability, and you spend one more dollar, you've reduced your taxable net profits by that dollar and you're saving 35 cents on your taxes. The Net Operating Loss Credit creates a mechanism for the State to let a newcomer, a new producer, someone exploring or developing a field that doesn't yet have any income, to get that same 35-cent benefit without having a tax liability. So, in some ways it's about equity, it's about making our resources available to not just the major incumbent producers but to the newcomers that are trying to enter ... into the oil field.

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REPRESENTATIVE HERRON requested an explanation as to why HB 247 would not actually discourage explorers when what is wanted is to gain explorers.

MR. ALPER answered:

We're not encouraging or discouraging explorers - the exploration credits are scheduled to sunset this summer. We're simply not addressing that, we're allowing that to happen. But, the Exploration Credit numbers pre-date the passage of [Senate Bill] 21, and it actually created unusual circumstances where the State has been paying up to 45 percent of certain costs on the North Slope. That's in many ways an unsustainable number. With those credits going away, the North Slope exploration credit support would be through the Operating Loss Credit at the 35 percent level.

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REPRESENTATIVE TARR, in regard to the aforementioned credits, surmised the Mustang Project would be in the \$1.45 billion category of a project that has come online, and then there are

the other companies that went out of business. She inquired whether the State has learned from this experience to evaluate a tipping point for whether a company is too small or too under-resourced and therefore unlikely to have success. She further inquired whether more specificity should be delineated on the Net Operating Loss Credits or whether, as currently being broadly applied, it is working in the way that it should.

MR. ALPER replied:

One of the things we contemplated as we developed this legislation was some sort of pre-approval or a filter process. Industry didn't like it very much. We were uncomfortable with it ourselves that we don't necessarily want to be picking winners and losers.... It ended up not surviving to the final version of this legislation. In the absence of that it's very hard. These are laws of general applicability, if you do the desired activity, you earn the thing. Regarding your point on Mustang, I can't comment obviously on a specific company. But what we are trying to do with the changes proposed in this bill to a certain extent is help control who's getting cash versus what company's we feel are more able to hold on to their credit certificates until that future point where they might have tax liability they could use them against.

COMMISSIONER HOFFBECK added:

The fact that we're actually removing some of these credits that can be stacked, which could actually result in sometimes 75-80 percent of the cost being borne by the State, is now going to be 25 or 35 percent. I think that will self-correct some of those issues as well because, if somebody has 75 percent of their own money in the game, I think ... they're more likely to be better capitalized before they come in.

[1:43:33 PM](#)

REPRESENTATIVE HAWKER noted that Mr. Alper brought up a really important distinction: the pre- and post- Senate Bill 21 tax regimes. The pre-Senate Bill 21 tax regime had very generous Qualified Capital Expenditure (QCE) Credits. That went away in 2013 and the cumulative numbers on the slides do not distinguish between pre- and post-Senate Bill 21. He continued:

I don't know that it is appropriate for us to be making a judgement call or pass judgement on our tax regime system when we're looking at a blended set of numbers here. I don't know that you can accurately, truly say ... how the current system is working based on a blend of two very different tax systems. Something you might want to think about ... as you present this bill [is] finding ways to distinguish those for us.... Let's talk about our current regime and let's not blend it with an old regime that we have substantially modified and already made substantial reductions in credits.

MR. ALPER responded "yes, we would like to try to parse that out by time period and we've tried in some preliminary documents." He clarified that during the ACES era prior to the passage of Senate Bill 21, the State's general level of support for North Slope activity was around 45 percent. That was the then 25 percent Operating Loss Credit stacked with the 20 percent Qualified Capital Expenditure Credit. With the passage of Senate Bill 21 the number was reduced from 45 percent to 35 percent, which is the new increased Operating Loss Credit with the elimination of the QCE. However, an asterisk on that is that there was a temporary measure where the Operating Loss Credit was bumped to 45 percent for calendar years 2014 and 2015, the first two years after the implementation of the effective date of [Senate Bill] 21. So, really, the State's level of support for North Slope activities has remained constant through the ACES era and to today, and it's only beginning in January 2016 where a drop-off in those relative numbers will be seen.

REPRESENTATIVE HAWKER remarked that Mr. Alper's response made his point.

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REPRESENTATIVE SEATON said:

I am somewhat troubled by the idea of a net operating loss being considered as being equity between non-producers and producers when a net operating loss used to be 25 percent based on the base rate and then we introduced a 35 percent rate with a gross dollar per barrel reduction; but when you go to net operating loss, that doesn't count, so ... expenditures get offset at 35 percent. So now we have a 35 percent and

... my concern is that when we first did PPT and ACES and Pedro van Meurs was helping us design this ... the statement was generally very adamant that we didn't want to have over 20 percent tax credit because our liability would be huge if we were in a downturn like we are now and we are committing to huge amounts of tax credits based on investment totally unrelated to our income. And so now we find ourselves in exactly that situation of having large amounts of credits that are based on investment supporting big international oil companies ... to over a third of their expenditures and having very little revenue. I am trying to figure out ... other than just testimony from industry saying they like 35 percent of their expenses being written off or carried forward at State expense, how are we justifying 35 percent net operating loss credit.

MR. ALPER answered that this bill, and Governor Walker's wish, is to not address the core components of the underlying tax system - the tax rate, the operating loss, the gross value reduction, for example. Allowing that Representative Seaton raises an interesting point, he noted that in the PPT and ACES era the Operating Loss Credit was tied to the base tax rate, but yet the base tax rate often increased because of the additive feature of progressivity. So, in effect, the State's support for the non-producers tended to be less than, or equal to, the support for the majors because now the Per-Barrel-Credit is a subtractive feature. Really, the State is providing a higher level of support for the non-producers, the newcomers, than it is for the major base producers, so Representative Seaton's observation is correct.

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MR. ALPER drew attention to slide 11 to conclude his discussion of the history of oil and gas production tax credits. Regarding this year's money, he reiterated that of the \$500 million that was authorized [for credit repurchases for FY 2016], about \$472 million has already been paid. Of that, about \$200 million was for the North Slope and \$272 million for the Cook Inlet area. That is a little less than 60 percent non-North Slope, which comports with the 2015 data so a trend is now had. The numbers that have gone out the door are almost entirely 2014 Net Operating Loss Credits. He clarified that "Cook Inlet drilling" means the QCE and the Well Lease Expenditure credits. In some cases, he noted, the companies apply for those quarterly rather

than waiting until the end of the year. It is still expected that there will be \$700 million in total demand with the rest of it being partial 2015 credits and other things that don't need to be officially spent on or authorized until next July, until 120 days after the next tax payment year.

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MR. ALPER next addressed slides 12-13, "History of Minimum Production Tax 'Floor,'" explaining that during the gross tax era there was a minimum "cents per barrel" tax. In 2005, which was the last full year of ELF, it was 60-80 cents with an adjustment tied to the American Petroleum Institute (API) specific gravity measurement. The more valuable oil was essentially taxed at the higher level. With the PPT bill the legislature introduced a Gross Minimum Tax as a potential security blanket against the Net Profits Tax. It was 4 percent of the Gross Value with a sliding scale down tied to the price of oil that's an annual average price of oil, and if the price is over \$25 it's a 4 percent gross tax. However, under the PPT and ACES era, that floor could be pierced by many of the credits, including the 20 percent QCE Credit. So, if ACES was the law today, the State would be receiving zero rather than some version of the minimum tax that it is getting today.

MR. ALPER turned to slide 13, pointing out that under Senate Bill 21 the floor was strengthened because it specifically says the [North Slope] Per-Taxable-Barrel Credit cannot reduce the tax liability below the floor. The legacy fields, the older oil fields, specifically are paying at the floor level. However, several other credits could reduce payments below that. These credits are the Net Operating Loss Credit, the Small Producer Credit, various exploration credits, and the Per-Taxable-Barrel Credit for so-called "new" oil, which is oil eligible for the Gross Value Reduction (GVR) and that \$5 a barrel credit could reduce payments all the way to zero. The minimum tax was really never broadly triggered or used until late in 2014 when [DOR] started seeing monthly payment estimates coming in at the floor level. Throughout 2015 nearly all the production tax receipts have been based on the minimum tax, the 4 percent gross.

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MR. ALPER moved to slide 14, "Major Bill Themes," to outline the six broad themes in the bill, with the first theme being that the State's annual cash outlay needs to be reduced. It is a sheer necessity, he said, because the State does not have the

money or the budget to be able to support half a billion dollars in spending. He pointed out that \$500 million in tax credits is 10 percent of the \$5 billion general fund (GF), and when looking to broadly cut the budget and make a sustainable Alaska the tax credits need to be cut as part of a broader package. Theme two, the Net Operating Loss Credit needs to be protected in some form because it is something of a playing field leveler. Theme three, repurchases need to be limited. Some new rules would be put in place as to who gets repurchased versus who might be required to hold their credits until they had a tax liability. Theme four, the minimum tax would be strengthened to ensure the State truly is getting the 4 percent. Theme five, the bill would allow more transparency and ability to talk about some specifics in public without violating taxpayer confidentiality. Theme six, credits that have been earned to date, and through any transition period, would be honored and paid. Whatever the effective date of the final legislation, it would be ensured that there is enough money to pay off all those credits.

[1:53:02 PM](#)

REPRESENTATIVE JOSEPHSON, in regard to limiting repurchases, offered his understanding that the principle feature is "this question of local hire." He asked whether there will also be "pre-screening of the rocks in the ground and ... the quality of the investment."

MR. ALPER confirmed that local hire is one of the provisions. Another, he continued, is an annual cap under which [the State] would not purchase more than \$25 million per company per year. Possibly more important is a cap on the size of the company. The bill includes language that says a multi-national company with global revenue in excess of \$10 billion per year would hold its credits on its own books and then use those credits in the future to offset taxes when its field comes into production.

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REPRESENTATIVE HAWKER commented that the themes are really the intent behind the bill. He asked whether an analysis has been done of projected consequences to the industry from substantially raising the taxes and the effect of that on future investment, production, and revenue to the State should the bill pass unchanged.

MR. ALPER replied that there is no specific analysis because it is very hard to predict. The legislation would touch many

different sectors in many different ways. The expectation is that most of the projects that are ongoing would continue to happen. A couple of future projects that might be a little bit marginal might not happen if they suddenly go from getting two-thirds State money to 25 percent money. But it is felt that enough is going to continue to happen that supply won't be a problem and that there will be a level of oil and gas activity that is commensurate with [the State's] ability to afford it. If something requires two-thirds State money to happen, he said it is appropriate at some point to have the conversation that maybe that shouldn't happen, that perhaps that activity should be able to stand on its own merits a little bit more.

[1:55:49 PM](#)

REPRESENTATIVE HERRON asked what the State's take will be if the bill passes.

MR. ALPER responded the State has gotten into a system of paying several hundred million dollars per year in refunded tax credits. No one really contemplated that until fairly recently because the State was receiving \$3, \$4, sometimes over \$6 billion a year in the production tax. The production tax revenue has now reached \$100 million or \$200 million a year; yet the credit liability is roughly the same, maybe slightly smaller, and suddenly it is said that something is out of balance. So, the first thing [the State] would get is one step closer to a balanced budget. The governor proposed \$500 million in cuts in his FY 2017 budget; \$400 million of them are in this bill. [The State] would get perhaps a bit more certainty that the projects that are going forward are on a sound financial footing that are more likely to be resulting in meaningful production. [The State] would also get a bit of production of its minimum tax. "We put in a 4 percent minimum tax," Mr. Alper said, "but I don't think there was full understanding at all levels of government as to what did and didn't penetrate that tax." The senate committee recommended that things be done to ensure [the State] really does get 4 percent of the gross. "Right now, because of some unusual factors, we are not actually getting a full 4 percent of the gross and we're trying to bump that up, and in a second conversation increase it to 5 percent," he said. "So guaranteeing ourselves at least a minimum level of annual revenue even in times of a shortfall in the industry."

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REPRESENTATIVE HERRON requested he be given some insight on the administration's policy discussion that led up to the introduction and who participated.

COMMISSIONER HOFFBECK answered that it was various people at various times. Explaining that the policy decision that led up to this was two-fold, he said:

One is the fact that, quite frankly, the size of the pie that we have to support all of the things that we're spending money on was not large enough to support everything anymore. And so ... we had to pull back and we're pulling back on essentially everything ... or most things. This was ... one of the outflows that quite frankly is not a core government service ... it had to be balanced against education, life, health, safety, roads, those kind of things. ... It was considered an area where ... it was prudent for the State to pull back on in this particular area. We're not pulling all the way out, but we just simply can't afford the level of support ... that we're doing right now. ... The second component ... was just that. We do recognize, however, that some level of support was necessary and so ... we tried to balance that by leaving ... a fairly substantial level of support still in the bill, but just ... quite a bit less than it was before. And so ... it was a recognition we couldn't afford it and secondly that we've needed to continue some level of support but ... at a lower level.

REPRESENTATIVE HERRON requested the commissioner to name names as to who participated in the discussions that led up to the bill's introduction.

COMMISSIONER HOFFBECK replied it would have been largely revenue staff. Mr. Alper, himself, the governor, and the chief of staff were probably the four that had the most input into it, but that was all based on information that the four of them received through extensive meetings with industry, the investment community, and the work that Senator Giessel did with her committee.

[2:00:32 PM](#)

REPRESENTATIVE HAWKER said there is a difference between the question that Representative Herron asked and the question that

he had asked. Representative Herron's question was, "What's the State's revenue side of this?" The answer was largely "we're doing what we need to do to balance our budget and that's what our priority in doing this is." Representative Hawker said his question was the other side, "What is the consequence of making this decision and literally at this point in time arguably taking another half billion dollars a year or more out of an industry in this state that is not making money today in this state at these prices?" He related that in a meeting today with a senior person from one of the major producers he was told that the company is losing \$3 million a day continuing to operate in Alaska. He asked whether he is correct in recalling that Mr. Hoffbeck or Mr. Alper earlier stated that no one has worked on modeling identifying the consequences of this legislation on the individual players and that members are to take it on faith that major tax increases can be assessed on entities that are losing money in this state today and there is not going to be a negative consequence.

COMMISSIONER HOFFBECK responded that the Institute of Social and Economic Research (ISER) has been contracted to look at the impacts of all of the decisions being made here. There is not a single lever in this entire budget, he said, that doesn't have consequences. An analysis is being done, but the recognition is that there just simply isn't a way to balance a \$4 billion budget deficit without some collateral consequences in the economy. Regarding Representative Hawker's earlier point about the difference between credits that are embedded in the tax system, which is a tax issue, and the credits that are really in place to try to incentivize certain activities, Commissioner Hoffbeck said that taking away money that [the State] is giving somebody is a little different than taxing somebody, taking money out that [the State] did not first provide to them in the first place. "And so I do see a little bit of a distinction between this \$400 million ... being characterized as a tax increase," he said. "I really do see it as a credit reduction."

[2:03:07 PM](#)

REPRESENTATIVE HAWKER charged that the people who will be most profoundly affected by taking away these credits are the small companies that don't have revenue in Alaska. The questions he is asking are: "What will be the consequences? Will we be driving those small companies out of state? Will we make Alaska a state that is not attractive?" He said an article in today's Alaska Public Media reports the head of BlueCrest Energy Inc. as stating that the company probably won't develop the natural gas

in the Cosmopolitan prospect [in Cook Inlet] if the legislature makes big changes to Alaska's tax credit program. That is the kind of consequence he would like to know about, he said. Taking away credits is going to affect one cohort of the state's investors in one way; the tax rate itself is going to affect those larger players, those larger producers that are contributing all the money that is ultimately being redistributed here today. Representative Hawker agreed there is definitely a difference between the two, but argued that at the end of the day the consequences on the relevant cohort must be looked at. It cannot be said that taking away this credit is not going to affect the big producers. Maybe it won't; but likewise, jacking up the tax rate on production is not going to have any effect on a non-producing entity; however, it has to be asked whether that entity will ever be willing to go into production if the tax rate is raised.

[2:04:56 PM](#)

REPRESENTATIVE TARR related that ConocoPhillips had \$393 million in profit for its Alaska operation for third quarter [2015]. So, she continued, at least one company is still making some money. She shared that in talks she's had with producers about changing the credits in Cook Inlet, even these producers said that the credits have met their intended purpose of spurring gas development in the inlet to prevent the possibility of a gas shortage. That has now largely been accomplished and the producers know it is time for change, although there is interest in keeping some in place. She asked how that experience can be used to better assess whether credits had their intended purpose for development in the way that was wanted.

COMMISSIONER HOFFBECK replied that he thinks this is a good point. When the credits really grew in the 2010 era, it was a market looking for gas and there was a real need to incentivize activity. Currently in the Cook Inlet, however, there is gas in search of a market. So, that dynamic has changed, and that begs the question, then, of whether that level of support is needed at this point in time. That level of support had some impact when it was needed. Does that level of support need to be continued? The question now is whether there is a different level of credit support that allows a more steady state going forward. A lot of it will be something that only time will tell whether in fact this is the right rate as well. "We've had a tremendous number of discussions with these particular players in Cook Inlet to get their impact ... on the credit before we proposed the credit reforms," he said.

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CO-CHAIR TALERICO asked when the ISER report will be available.

COMMISSIONER HOFFBECK responded it was supposed to have already been receive, and he has been told that it should be available in a couple of weeks.

2:07:49 PM

REPRESENTATIVE SEATON noted that oftentimes individual things are looked at and given credit for the outcomes; for example, pre-production on the North Slope that was already going forward before the tax system there was changed. It is being assumed, he continued, that credits were what drove the financial or the exploration in Cook Inlet. However, at this same time the Regulatory Commission of Alaska (RCA) changed its position from a barely breakeven amount of \$2.50-\$3.00 per thousand cubic feet (MCF) gas to \$6-\$8 per MCF, now allowing people to make money on the gas they were selling. It is hard to incentivize somebody with credits if their product isn't going to be profitable. So, which of the two - the credits or a profitable product - drove the investment? A balance needs to be looked at. Alaska has some of the highest priced gas in the nation right now at about \$7.50 where it is sold in the Cook Inlet Basin. People can make money on it. The Henry Hub is about \$2.80. There is a huge difference in the profitability of the gas and no one is giving any relationship to the profitability of the gas and saying that all the exploration was done not because a company could make a profit on its product, but because the State gave the company a subsidy. "I'm very concerned," Representative Seaton said, "that as we go forward with these credits we ought to say what they really are. They are subsidies to these companies and subsidies to the product ... so it's not just credits, and so I think that we should consider that term as well as we talk about these things."

REPRESENTATIVE SEATON turned to slide 14 and added that he is very concerned about the second theme, "Protect Net Operating Loss credits as a playing field leveler between legacy producers and newcomers". He stated:

I'm very concerned that if we say "oh we got to go to 35 percent of everybody's expenditures to level the playing field even if we're losing money on all of those credits that are being paid." We need to

actually look at the amount of the credit we're paying and see if it makes sense in the full term for what we're getting, not for just saying "oh, we're going to be a referee between legacy producers and new producers and we're going to give everybody a big subsidy or a big write-off against their expenses." And so I hope that as we go through this we also think of what's the State's liability in here as well.

[2:11:11 PM](#)

REPRESENTATIVE HAWKER returned [Representative Tarr's] earlier statement that ConocoPhillips' year-to-date third quarter earnings show the company as having earned money in Alaska.

REPRESENTATIVE SEATON clarified it was third quarter 2015; the fourth quarter report is not yet out.

REPRESENTATIVE HAWKER stated ConocoPhillips will be reporting its earnings tomorrow, not today.

MR. ALPER said his expectation is that the fourth quarter results will be weaker given the price of oil was in the fifties throughout the bulk of the third quarter and is now in the thirties and has hit the twenties. He added he is sure that that has had an impact on ConocoPhillips.

REPRESENTATIVE HAWKER stated that is his point. It is important to be talking accurately and about the right time frame, and looking at the right statistics as these analyses are made. To say that an entity is making a profit today may not be accurate and he won't know until they report tomorrow.

MR. ALPER added that the administration does not want to eliminate the tax credit program. Rather, the conversation the administration is trying to have before this committee and as the session progresses is, "What is the appropriate level of support that we should continue to give to the industry - both the mature and the new-coming industry - given our fiscal realities? Are there adjustments that deserve to be made based upon lessons learned in the last 10 years and the changes in the price of oil?" He noted he "would not want to characterize this ... as an upheaval or as an elimination of a program, it's an evolution of a program."

[2:13:03 PM](#)

MR. ALPER reviewed slides 15-16, "Recommendations of Senate Working Group," relating that after last year's session Senator Giessel put together a working group of several members of the other body, as well as some industry and local government input. The group put together a comprehensive and impressive report. In addition to highlighting the work done by the eight or nine hearings and characterizing the needs of the various sectors, the [December 2015] report makes six recommendations. He said the administration's bill is trying to meet, for the most part, the recommendations made by that working group.

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REPRESENTATIVE JOSEPHSON recounted that when he asked Mr. Alper about the limited repurchases on slide 14 and mentioned local hire, that Mr. Alper had answered there would be limit of \$25 million per company. He further recounted that Mr. Alper talked about treating the big companies less like small domestic companies and more like what they are. He asked whether HB 247 has some sort of pre-screening element to it because in regard to the imposition of new revenue it would be wonderful if he could explain to a constituent that "the State's geologists have looked at this and this thing is a great prospect, it's worth investing 35 cents in."

MR. ALPER recognized that Representative Josephson sat in on several of the fall working group meetings and that in these meetings there was talk about the possibility of a pre-screening process. However, he continued, that did not survive to the final version of the bill and so there is no application process. The earning of the credits remains open-ended. Right now the only restriction on getting cash from the State is whether a company produces 50,000 barrels or more in Alaska. Every company, whether the world's fourth largest oil company or a mom and pop working out of their truck, can get cash for their credits. [The bill proposes that] large companies with revenues in excess of \$10 billion would earn credit certificates, but would hold them and use them against future tax liability. The \$25 million is the fork in that road, the alternative program put in place for the smaller companies who can cash in \$25 million per year with the idea that if their projects are larger it might take several years to work through the credits.

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MR. ALPER, resuming his presentation, clarified that slides 15-16 are a paraphrasing of the six recommendations in Senator

Giessel's report, not a literal interpretation, and are [the administration's] sense of what was in the working group's final report. In regard to the first recommendation of gradual implementation and not forcing this on the industry too quickly, he said \$1 billion would be put into a transition fund for existing and future liability; there would be no attempt to go backwards with these changes.

[2:16:15 PM](#)

REPRESENTATIVE HAWKER charged that Mr. Alper was very selective about what he had chosen from Senator Giessel's report. For example, the report says to protect the stability of the Cook Inlet supply and that encouraging North Slope production to come online will be critical for the fiscal health of the state. In regard to "gradual implementation," he argued that the words in Senator Giessel's report state "a deliberate, methodical and graduated approach that still honors commitments currently being made under existing law would be a reasoned strategy." He said he doesn't think that "a deliberate, methodical and graduated approach" translates to a "'gradual implementation' of your concepts here."

MR. ALPER replied:

PowerPoints are inherently a little bit compressed; there was no attempt to mischaracterize any point that was in there. The idea that I believe the senator made, and her staff and her team and what we're trying to honor here, is that we want to honor what has been earned to date, what is earned through the effective date of this bill, and make sure that ... we're not pulling the rug out from anybody who's mid-process. The rules are going to change at a future date after the end of this session at which point the way, and the rate, and the rules under which we're paying people back will hopefully change. Likewise, in considering the impacts on different sectors ... there were six recommendations in the report and you could certainly deconstruct what was actually said in the six recommendations.

[2:17:56 PM](#)

MR. ALPER resumed his discussion of the recommendations on slide 15, stating that [the administration] feels it is honoring the second recommendation to maintain future cash support for

Operating Loss Credits. All the different sectors of the economy benefit from that Operating Loss Credit and [the administration] wants to ensure that the State doesn't completely back away from providing cash support for industry activities. Mr. Alper noted that the third issue on slide 15 is not in the bill, but said it is an important idea given there have been some high profile bankruptcies. Unfortunately, there may be others, he continued, and if that occurs oftentimes the secured lenders in the big banks in the East Coast tend to get paid before the local vendors providing local procurement. Although not in the bill, [the administration] would like to find a mechanism to better protect Alaska's folks because it is important.

[2:18:48 PM](#)

MR. ALPER reviewed the fourth recommendation on slide 16 that the minimum [production] tax "floor" be protected, reiterating that Operating Loss Credits have been able to penetrate that [floor] and reduce payments. He said that a newly precisely worded section in the bill would do exactly what is recommended to protect that flow. The bill would also increase the rate to 5 percent, which is not in the senator's recommendations. He addressed the fifth recommendation in regard to protecting the Frontier Basin tax breaks. He noted that exploration tax credits for the Interior parts of the state for the newly developing areas have already been extended in current law to a sunset of 2022. He said [the administration] intends to honor that and keep that going, which means that exploration work in the developing areas in the Interior will continue to receive State support up to 65 percent of their cost. That is important, these are areas that have no current production, but [the administration] believes there's tremendous potential and wants to continue on some of these projects that are in the very early stages of their development.

[2:19:48 PM](#)

MR. ALPER addressed the sixth recommendation that reporting requirements be enhanced, noting that it is awkward to sit before the committee and be unable to name names and talk about specific projects and specific dollar amounts. He continued:

It would be easier to have these conversations if we could explain who's done what and how much money they've got. We don't want to talk about how much of taxes someone pays or how much they're spending, how

much money they make. But if someone's receiving State cash benefit, we feel just as we report how much we pay on chairs or people's salaries, we should be able to talk about specific companies and how much money they earn in State refundable tax credits.

[2:20:57 PM](#)

MR. ALPER turned to slides 17-22, "Summary of Major Bill Provisions." He advised that a printed sectional analysis is available [on the table] outside the committee room. Rather than going through the analysis by order of the sections as they occur in the bill, he said he will present a "thematic" analysis by type of issue and type of proposed change that would be made. He began with the bill's proposed changes in the area of exploration credits [slide 17], explaining that the "Jack up Rig" credits expire July 2016, as do most of the AS 43.55.025 credits for the North Slope and for Cook Inlet. However, they have been extended for the Middle Earth area, the Interior area, until 2022. The administration's policy is to do nothing - to let these things expire, but to keep the Middle Earth credits and let the North Slope and Cook Inlet credits go away.

MR. ALPER noted there are a couple of other older exploration credit statutes on the books that have not been used in many years [AS 38.05.180(i) and AS 41.90]. Out of concern that they might be resurrected with the loss of the alternative credit for exploration, the bill would preemptively repeal them to prevent any unforeseen credits that are not currently being used to come up out of the woodwork. He said the Department of Natural Resources (DNR) has also been involved in the development of HB 247, having made several presentations to Senator Giessel's working group last fall. One of DNR's concerns is the loss of information. Through the exploration credit program, DNR gets a lot of specific data, such as seismic data and down hole data, and DNR is able to use that data for its own planning and strategizing and deciding what areas to lease in the future. Some of that data becomes public after a certain number of years and can be used by other companies. [The administration] would like to respect and protect that benefit and attach those DNR data reporting requirements [in AS 43.55.025] to the AS 43.55.023(b) credit, the Net Operating Loss Credit, which is the largest credit that will remain after the change.

[2:23:19 PM](#)

MR. ALPER moved to slide 18 to discuss the bill's provisions in the area of Cook Inlet Drilling Credits. Recognizing that this might be the most controversial provision, he explained that it would repeal AS 43.55.023(a) [and AS 43.55.023(1)], the "Qualified Capital Expenditure" and the Well Lease Expenditure Credit for Cook Inlet. He said:

Those are the credits that are typically stacked with an Operating Loss Credit, which leads to the very large numbers - the 50, 60 percent State support on the spending based credits. Senate Bill 21 repealed the comparable credits on the North Slope, so in some ways we're extending [Senate Bill] 21's tax treatment to other areas of the state. Another interesting feature of current law, and it's awkward to talk about, but because we have these spending based credits commingled with a tax cap for the hard maximum tax, you have circumstances where a profitable company producing oil and gas in Cook Inlet could be paying zero taxes but still receiving relatively large state tax credit payments based upon their activity drilling wells, what effectively becomes a large negative tax. By repealing these credits we would be eliminating that and saying ... through 2022 you'll continue to ... pay zero but we're not paying you credits if you're not paying taxes. There is an understanding that before the Cook Inlet tax caps repeal in 2022 the legislature is going to need to address the underlying Cook Inlet tax regime. It's something of a hybrid, it draws together pieces of ACES and [Senate Bill] 21. It's probably not stable, but it doesn't matter for the next five or six years because of the existence of those tax caps.

[2:24:42 PM](#)

REPRESENTATIVE HAWKER pointed out that he is "the father of those tax credits" and added that brownout and blackout drills in Southcentral Alaska were stopped because "we were successful in achieving what we wanted to accomplish." This committee saw that it accomplished something good and there is always that need for a feedback loop to evaluate it. That's why Senate Bill 138 [passed in 2014 by the Twenty-Eighth Alaska State Legislature] included a requirement that a comprehensive review be performed in, he believed, January 2017 of the Cook Inlet Basin tax system to provide a deliberate, rational, and analyzed basis for making changes. However, HB 247 would repeal those

credits and would repeal them this year. He asked what the consequence will be on his community and what will be done when there is no heat and no lights in his town in the middle of winter. Maintaining that HB 247 would repeal what solved his community's problem, he further asked what analysis and evaluation has been done to show that repealing these credits will not hurt his community.

COMMISSIONER HOFFBECK replied that in [the administration's] discussions with industry right now there really is a dynamic within Cook Inlet of gas looking for a market. The work that was done was successful. So, it begs the question of whether this level of credits needs to be maintained at this point in time in the life of those fields. The goal was accomplished, there is a reliable supply of gas in Cook Inlet right now. That will last for a while. It may be the case that in four to ten years from now there might be a need to re-incentivize. But, given the budget restrictions that are had right now, the question is whether it is prudent to maintain those credits when there is currently a gas supply available.

[2:27:16 PM](#)

REPRESENTATIVE HAWKER stated that Commissioner Hoffbeck is answering his question with a question. He said the legislature saw this coming and agrees that it is time to re-evaluate this. Under the previous administration, he recalled, DOR asked that it be given until January 1, 2017, to do a true evaluation and analysis so a fact-based decision could be made. While anecdotally in talks with industry it is being said there is gas out there, one of the major players in the Cosmopolitan development said on February 1 that it likely will not develop the natural gas in Cosmopolitan if the legislature makes changes to the tax credit program. He asked who else will not develop and reiterated his question about what DOR has done to evaluate this.

COMMISSIONER HOFFBECK responded that this kind of runs into that wall about who he can talk about specifically. However, what he can say is that [DOR] is still in ongoing conversations with these companies about what it is going to take to get them to the finish line.

REPRESENTATIVE HAWKER remarked, "But you'd like us to pass this bill and pull the rug out from under them before they get to the finish line."

COMMISSIONER HOFFBECK answered "I expect that ... they will provide you with information and we can engage in a further conversation as that information is provided."

[2:29:04 PM](#)

MR. ALPER offered his belief that the field in question has several years' worth of gas supply for Cook Inlet potentially that has been discovered, that is known. He continued:

Should we find ourselves in a crisis situation years down the road, it is not as terrifying to bring that on because we know that it's there. The provisions and the benefits in the bill that you carried five years ago have done great things towards giving supply certainty to your constituents, no question.... That supply is known and now it is just a matter of getting it ... "behind pipe," getting the wells drilled, which is a lot different than going out and finding it.

REPRESENTATIVE HAWKER said every petroleum engineer he knows says that nothing actually counts until it's on the surface and pumping. Once trying to develop it, all kinds of challenges and complications in getting it out of the ground can be discovered. For example, the Badami Oil Field has some of the greatest potential in the state but it's one of the hardest to develop because of being unable to get anything out of the structure. He said he is not willing to risk his community's energy security on comments here to just "'trust us, we're going to get there,'" and reiterated that he doesn't like the idea of pulling the rug out from under them now. He said he is only asking that he be given a competent, quality analysis that shows that his community's security will be retained, rather than just the "trust me" in this bill.

COMMISSIONER HOFFBECK replied, "Some of that we just simply can't provide the committee."

REPRESENTATIVE HAWKER said he understands.

[2:30:56 PM](#)

REPRESENTATIVE TARR commented that she feels uncomfortable with the idea that her responsibility is to a company rather than to the people she represents. She said that based on some of the comments that have been made she needs to say on the record that she hopes those individual [companies] will come testify before

the committee to give a full picture of their development plans and their reaction as to how those plans may be changed or altered going forward. She reiterated that her responsibility is to the people she represents and their many needs going forward, not the individual companies, and the committee must balance all of those needs.

[2:31:48 PM](#)

REPRESENTATIVE SEATON, regarding the Cook Inlet drilling credits, noted that one of the fields being talked about is in his district. He stated that subsidizing an operation with money from State coffers for gas that has no market unless it is exported may be of value to the company, but seems to be something that [the committee] needs to consider. That is another part of this mixture of things of what [the State] can afford to subsidize, give credits for, when there are no taxes being paid on that for an export market. While he is interested in listening to the arguments on this side, he said he wants to put it on the marketability of that gas.

MR. ALPER, following up on Representative Seaton's statements, stated that the credits in question in Cook Inlet were intended for issues of gas security, but they were not limited to just gas development and exploration work. A lot of that money has been spent on companies that were looking for an increase in oil production from Cook Inlet, which is great because there is no problem with more oil - it is jobs, revenue, and export - but it is not quite the matter of life and death for the people of Southcentral as gas supply issues are. A large amount of these Cook Inlet credits have, frankly, been spent on oil development projects.

[2:33:37 PM](#)

MR. ALPER turned to slide 19 to discuss the bill's provisions in the area of repurchase limits. He noted that the current restriction [AS 43.55.028(e)(4)] says companies with more than 50,000 barrels a day must hold their certificates until they have future production. Those limitations would be expanded under HB 247 to say a company with global annual revenue greater than \$10 billion per year will hold its note. In other words, a company with an economy that is larger than the State of Alaska probably doesn't need the State's cash money and can support a project on its own balance sheet. The bill would also reinstitute the 2006/2007 PPT-era repurchase cap of \$25 million per company per year. An Alaska hire provision would also be

included, an idea that the governor himself came up with. The idea, for example, is that if a company has \$10 million in credit repurchase coming to it and has 70 percent Alaska hire, the State would give the company \$7 million, 70 percent of its credit based on its Alaska hire percentage, and the company would carry forward the rest of the credit until it had a tax liability.

[2:34:39 PM](#)

REPRESENTATIVE HERRON inquired as to where else in the world this is done.

MR. ALPER responded he does not have an answer, but that he is not so sure there is that many places in the world where they are giving refundable cash credits for oil and gas development; so it is a fairly narrow universe to compare to.

[2:35:07 PM](#)

REPRESENTATIVE HAWKER asked what the purpose is of a government's tax revenue system.

COMMISSIONER HOFFBECK answered it is to collect taxes for revenue for State operations.

REPRESENTATIVE HAWKER inquired whether the purpose of the tax system is to enact social policy.

COMMISSIONER HOFFBECK replied that, in his opinion, no.

[2:35:40 PM](#)

MR. ALPER returned to slide 19 and addressed the last proposed change in regard to repurchase limits, stating that a company would have 10 years to use its carried-forward loss credits. If a company does not come into production and have a meaningful tax liability within 10 years, then those credits would start to expire.

MR. ALPER moved to slide 20 to address the bill's provisions in the area related to removing exceptions and loopholes. He explained that as [DOR] started processing credits it found that there are a couple of features in existing law that can inflate a Net Operating Loss Credit to larger than what it might be intended to be. For example, it was found that a company with an operating loss that is a new producer eligible for the Gross

Value Reduction is able to use the GVR as a subtraction mechanism from its taxable profits intended to reduce taxes, but a company at a loss is able to use that GVR to increase the size of its operating loss on paper and then the Operating Loss Credit is tied to that adjusted number, which has led to situations where [the State] is literally paying a company more than 100 percent of its loss through refundable credits. That was a surprise that DOR took through the legal system and found that in fact that is a literal interpretation of what the statute says and the hope is to fix that. Another exception or loophole has to do with a municipal utility. When a utility owns gas production and is burning the gas in its own turbines and supplying its own customers, it is not a taxable event. However, if the utility has a little bit of surplus production that it sells to a third party, a literal interpretation of the law says the utility can take that tiny amount of revenue that comes from selling 1 or 2 percent of its production and offset all of the utility's expenses against it for the purpose of calculating certain credits and certain benefits. That is one of those things where the lawyers say that is what [the statute] says, but [DOR] doesn't think that is what it is supposed to say and would like to get that cleaned up.

[2:37:39 PM](#)

REPRESENTATIVE SEATON requested Mr. Alper to explain the Gross Value Reduction (GVR), noting that sometimes it is called a credit or it becomes a credit. He asked whether it is really just a credit and being applied in different ways.

MR. ALPER replied he does not consider the Gross Value Reduction a credit per se because it is a subtraction from taxable value. It is an awkward calculation. He explained that during hearings in 2013 on Senate Bill 21 the assumption was an oil price of \$100 per barrel. At \$100 the oil in question results in roughly \$50 a barrel in taxable profits. It was then said that a benefit would be given to companies for any oil that met the criteria for being new oil. So a mechanism was set up to turn that \$50 into \$30 - that for the purposes of the tax system only \$30 of that profit would be taxed and the State would therefore effectively collect less taxes. Mr. Alper posed a scenario in which a company loses \$10 [per barrel] because it's drilling new wells and spending more than it's earning, or it's losing money because the price of oil has collapsed and now the company no longer has profits. Under normal circumstances, he explained, that \$10 loss would result in an Operating Loss Credit. Last year that was 45 percent, so in the aforementioned scenario [the

State] would pay that company \$4.50 for every barrel produced in which it had a \$10 loss. However, implementation of the Gross Value Reduction turns that negative \$10 into a negative \$30 on paper - the company gets to subtract what should be a profit reducer for tax purposes to become a loss increaser. So 45 percent of a \$30 loss is \$13.50 and now [the State] is paying that company \$13.50 a barrel on that barrel that the company actually lost \$10 producing. So, no, [DOR] doesn't consider it a credit; the term would be a value offset.

[2:39:53 PM](#)

REPRESENTATIVE SEATON inquired whether there would be any distinction if it was said that the State is going to give 20 percent credit on the value of the oil produced.

MR. ALPER responded that during the several years prior to Senate Bill 21 different variations of oil tax reform bills were working their way through the legislature, and there was an attempt to find a mechanism to give benefits to new oil. It's a technically complicated conversation because expenditures tend to be commingled and there are de-coupling issues, so tying it to a percentage of gross value was sort of the cleanest mathematical means of doing it. He said he supposed it could be a credit, but the credit would have to be tied to the gross value of the production, not the net, because it's hard to separate out net value from field to field. There are different ways to do it, he continued. The governor supports the existence of a specific benefit for new oil. If the committee wished to try to re-address that and find a different way to do it, he would be happy to put together some ideas.

[2:41:08 PM](#)

REPRESENTATIVE SEATON commented that it seems like it is a 20 percent credit on the gross value of the oil and it's applied as a credit since it is taken off through the calculations. He could be misunderstanding this, he allowed, and that is why he is trying to find out why this isn't just considered a 20 percent credit on the gross value.

MR. ALPER answered that in a loss situation, in many ways it could be. But how to characterize it as a credit in a situation where the producer in question is profitable? He continued:

By subtracting a percentage of gross value from a net profit number, there's a multiplier in place ... it

depends on the ratio of their costs to the value of the oil. Colloquially, we say a 20 percent gross value reduction is roughly equivalent to a 40 percent reduction in net value. That's not actually true today, that was true a few years ago when prices were higher. But, it was intended to, round numbers, cut the company's taxes in half. In today's world it's greater than that because the new oil is able to pay at the zero level and the old oil is paying at the minimum tax level, so it's an infinite cut of their taxes - it cuts all of their taxes.

[2:42:43 PM](#)

MR. ALPER moved to slide 21 to address the bill's provisions in the area related to strengthening the minimum tax, the floor. Under HB 247, a company would actually have to pay the minimum tax, he said, which in current statute is 4 percent at current prices. A company would not be able use an Operating Loss Credit or a Small Producer Credit or an Exploration Credit to offset the minimum tax. The minimum tax would be a minimum and if a company has credits that it has earned in excess of that and they can be carried forward, then the company would carry them into the next year. He qualified that the next point he will address is awkward and hard to say without violating confidentiality. In DOR's two-page credit estimate report from the Revenue Sources Book, he said that one or more of the major producers will show a net operating loss for 2015. What does that mean? The way the law is written, that company or companies will be able to turn their loss into a 45 percent Operating Loss Credit and beginning in January use that credit to offset their minimum tax payments all the way down to zero until such time, presuming prices stay low in 2016, that they're able to work through their operating loss credit and use it all up. This will be seen on the credit forecast as a North Slope credits used against tax liability in the AS.43.55.023 category. "We feel that the major producers should be paying at the minimum tax," he said, "that that's what the minimum tax is for and by implementing this we're going to say 'no, in fact the 4 percent is true and you carry it forward into the next year when there are higher profits and therefore higher tax liability and you could use it.'" He pointed out that this is the one provision of the bill that [the administration] is requesting be made retroactive to January 1, 2016, because of the specific situation just outlined.

MR. ALPER addressed the second bill provision on slide 21, explaining that the other expansion of the floor is to so-called "new" oil. The GVR-eligible new oil can go to zero and [the administration] wants to make that oil pay at the 4 percent level as well. Moving to the third provision related to strengthening the minimum tax, he said the Per-Taxable-Barrel Credits can sort of migrate from month to month under current law. There are months in which the credits get cut off and are unused because the minimum tax gets in the way, they can only subtract so much. What [DOR] found specifically in calendar year 2014 where there was a lot of volatility in the price of oil - from over \$100 in January and down into much lower numbers at the end of the year - companies were able to move their per-barrel credits around when the true-up happened at the end of the year and large refunds to certain companies were written at the end of calendar year 2014 that were not expected. The bill makes a change that would turn the Per-Taxable-Barrel Credit into more of a true monthly calculation. Turning to the fourth provision, Mr. Alper said the bill would increase the minimum tax rate itself from 4 percent [at prices above \$25] to 5 percent.

[2:45:42 PM](#)

REPRESENTATIVE JOSEPHSON, regarding the migrating Per-Taxable-Barrel Credit, inquired whether migrating means, in effect, it can be carried forward to a different month but within the same year and the industry could wait for a more profitable month.

MR. ALPER replied the production tax is an annual tax, not a monthly tax. It is a very long, precise, and convoluted section of law that talks about how a company makes monthly estimated tax payments. Then there is what is called true-up where the company pays its taxes at the end of the year and commingles it all. It is not so much carrying it forward. When a company does the combined calculation as opposed to the 12 separate calculations, it ends up being able to use more of those per-barrel credits that it wasn't able to use in a month-by-month basis.

[2:46:44 PM](#)

REPRESENTATIVE HAWKER requested Mr. Alper to clarify what he is talking about when talking about Per-Taxable-Barrel Credits.

MR. ALPER responded:

Per-Taxable-Barrel Credit ... is ... what [Representative Hawker] said earlier in the presentation was not really a credit but an offset but a component of the tax. This is the subtraction mechanism in [Senate Bill] 21 for North Slope production that says here's this 35 percent tax and then you get a reduction in that tax of between \$0 and \$8 per barrel, which is tied to the price of oil. That per-barrel credit is based on the price of oil in that month so that it varies from month to month. However, in those months were it might be at the highest level, \$8 a barrel, those are the months when the prices are very low and if the prices are low enough the companies don't get to use the full \$8 because the minimum tax payment gets in the way. They can only use them until it gets cut off and essentially foregone at the minimum tax. What happens though at annual true-up if there is volatility and higher value in earlier months, the foregone credits from one month could be used to offset taxes effectively from another month.

[2:47:53 PM](#)

REPRESENTATIVE HAWKER responded:

You hit exactly my point here and thank you for clarifying that these ... Per-Taxable-Barrel Credits are really the GVR, the Gross Value Reduction that we're talking about here.

MR. ALPER answered:

No, Representative Hawker, the GVR is the new-oil-specific subtraction mechanism to reduce the production tax value for what's called new oil fields that they pay the 35 percent on a smaller number. The Per-Barrel Credit is calculated after the 35 percent tax and it's subtracted from tax liability; it's the production-based tax.

[2:48:26 PM](#)

REPRESENTATIVE HAWKER offered his appreciation for the clarity. He recalled that the House Resources Standing Committee had days of testimony on this exact issue and it was a policy call of this committee and the legislature that the desire was to

average these things because when "you try to isolate them on a monthly basis you do get anomalous results that are really not intended in that we want to look at business on its annual cycle rather than saying 'okay this month you made a bunch and we're going to take every bit of it, next month you get a loss, we're not going to give you much value for that, and we're going to effectively increase our government take by taxing you on these spikes.'" It was a policy call of this committee and the legislature not to do that. [The administration] is asking [the committee and legislature] to take a complete reversal in policy direction.

MR. ALPER offered two observations. First, when the tax reform effort of 2013 took place the conversation before the House Resources Standing Committee and every committee were on a range of oil prices between \$80 and roughly \$120. He continued:

I don't personally believe that adequate consideration was given to what happens outside that range and we're finding realities that were unanticipated. We did not know what would happen; technical features of the law that are acting in unpredictable and unknown ways and we're trying to react to those. Secondly, I would say ... when we got to the end of 2014 we thought the taxes were collected. We projected at the time about \$525 million in production tax revenue; a combination of a few months of high prices and a few months of low prices. We were frankly surprised at when the tax returns came in at the end of March to learn that we owed close to \$150 million in refunds based on the feature that we're talking about in this provision right here, the ability to move some credits around within the year. And in a time of great fiscal shortfall that was \$150 million that we didn't think we wanted to spend but we had to per the law the way it was written.

REPRESENTATIVE HAWKER responded:

I agree. You're looking to make a new policy call here that is going to take some selling to convince us that the decisions we made - at least to me - the decisions we made previously which I will disagree with you that I do believe we did an adequate diligence in our process in this committee and in the legislature.... If that is your allegation that we

had an inadequate process here, I think we need to have a conversation in the public about that.

2:51:10 PM

MR. ALPER resumed his presentation, moving to slide 22 to review the other provisions in HB 247. Regarding the bill's provision for interest rate reform, he noted that all versions of Senate Bill 21 had an interest rate reform section and all previous versions had compound interest. However, a late technical amendment to that section in the final committee, the House Finance Committee, led to the scenario where [the State] now only collects simple interest on underpayments and assessments when [DOR] audits and says a company owes more money. That's a technical correction that needs to be made, he said, as [the administration] believes it was the intent of the body to have compound interest because every version of the bill had it. The late technical amendment in the House Finance Committee didn't discuss that change, so the bill would clean that up. He continued:

More importantly and more material, we're looking to increase the interest rate. Right now the interest rate on underpaid taxes is 3 percent above the federal discount rate. This quarter it's 4 percent. It was 11 percent under the previous law; that was most likely too high. The thinking we have inside the administration is presuming that we are soon or eventually going to be in one way or another spending the State's savings, spending earnings from the permanent fund, partially, to help fund government, every dollar that we don't get in taxes because someone didn't pay them is a dollar we have to take out of savings. And when we finally do get paid, because we've audited that taxpayer, we want to be paid back for our opportunity costs, for what we would've earned on that dollar had it stayed in savings over the intervening years. So we want the interest rate for tax delinquency tied roughly to the expected rate of return for the permanent fund, which is around 7 percent.

2:52:48 PM

MR. ALPER continued on slide 22, saying the bill proposes another major change - the confidentiality waiver. "We

just want to name the companies," he said, "and how much they've received in State repurchased credits."

MR. ALPER addressed the bill's proposed technical change related to transportation costs. He said:

Suddenly in an era of very low prices we are seeing, especially in those more remote fields that have higher tariffs, we have transportation costs that in a moment in time might exceed the market value. We could have gross value at the point of production of less than zero. That's unprecedented circumstance. We don't know how that will be implemented, so we just want to clean that up and want to specify in the gross value at the point of production statutes that it can't be brought below zero.

MR. ALPER discussed the last provision on slide 22 in regard to credit certificates. He said:

And, finally, right now if you have earned a credit and you owe ... any state tax - it could be a fish tax or a tobacco tax - we could offset that tax against your credit. However, if you have other obligations to the State, for example a royalty or a lease payment or some other judgement, we can't necessarily do that. We want to loosen that up and say before we give you cash for your credits we want to offset any obligation that you might have to the State. And that's a technical change that's made and there's a bunch of conforming language throughout the bill that makes that change.

[2:54:10 PM](#)

CO-CHAIR NAGEAK stated that the administration will continue its presentation on HB 247 at the next meeting. He said the committee needs to be deliberate and ask questions in regard to addressing these challenges. The administration, committee, industry, and others need to work together to make sure the future is clear during these times of harsh finance and find something that will work. He held over HB 247.

[2:55:30 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:56 p.m.