ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
February 12, 2016
1:07 p.m.

DRAFT

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Benjamin Nageak, Co-Chair

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

HOUSE BILL NO. 246
"An Act creating the oil and gas infrastructure development program and the oil and gas infrastructure development fund in the Alaska Industrial Development and Export Authority; relating to the interest rates of the Alaska Industrial Development and Export Authority; relating to the sustainable energy transmission and supply development and Arctic infrastructure development programs of the Alaska Industrial Development and Export Authority; relating to dividends from the Alaska Industrial Development and Export Authority; and adding definitions for 'oil and gas development infrastructure' and 'proven reserves.'"

- BILL HEARING CANCELED

HOUSE BILL NO. 177
"An Act relating to king salmon tags and king salmon tag designs."

- BILL HEARING CANCELED

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
02/03/16	(H)	Heard & Held
02/03/16	(H)	MINUTE(RES)
02/05/16	(H)	RES AT 1:00 PM BARNES 124
02/05/16	(H)	-- MEETING CANCELED --

02/10/16	(H)	RES AT 1:00 PM BARNES 124
02/10/16	(H)	Heard & Held
02/10/16	(H)	MINUTE(RES)
02/12/16	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

KEN ALPER, Director
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: On behalf of the governor, provided a sectional analysis on HB 247.

ACTION NARRATIVE

1:07:12 PM

CO-CHAIR DAVID TALERICO called the House Resources Standing Committee meeting to order at 1:07 p.m. Representatives Talerico, Hawker, Herron, Tarr, Josephson, Seaton, Olson, and Johnson were present at the call to order.

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

1:08:04 PM

CO-CHAIR TALERICO 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."

1:08:29 PM

KEN ALPER, Director, Anchorage Office, Tax Division, Department of Revenue (DOR), on behalf of the governor, provided a sectional analysis of HB 247. He said Sections 1-5 all refer to a repealer. Alaska statute includes some exploration tax credit programs that go back several decades that are dormant, have not been used, and in some cases the appropriate regulatory structure of the rules have not even been developed. Many of the alternative credits for exploration in AS 43.55.025 are sunsetting and the administration wanted to make sure that these dormant programs didn't get resurrected, brought to life, while a separate set of benefits for exploration remains in place. Section 40, the repealer section of the bill, is a repeal of AS 43.05.180(i) and different sections of AS 41.09; in doing so, there are other places in statute where those are referenced as part of a general reference in another concept. The specifics of Sections 1-5 talk about the Department of Natural Resources (DNR) and DNR's ability to audit royalties; it makes reference to these credits so those sections are being amended to reflect the repealing of those sections elsewhere in the statute. It doesn't change the underlying ability of DNR to audit royalties.

1:10:50 PM

MR. ALPER explained that Section 6 is a conforming change to Section 8. Section 8 is a substantive piece that has to do with the limited waiver of confidentiality, the ability of the state to report on the credits that it is spending, the companies that are receiving it, and the projects.

REPRESENTATIVE HAWKER inquired whether the substantive portion of the bill begins with Section 8.

MR. ALPER replied that the substantive portion begins with Section 7. But, because Section 6 is a conforming section that refers to Section 8, he skipped to Section 8 to better describe Section 6.

MR. ALPER returned to his presentation, reiterating that Section 8 talks about confidentiality waivers and Section 6 talks about what is confidential. It is part of the core "we keep taxpayer information confidential statutes" that describe that activity. There is limited waiver language that says what is and isn't confidential. That is being modified to include the new section that's added by Section 8 of the bill. So, Section 8 is purely conforming in that sense, which he will discuss in a moment.

1:12:13 PM

MR. ALPER turned to Section 7, noting that it is the interest rate change, which is in the general tax statutes, AS 43.05, and applies not just to oil and gas but to all taxes collected by the state. It is the interest rate that the state collects for anything coming from a delinquency, an assessment, or a past due tax that is determined to be owed. It is one of the core issues that the Department of Revenue (DOR) deals with when it comes to collecting money. He pointed out that that number also works the same in reverse. When someone overpays their taxes, or they pay their tax and then appeal an assessment and win that appeal, [the state] pays them back with interest at the same interest rate that is charged for a taxpayer's short payments. Mr. Alper reviewed the legislative history on the interest rate, noting that for many years the interest rate was 11 percent, which was generally understood to be a very high rate and led to some very high compound interest calculations if years took place. Senate Bill 21 made a change to this section that created an (A) and a (B) with applicability tied to the time. The higher interest rate of 11 percent is in place for before January 1, 2014, and the lower interest rate of 3 percent above the Federal Discount Rate is in place for the time after January 1, 2014.

1:13:44 PM

MR. ALPER explained that there are three changes in Section 7. One is a flat repeal of the language that refers to the time before 2014 because it's obsolete and no longer needed. Several pieces of that are seen in the bill because [the administration]

is trying to get rid of obsolete statute and shrink the statute books by a few pages. If any issue ever comes up referring to those time periods, the statute books that were law at the time are used and nothing is compromised or lost, it's just a matter of getting less words in the law books.

MR. ALPER said the second change in Section 7 reinstitutes the idea of compound interest. For most of history, when there was a delinquency or a tax owed there is the basic amount that's owed and then, as interest is accrued every quarter, the interest would be added to the balance; then new interest would be calculated on the balance plus the interest. That's the general idea of compounding, but it was lost in a late amendment to Senate Bill 21 and there are different opinions as to the reason for that. He offered his belief that most people think it was inadvertent when a technical amendment occurred in committee that was addressing a different topic. So, the idea of compound interest is reinstituted by HB 247.

MR. ALPER noted that third and most material in Section 7 is the change to the interest rate itself. Instead of being tied to 3 percent over the discount rate, it would be 7 percent above the discount rate. The discount rate today is 1 percent and is a quarterly adjusted formula the way the state treats it. Today the state is collecting 4 percent interest and under HB 247 the state would collect 8 percent. The number 8 is splitting the difference between what was too high and what is now generally considered as too low. Continuing, he pointed out that there is some expectation during this time of shortfall that Alaska will be, to a certain extent, using earnings on its savings to help fund ongoing government operations. If that occurs, that means that there is suddenly an opportunity cost to use of the state's savings. If an extra dollar has to be pulled out because someone didn't pay their taxes for three years, then when that dollar is repaid to the state's savings [the administration] wants to ensure that [the state] gets the amount that that money would have earned had it remained in savings. Thus, HB 247 would tie the state's interest rate approximately to the expected rate of return for the permanent fund and that number is in the 7 or so percent range according to the permanent fund's consultants, Callan Associates.

1:16:12 PM

REPRESENTATIVE HAWKER said Mr. Alper made a lot of statements he doesn't necessarily agree with, particularly that the Callan discount rate is the appropriate rate for the state's cost of

capital. He requested clarification in regard to when an assessment is made and the state charges interest as to whether that interest commences on the date the assessment is made or on the date that the original tax was obligated.

MR. ALPER responded that the interest begins accruing on the date the tax was due.

1:16:53 PM

REPRESENTATIVE HAWKER inquired as to how many years the state is delinquent in its audit process.

MR. ALPER answered that he doesn't want to use the word delinquent. He allowed [the Tax Division] does have a delay, that it does have a multi-year process to audit oil and gas production tax returns. The statutes provide six years as the statute of limitations. In prior years [the division] has pushed fairly close, weeks and even days, to that six-year deadline, but [the division] is moving off of that deadline. The short answer is that [the Tax Division] can be up to six years behind and [the division] is currently finishing calendar year 2009. Those taxes were due and payable and finalized through the true-up process on March 31, 2010, so sometime between now and March 31 [the division] will be completing the rest of 2009 and issuing the appropriate assessments.

1:17:51 PM

REPRESENTATIVE HAWKER recalled it was established very clearly at the last hearing that the motivation behind HB 247 was strictly to raise revenue; that that was the criteria as to how the decisions that were brought forward to the committee were established. He asked whether any consideration was given to what is a fair assessment rate and process, or whether it was done blindly to raise revenue. Maintaining that [the division] is delinquent in its audits and knows it can go back, he said a compounded interest rate over six years is now being proposed when a taxpayer doesn't even know what its obligation is. He recounted Mr. Alper's statement that many of these obligations are unresolved because the department didn't have the rules and regulations out there for the taxpayers to even know what they could expect out of audits. He offered his belief that that had a lot to do with why the compounding factor was eliminated as the last bill went through the legislature. Rather than being attributed to an error as stated by Mr. Alper, Representative Hawker said he thinks it was a judgement that was made to

provide a more fair tax structure. He asked whether he is wrong in thinking this.

COMMISSIONER HOFFBECK replied that the idea behind going to compounding interest at a 7 percent rate was simply to make it revenue neutral to the state, regardless of whether [the state] refunded money or collected money on an audit. Totally revenue neutral such that if the state had it in advance, and had it invested, the state would get about that rate of return; if it was owed to the state then the state should have been allowed that rate of return. If the state owed it back, the state would not be paying back any more than the state would have earned by having it. The idea is not to raise more money, but simply to make it revenue neutral given the state is moving into an era where its investment returns are going to be a source of funding government services. It wasn't wanted to be more or less, but about the same.

MR. ALPER clarified that these [proposed] interest rates are in no way retroactive. The interest rate that is in statute at the time covers the entirety of that time period. The only taxpayer that might be paying this new interest rate for six years is a taxpayer that owes taxes this year and might get audited six years from now. He said [DOR] does not want that taxpayer to be waiting six years and is working diligently to speed up that process and hopes to be within three or four years at most of the due date. For example, when last year's taxes were assessed in 2015, four and a half or five years of interest was in at the 11 percent rate and the last year or so was in at the lower Senate Bill 21 interest rate. The lower interest rate is working its way through the system and is becoming a larger and larger portion of any assessment until finally it becomes the main one or it is changed to the rate proposed in HB 247. The money received from a tax assessment goes to the Constitutional Budget Reserve (CBR); not much, if any, is general fund revenue. There is no general fund revenue impact in [DOR's] fiscal note related to this specific section of the bill.

1:21:43 PM

REPRESENTATIVE HAWKER addressed the statement that the opportunity cost for this money is not having it in the Constitutional Budget Reserve (CBR) fund. In regard to the idea that it be revenue neutral to the state without having that money in the state's accounts, he inquired as to what are the current earnings on Constitutional Budget Reserve funds.

COMMISSIONER HOFFBECK responded that the earnings will be negative this year, although not as negative as the permanent fund. That was done because of the situation where [the state] is spending heavily from the Constitutional Budget Reserve to fund government. If and when [the state] has a fiscal plan that starts using the earnings reserve of the permanent fund, then that money in the Constitutional Budget Reserve will be put back into the subaccount and will be invested in a fashion very similar to the permanent fund. This all fits into the totality of the fiscal plan and makes it consistent.

REPRESENTATIVE HAWKER thanked the commissioner for the insight he just provided.

1:22:56 PM

REPRESENTATIVE JOSEPHSON requested Mr. Alper to repeat what he said about interest owed in the event of an overpayment.

MR. ALPER answered that if there is an overpayment, or if there is an assessment that is paid and then appealed, and it goes through the process and the taxpayer wins its appeal, or settles at some in-between point, and [DOR] owes the taxpayer a refund, [DOR] will pay the refund with the same interest rate that [DOR] receives on the taxpayer's underpayments to [the agency]. It's a two-way interest rate that is throughout the statutes.

1:23:34 PM

REPRESENTATIVE JOSEPHSON surmised that if HB 247 were to become law, the State of Alaska is taking some additional risk because in the event of an overpayment the state would pay [an interest rate of] 7 or 8 percent rather than 3 or 4 percent.

MR. ALPER replied yes. He noted that, anecdotally from his staff's observation in the last year or so, in past years when there was an assessment [DOR] would be more likely to get the payment and then have it appealed because companies didn't want to be on the hook for that 11 percent for the year or two it might take to work through the appeals process. The tendency now, if a company is going to appeal, is to not pay and withhold the money until it works through the appeals process because the 3 or 4 percent is much less onerous to the company's cash flow, the company is better off keeping the money in its own books until the issue is resolved.

1:24:32 PM

REPRESENTATIVE JOSEPHSON inquired whether 7 percent plus the discount rate represents a sweet spot where the best auditors of both parties better be in their "A games" because there is an equal liability potential for both parties to get it wrong.

MR. ALPER responded that the oil companies are all different from each other. Each has its own expectation of return on its own investment; legislative committees have used the term "hurdle rate" for this expectation. The oil companies' numbers tend to be higher than that, the state's numbers tend to be lower because the state's money is in more conservative assets. The intent is to tie the interest rate to the opportunity cost based on the state's investment earnings; a metric was chosen in HB 247 that roughly approximated that. That could be obtained in several different ways, but the goal is try to get something like the money that the state would otherwise be earning if that money weren't being spent out of savings and was in the permanent fund.

1:25:44 PM

REPRESENTATIVE OLSON asked whether the most completed year is 2008.

MR. ALPER answered yes.

REPRESENTATIVE OLSON inquired whether it was the state or the producers that got favored in the assessment when a look is taken back 10 years ago.

MR. ALPER said he doesn't understand the question.

REPRESENTATIVE OLSON, in regard to looking at assessments for 10 years ago, asked whether the state collected additional monies or whether the producers got money back.

MR. ALPER replied that although it is by no means universal, when there is a change in oil and gas tax return it is almost always in the state's favor, the state is looking for more money.

1:26:24 PM

REPRESENTATIVE OLSON, in regard to those 10 years, inquired as to how many of them went almost to the statute of limitations.

MR. ALPER answered that the statute of limitations was increased in 2007 with the passage of Alaska's Clear and Equitable Share (ACES). After the passage of the earlier net profits tax in 2006, the production profits tax (PPT), it was recognized that the work load of auditing tax returns suddenly got much more complicated because [the Tax Division] was dealing with upstream expenditures, a type of industry work that it had never before looked at as far as the line-item detail. So, the struggle to get the PPT audit on time was seen years in advance and extra time was given for ACES. That, and the regulatory changes, and various statutory changes, meant that the division pushed fairly close to the line for 2007 and 2008. He offered his belief that the division's prior history was not like that, but that in the last two years the division was very close to statute.

1:27:36 PM

REPRESENTATIVE OLSON offered his understanding that [the Tax Division] cut its number of tax auditors from four to three.

MR. ALPER noted that Representative Olson is referring to the audit masters. He explained that audit master is an exempt job classification that was added as part of the ACES bill in 2007. The audit masters are designed to be industry experienced people who come in at a higher rate of pay so that they can provide expertise, guidance, regulatory assistance, and supervision to a certain extent. Under ACES, House Bill 2001, audit masters are expressly prohibited from doing the auditing themselves, so audit masters are helping the auditors but not doing the audits. The actual audit staff has not been changed in the last couple years.

1:28:23 PM

REPRESENTATIVE OLSON inquired whether it would be to everybody's advantage to take the statute of limitations back to three years so the State of Alaska could recapture that money more quickly than having it sit out there for six years.

MR. ALPER replied that if that were to happen immediately it might cause [the Tax Division] to do inadequate work to go through the next couple of years of taxes because the division would already be past that statute for 2010 and 2011. If there is a goal to reduce that number over the next several years, the division intends to catch up to it. The division is starting to do two years at a time; by a year from now the division will be a year off the statute of limitations, by two years from now the

division will be two years off the statute of limitations, but these things cannot happen instantaneously. [The Tax Division] would be happy to provide some of the source documents, but the upstream information provided by the major oil and gas companies is hundreds of thousands of line items. It's a massive information undertaking with a lot of back and forth, requests for follow-up information, and examining of records. It's a very technical and complex process. He said he would be reluctant to say the division could speed it up faster than the division is saying it is speeding it up.

1:29:37 PM

REPRESENTATIVE OLSON asked whether extending the effective date two years would be an option in order to give [the Tax Division] two years to do it.

MR. ALPER responded that two years to catch up three years is probably more than the division could handle; the division likes the idea of having a little bit of cushion. What if something happens? What if a key employee is lost? What if there is another statutory change between now and then? He said he likes having the six years and that for as long as he has this job it is his intent to not use it. He strongly recommended that, if it is wanted to go in that direction, that the conversation about changing the statute of limitations be had in a year or so when it can be seen how well the division has followed through on its mission to catch up some.

REPRESENTATIVE OLSON commented that everybody can be replaced, including in the legislature. He said he does not believe [the Tax Division] has one key person who would slow things down for more than several months.

1:30:46 PM

REPRESENTATIVE TARR understood that with the PPT and ACES the changes became more complicated in terms of figuring things out. She inquired whether there would be a way of separating just that to get through the 2012 tax years, such as contracting with a company or hiring additional staff to get through those more quickly.

MR. ALPER answered he is not certain that more staff would speed it up because generally speaking there is typically a team of three people working on each major producer, to limit the conversation to that because that's where the money has been.

Each team has a senior auditor and two junior auditors. They work closely under the direction of the supervisor of the group who is a classified staff member, and the audit master provides technical assistance, review work, and amendments to the narrative. So, he said, he doesn't know if more bodies would speed that up. While there's a lot of work to go through, a lot of the time is spent in simply the back and forth and the trying to convey to the taxpayer the type of information that [the Tax Division] needs and then waiting for it to be submitted. The division is behind not because it takes six years to do an audit, it takes a year, but because years went by in the past where the division wasn't finishing audits because of external factors; for example, the initial writing of regulations after major tax changes consumes a lot of time. A major consumer of time was the implementation of the software system, the tax handling system. He reiterated that he strongly believes the division is past all of those hurdles and delay elements, and staff are now simply doing their jobs. He offered his hope that as the division gets more years behind it of a complex net profits system, that the issues where the division disagrees with industry start working themselves out and the returns come closer to getting it right the first time.

1:33:15 PM

REPRESENTATIVE TARR asked whether the proposed changes in HB 247 would simplify the process, once past ACES, and make it easier to do the assessments and do them in a shorter timeline.

MR. ALPER replied yes, adding that he thinks division staff are getting better at their jobs. He explained that a commingling of the two halves of the production audit group is being seen. One discreet group of staff primarily deals with audit and tax returns, and the other group primarily deals with auditing and reviewing requests for refundable credits, which have different timelines and tend to be smaller dollar items. The staff dealing with the credit data set have become the division's in-house experts on upstream expenditures because people are coming in with Operating Loss Credits or Capital Credits and staff are now working with the production tax people to help those people develop the expertise because they need to develop that for the tax returns going forward. So, there is a little bit of a streamlining, but he doesn't know what that's going to look like in two years - like all operations it's a work in progress. He related that the other day he told [DOR's] budget subcommittee that there are 15 fewer employees in the Tax Division than there were 14 months ago when the administration came in. Thus far

the production audit group has not lost any positions and [the division] is trying to keep that together because they have a very important job to do; [the division] is close to six years behind and it must be ensured that no deadlines are missed.

1:35:26 PM

REPRESENTATIVE HAWKER recalled the old adage that if it's in the yellow pages then why have the state do it. He said he is therefore sincerely asking why keep and build an in-house auditing capacity when the work could be outsourced to a highly competent industry.

MR. ALPER responded that that is outside the scope of HB 247. He said he personally hasn't addressed that issue in the 14 months he's been doing this job, but cost estimates and theorizing can be undertaken if it is requested and he will get back to the appropriate committee at the appropriate time.

1:36:46 PM

REPRESENTATIVE OLSON inquired as to how much of the $235 million in 2008 was compound interest.

MR. ALPER answered that the total assessments in 2008 were $265 million, of which about $115 million was interest. Only a small fraction of that was compounded, but a lot of it was interest, and $150 million was the taxes themselves. About half of that has been paid and the books are closed and about half of that is currently in the appeals process.

1:37:30 PM

REPRESENTATIVE SEATON said it seems what is really being looked at is that the state is asking the oil companies that are submitting tax forms whether they would like to get a 4 percent non-compounded loan by maximizing all potential deductions that they could possibly achieve, and over a long period of time this is a great interest rate that anyone would like. He asked whether the concern is that the state is giving an incentive to people to absolutely maximize their deductions, not fraudulently, but deductions that they could possibly obtain knowing that if it comes back they will owe money and they will have had a much lower interest rate loan than they could possibly have gotten any other way. So, he surmised, the State of Alaska ends up subsidizing to that maximum amount, although he realizes this is a policy question.

COMMISSIONER HOFFBECK replied that that could possibly be occurring, but he doesn't place on industry that that would be the motivating factor for what they do as far as maximizing the deductions. Companies claim what they think they are eligible to claim, and then there are disputes as [DOR] goes through the audits on whether some of those were actually deductible. He isn't looking at this so much as an issue of an opportunity cost for claiming more than may be appropriate, he simply thinks that the rate the state is charging is not commensurate with the loss of revenue that the state has experienced by taxes not being paid. It is not to make a profit or a loss, but rather to make it revenue neutral.

1:40:03 PM

MR. ALPER resumed his sectional analysis, explaining that Section 8 is the confidentiality waiver specific to the state's paying of credits. The language in HB 247 states, "The name of each person claiming a credit ..., the aggregate amount of credits ..., and a description of the taxpayer's activities that generated the credits claimed are public information." There are some limitations on that, he said, but the key point is if state dollars, public money, is being spent for the purpose of subsidizing or providing a benefit to a company, that is information that should be able to be shared with the legislature and with the general public so people can understand where their money is going. [The state] has a general sunshine-law-type requirement to put its expenditures on the internet, the state's checkbook is available. The public can find out how much the State of Alaska paid for chairs, airplane tickets, office supplies, or consulting services. [The Department of Revenue] cannot tell the public how much it paid to any of these companies in oil and gas tax credits. He said he wants to be very clear that [DOR] does know, but will not and cannot report, how much money companies make, how much they pay in taxes, or how profitable they are because that is absolutely taxpayer confidential information. No linkage or loopholes are being sought to be able to report that information. In fact, that is Internal Revenue Service (IRS) protected information and attempting to do so would put the State of Alaska in big trouble with the federal government; the ability to share certain information with the IRS would suddenly cease, the IRS would no longer trust the State of Alaska. [The administration] merely wants to be able to report where public money is being expended for the purposes of providing subsidies and benefits to oil companies.

1:41:58 PM

REPRESENTATIVE HAWKER recalled that in previous testimony it was stated that HB 247 was designed to raise revenue. He asked how this provision would raise revenue.

COMMISSIONER HOFFBECK responded that this particular piece will not raise revenue, is not revenue generating itself. But, it will allow [DOR] to have a more open discussion on these issues around the revenue associated with this particular component.

1:42:32 PM

REPRESENTATIVE HAWKER inquired whether any analysis has been done or any consideration given as to whether this provision could result in a taxpayer's competitiveness being compromised. A taxpayer is very different than the State of Alaska buying chairs for this committee room, he admonished, and added that he is offended by the analogy. He said [the State of Alaska] has an obligation under the federal Internal Revenue Code to protect taxpayer information which is deemed as confidential and private. "We've probably found a point here where we can push that limit, we can push beyond it, and disclose particular taxpayer information," he said. He further asked whether he can be given an assurance that the provision will not compromise the individual competitiveness of the state's taxpayers.

MR. ALPER replied:

> We have spoken to our own counsel at the Department of Law about the degree to which this provision might expose us to being forced to, or able to, disclose the other information I described earlier ... the earning specific, the tax paying specific, and were assured that there was no potential linkage there. The activities described in Section 8 of the bill are somewhat aggregated in nature. ... Company X received $10 million last year for drilling a well in the X unit. ... I'm not providing information about their vendors, about their cost of capital, about their labor practices. It's very high level information, summary level information that I have a hard time envisioning ... rising to the level of being an imposition on someone's competitiveness with their fellow players in the oil field.

1:45:03 PM

REPRESENTATIVE HAWKER inquired whether Mr. Alper is an expert in what he is envisioning. He posed a scenario in which Company X owns leases all across the North Slope and has specifically invested in a particular project in a particular part of the basin. He asserted that providing the information [allowed by Section 8] could disclose the prospectivity and stratigraphic information belonging to Company X, and would literally point everybody else in the world to where Company X is making a play and result in another company bidding higher on a lease sale to take away land that Company X may have developed information on. The competitive advantage that a company gets by investing its money, and for which the legislature provided an incentive, would be compromised. He said he wants to respect the taxpayers and wants to give them the advantage that when they make an investment in Alaska they are given the greatest advantage possible for having made that investment.

MR. ALPER answered that Representative Hawker is right. There is a philosophical issue and people can disagree, so he said he doesn't want to continue debating the specifics of this idea. He pointed out that it is known where people are drilling because people get drilling permits and that is available. Plans of development are on the internet. Many of the existing credits that DNR authorizes, the exploration credits, come with the requirement for seismic, stratigraphic, downhole data. It is not unusual for a certain amount of that information to be made public. The only thing being looked here is to talk about dollars. Compared to some of this other information, the mere fact that someone is drilling a well in this part of the state is already known. All that this additional increment of information is going to let people know is approximately how much a company spent "if you could reverse engineer that from how much of a state credit benefit they got."

1:47:23 PM

REPRESENTATIVE HERRON asked why the administration has at this time decided to insert this into a bill. He further asked whether previous administrations have attempted this before the legislature.

COMMISSIONER HOFFBECK responded:

> The issue of more transparency came up when we tried to actually have any kind of discussions on credits

> and found that we simply couldn't provide the information that people were asking, a lot of people from this particular body that when we wanted to discuss this issue of credits and whether we thought there needed to be some adjustments made. And people were greatly frustrated by the fact that we could not give them granular enough information for them to even remotely make a decision. And so part of that was driven just by the fact that in order to have open transparent decisions some of this information, which we feel quite frankly is not confidential, should be available for that. The second part of the question, I don't know whether it's been attempted before or not.

MR. ALPER offered his belief that this has not been attempted before. Tax credits as an idea, as a concept, have increasingly become a high profile issue with the general public, including in op-ed pieces and blog comments. He said he thinks those conversations would be better informed if people had more complete information and more understanding of what is being talked about regarding what sorts of activities the State of Alaska is benefitting, is subsidizing with these programs.

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REPRESENTATIVE JOSEPHSON said he takes Mr. Alper's point regarding the information that is publically available about drilling, permits, and plans of development. For example, last fall during a resources development conference that he attended there was a major lease sale happening further down the hall. Most companies are eager to report their successes, he said, and his assumption is that they do that for a show of confidence in the shareholder or the Alaska people.

MR. ALPER responded that Representative Hawker is right that companies don't like to share their results. If a company drills a well, [DOR] is going to be able to say how much the company spent on that well. [The department] is not going to tell anyone that the company found oil, and that's where the competitive advantage as to who's going to try to lease the lot next to them is going to come from.

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REPRESENTATIVE SEATON noted that in Cook Inlet there were a number of players, some of whom went bankrupt. The State of

Alaska was expending a tremendous amount of money but [legislators] couldn't find out how much. A company might say in the newspaper that it was using tax credits and that it had received $50 million in financing, yet [legislators] couldn't find out how much [the State of Alaska] was investing in a particular company because it was confidential information when coming from [the state's] own sources. He said he thinks it is imperative that [legislators] be able to tell [constituents] what [the state] is investing in and if [the state] is investing an amount of money in certain companies and certain areas. He inquired whether there is anything in Section 8 that does anything other than giving the state the ability to say how much tax credits were given to a particular company.

MR. ALPER answered that Section 8 is somewhat broad, although it primarily will enable the state to report refundable tax credits which are truly an expenditure of the state, and, he would posit, is not the same as saying a change to tax. There are circumstances where credits used against tax liability would fall under this definition. The specific exclusion of AS 43.55.024(j) on page 4, line 27, of the bill is reference to the Per-Taxable-Barrel Credit, the sliding scale per-barrel credit on the North Slope. The thought there is that if the amount of per-barrel credits a company got is reported, and it is already known how much production a company has because that's public information, someone could reverse engineer the company's sales price. So that is something [DOR] wants to be able to protect. But, other credits against liability would be similarly reported the way the section is written now, for example the $5-a-barrel credit from new oil or the Small Producer Credit.

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REPRESENTATIVE TARR recalled that in 2013 Senator Gardner had a bill about disclosing this information; she received interest from her neighbors that they were interested in being able to receive this information. Representative Tarr noted that one thing that has been talked about is trying to understand better whether the credits are having the intended effect on exploration and development activities and therefore she sees this provision as perhaps helping [legislators] getting closer to answering those questions too. She requested Mr. Alper to comment on how this provision might help [legislators] better understand whether they are doing the right thing, whether the tool that was used is getting the result that was wanted. For example, one of the criticisms of ACES was that the credits

weren't linked to production. It seems that this provision might be one way to get a little more of that information.

MR. ALPER replied that in response to previous testimony, he and the commissioner have been talking to staff at DOR and will come back to the committee with a much more detailed explanation and granular modeling as to some of the bill's impacts and how they might impact a theoretical or particular project. If [DOR] was able to talk with more precision about actual things that had occurred, or were going to occur, it would be much easier to tell this story; but that is a story that [DOR] is not able to tell under the law the way it is currently written.

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REPRESENTATIVE HAWKER said he appreciates the word about reverse engineering because that's what analysis of this information would do, and would potentially compromise the proprietary trade information of any given company. With disclosure of a cost-based credit, someone can reverse and extrapolate the amount of expenditure that was required to generate that credit. Expenditure levels, investment levels, are pretty proprietary information when they are looked at in terms of individual prospects that would arguably be disclosed here. That's the thing to keep in mind when demanding this information. While sitting here and making laws it would be nice to have all that individual taxpayer information, but [legislators] have to accept that some things just can't be had out of respect for both federal law and that competitive advantage. The ability to reverse engineer cost credits would expose companies to having a great deal of their proprietary information, cost efficiency, and capital allocations divulged. In that these are all credits under AS 43.55, he asked whether that would also include the Net Operating Loss Credit carry forward.

MR. ALPER responded yes, Section 8 as written would require that [DOR] divulge the size of an Operating Loss Credit.

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REPRESENTATIVE HAWKER maintained that this divulges a taxpayer's most critical information, their taxable level, which is exactly what the federal government doesn't want [the state] to do to an individual taxpayer. He said he disagrees with the attorney generals at the Department of Law if they say that this is okay.

MR. ALPER answered that, in the broader concept, there is a dissonance in priority between what is seen to be the state's benefit to divulge certain information and industry's need to keep something secretive. [The administration] would like to find language that is acceptable to all parties as HB 247 moves forward. An excellent point is made by Representative Hawker. In some ways, limiting this type of disclosure to just cash credits where companies are receiving an appropriation of state funds might be something a little narrower and a little bit less challengeable as proprietary accounting information. The Operating Loss Credit is an interesting point to raise because it relates back to a company's profits and losses. Noting that [committee members] understand [the administration's] intent in proposing this section, he said the administration looks forward to working with members on this very complex area of law to try to find language acceptable to everybody.

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REPRESENTATIVE TARR surmised that in looking at operating loss it might depend on the size of the company because, in terms of the big three, some don't do separate accounting so their Alaska operations aren't separated from their worldwide operations. Thus, she concluded, the State of Alaska would just get the aggregate information relative to the whole company and it would be just the portion of credits that were Alaska development.

MR. ALPER replied that that's not quite right. The type of accounting by aggregation and apportionment is relative to Alaska's corporate income tax structure. The oil and gas production tax is quite discreet in its Alaska-specific revenues and expenditures. Existing law has a lot of restrictive language regarding what is an allowable deduction - they are spending the money but they don't get to count it, a classic example being lobbying expenditures. When switching to a net profits tax, the legislature chose to specifically exclude lobbying expenses, so those dollars are not deductible from production tax.

2:00:08 PM

MR. ALPER resumed to his sectional analysis, noting that Sections 9, 10, and 11 are conforming language. He explained that these are three of the credits that were built into the corporate income tax statutes added by different pieces of law in three different time periods. Section 9 refers to the Cook Inlet Natural Gas Storage Alaska (CINGSA) facility. The 2010

Cook Inlet Recovery Act provided a credit to build the gas storage facility located in Kenai. Section 10 refers to the Liquefied Natural Gas (LNG) Storage Facility Credit written primarily around the Interior gas utility in Fairbanks but also available to other bulk storage tanks for LNG that might be built elsewhere in the state. Section 11 is the In-State Refinery Tax Credit, the most recent credit that was added in 2014. These three credits are not being changed in any way. However, these credits contain language that says if a company owes any kind of tax to the state - whether production, property, cigarette, or another kind of tax - that could be withheld before they get paid their credits. The change being made in these sections would broaden that by deleting the sentence that says for unpaid delinquent taxes and to instead say outstanding liability. So, with this change, if a company owes something that is not part of the tax code, such as a royalty or a lease payment to the Department of Natural Resources, that also could be offset against a credit payment before the state pays the credit. Thus, the structure in Sections 9, 10, and 11 remains identical, it is just simply broadening that ability to withhold funds for other obligations to the state.

2:01:56 PM

REPRESENTATIVE JOSEPHSON recounted that the Alaska Oil and Gas Association (AOGA) expressed some concern that this section is sort of an overreach, that there could be some de minimis fee or tax that's owed and it would hold up the process of receipt of the credit. He inquired whether Mr. Alper thinks there is any merit to that and is more alarmist than Mr. Alper would view it.

MR. ALPER responded he doesn't want to use the word alarmist. If the issue itself is de minimis, then the [amount of] withhold would be de minimis. If someone is fighting over a $500 fine somewhere, then only $500 would be held back from the credit. It is not that the entire credit gets stopped in its tracks over the dispute, it's that the amount of the dispute is held essentially in escrow. This specific issue has happened within the last year - someone who was seeking a credit owed money to other state agencies.

2:03:03 PM

REPRESENTATIVE HAWKER said he understands and appreciates the intent being made here, which is to protect the State of Alaska against someone who is going to take advantage of the tax

structure to get funds back from the state when in fact they really ought to be paying the state. However, he argued, this is horribly unartful language. Speaking as a former certified public accountant (CPA) who also did tax returns, he said that if a claimant has any liability to the state "you can basically withhold anything." He pointed out that a taxpayer accrues a liability to the state every single day of operation. For example, these companies have millions of dollars of payroll in the state and every time they write a payroll check they have a liability to the state to transmit those funds that were withheld from payroll checks. The whole point of the language that HB 247 would delete is that it is wanted to withhold payments to companies that have unpaid delinquent tax. That was there so the state didn't cross that line of the universal definition of liability. Funds that a company owes from a payroll check, he said, could very well be used here to completely eliminate, shut down entirely, a refundable tax credit program. Saying he respects the desire to tighten this up, he requested that [the administration] go back to the drawing board to find a way to not cast such a broad net.

MR. ALPER offered his appreciation for Representative Hawker's suggestion. He noted that he previously spoke to the intent, which is that only the amount of any liability would potentially be withheld from a credit. He pointed out that a definition of outstanding liability to the state is included in Section 39 of the bill because a new concept is being created. It used to say an outstanding liability to the state for delinquent taxes. Section 39 states that "outstanding liability to the state" means "an amount of tax, interest, penalty, fee, rental, royalty, or other charge for which the state has issued a demand for payment that has not been paid when due and, if contested, has not been finally resolved against the state." He offered to work with the committee to further refine that, but said he believes this resolves a lot of the potential issues that Representative Hawker raised.

2:06:09 PM

REPRESENTATIVE HAWKER reiterated that the way this language is written, a taxpayer assessed a fee and pursuing a legitimate remedy to challenge the state's assessment could be shut down completely with receiving any funds from the state while the taxpayer is, in good faith, contesting an assessment, and that assessment could be a payroll tax assessment or anything else.

REPRESENTATIVE HERRON, regarding Representative Hawker's point, asked whether this is for non-tax liabilities as well.

MR. ALPER answered yes, [the state] has current ability to withhold [credits] for any tax liability. The intent is to broaden that for other liabilities to the state, with the most prominent ones being royalties, lease payments, AOGCC fines, and those kind of things that are relevant to the oil and gas industry. Per Section 39, there has to have been an assessment, a demand for payment, and then a non-payment on that demand for it to trigger the condition.

2:07:42 PM

MR. ALPER continued to his sectional analysis, pointing out that Section 12 is very much a material section. He explained that AS 43.55.011(f) is the so-called floor provision of current law, the minimum tax for production from the North Slope. As currently written it is a step-down tax. Colloquially, most people think of it as a 4 percent floor, but in fact that's only true if the price of oil for the last year has averaged greater than $25 and thankfully for modern history that has been the reality. But, should the price of oil drop between $20 and $25 the floor goes to 3 percent; between a price of $17.50 and $20, if he has that right, the floor goes to 2 percent and steps down from there. All of that would be repealed and reenacted. He commented he is always uncomfortable with a repeal and reenact, but because of all that stepdown language it was, for drafting simplicity, easier. The bill would replace all of that with a 5 percent minimum tax, and that is 5 percent of the gross value at the point of production. The underlying tax is a net profits tax, or a tax on a calculation called production tax value, which is an analog for net profits. When that number adjusted for certain credits is less than a number that equals 4 percent of gross revenue, then the larger gross revenue figure is paid, an alternative minimum tax. Section 12 increases that by 25 percent, from 4 percent to 5 percent.

2:09:12 PM

REPRESENTATIVE HAWKER recalled DOR's earlier statement that the committee will be provided with some granular analysis of the consequence of the provisions in HB 247. He said this provision is significant and effectively increases taxes on companies that are today losing money in the state of Alaska. He would like to know truly what the consequence is going to be on industry in a financial perspective as well as the macroeconomics on what this

is really going to do to the state's competitiveness and ability to continue to attract investment capital. This is not just a simple credit change, it's not a simple repeal and reenact; it is a very material provision, so he is looking for very explicit analysis of what the consequences of this provision will be on Alaska's international competitiveness.

MR. ALPER replied that [the administration] absolutely intends to go to that level of detail with a quantitative presentation that is being prepared for the next time the committee hears [the administration] on the bill, whenever that might be.

2:10:42 PM

REPRESENTATIVE JOSEPHSON asked whether this is the provision that might generate $50 million in additional revenue to the State of Alaska.

MR. ALPER responded yes, provided that the price of oil in the given fiscal year in the fiscal note is below the amount to where it is out of the minimum tax and into the underlying production tax. For the foreseeable future, per the Department of Revenue's forecast, the price of oil is expected to stay below approximately $85 a barrel price, which is the threshold for the minimum tax. So, about $50 million a year of revenue is tied to the change in Section 12.

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REPRESENTATIVE JOSEPHSON, relative to Representative Hawker's question, the importance of which he respects, inquired whether at some fundamental level the question might be what the loss of $50 million in profit at a certain barrel price does to Alaska's competitiveness vis-a-vis other worldwide markets. He further inquired whether it is that simple at some basic level and whether such a thing could possibly be analyzed.

COMMISSIONER HOFFBECK answered that in its [2015] report the Oil and Gas Competitiveness Review Board looked at some of the tax rates in the regimes the board thought would be competitive. It didn't go to Saudi Arabia, but rather to Kansas, Wyoming, Texas, and Canada, places that would directly compete in the market for that. He said that information will be brought forward.

2:12:41 PM

REPRESENTATIVE JOHNSON asked when the Alaska Oil and Gas Competitiveness Review Board last met.

COMMISSIONER HOFFBECK replied it has been more than six months. Because of the downturn in the market several of the people resigned from the board because they needed to focus on their own business, and the board hasn't been put back together.

REPRESENTATIVE JOHNSON inquired whether the governor has re-appointed people to that board.

COMMISSIONER HOFFBECK responded that the last conversation he had with the governor's office was that some people were being considering and more names were being looked for. Getting the board back up and running has been a struggle. The next report from the Alaska Oil and Gas Competitiveness Review Board isn't due until January 2017, but the board took on a more aggressive agenda than what was dictated in the statutes. One of the reports the board was trying to achieve this year was a competitiveness review but one of the primary people involved in that was one of the people who resigned.

REPRESENTATIVE JOHNSON said he thinks now would be the time for efforts to be redoubled in getting those people appointed so that those kind of reviews could be done. Or, he continued, have the department take it on as a project because part of what is being talked about here is how competitive is Alaska on a worldwide and nationwide basis. He said he would like to see these appointees at the next round of confirmations if confirmations are required for this board.

COMMISSIONER HOFFBECK answered he doesn't think those are confirmed positions and stated that [the administration] is working diligently trying to get the board positions filled.

2:14:28 PM

REPRESENTATIVE HERRON asked how much of an increase this is percentage-wise and why, from a policy perspective, it would be wanted to tax companies that are in a negative cash flow right now.

MR. ALPER replied that increasing the tax rate from 4 percent to 5 percent is a 25 percent increase. Regarding the second question about why, he said the reason the state's tax system includes an alternative minimum tax is to protect the state from the potential consequences of the switch to a net profits tax.

During the era of the Economic Limit Factor (ELF) the state did receive a minimum that was measured in cents per barrel, but the idea during that time was that the state was getting a percentage of gross regardless of what a company's expenses were, regardless of whether a company was making money. The state wasn't calculating profitability so it wasn't taxing profitability. In an era where [the state] is allowing the offset for operating and capital expenditures, it can get to a circumstance where the company might be losing money, but that means that [the state's] taxes could go below zero, a risk [the state] didn't have during the ELF era. So this minimum tax is there to protect the state in case of that eventuality. Once that is accepted as a premise, then it's just a matter of what's the appropriate level and [the administration] is positing that the appropriate level is slightly higher than what is currently in statute.

COMMISSIONER HOFFBECK added that part of the reason there's an increase in all these various industries across the state is that the governor simply said he wanted everybody to participate in the fiscal situation that the state is facing. There was nothing about the 5 percent except that it is a component of the oil and gas industry contributing as well.

REPRESENTATIVE HERRON commented it is important to have these explanations on the record.

2:16:58 PM

REPRESENTATIVE HAWKER said he thinks there was a previous question about what is the effective tax rate as a result of this change. He reiterated that it was previously stated that HB 247 was to raise revenue without consideration of the consequences on the state's competitive ability to attract capital, to keep reinvestment going, and continue to develop a field in its later stages, particularly Prudhoe Bay and the North Slope, in a very developed aging field in which it is more difficult and expensive to extract. The rate would be raised without any real understanding of what the consequences are, he said. It was seen what happened under ACES when taxes were raised too far. It is important to know what the total government take would become under this additional scenario so legislators have some basis for evaluating the state's continuing competitiveness. While it might be great to get money from the industry now, where will the State of Alaska get money in five years when production collapses again? These are the kind of questions that members need to see answered.

2:18:17 PM

MR. ALPER resumed his sectional analysis, noting that Section 13 is very long because of the standards of statutory construction in which the entirety of a subsection is redrafted, which in this case is AS 43.55.020(a), regardless of the smallness or tightness of the actual amendment. Thus, Section 13 is eight pages of the bill, but the section only actually makes two changes. He explained that AS 43.55.020(a) describes the laborious process by which producers make a monthly installment payment on their production taxes to the state. It is long because there are separate provisions and rules for different time periods and also different segments, such as the North Slope, oil from Cook Inlet, gas from Cook Inlet, and oil produced after 2022 when the gross tax on gas kicks in. Each of these different scenarios and alternatives has its own very complex language in AS 43.55.020. The bill would not change the idea of a monthly installment payment, but that language does reference in a couple of places the minimum tax and it says "given X, Y, Z set of circumstances they pay 4 percent of the gross" and HB 247 changes that to say "now they're going to pay 5 percent of the gross." So, there are two specific reference points where another number is being changed to 5 [percent]. Section 13 is conforming to the change made to the minimum tax rate in Section 12.

2:19:59 PM

REPRESENTATIVE HAWKER understood that the point being made is long section, small change. Drawing attention to the prefacing point of Section 13 on page 6, line 9, of the bill, he said this whole section is basically the statute that's part of the statement of taxes, it's the instructions for making the payment of a tax liability to the state. He noted that line 9 states "For a calendar year," which defines that the tax period is a calendar year. This is a way to try to make a provision for periodic deposits of tax throughout the year and then a true-up at the end of the year. He recalled that [DOR] testified that it had serious problems with a true-up at the end of a year because this section did not capture on a ratable basis as prescribed here all the taxes that were due by the end of the year in full compliance with the statute. While this small change is being made in Section 13 for the proposed change in the minimum tax floor, he asked whether this a section that might be looked at to find a way to do a better job of ratably

collecting the taxes that are owed, given [DOR] has stated that this is a problem.

MR. ALPER responded he is sure that the committee will have specific questions on the change that is in Section 17 that Representative Hawker referred to, having to do with the true-up and how certain credits are treated. That is an issue [DOR] found to a specific circumstance related to the treatment of Per-Taxable-Barrel Credits, which he will discuss at the appropriate time. He said he personally would like to see a simplification of this section because he finds it almost unreadable, yet he is responsible for implementing it. He knows what it does, he knows what it purports to do, and he has seen it evolve over the years as various pieces of oil and gas legislation have worked through the body. He has seen, because of the nature of it, that it refers to a lot of things that aren't being amended but it puts them in black in white, it draws attention to issues that people were unaware of. It would be great if it could be simplified. The fact that the state has different tax regimes and different tax treatments for multiple areas throughout the state is what makes it necessary to have such a complicated structure to make monthly estimated tax payments. At some point, he said, it might behoove the state to come to a statewide more uniform structure for oil and gas taxation and then this section could be simplified.

2:22:49 PM

MR. ALPER continued his sectional analysis, addressing Section 14. He first pointed out that within Section 13 there is a lot of applicability language inside the oil and gas statutes that say this subsection refers to production before 2014, or this refers to production before 2016, or before 2011. He said AS 43.55.020(a)(1) and (2) refer exclusively to production that takes place prior to January 1, 2014; they are remnant sections from before the effective date of Senate Bill 21. Later in the bill, .020(a)(1) and (2) are repealed, which will reduce the footprint of that section and make future amendments, if necessary, take less pages in the bill. In making those repeals certain conforming language is needed elsewhere in law. He reiterated he doesn't like repealed and reenacted because it tends to make people think that something is being hidden, but he assured committee members that all Section [14] does is repoint existing law that talks about a technical part of monthly installment payments and eliminates the reference (a)(1) and (a)(2) because those are being repealed elsewhere in the bill. He pointed out that on page 13, line 22, of the bill,

"(a)(3), (5), or (7)" are references in current law that also talk about (a)(1) and (2).

REPRESENTATIVE HAWKER asked whether it is needed to keep these sections in statute while the audits for this period are yet unresolved.

MR. ALPER answered "no we do not, absolutely." It is quite clear in the history, the case law, that if there is a dispute on a tax that took place in year X, the statutes that were in place at the time are what govern that dispute.

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MR. ALPER reviewed Sections 15 and 16, saying they are the same as Section 14, only they're amended rather than repealed and reenacted. They remove references to (a)(1) and (a)(2) in other technical sections relating to monthly installment payments. For example, this can be seen on page 14, lines 3 and 23, of the bill where references to (a)(1) and (2) are being eliminated. He reiterated that (a)(1) and (2) are repealed in the repealer section of the bill, which currently is Section 40, and they refer only to production and monthly installment payments prior to January 1, 2014.

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MR. ALPER pointed out that Section 17 is one of the most material sections of the bill. He explained that AS 43.55.022 is a new section of law, as currently there is no AS 43.55.022, and it is titled "Limitations on tax credits." It's a limit in the applicability of certain tax credits to either reduce taxes or be claimed. He said AS 43.55.022(a) lays the framework and (b) and (c) make actual changes, with (b) providing that if a company has these credits it cannot use them to reduce its monthly installment payment below the minimum tax level. There are complicated reference points, AS 43.55.020(a)(5)(B)(ii) and (a)(7)(A)(ii), which are references to statute that specifically identify the 5 percent minimum tax, or in current law the flexible 4 through 0 percent minimum tax. It says that a company in possession of a certain credit cannot use that credit to reduce its monthly installment below the minimum tax level, so it is going to require a higher monthly installment payment. He explained that (c) says that the use of those credits over the course of a year may not exceed the sum total of the amount used in the 12 months of the year. While it is written more

broadly, it almost entirely refers to the Per-Taxable-Barrel Credit. In a year where there is very high volatility, such as the calendar year 2014 where this arose, there were months earlier in the year where the price of oil was quite high. The per-taxable barrel was $5 or $6, a number less than $8. The companies were able to claim it, reduce their taxes, and pay at some higher level. In the later months of the year as the price started to drop, the bottom of the Per-Taxable-Barrel Credit was reached, the $8 maximum figure. Then as prices dropped yet further, the limitation on the use of the Per-Taxable-Barrel Credit was seen because under current law they cannot be used to go below the minimum tax payment, the floor stands in the way of the use of the Per-Taxable-Barrel Credit. At the end of calendar year 2014, DOR had 12 monthly installment payments and thought it had its revenue for the year. As it turned out, when the 12 months were commingled and the true-ups done, DOR owed refunds of between $100 million and $150 million to this suite of producers because of the ability to, in effect, migrate some of those per-barrel credits from month to month. Because this complicated technical concept is very hard to explain with words, he said he will be bringing slides, examples, and formulas to show how that has worked in practice and how it would be corrected with the change in Section 17(c).

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REPRESENTATIVE HAWKER argued that this is not as difficult as Mr. Alper is proposing it to be, but really quite simple. He observed that page 2 of the sectional analysis regarding Section 17(c) states, "This effectively turns the per-taxable-barrel credit into a monthly rather than an annual calculation." Representative Hawker argued that this would significantly change the entire premise upon which the state's whole tax structure is designed, which is that it is an annualized calculation rather than a monthly calculation. It would no longer be an annual calculation, it would be purely monthly, which is a huge and absolute complete and total change. He suggested that it is not unlike telling an individual who has personal income that fluctuates throughout the year that the person must pay taxes on the one month that he got income at a very high personal tax rate rather than on the rate that applies on an average throughout the year under the Internal Revenue Code. He said he is looking forward to the consequences that [DOR] shows for this, adding that the concept of what is fair and reasonable must be introduced into this dialogue. He maintained that this is purely a money grab.

MR. ALPER replied there is zero impact in DOR's fiscal note from this provision because DOR doesn't project volatility and the issue is only relevant when there is volatility, change in price from month to month. The material impact on the state happened in the past. This was a $100-$150 million impact on the state in the true-up of the calendar year 2014 taxes. He clarified that the Per-Taxable-Barrel Credit in current law is already a monthly calculation. It is based on the price of oil in that month whether the per-barrel credit is $8, $7, all the way down to $0. So, it is already reflecting fluctuations from month to month in the gross value of the oil. What would be constrained is the ability to take that $1, $7, or $8 and move its value, its implication, from month to month within a tax year. "It is an issue of policy, it's an issue where individuals are going to disagree," he said, "and it's something that we see to be a priority to protect the state's interests in the event of volatility."

2:32:29 PM

REPRESENTATIVE HAWKER recalled Mr. Alper's statement that the state cannot predict volatility, and said a taxpayer cannot predict it either. The taxpayer would have no assurance other than just knowing that under statute the state is going to take away all the upside of any individual month's price fluctuation so that all a taxpayer is left with are the bottoms of the fluctuations. He agreed it is a policy call, but said it's one that he is personally particularly troubled by.

MR. ALPER responded:

> By no means are we taking all of the upside, we may be taking a little bit more of it and I would even go further and say during the ACES era when the entire tax rate with progressivity varied from month to month, we took a substantially larger portion of the upside from industry than we do currently. This bill ... takes a tiny fraction of that back and only in circumstances where there's quite low prices in certain months of the year.

2:33:36 PM

REPRESENTATIVE HAWKER recalled Mr. Alper saying that this element is not in the fiscal note. He asked whether that means there is a much more granular analysis than what is in the

fiscal note. The fiscal note basically has one lump number that would be put aside into a tax credit fund for the future with no analysis. He again asked whether there is an analysis on the components, the financial consequences, as DOR estimates them on the various components of the bill.

MR. ALPER answered that there is an analysis of how it works in practice in a theoretical year with high volatility. He said he would love to be able to bring the specifics of calendar year 2014 before the committee. Because there are at least three taxpayers and aggregated data, he needs to check with his staff and counsel to see whether it can be shown. It is an interesting calculation and it led to an internal discussion among staff as to whether staff wanted to go forward with this provision and the consensus was that it would be a good idea, that it would be in the interest of the state, and he does want to bring it before the committee at a level of granular detail. The reason it's not in the fiscal note is because the fiscal note is tied to DOR's revenue forecast, the revenue forecast is by its nature lumpy, it has an average price of oil for each fiscal year but it doesn't contemplate the possibility of volatility within an individual fiscal year.

2:35:00 PM

REPRESENTATIVE HERRON recalled Mr. Alper stating that page 15, line 19, is a brand new section and there isn't one like it in the statutes. He related that his staff "googled" the title, "Limitations on tax credits," and it came up as a tax increase. He asked why it isn't just called a tax increase given it looks like a tax and walks like a tax.

MR. ALPER replied it is a tax increase and there is no attempt to disguise that. This bill does two things. The majority of the changes made by HB 247 reduce the use of credits and the state's outlay in spending money on credits, or defer, or make various changes related to credits. A few of the changes increase the state's revenue in certain specific circumstances, primarily dealing with the minimum tax, and Section 17 is one of those categories. If a condition is met and Section 17 is triggered, it would increase the amount of money that the state gets from a given oil and gas producer. That is a tax increase. Without question, it shows up on the revenue side, not the expenditure side, of the ledger.

2:36:25 PM

REPRESENTATIVE SEATON said it seems that there is a problem with the volatility even though it is a monthly per-barrel credit and that's because the per-barrel credit can be different from month to month. He inquired whether going to a $5 per-barrel tax credit throughout, without any sliding scale, would take care of this volatility problem.

MR. ALPER responded he is not certain and offered his belief that it would to a large extent but not completely. With volatility - for example, a $5 flat per-barrel credit as in the version, say, of Senate Bill 21 that was passed by the Senate before it came to this committee in 2013 - if there are months with very low prices where the $5 was limited by the floor, there might be the ability to shift some of that around. [The department] hasn't specifically modeled it, but DOR will find that out as part of its analysis when back before the committee.

2:37:29 PM

CO-CHAIR TALERICO suggested that the language here could be expanded and cleaned up. While he is not saying the language is so clever that he thinks people are being tricked, it certainly tricks him a little bit. He said he has a question about the structuring of the calendar year versus the monthly estimate versus what can be done in the end in the credits and it looks to him like anything can be done forward. Noting that although [the state] may have promised a credit, a particular credit in one month, he asked whether Mr. Alper can assure him that these credits move forward at all and compile for the end of the calendar year when these folks figure this out, or whether this strictly limits it just to the monthly configuration.

MR. ALPER answered that the tax is an annual tax, full stop. The credits are annual credits. Section 13 describes mechanisms for monthly estimates that are supposed to add up to an annual tax. What is being attempted through these sections in this portion of the bill is to harden up some of those monthly calculations so that the sum total of the 12 monthly calculations more closely adds up to the annual total. Section 17 is trying to fix where if it's limited because of the minimum tax in a month, then that month's limitation should carry through for the rest of the year. "What we're trying to prevent," he said, "is if there's a limitation in one month that the company can't scoop up that limited credit by applying it against another month's taxes." This is one of those concepts that's very hard to explain without numbers.

CO-CHAIR TALERICO remarked that it is hard to understand without the numbers as well.

2:39:36 PM

REPRESENTATIVE OLSON said he would like to correct a statement made by Mr. Alper that HB 247 doesn't grab as much as ACES did. He said that, to his knowledge, the legislature didn't have a model that went above $105 a barrel during the consideration of ACES. What ACES captured on the top end when the price reached $135 or $140 a barrel was certainly an unintended consequence. He offered his belief that ACES would not have moved out of the legislature had there been models that went up to $150 a barrel. "The difference is you guys know what you're doing," he said. "At that point in time that was a totally unintended consequence, at least to, I believe, most of us in the legislature."

MR. ALPER agreed that the legislature did not contemplate what would happen at $140 oil, especially at the cost profile that was had at that era, which was only $22-$25 per barrel. There was a lot of taxable value for a few months, and with the monthly tax calculation there were production tax rates with progressivity in excess of 50 percent. He said the point he was trying to make a few minutes ago was that when describing all of the upside, or some of the upside, or most of the upside, what is really being talked about is the marginal tax rates at that point. If a company makes the incremental dollar, is the state taking 80 cents of that, 20 cents of that, or somewhere in between? The change envisioned by Section 17 does take a little bit more of the incremental money that comes in if there are some high months versus some low months, but it does not approach the level of marginal tax of high percentages taken in the high price spikes that ACES did.

2:41:29 PM

MR. ALPER resumed his sectional analysis, noting Section 18 relates to the carried-forward annual loss credit as it applies to the Gross Value Reduction (GVR). He explained that currently the GVR is a subtraction from taxable value before the tax is calculated. A North Slope-only provision for "legacy" oil, oil that is not eligible for the GVR, is that a company gets to its net profits, gets to its production tax value, and then that is multiplied by the tax rate, which is 35 percent for the North Slope. Another North Slope-only provision is that if a company has "new" oil it gets to its production tax value and then it

gets to further adjust that production tax value through the subtraction of, for the most part, 20 percent of the gross value. That 20 percent of the gross is subtracted from the net, thus the term Gross Value Reduction, to come up with a reduced modified net profits that is then multiplied by the 35 percent tax rate. Effectively it's a tax reduction, and there are technical reasons why the calculation was structured in that way, having to do with the commingling of expenses from field to field. The concept was to reduce the tax. However, [DOR] learned what happens if a company has a loss instead of having a profit that might be reduced by this calculation so that the company would pay a lower tax rate. If a company has a loss under normal circumstances for legacy oil, it would be eligible for a Net Operating Loss Credit of a percentage of that loss. Last year that was 45 percent. A $10 million loss with a 45 percent Net Operating Loss Credit would be a credit of $4.5 million that the state would pay out in cash to the company.

2:43:40 PM

MR. ALPER continued, explaining what happens under current law when the oil in the aforementioned scenario is new oil, oil that's eligible for the GVR. In that case, the $10 million loss could be modified by a calculation based on the gross revenue and turned into a $30 million loss. So, while the company actually lost $10 million, the calculation of the GVR makes it look like a $30 million loss for purposes of tax. A 45 percent credit on a $30 million loss is $13.5 million in credit, so [the state] is in a position of writing a credit check for $13.5 million to offset a $10 million loss, giving the company a credit of greater than 100 percent of the amount of the loss. It was surprising to find this circumstance allowable under law, but according to the attorneys it was allowable under the strict interpretation of Senate Bill 21's provisions as written. So, [the state] has paid credits based upon that calculation. Section 18 would not change the Gross Value Reduction in the circumstance where the company is paying taxes, but it would change the Gross Value Reduction if there is a loss. Section 18 says a company cannot use it to reduce the size of the operating loss for the purposes of calculating a credit and it prevents that circumstance where [the state] could potentially be paying credits of greater than 100 percent of the amount of the loss.

REPRESENTATIVE SEATON offered his hope that when Mr. Alper brings in the graphic presentation there will be some way to explain the aforementioned a little bit easier.

2:45:17 PM

REPRESENTATIVE HERRON said he thought he heard Mr. Alper say this is a tax reduction, but asked whether it isn't actually a tax increase.

MR. ALPER replied that this provision would only be relevant in a circumstance where the taxpayer in question was in a loss. So it would be a reduction in the state's credit spend, a reduction in the credit offered to the company.

REPRESENTATIVE HERRON reiterated that he thought he heard Mr. Alper say that this a tax reduction, but now Mr. Alper has explained it is a tax increase.

MR. ALPER responded he doesn't recall saying it was a tax reduction, and either he was misheard or he misspoke, but it was not his intent to say that this was a tax reduction.

2:46:30 PM

REPRESENTATIVE SEATON understood Section 18 is particularly applicable to new oil.

MR. ALPER answered it is specifically and uniquely applicable to new oil on the North Slope.

REPRESENTATIVE SEATON further understood that the problem trying to be avoided is where [the state] would pay more than the total expense of a project because it's all a net loss if there isn't production. So, he surmised, with the vagaries of the law as written, [the state] could actually be providing the company more than 100 percent of its total costs which generate a loss.

MR. ALPER replied that is not precisely correct because it is not 100 percent of the company's costs. This provision is only relevant if the company in question has production, if the company has some sort of sale, some sort of gross revenue that the company is producing oil, but in doing so the company is operating at a loss. That circumstance would occur in very low prices or would sometimes occur with a new field where a company is producing from the early wells but still building out the field and drilling subsequent wells and the company continues to operate at a loss for some years before the field is complete. If there is a loss, the company has revenue minus expenses that leads to a negative number. The way the Net Operating Loss Credit works in that circumstance is the credit is tied to the

net loss, the revenue minus expenses. What is trying to be done in Section 18 is to prevent the credit itself from being larger than the amount of the entirety of the loss.

2:48:14 PM

REPRESENTATIVE TARR inquired whether, to date, that circumstance has occurred.

MR. ALPER responded he doesn't want to go into details because of confidentiality, but said there have been a couple of specific credit applications since he became director of the Tax Division where he actually questioned the calculation and kicked it back to the auditor saying that it couldn't be right. But in checking with the audit masters and legal counsel, it was found that it was the appropriate treatment under the way the law is written - the auditor had it right and [the state] did owe that credit.

2:48:59 PM

REPRESENTATIVE HAWKER said he is still struggling with getting his arms around this. Regarding the effective change, he understood it would just eliminate before January 1, 2014. He offered his understanding that the operative language is that any reduction under AS 43.55.160(f) or (g) is added back to the calculation of production tax values for the calendar year and that that is the Gross Value Reduction as applicable to new oil.

MR. ALPER clarified that this particular section is inside AS 43.55.023(b), which is the statutory section describing the carried forward Annual Loss Credit. So, it's only in the calculation of an Annual Loss Credit and when there is a circumstance that might trigger the Annual Loss Credit, in other words an annual loss, then these Gross Value Reductions would be re-added before the credit itself is calculated.

2:50:15 PM

REPRESENTATIVE HAWKER commented he is still confused on this if under .160(f) [the state] already had a provision in there that says the GVR could not be used to reduce the gross value at the point of production below zero. The whole mechanism there was adjusting the tax rate, [the state] wasn't going to allow potentially a tax rate adjustment. He said he is trying to understand how both of those limitations apply and he is looking forward to a far more clear explanation.

MR. ALPER answered that these are technical provisions of law. He explained:

> There are places that say production tax value can't be less than zero ... so we're not paying taxes in reverse," he explained. But a net operating loss still exists even if production tax value is limited to zero. So the limits in .160(f) prevent the subtraction to get ... a production tax value below so we're not paying a negative tax ... but the net operating loss is not impacted by that. ... We're extending that limitation also to a net operating loss to say we can't use these reductions to increase the size of an operating loss. An operating loss itself is a cash flow calculation, it's tied to actual revenue and actual allowable expenditures. That's the basis for the Operating Loss Credit right now.

2:52:02 PM

REPRESENTATIVE HAWKER said the philosophy on this is all he can talk at this juncture on these details. He continued:

> But the point there exactly was that ... the big push from folks was to incent the development of new areas, again, new oil, oil that wasn't otherwise going to be able to be brought forward. That's how we established the GVR and, in this case, because we really wanted to incent these new developments, these new producers ... a very strict reading out of [Senate Bill] 21 allows, effectively when you're doing it, carry forward net operating loss for an industry, a player, a new entrant ... someone who's developing new oil to, if they are operating at a loss position, to truly get full value for those losses into the future. And here we're truncating that incentive that we were providing for the development of new oil. I think that's why it was really different than further development in old oil. ... What is going to be our consequence? It is going to have a chilling effect on the pursuit of new oil, which was a very high priority for us, by essentially taking away that opportunity, that advantage, in a situation where somebody is getting started, they're getting their field developed, they're getting their initial production going, and they have a loss and we're saying "oh ya, oh by the

way, that incentive ... we're trying to give you to get this done, you don't get it when we look at a ... longer term field life issue as opposed to a very small short moment in time here ... a point in time in an early part of a field development."

MR. ALPER replied:

The actual negative cash flow that generates the operating loss is unchanged and, for the most part, we are not, in this section anyway, changing how it can be used. There's other sections of the bill that we'll get into that might modify how companies could use their Operating Loss Credits. The way, philosophically, I would look at it is the Gross Value Reduction exists to reduce the tax burden on a new producer that's producing oil at a profit and therefore would owe taxes and now they're going to owe less taxes. If that company is losing money for whatever reason, we have the Net Operating Loss Credit as a benefit to pay them back for a portion of their losses. What we've found is circumstances where they're able to use both and magnify the size of their Operating Loss Credit through using this new oil benefit ... and it led to unexpected calculations. Philosophically we can talk a long time, but I think we'll all benefit from having real numbers before the committee to show you examples.

2:54:55 PM

REPRESENTATIVE JOSEPHSON noted that in Middle Earth the state is investing 80 cents versus the taxpayer's 20 cents on any investment. On the North Slope a company with new oil benefits from a Net Operating Loss Credit and a second credit bringing the totality of the state's investment to 120 percent of the total expense. He posited that the state is paying the company to generate nothing even though it produced something; it isn't like a New Explorer Credit where that isn't a phenomenon that happens. He asked whether the state is actually covering all of a company's expenses even in circumstances where the company produces.

MR. ALPER responded that, in part, his answer to this question is the same as the one he gave to Representative Seaton. It's not necessarily all of the company's expenses, but it's all of the company's loss. The state is compensating for more than 100

percent of the company's cash flow loss and that's what this provision in the bill would fix.

2:56:24 PM

REPRESENTATIVE TARR surmised that for ACES the modeling did not go high enough on oil prices and for Senate Bill 21 the modeling did not go low enough. She said she doesn't recall [committee members] contemplating situations where the large companies would have net operating loss because this is an unusual circumstance of very low prices. She inquired whether this is an accurate statement and could Mr. Alper elaborate in this regard. She further requested that when DOR does provide the committee with numbers that it include the range of realities that might actually be experienced on both ends, given that not having done this previously has gotten [the state] into some trouble when unexpected things happened.

MR. ALPER answered there is a psychological bias to assume the present is going to continue on into the future; it extends to regular people, academic economists, and everyone in between. There is always the broad discussion of what could happen. But, as he said earlier and not everyone agreed, his sense from having sat as a staffer during the hearings for both of those bills was that the modeling and day-to-day specifics of the ACES bill tended to look at a range of prices between $40 and $80 and, as Representative Olson said earlier, didn't really contemplate what happened if there was a price spike. Senate Bill 21 tended to focus its conversation on a range of prices between $80 and $120 and did not fully contemplate and model what might have occurred at severely lower prices. That is not to say that people were ignorant of it, but that it wasn't a prominent part of the conversation.

2:58:06 PM

REPRESENTATIVE TARR asked whether this can we avoided as things move forward on HB 247. She said she is making an honest request to look at a broad range of prices and how some of these changes in the bill would impact things.

MR. ALPER replied it is his sincere hope to go as broad as possible. He explained that [DOR] used to model general fund estimates for the year based upon a certain set of assumptions. Last year [DOR] published one that went between $40 and $140. The report was updated for this year and now the price goes down to $20.

2:59:29 PM

CO-CHAIR TALERICO informed members that both Director Alper and Commissioner Hoffbeck will be compiling some more information for the committee with quite a few more details. He said he will work directly with the director and the commissioner to give them enough time to compile those things that were talked about earlier today.

[HB 247 was held over.]

3:00:02 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:00 p.m.