Lisa Weissler
Juneau, Alaska

HB 247 Comments
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Reasons to change Alaska's oil and gas production tax as proposed in the administration's version of HB 247:

1. There is no evidence that the state's investment in oil and gas projects will pay off.

Tax credits are an investment by the state in oil and gas exploration and development. The assumption is that the state's investment will pay off in new production that leads to additional revenue. Yet it is unknown whether the state's investment will in fact result in more production and revenue that makes the investment worthwhile, or whether the state incentives substantively contribute to potential future production that would not have occurred without tax credits.

What is known is that previous tax incentive programs failed to result in more production sufficient to be worth the loss of billions to the state.

Starting in the 1970s, the tax rate decreased as a field's oil production declined as an incentive to prevent the premature shutdown of marginal fields. Decades later, the state found that companies were not making the investments necessary to secure future production in the state, even with low or no production tax.

In 2006, a net profits tax with tax credits was introduced as a way to provide incentives for investment in oil and gas exploration and development. In 2013, when the Parnell administration analyzed what the state was getting as a result of approximately $6 billion in tax credits, they could find no direct connection to future oil production that would not have occurred without the credits.[1]

Whether the state's current investment will result in new production and revenue is unknown because of taxpayer confidentially that keeps most company records secret and the multitude of factors that go into a company's investment decisions. Consequently, the state is paying billions without knowing whether it is worth the cost.

2. The state is paying out billions with no control over how or where the money is spent.

Either through reduced tax revenue or direct cash payments from the state, Alaska is a major indirect investor in new oil and gas projects, sharing in the risks of company investment decisions but not the decision-making. Companies control the state's investment regardless of their financial soundness, expertise, or the viability of a project. The state has no control over how the companies spend money the state subsequently reimburses.

While the intent is for state tax credit refund dollars to be reinvested in Alaska projects, the requirement for instate investment in order to qualify for a refund was

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[1] Senate Special Committee on TAPS Throughput, January 22, 2013, page 11; Senate Resources Committee, February 11, 2013, page 11.

repealed in 2010. With no investment requirements, companies can use tax credits as collateral to obtain financing from private investors. Some sell their refundable tax credits to a bank or investment company for less than the credits are worth. The buyer gets the full refund from the state, meaning the state is paying the buyer's profit on the credits. The company can spend the proceeds from selling their credits any way they want and anywhere they choose, including outside Alaska.

3. There are too many tax credits and other incentives.

   Over the years, as oil production on the North Slope declined and Cook Inlet oil and gas exploration stagnated, more incentives were added and existing tax credits increased. High oil prices allowed the addition of new tax credits without adequate consideration of their cumulative impact to the state's production tax revenue, particularly when oil prices are low.

   In addition, a taxpayer can take advantage of more than one incentive. For some oil and gas activities, the state is reimbursing up to 70 percent of a project's expenses with no control over project expenditures and no evidence showing that the state's investment will pay off with future production.

4. Adjustment of the tax credit refund program during low oil prices was anticipated.

   In 2006, legislators were reluctant to introduce a tax credit cash refund program. They were concerned about the impact to state finances if oil prices dropped and the state was on the hook for millions in credit refunds. During legislative hearings, oil and gas companies suggested that there could be limitations to protect the state's cash flow in the event of low oil prices.[2]

   The refund program passed in 2006 with provisions to help reduce the risks to the state, including a $25 million cap per company, limiting refunds to companies with no or minimal oil and gas production, and the requirement that to qualify for a cash refund, an applicant had to incur instate expenditures within 24 months of applying for a credit.

   In 2007, the $25 million cap was lifted and a tax credit fund established to pay for credits. The amount of money available to the fund was based on a set percentage of production tax revenue. Legislative committee discussions made it clear that low oil prices could lead to insufficient money in the fund after credits were paid out, and the legislature might choose to not spend money on credits.[3] Accordingly, the law allows for funds to be allocated among refund applicants if there is insufficient money to pay all the credits.

   This history shows that legislators and the oil and gas companies were aware and accepted that low oil prices could create too much of a burden for the state and necessitate adjustments to the tax credit program to protect the state's finances.

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[2] House Resources Committee, March 1, 2006, page 45-48; Senate Resources Committee, March1, 2006.
[3] Senate Judiciary Committee, October 30, 2007, page 24.