Alaska Oil & Gas Association
Outline of Discussion Topics regarding
Regulations for HB 11 for DOR Public Workshop
August 22, 2017

Introduction

- Thank you for providing today's workshop to discuss topics related to regulations needed to implement the latest change in Alaska's tax policy, HB 111. For the record, my name is Kara Moriarty and I'm the President/CEO of the Alaska Oil & Gas Association (AOGA).
- AOGA is the professional trade association for the oil and gas industry. The topics we will bring forward today have been discussed internally by AOGA members, and there is no objection from any member for me or any AOGA member to expand on these topics during the workshop.
- AOGA members are still reviewing the recently adopted law, HB 111, and as such, the topics mentioned this morning may not be a complete and exhaustive list of questions, concerns, and/or areas of necessary clarification regarding the pending HB 111 regulations.
- Additionally, AOGA will likely submit written comments by the deadline next week.
- Today, we would like to bring up several topics and areas that you may already be addressing as you draft the regulations, but these are areas that need clear and concise direction.
- To provide that direction, it will be imperative for the Department to have a well-defined understanding of the Legislative intent behind several sections of HB 111, and if it has not already occurred, we would encourage the Department to be in discussions with leaders of the Legislature as you draft these regulations to ensure the regulations meet the Legislature's objectives. During our conversation today, we will discuss what we understood the Legislature's intent was in a few of the sections.
- Joining me today are representatives from several member companies. They may expand on the following topics and they may also be able to answer any questions you may have this morning during the discussion.

Topics

- Determination of allowable and cashable 2017 tax credits (Section 7 & 28).
  - How will the state determine what qualifies?
- Allowing tax credits and tax credit certificates under AS 43.55.023 and AS 43.55.025 to be applied against taxes and other charges for a prior year (Sections 6, 9 and16)
  - It is our understanding the Legislature's intent in these bill sections is to allow tax credits to be freely carried back and applied for prior years, so long as the credit does not reduce a prior-year amount that must be deposited in the Constitutional

Budget Reserve, just as law already provided in AS 43.55.028(b)(1). While the words in HB 111 are different, the intended result is the same.

- Conditional tax credit certificate (Section 19)

    - Because this is a new section and there have not been conditional tax credit certificates issued before, there are several questions as to how this will be applied to 2017 tax credit certificates, as well as to those tax credits already in the queue. New procedures will need to be clearly written so industry has a guidance on how conditional certificates will be issued. For example, will be it be first in, first out? How will Alaska hire preference be determined? Will there be other preferences created or used in the issuance of a conditional tax credit certificate?

- Assignment of tax credit certificates to conform with the repeal of the net operating loss credit (Section 22)

    - Section 22 of HB 111 makes a change to the statute that provides for the assignment of tax credit certificates, AS 43.55.029, to conform with the repeal of the annual loss credit under AS 43.55.023(b). This change, which is the removal of the reference to AS 43.55.023(b), has an effective date of January 1, 2018. However, January 1, 2018 is the earliest date that an application for the annual loss credit for costs incurred in 2017 can be filed, and per AS 43.55.029, the assignment of the credit certificate for that credit cannot be filed before the application for credit is filed. Because of this timing issue, HB 111 would appear to inadvertently preclude the assignment of the 2017 loss credit. We do not think that was the Legislature's intent, and this section appears to be be a drafting error, but again, this is an area where DOR may want to meet with the Legislative leaders who worked on this bill, and if it is a drafting error make that clarification in the regulations.

- New NOL carry forward and ringfencing provisions (Section 25 & 28).

    - Prior to HB 111, a producer with one or more producing properties within the same segment or category could utilize all applicable lease expenditures from all fields (in production or not) when determining that producer's overall production tax obligation for that segment or category. A NOL was only determined if the producer was in a NOL position for the entire segment or category for the entire year – and was not determined by individual leases or properties.

    - During the legislature's discussions on these new sections, the focus was on the determination and use of carried forward annual losses for leases or properties not in regular production at the time the loss was incurred. There was not as much focus as to how this would apply to a producer with currently producing properties with regular production, but who may have one or more properties also in regular production which by themselves may be operating at a loss for 2018 in the same segment or category.

- It is our understanding the Legislature intended for current law to apply, meaning a company could continue to allow such lease expenditures to be applied against current year revenues from other fields within the same segment or category in the current year vs. having to wait and carry forward any lease expenditures as a NOL to be applied as a loss in future years.

- This issue is also important because it would be helpful if the department would provide clear guidance as to what happens if a lease or property in regular production not projected to be in a NOL situation but at the end of the year ends up being in a NOL situation (due to additional lease expenditures for expansion or development, low prices, etc.) – how is the department intending on treating the estimated monthly payments made during the year that would now be understated if the department requires the leases expenditures to be carried forward as a NOL instead of being allowed as current year deductions.

- Again, this is another section that needs clear direction as it was our understanding the Legislature did not intend for a permanent tax increase for 2018 and potentially all future years as well, which could potentially occur depending on how DOR applies these new sections to currently producing fields.

- AOGCC determination of regular production (Section 28)

  - A process and procedure needs to be established so industry will know the requirements and documentation of when AOGCC determines regular production.

  - It would be helpful if the department would provide guidance on how the department intends to treat properties that are and have been producing prior to 2018 but have not received any official confirmation or determination by the AOGCC that such property is in and has been in "regular production".

  - It would also be helpful if the department would provide guidance on how it intends to treat a property that is in regular production and which has received the required determination by the AOGCC but such property has to stop production for some period of time (force majeure, scheduled extended downtime, etc.) and later resumes production, will another determination by the AOGCC that such property has resumed regular production be required? If so, will the department or AOGCC provide guidance on under what circumstances such redetermination by the AOGCC is required?

- Exploration lease expenditures that are "reasonably related to the lease or property (Section 28)
    - Again, because this is a new section, it would be helpful if the department provides guidance and objective standards in how they will determine if a lease expenditure is reasonably related to the lease or property, as well as appeal rights and procedures for industry. It would also be helpful if the department would issue an advanced determination of whether or not an expenditure will qualify to provide for accurate filing of tax payments.

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AOGA COMMENTS[1]
IN RESPONSE TO THE
"NOTICE OF PUBLIC SCOPING AND WORKSHOP"
DATED AUGUST 6, 2017 REGARDING
POSSIBLE UPDATES AND REVISIONS TO
15 AAC 55 (OIL AND GAS PRODUCTION TAX AND OIL SURCHARGE)
AND
15 AAC 05 (ADMINISTRATION OF REVENUE LAWS)
IN LIGHT OF THE ENACTMENT OF CH. 3, SSSLA 2017

Submitted
August 29, 2017

On July 15, 2017, the Thirtieth Alaska State Legislature passed the Conference Committee Substitute for House Bill 111, which Governor Walker signed into law as chapter 3, Second Special Session Laws of Alaska 2017 ("HB 111") on July 27. This act makes major changes to the present system of oil and gas tax credits under AS 43.55, with credits cashable under AS 43.55.028 being phased out altogether.[2]

The existing tax-credit system before HB 111 is already very complex, so the regulations to wind it down or replace various parts of it under HB 111 will likely be very complex as well. And because key provisions of HB 111 take effect January 1, 2018, regulations to implement HB 111 must, if possible, be adopted and in effect on that date. This is a challenging schedule for the Department of Revenue ("Department" or "DOR") to meet, but it can be met.

Further to the comments AOGA already provided in the Department's "Public Scoping Workshop" held on August 22, the following is a more detailed discussion of issues and questions we identified during our testimony at the Workshop that we hope can be clarified or answered in the regulations that are ultimately adopted.

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1 "AOGA" is the Alaska Oil and Gas Association, the trade association for the oil and gas industry in Alaska whose members represent the majority of the exploration, production, and refining companies in Alaska, as well as Alyeska Pipeline Service Company. These comments reflect the consensus of the members of the AOGA Tax Committee, with no dissent.

2 HB 111 also amends the statutory rate of interest that accrues under AS 43.05.225(1) on delinquent taxes and creates a "legislative working group … to analyze the state's fiscal regime for oil and gas, review the state's tax structure and rates on oil and gas produced in the state, recommend changes to the legislature for consideration during the Second Regular Session of the Thirtieth Alaska State Legislature, and develop terms for a comprehensive fiscal regime[.]" *See* §§ 3 and 32, respectively, HB 111.

A. Applying credits (and certificates for them) against production tax for years before the respective credit arises (§§ 6, 9 and 16 of HB 111)

Using substantively identical language in their pertinent parts, sections 6, 9 and 16 of HB 111 respectively amend AS 43.55.023(c) and (e) and 43.55.025(h) so that "all … or a portion of" a tax credit (or a certificate for it) —

> … may, regardless of when the credit was earned, be applied to satisfy a tax, interest, penalty, fee, or other charge that
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>> … is related to the tax due under this chapter for a prior year, except for a surcharge under AS 43.55.201 – 43.55.299 or 43.55.300 or the tax levied by AS 43.55.011(i) or AS 43.55.014 … and
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>> … has not, for the purpose of art. IX, sec. 17(a), Constitution of the State of Alaska,[3] been subject to an administrative proceeding or litigation. [emphasis added]

HB 111's reference to "an administrative proceeding or litigation" comes straight from Article IX, section 17(a) of the Constitution: "all money received … as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation … involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund" (emphasis added). The expected result of HB 111's new statutory language will be to prevent a carried-back tax credit from directly reducing any portion of a prior year's production tax that would otherwise go into this constitutional "budget reserve fund" (the "CBR").[4]

There already is statutory language in AS 43.55 with a similar purpose of preventing a general provision about production tax revenue from applying to any portion of the production tax revenue that goes into the CBR. AS 43.55.028 contemplates that the legislature may fund the Oil and Gas Tax Credit Fund ("Credit Fund" by appropriating a percentage of a year's production tax revenue, instead of a specific dollar amount from that revenue; and subsection (c) prescribes what that percentage will be. Accordingly, subsection 028(b) provides —

> (b) The oil and gas tax credit fund consists of
>
> (1) money appropriated to the fund, including any appropriation of the

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3 In full, Article IX, sec. 17(a) of the Alaska State Constitution provides:

> (a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section. [emphasis added]

4 Since a state statute cannot be inconsistent with the Alaska Constitution, subparagraph (B) in HB 111's three parallel amendments is, technically, surplusage.

> percentage provided under (c) of this section of all revenue from taxes levied by AS 43.55.011 that is not required to be deposited in the constitutional budget reserve fund established in art. IX, sec. 17(a), Constitution of the State of Alaska; and
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> (2) earnings on the fund. [emphasis added]

Despite the difference between HB 111's language and the statutory language above that is already on the books, it is clear that the legislative concern underlying both phraseologies is to ensure that money that is supposed to be deposited into the CBR under the Constitution will not be reduced or diverted away from the CBR as the result of a tax credit. In the case of AS 43.-55.028(b)(1) already on the books, the language ensures that, if the legislature appropriates a percentage under subsection (c) of production tax revenue, the "revenue" to which that percentage applies is net of the CBR's share. The language in sections 6, 9 and 16 of HB 111 prevents a tax credit from directly reducing any portion of a prior year's production tax that has to go into the CBR.

Under the constitution, the relevant test in the context of tax revenue that has to be deposited into the CBR is whether the "money [is] received … as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property" (emphasis added). The Alaska Supreme Court — in the context of "an administrative proceeding … involving taxes imposed on mineral income, production, or property" — has held that the issuance of an audit assessment is the starting point of "an administrative proceeding" in that context. *Hickel v. Halford*, 872 P.2d 171, 181-183 (Alaska 1994) (discussion titled "2. In a tax collection context, an assessment marks the beginning of an administrative proceeding.").

We would be surprised if the Department or the Attorney General's Office materially disagrees with the substance of our discussion on this matter. Accordingly, we ask DOR to adopt a regulation allowing a tax credit (or a tax certificate) to be applied to any prior year's production tax for which an audit assessment has not been issued.

We are concerned, however, about the potential adoption of a regulation that would disallow the use of a tax credit or credit certificate against increased tax for a prior year that a taxpayer reports in an amended return reflecting reductions in pipeline tariffs for that prior year by FERC or the Regulatory Commission of Alaska, or reflecting changes in Quality Bank differentials for the prior year, or reflecting similar external matters unrelated to the meaning and application of Alaska's tax laws.

Such a regulation might be defended on the pretext of being an interpretation solely of the statutory changes to AS 43.55.023(c) and (e) and 43.55.025(h) under HB 111, as opposed to being an interpretation of Article IX, section 17(a) of the Alaska Constitution.[5]

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[5] The standard of review for a regulation usually allows DOR considerable discretion in interpreting and applying a statute like HB 111. AS 44.62.020 ("each regulation must be within the scope of authority conferred and in accordance with standards prescribed by other provisions of law"); AS 44.62.030 (consistency of regulations with their underlying statutes). In contrast, the Alaska Supreme Court gives little or no deference to any interpretation of the Alaska Constitution by another court or a state agency.

We sincerely believe, however, it was never the Legislature's intent for DOR to be able to adopt such a regulation. There was no discussion during the Free Conference Committee hearing on HB 111 — nor during the floor discussion on Conference Committee Substitute for HB 111 in either Chamber — that even hints at exploiting this language to adopt a regulation preventing credits from being carried back and applied to tax for prior years when the tax itself is not subject to "an administrative proceeding" under *Hickel v. Halford*, *supra*, and therefore is not yet constitutionally required go into the CBR.

It is quite clear to us that such a possibility wasn't the Legislatures intent. Indeed, if legislators had been aware of this possibility, we submit they most likely would not have agreed to this language in sections 6, 9 and 16 in the CCS for HB 111.

We believe if the Department were to adopt a regulation to limit the carryback of tax credits against prior years' production tax in this way, it would invite yet another year's struggle — and uncertainty — about the Legislature's response to the regulation. And it would send another clear message to industry that, if you come here to invest, you do so at your peril.

Alaska simply cannot afford to prolong its history of uncertainty about its oil and gas taxes: the harm for the future gets greater each time, and for far too many companies that have come to Alaska, this threat to their business here seems to be heading toward the catastrophic. DOR is not required by HB 111 to create additional harm by its regulations, nor should it do so merely as a matter of discretion.

B. Timing Problem under HB 111 Regarding Credit Certificates for "Carried-Forward Annual Losses" from 2017 [§§ 22 and 30 of HB 111]

As amended last year effective January 1 this year by § 18, ch. 4, 4SSLA 2016, AS 43.-55.023(b) currently provides in part:

> [A] carried-forward annual loss is the amount of a producer's or explorer's adjusted lease expenditures under AS 43.55.165 and 43.55.170 for a previous calendar year that was not deductible in calculating production tax values for that calendar year under AS 43.55.160[.]

See AS 43.55.023(b)(1).

The key point here is that, a tax credit under AS 43.55.023(b) can only be for a "carried-forward annual loss … <u>for a previous calendar year</u>" (emphasis added). Accordingly, if a taxpayer ends up with an "annual loss" for 2017 that could be carried forward, it cannot — because of -.023(b)(1) — make a claim for a tax credit for that loss during calendar year 2017 even if it were possible to determine or estimate its amount accurately before the end of 2017.

However, section 30 of HB 111 provides, "AS 43.55.023(b) is repealed January 1, 2018." And AS 43.55.029(a) is amended by section 22 of HB 111 to delete its current reference to production tax credits under AS 43.55.023(b) for which "a present assignment" may be made, and this change takes effect under Section 47 of HB 111 on January 1, 2018.

So under the current statutes, a taxpayer cannot apply for a 2017 carried-forward annual loss until January 1, 2018 at the earliest. But, as of that date, the statutory authorities allowing for a tax credit on that loss, for making "a present assignment" of that credit, and for applying for payment of it from the Credit Fund are all repealed.

This strikes us as a kind of "manifest error" in drafting that the Revisor of Statutes might have been able to correct before the bill was enrolled and transmitted to the governor. Obviously it's too late for that now.

Perhaps the Department could adopt a regulation to fix the problem,[6] assuming the Attorney General's Office views it as a valid action.

C. June 30, 2017 Cutoff on Activities Underlying Tax Credit Certificates that the Oil and Gas Tax Credit Fund may Purchase (§§ 20 and 21[7] of HB 111)

Section 20 of HB 111 amends AS 43.55.028(a) to prohibit the Credit Fund from purchasing

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[6] AOGA offers the following in the spirit of brainstorming toward a solution, rather than making an actual proposal.

One possible solution may arise from AS 44.62.030, which in pertinent part says, "If … a state agency has authority to adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of [a] statute, a regulation adopted is not valid or effective unless consistent with the statute …." Here we have two statutes — the current law, and the law as it will be as of January 1, 2018 — that are inconsistent with each other, and the effect of this inconsistency is that neither statute will work as the Legislature intended.

Perhaps in this exceptional circumstance DOR can adopt a regulation under current law to allow provisional applications to be made before December 31st for the 2017 annual loss which, if not withdrawn or canceled by the applicant, are perfected or become non-provisional by operation of law under the regulation at 12:01 a.m. on January 1st, which would be simultaneous with the moment under AS 01.01.070 when, first, the repeal of the current law takes effect, and second, when the amendments under HB 111 to the current law will come into force. Until 12:01 a.m. January 1st, the regulation would be consistent with present law because any provisional application could always be withdrawn or canceled, and after that moment it would be consistent with HB 111 because the matters that HB 111 no longer authorizes would have already been taken as a result of the applicant's inaction prior to that moment.

Alternatively, it may be worth noting that Article II, section 18 ("Effective Date") of the Alaska Constitution says only: "Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date." There is nothing in the constitution about 12.01 a.m., which is entirely a creation of AS 01.01.070. So perhaps a regulation could be adopted by the lieutenant governor that interprets and applies AS 01.01.070 to divide the first minute of January 1st in circumstances like this and allow DOR to adopt a special regulation like the one described above, but with the application ceasing to be provisional at 12:00:30 a.m. January 1st instead of 12:01 a.m., and with DOR's new regulations implementing HB 111 for post-2017 years taking effect at 12:01:00. DOR has already adopted a regulation — 15 AAC 55.320(A)(2) — providing that that the application for an NOL credit cannot be made before the year after the loss is incurred. Accordingly, it seems appropriate for DOR to adopt a counterpart provision regarding 2017 losses to address this problem along the lines we suggest.

Of course, the cleanest alternative would be a purely technical piece of legislation introduced by the Governor to fix this single problem and nothing else. But unless there is a strong political consensus about making this fix and making it quickly so taxpayers aren't harmed any more than necessary, there would be the risk of other provisions being added to the bill — like ornaments on a Christmas tree — as it proceeds through the Legislature.

[7] Section 21 makes purely technical conforming changes to AS 43.55.028(e) to reflect this new cutoff date under Section 20 on activities giving rise to credit certificates that the Credit Fund can purchase.

"a tax credit certificate for a credit earned under this chapter [i.e., AS 43.55] for activity occurring on or after July 1, 2017." This provision does not affect the tax credit certificate itself, but only limits the ability of the Credit Fund to purchase it. In other words, a certificate-holder can apply the certificate against its own production tax liability regardless of this limitation.

For tax credits arising from a specific activity in 2017 such as drilling an exploration well, this mid-year cutoff on expenditures that generate such a credit may create some administrative problems, but they should not be unduly difficult to solve. Basically it's just a matter of making sure that contractors doing the work — or employees of the taxpayer — accurately log the days when the work is done so the costs of the work can be tied back to the work-days.

The tough nut to crack is the NOL credit under AS 43.55.023(b). A taxpayer's 2017 NOL will be the amount (if any) by which its lease expenditures for calendar year 2017 exceed the "gross value at the point of production" ("GVPP") of its 2017 taxable production. For a producer[8] the existence and amount of the NOL depends <u>both</u> on the amount of the producer's lease expenditures and on the average price of oil during the year. This is because, for any given amount of lease expenditures there is an oil price below which the producer will have an NOL; conversely, for any given average oil price during the year, there is a level of lease expenditures above which the producer will have an NOL.

> <u>EXAMPLE 1</u>. Producer X has 1 million barrels of taxable production on the North Slope and $25 million of lease expenditures in 2017. Transportation costs from the "point of production" of X's production to the U.S. West Coast are $10/bbl.
>
> <u>Analysis</u>. The cross-over point where X would start having an NOL for 2017 is when the GVPP/bbl. of its production exactly equals its transportation costs; i.e., when —
>
> 1,000,000 bbl. x GVPP/bbl. = $25,000,000.
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> Dividing both sides of the equation by a million barrels yields a cross-over GVPP/bbl. of $25/bbl. Adding transportation cost of $10/bbl. to that yields a West Coast price of $35/bbl. Any West Coast average below that causes an NOL for X.
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> If X had only $20 million of lease expenditures but the same production, the cross-over GVPP/bbl. would be $20 and the corresponding West Coast price would be $30/bbl.
>
> If X had only 800,000 barrels of production but the same lease expenditures, the cross-over GVPP/bbl. would be $31.25/bbl. with a corresponding West Coast price of $41.25.
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> This demonstrates the logical truth of the last sentence in the previous paragraph.

The analytical dilemma is how to fit these traits of NOLs and their resulting credits with the requirement of AS 43.55.028(a). In other words, in what sense can the credit for a 2017 NOL be considered to be "earned" by "activity occurring on or after July 1, 2017" and hence disqualified from being eligible for purchase-by the Credit Fund? This dilemma seems easier to illustrate and explain through an example.

[8] A taxpayer that is purely an explorer has no production, so its NOL is simply its lease expenditures. The NOL "earned" from its exploration activity before July 1, 2017 is simply the lease expenditures for the work done before that date — this is essentially the same as the exploration well example and similarly specific activity discussed in the preceding paragraph of the main text.

> <u>Example 2</u>. Producer Q produces 100,000 barrels[9] on the North Slope each month throughout 2017. Assume all lease expenditures and transportation costs are "reasonable" and all West Coast prices are proper and correct for AS 43.55 purposes.
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> In January – June 2017 ("1H") Q has lease expenditures of $6 million/month, of which $2 million is operating expense ("opex") and $4 million is capital expense ("capex") for a new facility expected to cut opex in half. The GVPP of Q's production each month is $61/bbl., reflecting West Coast prices of $71/bbl. and transportation costs of $10/bbl. each month.
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> On July 1 the new facility starts up and does cut opex for July – December ("2H") in half, to $1.0 million a month. Q has no capex during 2H. West Coast prices collapse starting July 1st to $15/barrel and stay there throughout 2H. The GVPP for Q's production each month during 2H is $5/bbl. with transportation cost of $10/bbl. each month.
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> *1H results*. Lease expenditures are $6 million/month x 6 months, or $36 million. GVPP is $61/bbl. x 100,000 bbl./month x 6 months, or $36.6 million. Net PTV is $0.6 million.
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> *2H results*. Lease expenditures are $1 million/month x 6 months, or $6 million. GVPP is $5/bbl. x 100,000 bbl./month x 6 months, or $3 million. Net PTV is zero with a net "loss" of $3 million.
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> *Full-year results*. Positive PTV of $0.6 million in 1H minus the $3.0 million "loss" in 2H, for an overall NOL of $2.4 million.

<u>Discussion</u>. For simplicity in this discussion, we use "disallowed" (with quotation marks) to indicate activity (and, as appropriate in the context, its associated lease expenditures) "occurring on or after July 1, 2017" for which any resulting tax credit certificate cannot be purchased by the Credit Fund. And conversely, we use "allowed" (with quotation marks) to indicate activity (and, as appropriate in the context, its associated lease expenditures) for which any resulting tax credit certificate can be purchased by the Credit Fund.

The issues here are: How much, if any, of the $2.4 million NOL for the full year is "earned … for activity" in 2H and "disallowed"? And why is that the correct "disallowed" amount?

The primary causes of the overall NOL for the year are — first, the collapse in West Coast oil prices from $71 a barrel in 1H to $15 starting July 1; and second, the heavy capex in 1H for the new, opex-saving facility. If either had not occurred, there would be no NOL for the year.

The analysis for applying AS 43.55.028(a) in Example 2 is made difficult for four principal reasons:

(A) one of the causes occurs only in 1H (the "allowed" period) and the other only in 2H (the "disallowed" period), but the full-year NOL only occurs because of both causes;

(B) one of the causes of the full-year NOL results from lease expenditures for "activity" while the other results from West Coast market conditions completely unrelated to the producer's "activity";

(C) in 1H when the bulk of the "activity"-related lease expenditures are incurred, the net

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9 The 100,000 figure is solely for illustrative purposes and has been chosen for two reasons. One, it's too small for anyone to speculate about any particular taxpayer(s) we might have had in mind (we didn't) in developing this example. And two, it keeps the arithmetic simple and avoids big numbers. Accordingly, size-related parts of AS 43.55 like "small producer" credits under AS 43.55.024 should be ignored as they are not relevant to the points we want to make.

PTV for those months is greater than zero; i.e., there is no "loss" then, which – even if logically correct – may be hard to explain to the public, the press and others; and

(D) the opex-saving project works, so the investment for it in 1H creates offsetting reductions in lease expenditures in 2H (and any NOL for the year).

These analytical difficulties make it unrealistic to search for some means such as a mathematical formula to calculate directly the amount of the "disallowed" portion of a 2017 NOL tax credit. There is no common logical or factual thread running through these difficulties that might tie them all together and allow a single, inherently "correct" answer to be found even for Example 2, much less for the myriads of other possibilities.

What is feasible would, we believe, be some reasonable method or formula for allocating the total NOL for 2017 between the "allowed" first half "activities" and the "disallowed" second half. Since we are in a "scoping" process rather than a "rule-making" process under AS 44.62, we suggest this as a possibility for the Department to consider.

If there is interest in DOR for it, we would readily search for a suitable allocation method. We acknowledge the limitations under AS 44.62 on our involvement with DOR as it moves forward to develop its own draft regulations to propose for adoption and public comment. However, we also note that AS 44.62.220 gives AOGA, its members individually, and any "interested person" in the public a general right to petition the Department to adopt a regulation — including one about allocating 2017 NOLs to "allowed" and "disallowed" credits.[10] So, if there is interest in DOR for an allocation approach here, letting us (and the public) know of that interest[11] would likely prompt us to start work to develop an allocation regulation that we would then petition for under AS 44.62.220.

D. Conditional Tax Credit Certificates (§ 19 of HB 111)

Section 19 of HB 111 enacts AS 43.55.025(q) creating and authorizing the issuance of "conditional tax credit certificates" to explorers. In practical terms, these "conditional" certificates act as placeholders allowing the explorer to get into the queue under AS 43.55.028(g) for purchase by the Credit Fund as of the date the explorer applies for a transferrable tax credit certificate for that tax credit, instead of later when DOR issues the applied-for certificate after determining the correct amount of the tax credit. In the interim, the conditional tax credit certificate "may not be sold, transferred, or conveyed;" "has no value;" and otherwise can only be used to purchase the regular transferrable tax credit certificate that will replace it, at which time it "expires."

There are three technical drafting issues in the statute that the regulations should clear up. One is to clarify that each conditional tax credit certificate is issued for — and in the face amount

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[10] By its terms AS 44.62.220 does not supersede any specific statutory provision limiting the right to petition for a regulation so only a "designated group" can make the petition, but there is no such limitation for tax regulations.

[11] For instance, the Department might do this by publishing a supplemental scoping notice as a follow-up to the one it already made, inviting anyone to submit ideas about allocating NOLs.

being applied for — the tax credit for the claimed exploration costs for which the explorer submits the initial tax credit certificate application under AS 43.55.025(f). Another is to clarify that a conditional certificate expires on the day when DOR issues the transferrable certificate that triggered the issuance of that conditional certificate. And the third is to clarify that DOR "may … accept … a conditional tax credit certificate" and issue the applied-for transferrable tax credit certificate regardless of any difference between the face amount on the conditional certificate and the final face amount on the transferrable certificate that replaces it, and how the explorer may appeal if the face amount determined by the Department for the transferrable certificate is less than the face amount of the conditional certificate.

There is a host of other issues about what effect a conditional tax credit certificate might have on where in the queue under AS 43.55.028(g) and 15 AAC 55.525 the explorer will go, and what effect, if any, the face amount of its conditional tax credit certificate may have in determining the amounts that may be paid by the Credit Fund to other certificate-sellers — and what the consequences are if the face amount of the transferrable certificate is less than that of the conditional certificate it replaces — when the money available in the Credit Fund is insufficient to pay all the certificates fully.

Related to the subject of conditional tax credit certificates is a number of provisions in 15 AAC.55.525 and associated regulations regarding transferrable tax credit certificates that reflect mistakes we believe the Department made in adopting those provisions instead of the ones we proposed or ones similar to ours. As part of the scoping, we note these for the Department's reconsideration as it revises 15 AAC 55.525 and its associated regulations in light of HB 111.

E. NOL Carryforwards — Carryforward of NOLs under AS 43.55.023(b)

Currently AS 43.55.023(b) allows a producer to convert an NOL into a tax credit equal to a specified percentage of the NOL, which it can use year by year until the credit is exhausted. The producer can get a transferrable tax credit certificate for the credit instead, and either keep it and apply it against its own tax in later years, or transfer it. However, a transferred certificate may not reduce the certificate-holder's production tax below 80% of what it otherwise would have been.

AS 43.55.023(b) is being repealed effective January 1, 2018 by section 30 of HB 111 and replaced as of that date by a system of "carried-forward annual loss" ("carried-forward NOL") under new AS 43.55.165(a)(3) and AS 43.55.165(*l*)(4) and (m) – (s).

The new carried-forward NOL system will apply to lease expenditures incurred outside the Cook Inlet sedimentary basin (*see* new AS 43.55.165(a)(3)(D)) that have not been deducted in determining the PTV of oil and gas production in a previous year and were not the basis of a tax credit. We submit this means that, if a producer didn't convert some of its pre-2018 annual loss into a tax credit, that unconverted NOL carries forward as a "carried-forward annual loss" for purposes of AS 43.55.165(a)(3), just as a pre-2018 NOL tax credit under AS 43.55.023(b) remains valid. We submit, further, that such an unconverted pre-2018 NOL should carry forward under the new carried-forward NOL system even if that loss was for Cook Inlet. This is because the exclusion of Cook Inlet under AS 43.55.165(a)(3)(D) is effective January 1, 2018 and nothing in HB 111 makes the exclusion retroactive. The regulations should keep this clear.

F. NOL Carryforwards — Ringfencing by "Category"

Under new AS 43.55.165(o)(1) a carried-forward NOL "may only be applied … to determine the production tax value of oil or gas for a category for which a separate annual production tax value is required to be calculated under AS 43.55.160(a) or (h) if the lease expenditure resulting in the carried-forward annual loss was incurred in the same category" (emphasis added).

The categories under AS 43.55.160(a)(1). These categories apply to oil and gas produced after 2013 and before 2022 and they are:

"(A) oil and gas produced from leases or properties in the state that include land north of 68 degrees North latitude, other than gas … used in the state;

"(B) oil and gas produced from leases or properties in the state outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude [except] gas … used in the state; or … oil and gas subject to AS 43.55.011(p);

"(C) oil produced … from each lease or property in the Cook Inlet sedimentary basin;

"(D) gas produced … from each lease or property in the Cook Inlet sedimentary basin;

"(E) gas produced … outside the Cook Inlet sedimentary basin and used in the state, other than gas subject to AS 43.55.011(p);

"(F) oil and gas subject to AS 43.55.011(p) produced from leases or properties in the state;

"(G) oil and gas produced from leases or properties in the state no part of which is north of 68 degrees North latitude, other than oil or gas described in (B), (C), (D), (E), or (F) of this paragraph" (format altered).

Categories (C) and (D) in 160(a)(1) are for production from Cook Inlet. AS 43.55.-165(a)(3)(D) limits new carryforward to lease expenditures "incurred to explore for, develop, or produce an oil or gas deposit located in the state outside the Cook Inlet sedimentary basin" (emphasis added), and so the (C) and (D) "categories" are not subject to ringfencing. The regulations applicable to carrying NOLs forward for lease expenditures incurred after 2017 and before 2022 must reflect this, just as they must reflect the ringfencing categories that AS 43.55.-165(o)(1) does call for. Similarly, 165(o)(1) does not authorize ringfencing at a smaller-scale level than the categories it identifies.

The categories under AS 43.55.160(a)(2). These categories apply only to oil and gas produced before 2014 and are irrelevant to ringfencing.

The categories under AS 43.55.160(h). These categories are for production "on and after January 1, 2022" and are:

"(1) … leases or properties in the state that include land north of 68 degrees North latitude …;

"(2) … before or during the last calendar year under AS 43.55.024(b) for which the producer could take a tax credit under AS 43.55.024(a), from leases or properties in the state outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude, other than leases or properties subject to AS 43.55.011(p)…;

"(3) … leases or properties subject to AS 43.55.011(p) …;

"(4) … leases or properties in the state no part of which is north of 68 degrees North latitude, other than leases or properties subject to (2) or (3) of this subsection …" (format altered).

The category in AS 43.55.160(h)(4) includes Cook Inlet, so if the ringfencing provisions in AS 43.55.165.165(o)(1) remain as they are, the ringfencing regulations for post-2021 production will have to exclude Cook Inlet.

The regulations applicable to carrying NOLs forward for lease expenditure incurred after 2021 when the 160(h) categories are applicable may not attempt to limit the applicability of carried-forward NOLs on a basis narrower than these categories.

Prior to HB 111, a producer with one or more producing properties within the same category could utilize all applicable lease expenditures from all fields (in production or not) when determining that producer's overall production tax obligation for that category. A NOL was only determined if the producer was in a NOL position for the entire category for the entire year – and was not determined by individual leases or properties.

During the Legislature's discussions on these new sections, the focus was on the determination and use of carried-forward NOLs for leases or properties not in regular production at the time the loss was incurred. There was little focus as to how this would apply to a producer with a net positive PTV for an entire category with currently producing properties with regular production, but who may have one or more properties which may also be in regular production but which by themselves may be operating at a loss for 2018 in the same category.

It was also our understanding that the Legislature did not want to penalize or discourage continued exploration or development by preventing a producer after 2017 with currently producing properties with regular production, but who may have one or more properties which may not be in regular production, from using all allowable lease expenditures in determining the producer's category-wide PTV provided the producer is not in a NOL situation for the entire category.

It is our understanding the Legislature intended for current law to apply, meaning for years after 2017 a NOL would still be determined only on a category basis, i.e., a company with a positive PTV for a category could continue to use all qualifying lease expenditures from all leases or properties within that category after 2017 when determining its overall PTV for that category, regardless of whether one or more leases or properties might by themselves be in a NOL situation. A carried-forward NOL would only be determined in the company was in a NOL for the entire category and under that situation the carried-forward NOL would be allocated to the lease or property generating the NOL.

Again, this is another section that needs clear direction as it was our understanding the Legislature did not intend for a permanent tax increase for 2018 and potentially all future years as well, which could potentially occur depending on how DOR applies these new sections to producers with currently producing fields and fields which may by themselves be in loss situation.

G. NOL Carryforwards — Ringfencing: Erosion of NOLs after Certain Periods of Time

Under new AS 43.55.165(o)(1) a carried-forward NOL is ringfenced — that is, it can only be used in determining the PTV of oil and gas production in the same geographical "category" as that where the underlying lease expenditure was incurred.

Subsection (p) provides for "erosion" (our term) of a carried-forward NOL — after a specific period of time, the carried-forward NOL decreases on January 1st each year by "one-tenth of the value of the carried-forward annual loss in the preceding year[.]"[12] For a lease expenditure incurred "on a lease or property that … commenced regular production of oil or gas before or during the year the lease expenditure was incurred", erosion starts in "the eighth year after the lease expenditure is carried forward under [AS 43.55.165](a)(3)". *See* AS 43.55.165(p)(2).

For a lease expenditure "incurred on a lease or property that … did not commence regular production of oil or gas before or during the year the lease expenditure was incurred", erosion starts in the eleventh year after the expenditure was incurred, not counting years for which "the department determines that regular production of oil or gas did not commence because of a natural disaster, an injunction or other court order, or an administrative order[.]" *See* AS 43.55.165(p)(1). These are some classic examples of *force majeure*, but by no means all of them. The Department should adopt a regulation similar to 15 AAC 55.260(a)(14) that would include the other classic types of *force majeure* such as war, rebellion, epidemics, etc. in the list of things that temporarily stop the clock for purposes of when a carried-forward NOL will start to erode.

H. NOL Carryforwards — Ringfencing: Determining the "Commencement of Regular Production"

The "commencement of regular production" factors into the ringfence system in two ways. One is for purposes of determining whether the eight-year period or the eleven-year period applies under AS 43.55.165(a) to a carried-forward NOL before erosion of it begins under AS 43.55.165(p).

The other is that, under AS 43.55.165(o)(2), "a carried forward annual loss may only be applied…. (2) beginning in the calendar year in which regular production of oil or gas from the lease or property where the lease expenditure resulting in the carried-forward annual loss was incurred commences" (emphasis added). In other words, even though a producer might have

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[12] This is different from saying the carried-forward NOL decreases each year by 10% of its amount carried forward into eighth or eleventh year, when erosion begins. The latter would completely eat up that NOL after 10 years, but an annual decrease of 10% from the "preceding year" will not erode it completely. After 10 years, the remaining NOL would be 90% of 90% of 90% of 90% of 90% of 90% of 90% of 90% of 90% of 90% , or 34.867844%, of the amount carried into the erosion period.

production from a "category" due to well tests or something else, if it isn't in "regular production" the producer cannot start applying the carried-forward NOL against the GVPP of that production.

AS 43.55.165(r) provides: "For purposes of (o)(2) and (p) of this section, the Alaska Oil and Gas Conservation Commission ("AOGCC") <u>shall</u> determine the commencement of regular production" (emphasis added).[13] No one in DOR can make the determination; only the AOGCC can. AS 43.55.900(23), enacted last year by sec. 31, ch. 4, 4SSLA 2018 defines "regular production" as follows: "'regular production' has the meaning given in AS 31.05.170" and AS 31.05 is the chapter creating the AOGCC, giving it its powers, and authorizing its activities. Indeed, section 1 of HB 111 amends AS 31.05.030(n) as follows:

> "(n) Upon request of the commissioner of revenue, the commission shall determine the commencement of regular production from a lease or property for purposes of AS 43.55.160(f) and (g) **<u>and 43.55.165(o) and (p)</u>**. [original bold and underlining, indicating language being added by HB 111 to the statute]

Our major concern here is that <u>somebody</u>, DOR or the AOGCC, has to adopt a regulation to establish procedures for making these determinations about when-regular production commences. But it's not clear who will do it, or how — nor even, if they both take a shot at it, that their regulations would even be consistent, much less congruent in their details like deadlines for filing, etc.

For instance, when AOGCC looks AS 43.05, it sees only that it has to make a determination "[u]pon request of the commissioner of revenue[.]" Does this mean a taxpayer can request AOGCC to make a determination, or does it have to go through the DOR commissioner? It is quite possible that AOGCC will see this question differently from DOR. After all, AOGCC's only statutory duty is to respond to the commissioner. How or why the commissioner is induced to make that request is not really the AOGCC's business, so long as the commissioner is the one making it. But from DOR's point of view, would it really matter if a taxpayer makes the request directly to AOGCC and cc's the commissioner?

Similarly, who is going to set objective standards and criteria for determining what is, or is not, "regular production"? DOR might adopt a regulation setting standards and criteria that, if and when met, will cause the commissioner to make the request to AOGCC. But AOGCC, since its duty to make the determination arises under AS 31.05.030(n), might adopt a regulation setting different standards and criteria from DOR's.

What we are asking in this scoping process is for DOR, first, to approach AOGCC and jointly develop clear and objective standards about what "regular production" is for purposes of AS 43.55 and when it "commences." And second, for the two agencies to adopt their respective

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[13] The use of "shall" makes this mandatory. *See* Legislative Affairs Agency, *Legislative Drafting* (Juneau: 2017), 65:

> Use the word "shall" to impose a duty upon someone. The Alaska Supreme Court has stated that the use of the word "shall" denotes a mandatory intent. <u>Fowler v. Anchorage</u>, 583 P.2d 817 (Alaska 1978).

parts of a set of regulations – effective at the end of this year – that embody those standards and establish consistent procedures that can be followed in getting the matter before the AOGCC and decided in an efficient and timely fashion.

I. NOL Carryforwards — Ringfencing: Confirming that "Regular Production" has "Commenced" for Leases or Properties or Fields Already in Production and Establishing the Date of that "Commencement"

This is easy to overlook, but there a couple of issues that need to be addressed. First, as mentioned above, only for years after 2017 can a carried forward annual loss be used and only after the lease or property generating the carried forward NOL is determined to be in "regular production" and the definition of "regular production" was only enacted last year. The DOR and AOGCC need to clarify in their regulations how they intend to treat leases or properties which have been in commercial or continuous production prior to 2018. Would the operators of such producing leases or properties be required to seek determination by the DOR or AOGCC that those long-standing producing properties are in "regular production" for purposes of AS 43.55.165?

Secondly, if a currently producing field were to suspend production for some period of time for whatever reason, it should not lose its current "in regular production" status.

A wrinkle on this matter is, what if a field has been producing and has been reporting and paying state royalties and production tax on that oil and gas, but AOGCC sees the production as an extended period of "reservoir testing" (or something else similarly provisional or temporary in nature) and says the field hasn't yet started "regular production"?

No current producer should be prevented under AS 43.55.165(o)(2) from using its carried-forward NOLs from lease expenditures for a currently producing field because AOGCC hasn't made a determination of when "regular production" from it "commenced." It might be more efficient and practical if the DOR or AOGCC were to publish a list of all currently producing fields determined to be in "regular production" as of January 1, 2018, without the need for separate requests for such determinations or provide the operators of such fields with immediate determinations that fields are and have been as of January 1, 2018, in "regular production". Alternatively, a "grandfathering" regulation for currently producing fields would be a fair and proper step for DOR to take, and a necessary one.

J. Implementing AS 43.55.165(s).

AS 43.55.165(s) provides:

> (s) In adopting a regulation that defines the lease or property where a lease expenditure resulting in a carried-forward annual loss is incurred for purposes of (o) and (p) of this section, the department shall include a exploration lease expenditure that is reasonably related to the lease or property. [emphasis added]

We note first that DOR probably is not legally able to implement AS 43.55.160(o) or (p) fully without adopting the regulation required by -.160(s). In *United States Smelting, Refining, and Mining Co. v. Local Boundary Comm'n*, 489 P.2d 140 (Alaska 197), Justice Jay Rabinowitz wrote for the court:

> In our view the Local Boundary Commission has had sufficient time to discover sensible principles pertaining to the changing of local boundaries. Permitting continued failure on the commission's part to promulgate stands for changing local boundary lines can no longer be justified by the need for further experience. Since under AS 41.19.260(a) the legislature required the commission to develop standards in order to recommend boundary changes, and the commission had not developed standards prior to the Nome annexation proceedings, we hold that the commission lacked the power to recommend the Nome boundary change in question. To do otherwise would be to condone the commission's nonobservance of a valid legislative prerequisite to the exercise of the commissions' discretion in matters of local boundary changes. [emphasis added]

489 P.2d at 142 (footnotes omitted).

Here, as in *U.S. Refining*, the legislature in AS 43.55.165(s) has "required"[14] DOR to "include an exploration lease expenditure that is reasonably related to the lease or property[,]" and to do this, some kind of definition or set of objective standards and criteria are necessary to determine whether a lease is expenditure "is reasonably related" to a lease or property "for purposes of (o) and (p) of" AS 43.55.165. Otherwise, the Department will "lack[ ] the power" to implement subsections (o) and (p) fully and properly.

With respect to the substance of the regulation, probably the most important thing is to specify clear, objective standards and criteria for determining whether and how an exploration lease expenditure can "relate[s]" to a lease or property, and who and why it does so "reasonably."

CLOSING

Thank you for holding the Scoping Workshop and for allowing draft written comments like

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[14] "Shall" is mandatory. *See* note 15, *supra*.

these to be submitted by 4:00 o'clock today.

Very truly yours,

Kara Moriarty, President
Alaska Oil and Gas Association

cc: AOGA Tax Committee
AOGA Government & Public Affairs Committee

Alaskan Seismic Ventures, LLC
P O Box 876489
Wasilla, Alaska 99687

August 29, 2017

VIA EMAIL ONLY: john.larsen@alaska.gov

John Larsen
Alaska Department of Revenue
Tax Division
550 W. 7th Ave., Suite 500
Anchorage, AK 99501

Re: HB 111 regulations

Dear Mr. Larsen:

Thank you for soliciting comments regarding potential regulations needed to implement HB 111.

Alaskan Seismic Ventures, LLC (ASV) is a seismic data library company that obtains seismic data and offers it for license to the oil and gas industry in Alaska. ASV obtains the data through contractual arrangements through which it pays seismic contractors to shoot seismic in areas of interest for oil and gas exploration in Alaska and to then process the seismic data. Production tax credits under AS 43.55.023 and AS 43.55.025 have been essential to these exploration projects.

As I stated at the August 22, 2017 workshop, the secondary market for tax credits is incredibly important for all explorers, and it has become even more important over the last year due to insufficient appropriations for the purchase of tax credit certificates. The Department's Advisory Bulletins 2016-01 and 2017-01 have devastated the secondary market for tax credits, leaving explorers with few, if any, viable options to make use of the certificates to recover exploration expenditures. Further, ASV will never be an oil and gas producer and thus will not be able to use the credits against its own production tax liability.

The legislature passed sections 6, 9, and 16 of HB 111 specifically to counteract Advisory Bulletin 2016-01, by allowing tax credits and tax credit certificates to be applied against production tax liability from a previous year. If the Department interprets these sections as the legislature intended, to broadly allow tax credit certificates earned in one year to be transferred to a producer for use against taxes from prior years, it will mitigate the damage done by the 2016 Advisory Bulletin and help the secondary market. Accordingly, the Department should interpret these sections of HB 111 as liberally as possible in favor of the legislature's clear intention to support the secondary market for tax credits, subject only to the limitations of the Alaska Constitution.

By statute, in order to obtain tax credits, ASV is required to provide the seismic data it obtains through seismic exploration to the Alaska Department of Natural Resources. ASV has provided very valuable, high quality data and data products to DNR from seismic exploration on the North Slope and in Cook Inlet. This data was obtained at considerable expense to ASV and the seismic data products include some of the most technologically advanced and informative 3-D seismic data obtained in Alaska. By statute, DNR may publicly release the data after 10 years, and the value of the data to ASV will drop considerably at that time. ASV has upheld its end of this bargain—the state needs to do its part by either promptly appropriating enough money to the oil and gas tax credit fund to pay for all of the pending tax credit certificates, or by doing everything possible to protect and enhance the secondary market for tax credit certificates. Otherwise it is possible that the seismic data will become public before the tax credits are paid to ASV by the State,

I appreciate your attention to this request as the Department proceeds with regulations. Please contact me at 907.982.2019 if you have any questions.

Sincerely,

Bill Van Dyke
CEO

ConocoPhillips
Alaska

Marie P. Evans
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August 29, 2017

Mr. John Larsen
Audit Master, Department of Revenue
550 W. 7th Ave., Ste 1820
Anchorage, AK 99501

Re: Department of Revenue, Notice of Public Scoping & Workshop
15 AAC 05 Administration of Revenue Laws
15 AAC 55 Oil & Gas Production Tax & Oil Surcharge

Dear Mr. Larsen:

At the Department of Revenue ("Department") Public Scoping Workshop held on August 22, 2017 you encouraged participants to provide written comments. We appreciated the Department holding the Public Scoping Workshop and we submit this letter with comments and recommendations relating to potentially new regulations as well as amendments to existing regulations as a result of CCS HB 111 ("HB 111").[1]

Section 1 of HB 111 modified AS 31.05.030, a new subsection from CCS HB 247 ("HB 247"). Beginning with HB 247 the Commissioner of Revenue must request the Alaska Oil & Gas Conservation Commission ("AOGCC") determine "the commencement of regular production from a lease or property" if a taxpayer qualifies for a gross value reduction.[2] HB 111 extended this required request by the Commissioner of Revenue to the AOGCC if a taxpayer has a carry-forward annual loss where regular production of oil or gas had not commenced.[3]

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[1] On August 6, 2017 the Department of Revenue issued a Notice of Public Scoping and Workshop for Possible Updates and Revisions to the Department Regulations 15 AAC 05: Administration of Revenue Laws and 15 AAC 55: Oil and Gas Production Tax and Oil Surcharge.
[2] AS 43.55.160(f) and AS 43.55.160(g).
[3] AS 43.55.165(p) and AS 43.55.160(p).

Section 1 requirement in HB 247 and in HB 111 that the AOGCC makes a determination regarding regular production for gross value reductions and carry-forward annual losses was effective June 28, 2016 and July 27, 2017, respectively.

We recommend the Department provide guidance on who is responsible for communicating to the Department that a determination on regular production is needed and whether it pertains to a gross value reduction or a carry-forward annual loss. Is the operator responsible for gross value reductions? Is the taxpayer responsible for carry-forward annual losses? Alternatively, is the Department going to assume internal responsibility and notify the taxpayer that it plans to make the request of the AOGCC? A regulation or some form of guidance on the timing of carry-forward annual loss requests, irrelevant of who is responsible for initiating the process, would also seem prudent.

Sections 6, 9 and 16 of HB 111 modified the production tax specifically allowing for use of purchased tax credits in an effort to revive the secondary tax credit market. Since the secondary tax credit market was extinguished due to regulation[4] and Advisory Bulletins[5] existing regulations need to be modified, especially 15 AAC 55.335(g), to implement the legislative intent.

The Department explained in its Advisory Bulletin 2017-01,

> Taken on their own, or in combination with each other, and subject to the limitations of the statutes and regulations, tax credits under AS 43.55.023(a), (b), and (*l*), AS 43.55.024(a), (c), and (i), and AS 43.55.025, are not subject to the limitations of AS 43.55.011(f). In the absence of a credit under AS 43.55.024(j), all may be used to reduce a taxpayer's tax liability under AS 43.55.011(e) to zero.

Based on this Advisory Bulletin, if a taxpayer has per barrel tax credits, which came into statute as of January 1, 2014, then the taxpayer is prohibited from using other tax credits with the per barrel tax credits.[6] For the modifications in Sections 6, 9, and 16 to provide a secondary market, 15 AAC 55.335(g) and 15 AAC 55.375 must be modified to specifically allow per barrel tax credits to be used in concert with tax credits qualifying in Section 6, 9 and 16 of HB 111. Absent repeal or modification of existing regulation, the legislature's intent to revive the secondary market will have a limited life, if any at all.

Sections 25 - 29 of HB 111, at a high-level, create a carry-forward annual loss which is statutorily deemed a lease expenditure and rolled forward until it may be used. At the public workshop we discussed that unless a taxpayer has a carry-forward loss for the year in a category as defined at AS 43.55.160, it will not be subject to new

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[4] *See* 15 AAC 55.335(g).
[5] Advisory Bulletin 2016-01 and 2017-01.
[6] Nothing in AS 43.55 prohibits using the sliding-scale per barrel credits until the North Slope oil segment reaches the minimum calculation per AS 43.55.011(f) and then applying tax credits that may reduce the tax liability to zero.

subsections at Sections 26, 27, 29 of HB 111. Assuming a taxpayer's annual production tax value calculated by category under AS 43.55.160 does have "excess lease expenditures" creating that carry-forward annual loss we recommend the Department consider providing guidance as follows:

Section 28 of HB 111 creates AS 43.55.165(o)(2) stating that "[a] carried-forward annual loss may only be applied...(2) beginning in the calendar year in which regular production of oil or gas from the lease or property where the lease expenditure resulting in the carried-forward annual loss was incurred commences."

Example 1. Using a simple example, assume the taxpayer has working interests in multiple producing units on the North Slope, all units had commenced regular production, estimated monthly payments were timely made based on positive production tax values. Due to a low price in December and high lease expenditures, the taxpayer ends up with a negative production tax value for the North Slope oil category of $16 in December and a full year carry-forward annual loss of $5.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual Return
Gross Value at the Point of Production	19	19	19	19	19	19	19	19	19	19	19	2	211
Lease Expenditures	18	18	18	18	18	18	18	18	18	18	18	18	216
PTV by Month	1	1	1	1	1	1	1	1	1	1	1	-16	
Year-to-Date PTV	1	2	3	4	5	6	7	8	9	10	11	-5	-5

- Since the $5 carry-forward annual loss was in the North Slope category with all properties commencing regular production, then does the identity of the lease or property matter "where the lease expenditure resulting in the carried-forward annual loss was incurred"?

- With production tax being an annual tax how is it possible to determine which lease expenditure resulted in exceeding the production tax value? Does the taxpayer assume the last lease expenditure incurred for the tax year is the excess lease expenditure?

- How does the requirement to smooth lease expenditures impact the answers to the above questions?

Example 2. Assume the same as Example 1, except the taxpayer has leases or properties or a unit that does not have regular production and some leases or properties or a unit that do have regular production.

- If expenditures were made for both regular producing and irregular production leases or properties, is the $5 carry-forward annual loss somehow attributed to a lease or property without regular production?

- If no expenditures were made in the tax year relating to the lease or properties without regular production it seems reasonable to assume the $5 carry-forward annual loss only pertains to leases or properties with regular production?

- If a taxpayer has more than one non-producing lease or property should the taxpayer choose to allocate the carry-forward annual loss equally or select a different method?

We recommend the Department hold another public workshop to review the draft regulations prior to formally noticing the regulations. This allows a dialogue between the taxpayers and the Department so the taxpayers understand the intent behind the proposed regulation and then the taxpayers may provide feedback as to whether the proposed regulation is helpful or why it may need revision.

We understand the Department's concern that the short timeline makes a public workshop with draft regulations challenging. As an alternative, we recommend the Department post sections of the draft regulations on their website and allow the public to provide written comments. Both the Department and the taxpayers benefit from an iterative process because it allows for knowledge sharing and mitigates misinterpretations.

Finally, rather than increasing the complexity of this production tax and its compliance, we ask the Department to strive for simplicity in developing regulations. If the Department would like to discuss the above recommendations, please feel free to contact me.

Sincerely,

Marie P Evans

Marie P. Evans

Scoping Work for HB 111
Dan E Dickinson
Aug. 29, 2017

The following issues were raised on the August 22 scoping meeting. In general I am not raising issues already raised by AOGA.

1. Can costs incurred between July 1 and December 31 2017 generate a tax credit certificate purchasable by the state?

At the scoping meeting the DOR requested examples that would illustrate this issue.

Consider an explorer that incurs $10 million dollars in costs in December of 2017 preparing to drill on the North Slope in the 2017-2018 drilling season. The explorer has no other costs during the year, and would generate a loss credit of $3.5 million dollars ($10 million times 35%).

New HB 111 language in AS 43.55.028(a) states that money in the 028 "fund ***MAY NOT*** BE used to purchase a tax credit certificate for a credit earned… for activity occurring on or after July 1, 2017." New language in AS 43.55.028(e) adds the positive: that available money can be used to pay for 023 or 025 certificates issued for "an expenditure incurred before July 1, 2017."

Those provisions would seem to be clear, and the $3.5 million credit in this example would not purchasable.

However the uncodified law at section 38 reads that "***Notwithstanding*** … AS 43.55.028(a) and 028(e) as amended, a taxpayer may apply …. for a transferable tax credit certificate … for the entire amount of the credit earned during calendar year 2017. However, the department may not purchase more than half….

If this section of the statutes prevails, and cancels out the proscriptions found in amended AS 43.55.028(e) and (e), then for this example, a credit of $1.75 (Half of $3.5 million) would be purchasable.

Regulations would be important here to indicate whether the amount of credit that can be purchased in this example would be $1.75 million or Nil.

2. Does HB 111 remove the 20% limitation on use of purchased AS 43.55.023 Credits if applied against obligations (1) in years after the initial application and (2) arising from prior calendar years?

Example: I have $10 of liability for a series of calendar years and purchase a certificate with a face value of $10 issued that year.

Under AS 43.55.023(e)(1) I can use $2 of that credit for that year. May I then use the entire $8 in the next year? Or only an additional $2?

Under AS 43.55.023(e)(2) If I have not paid already, I can use that $10 certificate to pay the prior years tax?

(3) Resident Workforce Issues?

Finally, much of the regulatory framework pertinent to Resident Workforce Percentage was added after the release of the preliminary regulations: The department certainly has the authority to do so, but it missed an opportunity to gain feedback from those affected by the rules. Clarifications of the following would be very helpful to those trying to abide by the new rules. In particular this is a unique situation because each taxpayer is affected not only by its own filings: but the filings of others, as those filings are used to rank the taxpayers. If I have a rank of 75%, and another taxpayer can chose between two sets of data that moves its percentage from 74% to 76 %, that change affects the order in which we get paid. So the first question that the regulations could explain is how the department is going to react to filings, and make corrections. Will it require new information form taxpayers? Will it make corrections on its own? Will it simply reject percentages and substitute zero?

Year

It appears that the pertinent year is the year prior to the actual allocation being made: the legislature was interested in the status of recipients at the time payment was about to be made. This year has not yet been reached. Thus the department's regulations tying the rank to the year when the work was performed seems inappropriate.

Because of the use the singular "year" in several places there was clearly a focus on AS 43.55.023 applications, which are limited to a single year. However, there remain a number of outstanding AS 43.55.025 certificates that the investing companies hope will be issued in 2017 – It is clear from public accounts that these include projects undertaken during the 2015-2016 drilling season, with costs incurred in both years. This is more evidence that the legislature was not looking at the "years" in which the work was performed. It also presents a quandary for those that receive AS 43.55.025 certificates for multi -year work (as several entities hope to do in 2017).

The direct work force.

The regulations could clarify that the only people the state are interested in are employees (in the W-2 sense) and direct contractors (in the 1099 sense). This is important because it is some what counter-intuitive: In fact, given work patterns in the state, on any given project, the largest number of individuals are probably self-employed, but under contract to a contractor. Thus the largest number of individuals working on a project would fall outside the test.

The current application process does not allow for any weighting: What about the distortion of having over 100 people submit time on a project, but over half have less than 5 hours, while several have a thousand plus hours. Is it appropriate that each is treated the same?

The regulations appear to focus on an operator. What about non-operators that can't get the appropriate information from their operator?

If a large contractor is hired, is that contractors overall percentage in the state the appropriate measure to use, or the residency status of the individuals working for that contractor that provide service to the applicant>

December 31,
What does the "as of December 31 in 15 AAC 55.280(g) mean? Does it restrict the test to people working on that day? To people present in Alaska on that day, but provided work in the year (or in the application for an 025)? Or does it just mean for people whose residence status is changing that it is there residency as of that day that matters. Or does it mean something else?

Thank you for your consideration of these matters.

LEADER in All We Do

DOYON Limited®

August 29, 2017

VIA EMAIL: john.larsen@alaska.gov

John Larsen
Alaska Department of Revenue
550 West 7th Ave., Suite 500
Anchorage, AK 99501

Re: Comments for regulations regarding HB 111

Dear Mr. Larsen,

Doyon, Limited ("Doyon") is submitting these comments regarding changes to the oil and gas production tax regulations in 15 AAC 55 that may be required as a result of the passage of House Bill 111 ("HB 111"). These comments are in response to the notice that the Department of Revenue ("DOR") published on August 6, 2017.

Doyon is the state-chartered Alaska Native Claims Settlement Act regional corporation for Interior Alaska. Doyon has over 19,500 shareholders, most of whom reside within Alaska. Doyon is the largest private land owner in Alaska, and one of our highest priorities is the continued exploration for oil and gas resources on state-owned lands in the Minto Flats/Nenana Basin, as well as on Doyon-owned lands near Stevens Village.

The structure of the Alaska oil and gas production tax is critical for the exploration and development of areas of the state sometimes referred to as "Middle Earth," which encompasses all areas of the state south of the North Slope and outside of Cook Inlet. Middle Earth includes the Nenana Basin and Yukon Flats in central Alaska where Doyon holds oil and gas interests, including several hundred thousand acres of state leases. Middle Earth also includes Kotzebue, Copper River, Bristol Bay, and the Aleutians.

Currently there is no oil and gas production in Middle Earth and the prospective basins are unexplored or underexplored. Federal and state studies indicate that many of the basins in Middle Earth are highly prospective areas for oil and gas. Some areas are near infrastructure and could be quickly developed to bring oil and gas into production in the near future. There are great opportunities for major oil and gas discoveries that could accelerate economic development and provide jobs, local sources of gas to communities, revenues from royalties, lease rentals, and taxes, and also valuable well and seismic data.

There are Middle Earth projects that are moving forward and the structure of the production impacts these projects and the appetite for investment in them. Doyon has drilled three wells showing oil and gas, and shot seismic in the Nenana Basin and Yukon Flats. Doyon has advanced its projects from unknown to the demonstration of an active hydrocarbon system. These prospects are roughly 40-60 miles from the Trans-Alaska Pipeline and the likely route of a major gas line, and can provide gas to Fairbanks. These projects are already spurring economic development and providing revenue to the state and localities - Doyon has paid the state millions in lease rentals over the last several years.

The oil and gas production tax—and the regulations that implement it—directly impact Middle Earth exploration and development. Doyon' s comments regarding potential regulations to implement HB 111 are below.

Preservation of the Market for Tax Credit Certificates: Sections 6, 9, and 16

The secondary market for tax credit certificates under AS 43.55.023 and AS 43.55.025 is critically important for exploration and development in Middle Earth. The governor's 2016 veto of all but $33 million of the legislature's proposed budget for purchase of tax credit certificates, and this year's appropriation of only $77 million, have dramatically impacted the economics of oil and gas exploration and development and dampened interest in investment in Alaska. If funding for the purchase of credit certificates continues at the minimum calculated under AS 43.55.028, many years will pass before the companies that invested in exploration and development receive these rebates. Accordingly, the ability to sell credits to producers has become vital for continued exploration and development, and as a means to reduce the state's liability for tax credit certificates.

In December of 2016, DOR issued Advisory Bulletin 2016-01 to preclude the application of tax credit certificates under AS 43.55.023 and AS 43.55.025 against production tax liability from a prior year. This resulted in a dramatic contraction of the secondary market for tax credit certificates. The legislature took action against the Advisory Bulletin through sections 6, 9 and 16 of HB 111. These sections would allow tax credits and tax credit certificates under AS 43.55.023 and AS 43.55.025 to be applied against taxes and other charges under AS 43.55 for a prior year as long as the charge "has not, for the purpose of art. IX, sec. 17(a), Constitution of the State of Alaska, been subject to an administrative proceeding or litigation."

In implementing sections 6, 9 and 16 of HB 111, DOR must recognize that it was the legislature's intent to overrule the Advisory Bulletin to allow tax credits—and certificates for them—to be applied against production taxes from prior years, as long as the credit certificate is not applied against an amount that would be required by the Alaska Constitution to be deposited in the Constitutional Budget Reserve. DOR should respect the intent of the legislature to allow tax credits and credit certificates to be freely applied to taxes from prior years, subject only to the constitutional limitation.

In addition, DOR should recognize that interpreting these sections of HB 111 in favor of the use of tax credits and credit certificates benefits the state's fiscal health. These outstanding tax credit certificates represent a liability for the state and an impediment to investment in Alaska. Addressing that concern through meaningful reductions in that liability will help exploration and development and the Alaska economy, and will help mitigate the damage that has been done to investment through the failure to meaningfully fund the purchase of tax credit certificates over the last two years.

Conditional Tax Credit Certificates: Section 19.

Section 19 HB 111 would allow an explorer to obtain a conditional tax credit certificate under AS 43.55.025 for expenditures incurred before July 1, 2017. The conditional certificate may be used to apply for purchase of a tax credit certificate under AS 43.55.028(e), effectively as a "placeholder" in the purchase queue subject to issuance of the actual tax credit certificate. HB 111 does not delineate how this section is to be implemented, and thus the regulations should provide clear rules regarding how conditional certificates will be treated vis-a-vis each other and other certificates already in the purchase queue. For instance, will there be a preference within a given calendar year based on the date the conditional certificate is issued? Also, do the criteria applicable to other applications for purchase apply equally to conditional certificates? One particularly complex subject is the preference for applicants with a higher percentage of resident workers, and DOR should clarify how that applies to conditional certificates, including whether the point of reference for the calculation is the year preceding the issuance of the conditional certificate versus the actual certificate.

Assignment of the 2017 Loss Credit: Section 22

Section 30 of HB 111 repeals the carried-forward annual loss credit under AS 43.55.023(b) ("Loss Credit") effective January 1, 2018. The transition language in section 39 makes it clear that the Loss Credit and certificate for it are still available for losses incurred in 2017.

Tax credit certificates can be assigned pursuant to AS 43.55.029 to serve as collateral and/or sources of payment in financings and other commercial transactions, and Section 22 of HB 111 makes a change to AS 43.55.029(a) to conform to the repeal of the Loss Credit. This change is a simple deletion of the reference to the Loss Credit and it is also effective January 1, 2018, per section 47. However, under AS 43.55.029(a), the assignment of a credit certificate may be made when the credit application is filed, or within 30 days thereafter. On its face, this appears to create a timing issue because the Loss Credit is calculated based on costs incurred in the calendar year, and the regulations at 15 AAC 55.320(a)(2) provide that an application can be filed no earlier than January 1 of the year after the year of the loss. In other words: (i) the 2017 Loss credit can be filed as early as January 1, 2018; (ii) under AS 43.55.029, a credit certificate cannot be assigned before it is filed; and (iii) the conforming change deleting the reference the AS 43.55.023(b) in section 22 is effective January 1, 2018.

We do not believe that the Legislature intended to repeal the ability to assign the certificate for the 2017 Loss Credit and suspect that the interface between these provisions was not considered in the drafting process.

Purchase of 2017 Credits: Sections 20, 21 and 38

Section 20 of HB 111 provides that the AS 43.55.028 oil and gas tax credit fund cannot be used to purchase a certificate "for a credit earned under this chapter for activity occurring on or after July 1, 2017." However, section 21 provides that DOR may purchase a tax credit certificate "for an expenditure incurred before July 1, 2017." DOR should interpret these sections consistently through regulation, and preferably based on when a cost is incurred, akin to 15 AAC 55.290.

Clarification is also warranted in regard to the interaction between sections 20 and 21 on one hand, and section 38 on the other. Section 38 provides that DOR may not purchase more than half of a tax credit certificate for the Loss Credit earned in 2017. Given that section 38 applies exclusively to the Loss Credit, perhaps it is intended to override sections 20 and 21 in that regard. In any event, the implementation of these provisions could have dramatically different impacts on credit applicants, depending on when costs are incurred during a calendar year.

It is also unclear how HB 111's mid-year repeal of the ability to obtain rebates under sections 20 and 21, and the transition language in section 38 regarding the rebate for the Loss Credit, impacts the assignment of credit certificates under AS 43.55.029 for costs incurred in 2017. Given that the assignment statute is linked to the purchase of credit certificates under AS 43.55.029(a) and (b), it makes sense to allow the portion of the certificate that can be purchased to also be assigned under AS 43.55.029.

Thank you for considering these comments.

Best regards,

James Mery
Senior Vice President
Lands and Natural Resources

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VIA EMAIL: John.Larsen@alaska.gov

John Larsen
Alaska Department of Revenue
550 W. 7th Ave., Suite 500
Anchorage, AK 99501

Re: Response to HB 111 regulations scoping notice

Dear Mr. Larsen,

Kuukpik has partnered with contractors for seismic work in Alaska over the last twenty years. The Kuukpik-SAExploration joint venture employs 400 people, and is a consistent revenue source for Kuukpik Corporation, the village of Nuiqsut, and hundreds of Alaskan families. SAExploration and Kuukpik Corporation jointly submit these comments in response to DOR's request for comments on possible regulations for HB 111.

Seismic acquisition creates good jobs for Alaskans, and the seismic data benefits the State of Alaska. Oil and gas companies use the data to develop prospects and drill wells, which can lead to discoveries and production. The state (DNR) gets seismic data to evaluate and administer oil and gas resources as well as for lease sales.

To obtain tax credits, seismic explorers must shoot the seismic, process the data and provide a copy of the data to DNR. The tax credit will not be issued until DNR accepts the data, which will become publicly available 10 years later, encouraging additional exploration.

The commercial arrangement manifested by the tax policy has been that the state invested in the project through tax credits. If the shoot is a speculative survey for sale to the industry, the state receives tax credit refunds on every sale of the data. This is analogous to building a road and then splitting the proceeds from a toll. The state pays its share of the road work, and then recovers costs through the tolls.

The seismic industry has kept its part of the deal. We have shot the seismic, delivered the data to the state—and ultimately the public, and made it available for sale to the oil and gas companies. Yet over the past two years the State of Alaska has withheld payment on refundable tax credits. This forced SAE to restructure, and Kuukpik has deferred shareholder payments.

Seismic explorers need state payment of tax credit certificates or a secondary market for tax credits because they will never produce oil and use certificates against production taxes.

HB 111 changed the production tax specifically to revive the secondary market through sections 6, 9, and 16, such that all or a portion of a tax credit or credit certificate may be used against production taxes from a prior year, subject to the Alaska Constitution. Thus, the Alaska Legislature has shown a clear intention to preserve and expand the secondary market for tax credits. DOR must honor this intent and any regulations or interpretation should not run contrary to making the secondary market as robust as possible.

Through Advisory Bulletins 2016-01 and 2017-01, DOR interpreted its regulations in ways that effectively extinguished the secondary market. The legislature intends to revive that market, so regulations must be promulgated or modified, including 15 AAC 55.335(g) and 15 AAC 55.375, to implement legislative intent. For sections 6, 9, and 16 of HB 111 to provide a secondary market, taxpayers must be allowed to use the sliding scale credit under AS 43.55.024(j) in conjunction with tax credits qualifying for use under sections 6, 9, and 16, such that the AS 43.55.025 and AS 43.55.023 credits that qualify under those sections can be used to against the minimum tax calculated under AS 43.55.011(f). Otherwise, the legislature's intended revival of the secondary market will be limited at best.

We strongly suggest that DOR hold another workshop to allow dialogue between the industry and DOR before the formal notice period. This would facilitate common understanding of the regulations, feedback, and would likely result in a product that is more aligned with legislative intent.

The secondary market for tax credits is vital to the health of Alaska's oil and gas industry. The regulatory language needs to emulate the intent of the legislature, provide clarity and restore the confidence eroded by the Advisory Bulletins 2017-01 and 2016-01 to those tax payers and certificate holders willing to participate in a secondary market for the purchase of transferable credits. Any constriction of that market will result in further lost investment and more lost jobs for Alaskans. We urge you to consider and act on these comments.

Best regards,

Jeff Hastings

Jeff Hastings
Chairman/CEO
SAExploration Inc.

ALASKA STATE LEGISLATURE
SENATE RESOURCES COMMITTEE

SEN. CATHY GIESSEL
Chair
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August 29, 2017

To:
John Larsen,
Audit Master, Tax Division
Alaska Department of Revenue

From:
Senator Cathy Giessel, Chair
Alaska Senate Resources Committee

Mr. Larsen,

The purpose of this communication is to affirm the intent of legislators such as myself who participated extensively in the crafting of House Bill 111. That legislation is now law, and your Department is in the process of creating the regulations to implement its provisions. My intent is to give your personnel the perspective that is corroborated in the legislative record on the following aspects of the legislation, as well as the intent of lawmakers that I understand was behind various aspects of the law.

Credits Used Against Past Liabilities

The intent of putting several sections in House Bill 111 to use credits against a liability incurred in a prior year was clear: so long as there was not a trigger requiring those moneys to go to the Constitutional Budget Reserve, a newly discovered liability could be satisfied with a qualified credit, either earned or purchased. The legislature intended to preserve the secondary market for transferable (by way of purchase) credits. Given the volatility since 2015 for reimbursing credits through the state, lawmakers who inserted these provisions wanted to create more avenues for those credits to have value, and to simultaneously wind down the backlogged balance of unreimbursed credits.

Trigger of Provisions on Losses

Throughout the hearings and discussions on the various provisions of House Bill 111, it was clear that provisions in the bill would be triggered only if a taxpayer entered a loss position. Our clear understanding was, since a taxpayer files an annual, segment wide tax, provisions such as ring-fencing and loss erosion over time in House Bill 111 would take effect only in the instance of a taxpayer's reported annual loss for the segment.
The concerns from the legislature were that, if a taxpayer were allowed to enter a loss position segment wide without any actions by the state to incent activity, there was not sufficient impetus to develop leases.
This was clear when discussing the "ring fencing" provisions of House Bill 111. There was clear discussion whether the language should create smaller segments for tax purposes if specific leases were at a loss but other leases had a positive production tax value (PTV). The record shows that, as long as the taxpayer had a positive segment PTV, and did not report a segment loss, provisions such as ring fencing did not apply to that taxpayer.
The intent of the legislature was that the triggering effect for provisions such as ring-fencing, and the erosion of the value of carried forward lease expenditures, would only take effect in the event of an annualized negative segment-wide PTV.

Election of Carried Forward Lease Expenditures

The intent of the legislature in amending AS 43.55.165 to establish a carried forward annual loss was to give discretion to the taxpayer to apply those losses in a year and manner the taxpayer decided. Other provisions that amended AS 43.55.165 instituted a time before the value of the losses began their erosion, as well as inherently hardened the minimum tax for losses accrued on non-Gross Value Reduction (GVR) leases.
Given the substantive changes to the value of losses, the legislature's intent was to give the taxpayer the ability to realize as much value to their recovery as the taxpayer saw fit. The intent of the legislature was for the Department of Revenue (the Department) to not restrict neither the manner nor the amount of losses applied.

Division of Losses for 2017, and Ending of Cash Credits for Work after July 1, 2017

The legislature clearly intended to end the cash credits for qualified work committed after July 1, 2017. However, ending the program mid-year posed an issue for the existing Net Operating Loss Credit (AS 43.55.023(b)), which would not be repealed until January 1, 2018, and is calculated on a yearly basis.
The intent of the legislature was the following: for credits other than the Net Operating Loss, any qualified work committed before July 1, 2017, is to be available for cash reimbursement. For the Net Operating Loss, 50% of the 2017 NOL was available for cash reimbursement, and 50% was not.

Given this unique situation, and that it would only apply in calendar year 2017, the legislature inserted transition language to accommodate the interaction of these different provisions of law.

I hope these clarifying remarks assist you and the Department in the formulation of the regulatory package. After reviewing the feedback from the Department's workshop on August 22, I respectfully recommend the Department consider additional rounds of communication between stakeholders and Department personnel.

A large part of the deliberations and testimony on House Bill 111 centered around clarity of the interpretation on its provisions and execution. I believe, even given the compressed timeframe you and Department personnel are under, would benefit from a longer period of dialogue on some areas related to the provisions in House Bill 111.

Should you or any members of the Department feel it beneficial to meet and discuss the questions about legislative intent, I would look forward to such a meeting.

Thank you for your service to the State of Alaska.

Respectfully,

Cathy Giessel

Senator Cathy Giessel, Chair
Alaska Senate Resources Committee

Alaska State Legislature

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REPRESENTATIVE PAUL SEATON
Rep.Paul.Seaton@akleg.gov

August 15, 2017

Alaska Department of Revenue
550 W. 7th Ave., Suite 500
Anchorage, AK 99501-3555

To Whom It May Concern,

I am writing to comment on the changes created by HB 111 to AS 43.55.165, specifically the addition of subsection (p). HB 111 was a compromise product, but I believe that the statutory language of this section that resulted from the last negotiated compromise does not fully accomplish the intent of the section.

This section creates an annual decrease in the value of a carried forward annual loss if the company does not use those carried forward losses within a certain amount of time from the year they were first incurred and further differentiates between projects that are and are not in production. The intention is to incentivize timely production and ensure a company does not hold onto carried forward losses, which represent a potential state liability, for an unlimited amount of time.

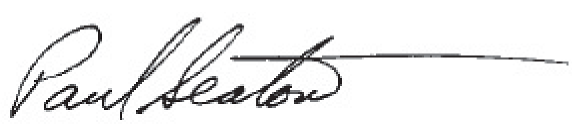
This section was based on language in HB 111 L.A as it passed the House. In version L.A, section 27 AS 43.55.165 (m) stated that on the eighth year after the expense is incurred the carried forward loss shall decrease in value each year by **10% of the amount carried forward in the first calendar year**. The result of this language was that if the company did not use the carried forward loss, at the end of 10 years of this annual decrease in value the value of an unused carried forward loss will have decreased to zero. This was part of the intent of this section, to remove the potential state liability of a carried forward loss from the books if it is not used within a certain amount of time. Draft compromise versions of HB 111 which were shared between the House and Senate negotiators included this same language of 10% of the amount carried forward in the first year, although other portions of the section were adjusted to allow for a later start to the value decrease and to differentiate between producers and non-producers.

However the language included in the final version annually decreases the value of the carried forward loss by **10% of the preceding year**, not by 10% of the first year. At the very end of the negotiations the point was made that under the original language, a company may have used up most but not all of their carried forward losses prior to the year when the decrease began, indicating that they were acting in good faith and bringing the project into production in a timely manner but simply did not have enough liability to use up the full amount. In this scenario it would be possible that decreasing the value by 10% of the *original* carried forward amount would remove all of the remaining value in one year, even if the company was actively looking to use the credits as soon as possible. The new language of **10% of the preceding year** addressed this issue. However an unintended consequence of this language is that though the value of the carried forward loss will diminish by 10% each year it will never be gone completely; there will always be 90% of the previous year's value left.

This was not the original intent of this section and causes two main issues. First, it means that a potential state liability can remain on the books indefinitely until the company decides to use it. Second and more importantly it might allow a company to hold on to an expense related to a specific project for an unlimited amount of time; although that value would get smaller it would never be gone completely. My concern is that since carried forward losses are now ring-fenced, meaning that the loss can only be used against that project until that project is brought into regular production, this carry forward loss value no matter how small might be considered a taking if the state tried to reclaim a lease from a company that was not developing it. In this situation, a carried forward loss of de minimis value could potentially allow a company to hold on to a state lease for 30 years without development towards production without the state being able to take action. Such consequences were not discussed when this provision was revised in the final negotiations.

A solution which would acknowledge the concern that prompted the language change but that would remove the risk of an indefinitely lasting carry forward would be to keep the language of **10% of the preceding year** but add regulatory clarity that after 10 years of this diminishing value the remaining value of the carry forward is reduced to zero. This would meet the original intent of this section. If this clarification is not possible through regulation alone, I request that the Department of Revenue and the Department of Law report to the working group established by HB 111 on the potential legal implications of this section and suggested statutory corrections.

Sincerely,



Rep. Paul Seaton

Rep.Paul.Seaton@akleg.gov