Alaska Oil and Gas Association

AOGA

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VIA EMAIL: john.larsen@alaska.gov

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

Re: Regulations - July 27, 2021 Scoping Notice

Dear Mr. Larsen:

The Alaska Oil and Gas Association ("AOGA") appreciates the opportunity to provide comments in response to the Department of Revenue's ("DOR") scoping notice dated July 27, 2021 concerning regulations in 15 AAC 55. For nearly half a century, AOGA has been the trade association of the petroleum industry in Alaska, and our members actively continue to explore for, develop, produce, transport and refine oil and gas in the state. In keeping with our practice regarding tax matters, all our members have had the opportunity to review and contribute to these comments, and they have been approved without dissent.

As an overarching comment, we would encourage DOR to use the implementation of SB 138, ch. 14, SLA 2014 as an opportunity to simplify and streamline its regulations, particularly in regard to allocations of lease expenditures between oil and gas and the calculation of carried-forward annual losses. We would also suggest that DOR not attempt to "over-engineer" any implementing regulations in an attempt to capture all possible scenarios—additional regulations can be promulgated in the future to address major gas projects if necessary.

Other specific comments are below.

<u>Application of Tax Credits</u>
Section 46 of SB 138 provides that AS 43.55.011(f), the North Slope minimum tax, would only apply to the levy of tax on oil starting on January 1, 2022. The result is that the tax on gas is not subject to the minimum tax. This is also reflected in Section 51, which amends AS 43.55.020 to provide that installment payments for the tax on oil produced from <u>North Slope</u> leases or properties cannot be less than the minimum tax, whereas installment payments for the tax on gas produced from each lease or property <u>in the state</u> cannot be less than zero.

AS 43.55.024(j) provides a credit of $0-$8 per barrel of North Slope oil produced ("Per Barrel Credit"). The statute states that the Per Barrel Credit "may not reduce a producer's tax liability in a calendar year" below the North Slope minimum tax under AS 43.55.011(f). Per Advisory Bulletin 2017-01, DOR interpreted this to mean that producers that use the Per Barrel Credit cannot use other AS 43.55 tax credits to reduce taxes below the North Slope minimum tax. As we have stated previously, we would encourage DOR to revisit Advisory Bulletin 2017-01. Regardless, given that there will no longer be a minimum tax for gas (and that gas production does not generate the per barrel credit), the AS 43.55.024(j) limitation on the use of the Per Barrel Credit should not apply to the production tax on gas. Accordingly, producers that use the Per Barrel Credit should be allowed to use other AS 43.55 tax credits to reduce their production tax on gas to zero.

Payment of Tax in Gas

Section 47 of SB 138 provides that DOR "shall allow a producer to make an election, under regulations adopted by the department" to pay the tax in gas. We suggest that any regulations implementing this provision be as simple as possible to provide clear guidance for those seeking to make the election.

Production Tax Value

Section 61 of SB 138, at AS 43.55.160(h)(1), provides that for North Slope leases or properties, the production tax value of oil "is the gross value at the point of production for that oil, less the producer's lease expenditures under AS 43.55.165 for the calendar year incurred to explore for, develop, or produce oil and gas deposits" located on the North Slope. The result is that all North Slope lease expenditures for oil or for gas are allocated to oil, without distinction as to whether the expenditures are for gas produced and used in the state. In other words, DOR should craft any implementing regulations in a manner that does not provide for allocations of expenditures for gas, including gas produced and used in the state.

AS 43.55.160(h)(4) provides for similar treatment for Cook Inlet, such that although a separate production tax value is calculated for oil produced from each lease or property, the lease expenditures for oil and gas exploration, development and production are used in the calculation of production tax value for oil. There is no distinction as to whether the expenditures are for gas produced and used in the state. Again, any implementing regulations should not provide for allocations of expenditures for gas, including gas produced and used in the state.

By no longer allocating lease expenditures between oil and gas (because there will no longer be a production tax value for gas), these changes should allow for substantial simplification of the production tax calculation and current regulations. We encourage DOR to revise current regulations, including 15 AAC 55.215, to reflect this simplification.[1]

[1] Please note that we are not attempting in our comments to capture every instance in which DOR will need to update its regulations. For instance, 15 AAC 55.275 refers only to a calendar year before 2022 and there needs to be clarification as to how the calculation of the AS 43.55.165(e)(18) "haircut" would work after 2021.

Carried-Forward Annual Losses
As stated above, all lease expenditures for North Slope oil and gas will be allocated to oil and there will no longer be a calculation of production tax value for gas. The creation of carried-forward annual losses will thus be driven by the calculation of production tax value for oil. In turn, the loss will be used in the calculation of production tax value of oil per AS 43.55.165(n)(1). We anticipate these changes should lead to substantial simplification of 15 AAC 55.217.

Other Issues

In prior correspondence we called DOR's attention to a number of additional areas where regulations would benefit both the DOR and the taxpayers. These areas for improvement include:

- Providing regulatory guidance regarding the exclusion from lease expenditures for unscheduled interruptions in production under AS 43.55.165(e)(19), including materiality thresholds
- Delineating the temporal calculations for the gross value reduction and the related price threshold
- Clarifying the application of AS 43.55.170 to major asset sales
- Aligning the application of 15 AAC 55.260 with modern industry practices in regard to labor charges
- Revisiting Advisory Bulletin 2017-01 regarding the North Slope minimum tax

We appreciate the opportunity to comment and recognize the value in DOR's efforts to improve regulations and audit processes.

Please contact me if DOR has any questions or would like to meet to discuss these comments.

Very truly yours,

ALASKA OIL AND GAS ASSOCIATION

Kara Moriarty

Kara Moriarty
President/CEO

CC: Colleen Glover, Tax Division Director, Alaska Department of Revenue

Hi John,

Attached are questions from Hilcorp Alaska regarding details in the current regulations. I will be out of the office August 2-20, if you have any questions please reach out to Shannon McKinley.

1.) Allocation of Lease Expenditures between oil and gas for Cook Inlet areas in which both are produced is detailed under 15 AAC 55.215(b). This regulation specifically states it is for lease expenditures incurred before 2022. Is regulation clarification coming to clarify allocation for 2022 forward? Specifically, how is Department going to handle the allocation or remove the allocation lease expenditures between oil and gas going forward. The allocation between oil and gas is one of the most complex calculations in the production tax, removing the allocation would ease industry's calculation in this area.

2.) Allocation of Lease Expenditures between oil and GUIS on the North Slope appears to remain unchanged per 15 AAC 55.215(d) and (e). However, AS 43.55.011(e)(3)(B) states that, "gas is equal to 13 percent of the gross value at the point of production of the taxable gas; if the gross value at the point of production of gas produced from a lease or property is less than zero, that gross value at the point of production is considered zero for purposes of this subparagraph." GVPP does not include lease expenditures, however, 15 AAC 55.215(d) and (e) allocates lease expenditures to gas produced from the North Slope. The new statute does not differentiate between 68 degrees North latitude and South. Please provide clarification on the lease expenditure allocation between oil and gas for land North latitude of 68 degrees.

3.) The calculation of the “haircut” mandated by AS 43.55.165(e)(18) is clarified in 15 AAC 55.275(a) to be an independent calculation for each segment, calculated as $1 less than the product of $.30 multiplied by the total amount of taxable volume in BTU equivalent barrels for that segment. This application of the exclusion in regulation specifically states that it is for the exclusion of lease expenditures incurred during a calendar year before 2022. Is the Department going to add clarification to 15 AAC 55.275(a) after 1/1/2022?

4.) Producers can elect to pay in kind the production tax levied under AS 43.55.011(e) for gas. This is only if the department has adopted regulations specifying, and only for certain leases in which the commissioner of DNR has determined to take a royalty in kind. Is the Department planning on adopting regulations to specify payments of tax in kind?

Regards,

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Response to the Department’s July 27, 2021 request for AS 43.55 Regulations scoping comments.
Dan E Dickinson
August 11, 2021

I represent Alyeschem (formerly Prudhoe Bay Chemical) LLC. My client is developing a project to supply chemicals needed for oil and gas production in Alaska in the Prudhoe Bay Area using North Slope gas as feedstock or fuel. The initial focus is on methanol and removing sulfur from Artic Heating Fuel although over time as the market develops they believe additional chemicals would be supplied as well.

We are responding to the Department’s July 27, 2021 request for AS 43.55 regulations scoping comments. Our recommendation would lead to a more effective implementation of the traditional doctrine of free use of gas that leads to further oil (and gas) production in the state. Currently AS 43.55.020(e) approaches the taxability question by focusing on what is considered “produced” – hence taxable, versus what is considered not to be “produced” – hence not taxable. It states in pertinent part:

> …Oil or gas used in the operation of a lease or property in the state in drilling for or producing oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and Gas Conservation Commission to be waste, is not considered, for the purpose of AS 43.55.011 - 43.55.180, as oil or gas produced from a lease or property.

Our recommendation is that the department implement that statute with positive regulatory language making it clear that any use of gas in the state, whether as a feedstock or fuel, which contributes to further production of oil, (or gas) not be considered produced, hence not taxable under AS 43.55.