Alaska Oil and Gas Association

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TESTIMONY OF THE ALASKA OIL AND GAS ASSOCIATION AT THE PUBLIC HEARING ON PROPOSED REGULATIONS IMPLEMENTING CHAPTER 3, SECOND SPECIAL SESSION LAWS OF ALASKA 2017 ("HB 111")

OCTOBER 17, 2017

Good morning. My name is Kara Moriarty and I am president of the Alaska Oil and Gas Association, or "AOGA." For nearly half a century AOGA has been the trade association of the petroleum industry in Alaska, and our members actively continue to explore for, discover, develop, produce, transport, and refine oil and gas in the state. As with our comments ("Scoping Comments") submitted in response to the August 6th "Notice of Public Scoping and Workshop" on regulations to implement HB 111, all of our members have had the opportunity to review and comment on this testimony as it was being developed, and it has been approved without dissent.

Our testimony today addresses the proposed regulations for HB 111 at a broad level, and for the Department's convenience, I am submitting for the record the written text of this testimony. However, we reserve our right to submit a more detailed and technical review in written comments by November first.

The most salient feature of HB 111 is its phase-out and termination of most of Alaska's present system of tax credits, including all credits and credit certificates that can be cashed out with funds from the Oil and Gas Tax Credit Fund under AS 43.55.028.

We would like to begin our discussion on a positive note by observing that the proposed regulations appear to respond appropriately to four concerns that we raised in our Scoping

Comments. First, proposed 15 AAC 55.365(e) correctly resolves a potential technical timing problem in HB 111 and avoids a result that the legislature manifestly did not intend with respect to the ability to assign tax credits generated under AS 43.55.023(b) for calendar year 2017.

Second, our Scoping Comments expressed concern that the regulations on ring-fencing of lease expenditures incurred for a lease or property before it begins regular production might define "category" in a way that does not match the categories set out in AS 43.55.160(a)(1)(A)-(G) and (h)(1)-(4) . The proposed regulations do not seek to ring-fence such lease expenditures in this way.

Third, we were concerned in the Scoping Comments that statutory language in Sections 6, 9 and 16 of HB 111 might be construed and applied in the regulations differently from what Article IX, section 17(a) of the Alaska Constitution requires and could thereby prevent the carryback of credits against an increase in tax liability for a prior year arising from administrative proceedings or litigation that does not directly involve the production tax itself, but involves only indirect matters like transportation costs that affect the calculation of the amount the tax liability for the respective prior year. The proposed regulations — and 15 AAC 55.305(c) and (d) in particular — do not seem to construe and apply that statutory language in this way. In particular, Example 1 in subsection (d) refers specifically to "a decision of a regulatory agency that results in a retroactive change to costs of transportation that has a corresponding increase on the production tax value[.]" We see this as applying, for instance, to FERC's Opinion 544 for TAPS, and would like to confirm this on the record, if we may. So, let me ask, does the Department agree that Opinion 544 would be covered by Example 1 for taxpayers with open, unaudited tax years to which Opinion 544 (or FERC orders pursuant to Opinion 544) apply? You needn't answer right now, but if you answer after this hearing, please do so in writing so I can distribute it verbatim to AOGA members.

Fourth, in Example 2 in our Scoping Comments, we showed how a net operating loss for any given period is a function of both the amount of lease expenditures incurred in that period, and the level of oil prices for that period. In that example, there was no operating loss in the first half of the year even though the great majority of the year's lease expenditures were incurred then, because oil prices in the first half were high enough to cover those costs with a little net revenue left over; and in the second half of the year oil prices were so low that, even with lease expenditures at a much lower level than the first half, there was an operating loss in the second half that was big enough to put the entire year into a net loss position.

For 2017, proposed 15 AAC 55.525(m) seems to deal specifically with this by limiting purchases by the Tax Credit Fund for a certificate issued under AS 43.55.023(d) for an operating loss "under AS 43.55.023(b), as the provisions of that subsection read before January 1, 2018, for lease expenditures incurred in 2017." Only "one half of the amount of [the] tax certificate" may be purchased by the Fund.

We understand this to mean, as it is put into operation, that any net operating loss under AS 43.55.023(b) is determined for the full year of 2017, but only half of the tax certificate under AS 43.55.023(d) for that loss can get paid from the Fund. And the second half of the lease expenditures reflected in the certificate will not carry forward as a carried-forward annual loss into 2018 because they are already included in the certificate. If this is indeed the operational effect of 15 AAC 55.525(m), then this neatly avoids all the analytical complexities, paradoxes and inequities that our Example 2 illustrates if one were to try instead to quantify the first-half loss for 2017 purely on a stand-alone basis. Of course, if we are incorrect about how 15 AAC 55.525(m) will work in practice, then it needs to be rewritten so it is clear about how it works.

By noting these positive aspects of the proposed regulations, we are not saying they are free of errors, problems and questions.

For example, we are concerned about the last sentence in 15 AAC 55.305(c) regarding the assessment of penalties. By its terms this sentence applies only to a situation where "a producer under reports tax due on its original return in order to file an amended return and carryback tax credits [to that tax year.]" Does this mean the Department cannot assess any of the listed penalties when the underreporting was <u>not</u> made "to file an amended return and carryback tax credits [to that tax year]" even though there is another ground for assessing such a penalty? We doubt the Department intends that; but if a penalty <u>can</u> be assessed on one of those other grounds in such a situation, then we don't see what this last sentence in subsection (c) accomplishes — isn't such a purposeful underreporting in itself already "civil fraud, failure to pay, or negligence or intentional disregard"? If so, then the last sentence is unnecessary.

Alternatively, if somehow such a purposeful underreporting in order "to file an amended return and carryback tax credits" is not already "civil fraud, failure to pay, or negligence or intentional disregard" in itself, then the regulation needs to identify what the taxpayer's specific intent for the underpayment must be in order for it to fall within the scope of the last sentence in -.305(c) but outside the existing scope of the other penalties for "civil fraud, failure to pay, or negligence or intentional disregard[.]" Basic principles of equity and Due Process require that, if a taxpayer can be punished for having such an intent, it must be aware of what that intent is.

Another issue we have with 15 AAC 55.305(c) is that its first two sentences both allow the carried back credit to be applied only against "the additional amount of tax and associated interest." However, AS 43.55.023(c)(3), 43.55.023(e)(2) and 43.55.025(h) as respectively enacted in Sections 6, 9 and 16 of HB 111 all provide that the credit "may … be used to satisfy a tax, interest, penalty, fee, or other charge[.]" By excluding any "penalty, fee, or other charge[]", the proposed regulation is inconsistent with its underlying statute and, at least to that extent, would be invalid under AS 44.62.030. There is a parallel problem with 15 AAC 55.370(e).

A third concern with 15 AAC 55.305(c) is the following sentence in it, which appears near the middle of page 5 of the Proposed Regulations:

> A producer that elected to apply the tax credit in AS 43.55.024(j) in that prior year may, in its amended return reporting the additional amount of tax, withdraw the producer's application of THE tax credit in AS 43.55.024(j) in order to carryback a tax credit under AS 43.55.023 or 43.55.025 or a tax credit certificate under AS 43.55.023 or 43.55.025 for application against the additional amount of tax provided no claim for refund would result and no assessment has been issued by the department for the prior year. [emphasis added]

Our concern with the "THE" that is emphasized with capital letters in the written text of these comments is that it implies that only the entire amount of the sliding-scale credit under AS 43.55.024(j) may be "withdraw[n]" — that is, it is an all-or-nothing proposition for such a withdrawal.

AS 43.55.024(j) says categorically that a “producer may apply” these credits without limitation, except they “may not reduce [the] producer’s tax liability for a calendar year under AS 43.55.011(e) below the amount calculated under AS 43.55.011(f).” This does not allow any leeway for the Department, by regulation, to limit or restrict the use of these credits any further as proposed in 15 AAC 55.305(c).

Alternatively, if any withdrawal of a credit under AS 43.55.024(j) is allowed at all, we believe only the portion of the credit that brought the tax under AS 43.55.011(e) down to the minimum tax under AS 43.55.011(f) should be withdrawn, so that — in the event the Department on audit raises the production tax value above the crossover point where the minimum tax becomes payable — any initially unused portion of that credit remains available to reduce the tax under the audit back down toward that crossover point. Otherwise the Department will be taking away part of the credit to which the producer is statutorily entitled.

Similarly, if the audit increases the gross value at the point of production so that the per-barrel amount of the credit under AS 43.55.024(j) is greater than the per-barrel amount that the taxpayer filed, this increase in the credit should also be applicable — the same as any initially unused portion of the original per-barrel amount — to reduce the tax down toward the statutory crossover point where minimum tax becomes payable.

Our final concern with 15 AAC 55.305(c) is the restriction imposed by the regulation that the carry back of any tax credit cannot result in a tax overpayment or claim for refund. AS 43.55.023(c)(3), 43.55.023(e)(2) and 43.55.025(h) as respectively enacted in Sections 6, 9 and 16 of HB 111 all provide that the credit can be carried back to “satisfy a tax, interest, penalty, fee or other charge” without limitation to whether such carried back credit results in a tax overpayment or a claim of refund for such earlier tax year. The plain language of sections 6, 9 and 16 of HB 111 does not prohibit the use of any carried back tax credits to create an overpayment or claim a tax refund. While there were some brief comments made by a single legislator on this issue during the legislative process surrounding the enactment of HB 111, the Legislature as a body choose not to include any restrictive language preventing the use of carried back tax credits to generate a tax overpayment or claim of refund in the actual bill that was passed and signed into law. By establishing such a restriction, the proposed regulation is inconsistent with its underlying statute and, at least to that extent, would be invalid under AS 44.62.030.

Moving now to the subject of conditional tax credit certificates under AS 43.55.025(q), we understand the intent and purpose for that statute are to allow the holder of such a conditional certificate to secure a place in line under AS 43.55.028 among all others who are seeking payment from the Tax Credit Fund for their respective certificates. Proposed 15 AAC 55.356(e) generally implements this purpose reasonably, but we are concerned about the provision in paragraph (1)(A) regarding denial by the Department of a conditional-certificate holder's application.

Being in line under AS 43.55.028 not only determines priority for when a holder's regular tax credit certificate is purchased by the Fund, but also the amount that the Fund pays for that certificate if payments are proportionally reduced from the certificate's face value. We believe that a dollar spent to earn a conditional tax credit certificate is just as worthy of being paid by the Fund as a dollar spent to earn a regular tax credit certificate, and accordingly we ask the Department to let the face amount of a conditional tax credit certificate reserve the same opportunity for payment by the Fund as the face amount of a regular certificate — after all, the supporting data for the underlying conditional tax credit will have been duly submitted to the Department of Natural Resources at least six months earlier (except for a credit under AS 43.55.025(k)), so its face value should be comparably reliable as that for a regular tax credit certificate.

We propose that the Department change proposed 15 AAC 55.365(e) so that, for purposes of priority in receiving payment from the Fund and for any pro rata discount reflected in that payment, the face amount of a conditional tax credit certificate is counted the same as the face amount for a regular tax credit certificate. If the Department denies the application for the conditional tax credit certificate, the holder of that conditional certificate should be able to "back-fill" that certificate's face amount with the face amount of other certificates it is holding. Only if the holder has nothing to back-fill with would the Department's denial of the conditional certificate's application affect the amount to be paid by the Fund to that holder.

Finally, before closing, let me state that no statement or omission in this testimony is intended to, nor may be construed to, express or imply any endorsement of or acquiescence in Advisory Bulletin 2016-01 dated December 21, 2016 or Advisory Bulletin 2017-01 dated March 31, 2017.

Thank you on behalf of AOGA and its members for the opportunity to testify today, and for your attention and consideration of what we have said.

November 01, 2017

VIA EMAIL: John.Larsen@alaska.gov

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

Re: Proposed regulations to implement HB 111

Dear Mr. Larsen:

Caelus Energy Alaska, LLC ("Caelus") submits these comments in response to the Department of Revenue's ("DOR") proposed regulations to implement House Bill 111 that were issued on September 27, 2017.

The structure of the AS 43.55 production tax and the ability to monetize tax credits under AS 43.55.023 and AS 43.55.025 profoundly impact Caelus' exploration, development, and production operations in Alaska. A robust and available secondary market for tax credit certificates is a tremendous concern due to the lack of meaningful appropriations to the oil and gas tax credit fund in FY 2017 and FY 2018. If funding for the program continues at those levels, it will take many years for Caelus and others that have invested in good faith in Alaska to receive the rebates. Thus, the ability to sell the credits to taxpayers has become critically important and confidence in a broad secondary market is paramount.

In 2017, The Alaska Legislature understood the importance of the secondary market and in order to find alternative solutions to the growing tax credit liability took action to support the market through Sections 6, 9, and 16 of HB 111. These sections create the vehicle to allow tax credits and tax credit certificates to be applied against liability related to production taxes, penalties, fees or other charges from prior years, provided that the charge was not "subject to an administrative proceeding or litigation" that would require a payment to the Constitutional Budget Reserve Fund.

As proposed, 15 AAC 55.305(c) and (d) indicate that DOR is interpreting the terms "administrative proceeding or litigation" in Sections 6, 9, and 16 of HB 111 according to what is required under Article IX, Section 17(a) of the Alaska Constitution, as construed by the Alaska Supreme Court. The "administrative proceeding or litigation" would not commence until DOR issues an assessment, and would not include other regulatory matters like FERC tariff concerns that may impact the production tax calculation, but are not actually tax proceedings. Caelus agrees with this interpretation.

However, DOR has disregarded legislative intent through the proposed 15 AAC 55.305(c), which would prohibit the use of credits against a production tax liability when it would result in a refund. This limitation is not specified in this bill or statute, and so the current drafted regulations are in conflict with both statute and legislative intent and we request the department address this discrepancy.

The draft regulations also find some conflict with the statutory language in Sections 6, 9, and 16 of HB 111 that would allow credits to be applied against production taxes and related interest, penalties, fees, or other charges. 15 AAC 55.305(c) and (d) expressly allow credits against production taxes and interest, but fail to mention "penalties, fees, or other charges." Again, both the statutory language in HB 111 and legislative intent are clear here and we ask that this error must be corrected.

Caelus also disagrees with the limitation in 15 AAC 55.305(c) precluding the application of AS 43.55.023 and AS 43.55.025 tax credits against the minimum tax calculated under AS 43.55.011(f) by taxpayers that use the credit under AS 43.55.024(j). The Legislature imposed no such limitation under Sections 6, 9 and 16 of HB 111. Regardless, the reference to withdrawing the application of "the" AS 43.55.024(j) credit could be interpreted to mean "the entire" credit rather than just a portion. That restriction is nowhere in the statutes and the proposed regulation should be revised accordingly.

In addition, the proposed 15 AAC 55.525(*l*) and (m) appear to set forth inconsistent criteria for purchase of tax credits. Subsection (*l*) states that "[e]xcept as provided in (m)" DOR may only purchase tax credit certificates if (1) the tax credit was "earned for activity occurring before July 1, 2017" and (2) the costs for the activity were incurred before July 1, 2017. DOR should revise the proposed regulation to focus exclusively on when costs are incurred, consistent with standards already in place under 15 AAC 55.290 that are understood by DOR and the industry—there is no reason to add unnecessary complexity. Further, 15 AAC 55.525(m) provides that in addition to "the regulations implementing [AS 43.55.028]" DOR may purchase no more than half of the certificate issued for the 2017 AS 43.55.023(b) loss credit. By incorporating "the regulations," subsection (m) seems to bring in subsection (*l*), which contradicts the "except as" language in subsection (*l*) and appears to apply the subsection (*l*) limitations to purchase of the loss credit. We do not believe that the legislature intended for these limitations to be cumulative. DOR should make these regulations consistent with Section 38 of HB 111—the loss credit is calculated on an annual basis and thus the only limitation is that half of the tax credit certificate can be purchased.

In sum, having certainty and flexibility in a secondary market for tax credits is critical to companies like Caelus as we look to continue our investments in Alaska. We encourage the

DOR to abide by the Alaska Legislature's intent to support such a market as the resulting reduction in outstanding tax credit liability would greatly improve Alaska's fiscal health, and send a strong signal to investors that Alaska's open for business. The DOR should take all possible actions to inspire confidence in a broad secondary market for the health of the oil and gas industry, and to the benefit of Alaska and Alaskans alike.

Thank you for the opportunity to share our comments on the draft regulations.

Regards,

Casey Sullivan
Director, State Public Affairs

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ConocoPhillips
Alaska

November 1, 2017

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

Re: Department of Revenue Notice of Proposed Changes on Oil & Gas Production Tax in Regulations, September 27, 2017

Dear Mr. Larsen:

In response to the Department of Revenue ("Department") Notice of Proposed Changes on Oil & Gas Production Tax in the Regulations of the Department of Revenue,[1] ConocoPhillips Alaska made oral comments[2] and now submit written comments.

15 AAC 05.330(e) - Interest

The existing regulation 15 AAC 05.330(e) pertains only to production tax, Title 43, Chapter 55.[3] In the proposed regulation, the entire existing regulation is repealed and replaced. The first sentence of the readopted regulation states:

> For the purposes of this subsection a delinquent tax consists of the balance of unpaid tax on January 1, 2017, including any accrued and unpaid interest the

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[1] Notice of Proposed Changes on Oil & Gas Production Tax in the Regulations of the Department of Revenue, dated September 27, 2017.

[2] October 17, 2017.

[3] Regulation 15 AAC 05.330(e) states "[f]or a delinquent tax under AS 43.55 before January 1, 2017, the interest rate in AS 43.05.225(1)(C)(I) applies for the first three years after January 1, 2017, notwithstanding any period the tax was delinquent before January 1, 2017. For purposes of this subsection a delinquent tax consists of the balance of unpaid tax on January 1, 2017, including any accrued and unpaid interest the taxpayer owes on that date."

> taxpayer owes on that date. An overpayment of tax consists of the balance of the tax overpaid on January 1, 2017, including any accrued interest owed to the taxpayer on that date.

At the hearing we inquired whether this statement was intended to apply to all taxes under Title 43 or only to production tax (AS 43.55) like it does in the existing regulation. The Department, after a break, confirmed that it was intended to apply to production tax.

We recommend the following change to clarify that this statement applies to AS 43.55 rather than all tax types under Title 43:

> For the purposes of this subsection a delinquent tax **<u>under AS 43.55</u>** consists of the balance of unpaid tax on January 1, 2017, including any accrued and unpaid interest the taxpayer owes on that date. An overpayment of tax consists of the balance of the tax overpaid on January 1, 2017, including any accrued interest owed to the taxpayer on that date.

The proposed change will eliminate confusion as to what tax type is impacted by the proposed regulation change.

15 AAC 55.305 – Application of Tax Credits.
The proposed regulation for applying tax credits at 15 AAC 55.305 fails to implement the statutory changes made by the Alaska Legislature in Conference Committee Substitute House Bill 111 ("HB 111") to production tax (AS 43.55).

(A) At Sections 6, 9, and 16 of HB 111, the Legislature clearly articulated that "[a] credit or a portion of a credit…(3) may, regardless of when the credit was earned, be used to satisfy a tax, interest, penalty, fee or other charge…"

In direct contradiction, the Department issued proposed regulation 15 AAC 55.305(a) which states, in relevant part,

> "A producer may apply a tax credit as allowed by law only against the specified type of tax liability. A producer may not apply a tax credit against a penalty or interest, **except for interest associated with an additional amount of tax as provided in (c) of this section**."

The proposed regulation prohibits tax credit application against a penalty, then narrows the application of a tax credit against interest only related to the additional tax. The Legislature's wording states the credit may be "used to satisfy a tax, interest, penalty, fee or other charge…" It is clear the Legislature intended to allow the application of a tax credit against a penalty and that the Legislature made no restriction on interest.

To comply with the Administrative Procedures Act (AS 44.62), the Legislature's modifications to AS 43.55 in Sections 6, 9, and 11 of HB 111 and to implement the Legislature's intent, the Department must modify the proposed language at 15 AAC 55.305(a), 15 AAC 55.305(c)[4] and 15 AAC 55.370(e)[5] and allow tax credit application against penalty and interest.

(B) The Legislature's enactment of HB 111 made a purposeful and explicit change to AS 43.55. It modified and added statutory language to rehabilitate the secondary tax credit market.[6] A market that became non-existent due to regulation 15 AAC 55.335(g) and Advisory Bulletins 2016-01 and 2017-01. This language to revive the secondary tax credit market exists at Section 6, 9 and 16 of HB 111. Section 6 is quoted below for discussion.

> (c) A credit or portion of a credit under this section
>
> (1) may not be used to reduce a person's tax liability under AS 43.55.011(e) for any calendar year below zero;
>
> (2) **may, if** not used under this subsection, be applied in a later calendar year;
>
> **(3) may, regardless of when the credit was earned, be used to satisfy a tax, penalty, fee or other charge that**
>
> > **(A) is related to the tax due under this chapter for a prior, 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 43.55.014; and**
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> > **(B)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.**

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[4] Regulation 15 AAC 55.305(c) states, in relevant part,"[a] producer reporting an additional amount of tax due and associated interest from the tax levied under AS 43.55.011(e)...may carryback a tax credit under AS 43.55.023 or AS 43.55.025...for application against the additional amount of tax and associated interest.

[5] Regulation 15 AAC 55.370(e) states, in relevant part, "[a] production tax credit certificate does not accrue interest, and except for application against a [PRODUCTION] tax liability as provided in this section, **or for associated interest for an additional tax as provided in 15 AAC 55.305,** may not be used in payment of any tax or other amount owed.

[6] Senator Cathy Giessel, Letter dated August 29, 2017, p. 1, states:

> 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.

In contradiction to the Legislature's intent and change to the production tax statute, the proposed regulation at 15 AAC 55.305(c) states, in relevant part:

> For a producer that elected to apply the tax credit in AS 43.55.024(j) in the prior year, the amount of tax credit under AS 43.55.023 or 43.55.025 or the amount of tax credit certificate under AS 43.55.023 or 43.55.025 that the producer may carryback for application against the additional amount of tax due for that prior year is limited to the amount of the tax credit under AS 43.55.023 or 43.55.025 or tax credit certificate under AS 43.55.023 or 43.55.025 that would reduce the tax levied under AS 43.55.011(e) for that prior year to the amount in AS 43.55.011(f) as provided in 15 AAC 55.335(g).

By prohibiting a taxpayer with tax credits earned under AS 43.55.024(j) from "reduc[ing] the tax levied under AS 43.55.011(e) for that prior year to the amount in AS 43.55.011(f)," this proposed regulation nullifies the Legislature's change to revive the secondary tax credit market for tax years on and after January 1, 2014 (the effective date for sliding scale, per barrel credits at AS 43.55.024(j)). The nullification is repeated in the proposed regulation by incorporation of 15 AAC 55.335(g), an existing regulation that the Department interpreted in its Advisory Bulletin 2017-01 to mean that 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.

Regulations, whether existing or proposed, must implement the Legislature's decision to make this statutory change --- the Legislature's statutory language does not prohibit the application of AS 43.55.023 and AS 43.55.025 tax credits to the gross minimum tax on the North Slope (calculated at AS 43.55.011(f)) or where the taxpayer's credits include per barrel, sliding scale tax credits. The Legislature's statutory language allows a credit, regardless when it was earned, to reduce a person's tax liability to zero as long as it is not the subject of an administrative proceeding or litigation. Yet, the Department failed to modify 15 AAC 55.335(g) and 15 AAC 55.375 to reflect the Legislature's changes and intent in HB 111 and further abolishes the Legislature's changes with proposed regulation 15 AAC 55.305(c) by prohibiting application of tax credits for tax years beginning on and after January 1, 2014.

(C) The last sentence of proposed regulation 15 AAC 55.305(c) states:

> A producer may be assessed penalties under 15 AAC 05 for civil fraud, failure to pay, or negligence or intentional disregard if a producer under reports tax due on its original return in order to file an amended return and carryback tax credits under this subsection.

Both civil and criminal penalties exist in statute under Title 43. The Legislature did not modify or discuss a need to modify civil and criminal penalties nor did any changes occur in HB 111. Hence, it is perplexing why this proposed regulation is drafted. In addition, the Drafting Manual for Administrative Regulations, prepared by the State of Alaska, Department of Law, instructs that regulations should not paraphrase or restate a statute.[7]

We request the Department revise the proposed regulations to comply with the Administrative Procedure Act by implementing the Legislature's changes in HB 111 and the Legislature's intent for making such changes. If the Department would like to discuss the above recommendations, please feel free to contact me.

Sincerely,

Marie P Evans

Marie P. Evans

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[7] *See* page 45: Do not paraphrase or restate a statute in a regulation. Paraphrasing or restating a statute does not create a regulation, and does not add to the force of the statute; a regulation implements, interprets, or makes specific the statutory law being enforced or administered by the regulatory agency. In addition, it makes errors more likely because (1) the more often a statute is paraphrased the greater the chances are of its meaning being inadvertently changed; and (2) the more places a statute is stated the greater the chances are of subsequent statute amendments not being reflected in all of those places.

<u>Comment on Draft Regulations Package</u>
Nov 1 2017
Dan E Dickinson

<u>(1) New rules for carrying back certificates under proposed 15 AAC 55.305 (c) (pages 4 through 7).</u>

It appears that the intent of the proposed rules at 15 AAC 55.305(c) is to implement the provisions of HB 111 dealing with acquired certificates. If so please make that explicit such as stating that the section

"**includes** certificates arising from costs incurred by taxpayer or certificates transferred to conveyed to sold to or acquired by the taxpayer under 023(e) or 025(g) "

If this is the intent, the last full sentence on page 5 seems out of place and should be clarified. There is no question that the department may issue a notice and demand for payment to the party to whom the certificate was originally issued as for example per the explicit directions in AS 43.55.023(g). That provision is still in effect, and so any such demand would not be against the acquiring entity, but against the original holder. That sentence in the place where it is found implies the assessment would be against the acquirer of the certificate.

(If such acquired certificates are not covered, please make that explicit as well clarifying that the section "**excludes** certificates conveyed to sold or acquired by the taxpayer…". Also then please clarify the sentence running between page 4 and 5 about the applicability of the percentage limitation found in As 43.55.023(e).

<u>(2) The absence of any language in reference to penalties, fees and other charges.</u>

HB 111, sections 6, 9, and 16 expands the list of categories that an acquired credit can be applied against. The regulations appear to only deal with taxes, and interest on those taxes. Does that simply leave penalties, fee, other charges and interest other than that covered by the regulations – wide open to be worked out in practice? If the intent of the legislature was to widen the market for the certificates, not articulating any rules, and waiting for them to be worked out in practice will keep the market frozen. I urge the DOR to recognize these other permissible uses, and clarify any restrictions on that use found in the statute.

(3) The Purchasable portion of 2017 Certificates.

This set of comments references the process by which a loss generated in 2017 will be partitioned into a purchasable portion and a non-purchasable portion.

The transitional rules in HB 111 section 38, only require that once a loss has been calculated using all the tools developed as a consequence of AS 43.55.023 (b) over the past decade, that certificate be "halved" into a purchasable and non-purchasable portion.

The rule in section HB section 21 requires that the purchasable portion may only include an "expenditure incurred before July 1, 2017".

I would hope that "expenditure" would be read narrowly to not include transportation costs under AS 43.55.150 or other deductions used to arrive at the gross value of the point of production, but rather read as the term "lease expenditure" is defined in AS 43.55.165 ("lease expenditures.") Then the rule that incorporates sec 21 and 38 is simple:

(1) Calculate the GVPP for the year, and then divide by 2.
(2) Sum the total lease expenditures for the year, and divided by 2.
(3) Sum the total lease expenditures incurred prior to July 1, 2017.

The purchasable portion of a certificate is item (1) less the smaller of (2) or (3).

An example could further clarify this.

Additional issues:

(a) Circular reference

On page 13 the proposed 15 AAC 55.525(l) starts with

"Except as provided in (m) of this section…"

Then on page 14, the proposed 15 AAC 55.535(m) includes the language.

"…in addition to the provisions in this chapter implementing that statute…"

It is not clear to me how each of those provisions affects the applicability of each other, or how the "in addition" language effects a limitation. I suggest laying out the rule clearly perhaps as a series of steps (as above).

(b) Costs incurred has worked for the last decade why add when costs were "occurred"

On page 13 the proposed15 AAC 55.525 (l) sets the following two criteria

“ (1) earned for **activity occurring** before Jul 1, 2017; and
(2) the expenditures for that activity were expenditures incurred before July 1, 2017.”

Where did the limitation about “activity occurring” come from? It is not in section 21 of HB 111 – which refers to “an expenditure incurred before July 1, 2017.” It is not in the uncodified language in section 38 of HB 111 (which only refers to “half of the value of a transferable tax credit certificate...” This rule will cover the final work for CI and NS that will be certificated under a program over a decade old. Why would the department choose this time to introduce a new test, especially one not authorized by the statute?

If “activity occurring” is an attempt to capture the various elements that go into the calculation of GVPP, a more precise description would be appropriate. Nor does cutting the year in half this way implement the requirement of section 38, to isolate “half of the value of the a transferable tax credit certificate”

(c) GVPP rules and an Example.

As indicated above HB 111 section 38 appears to simply require halving a certificate. If the department is trying to get more complex with it, I suggest fleshing out the enclosed example (please see next page).

I have 5 million of GVPP in months January through June of 2017 and 9 million in LE. I have 9 million of GVPP in July through December 31 and 11 million in LE.

As set forth above, the calculation would be (5 + 9)/2 = 7 in GVPP, less the smaller of (9) or ((9+11)/2 = 10), which yields 7 less 9 = 2.

Although I do not think any of the other interpretations are available, by mixing and matching these two rules in how they apply to LE and GVPP, losses of 2, 3, 4 or 5 can be computed.

	Inputs		Results			
			Same Rule for Both		Different Rules	
	Jan - Jun 2017 GVPP	Jul - Dec 2017 GVPP	Jan - Dec 2017 divided in half	Jan - Jun 2017 GVPP	Jan - Dec 2017 divided in half	Jan - Jun 2017 GVPP
GVPP	**5**	**9**	**7**	**5**	**7**	**5**
	Jan - Jun 2017 LE	Jul - Dec 2017 LE	Jan - Dec 2017 divided in half	Jan - Jun 2017 LE	Jan - Jun 2017 LE	Jan - Dec 2017 divided in half
LE	**9**	**11**	**10**	**9**	**9**	**10**
Resulting Loss	(4)	(2)	(3)	(4)	(2)	(5)

LEADER in All We Do

October 31, 2017

VIA EMAIL: john.larsen@alaska.gov

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

Re: Comments on proposed regulations implementing HB 111

Dear Mr. Larsen,

Doyon, Limited ("Doyon") is submitting these comments to the oil and gas production tax regulations in 15 AAC 55 that Department of Revenue ("DOR") is proposing to implement House Bill 111 ("HB 111"). These comments are in response to the notice published on September 27, 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 the proposed regulations to implement HB 111 are below.

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 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."

Based on the proposed 15 AAC 55.305(c) and (d), it appears that DOR is not construing the statutory language in Sections 6, 9, and 16 of HB 111 differently than is required by the Alaska Constitution as interpreted by the Alaska Supreme Court — the "administrative proceeding or litigation" must directly relate to the tax under AS 43.55 and the "administrative proceeding" does not commence until DOR issues a notice and demand for payment for the tax year at issue.[1] Other matters that impact inputs to the tax calculation like FERC or RCA tariff orders, but that are not actually about oil and gas production taxes, are not "administrative proceedings or litigation" that

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[1] *See Hickel v. Halford*, 872 P.2d 171 (Alaska 1994).

would preclude the use of AS 43.55.023 and AS 43.55.025 tax credits and tax credit certificates against liability from a prior calendar year. We believe that is the correct interpretation and request confirmation from DOR on this issue if DOR disagrees.

We also believe that the term "tax credit certificate" in 15 AAC 55.305(c) and (d) would include tax credit certificates that have been transferred to a taxpayer for use against its liability. We believe that is the correct interpretation and request a response from DOR if DOR disagrees.

Although we appreciate that DOR has not attempted to interpret "administrative proceeding or litigation" differently than is required by the Alaska Constitution, the proposed regulations raise other serious concerns. Notwithstanding clear legislative intent to support and enhance the secondary market for tax credits, DOR appears to be attempting to impose limitations on the use of tax credits that do not exist in the statutes.

First, the proposed 15 AAC 55.305(c) and (d) provide for the use of tax credits under AS 43.55.023 and AS 43.55.025 against production taxes and associated interest, but do not mention penalties. This omission needs to be corrected, because Sections 6, 9, and 16 of HB 111 specifically allow the credits to be applied not only against production taxes and interest, but also against a "penalty, fee, or other charge" related to production taxes. DOR cannot ignore this clear statute.

Second, 15 AAC 55.305(c) would preclude using tax credits against taxes from prior years if the result would be a refund. There is simply no basis in the law for this restriction.

Principles of statutory construction require that DOR revise its proposed regulations to: (i) abide by the clear language in HB 111 that would allow tax credits to be applied against any charge relating to production taxes; and (ii) recognize that there is no restriction in HB 111 on using tax credits when it would result in a refund — imposing such a restriction would be contrary to legislative intent.[2]

In implementing Sections 6, 9 and 16 of HB 111, DOR must recognize that it was the legislature's intent to overrule Advisory Bulletin 2016-01 to allow tax credits — and certificates for them — to be applied against related 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 and the clear statutory language 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.

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[2] "While every word of a statute must be presumed to have been used for a purpose, every word excluded from a statute must be presumed to have been excluded for a purpose." *Ganz v. Alaska Airlines, Inc.*, 963 P.2d 1015, 1019 (Alaska 1998).

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 and DOR's recent advisory bulletins.

There is an additional concern regarding the proposed regulations that is technical in nature. In determining the portion of a credit eligible for purchase, the proposed 15 AAC 55.525(*l*) appears to limit purchases to credits "earned for activity occurring before July 1, 2017" *and* requires that "the expenditures for that activity were expenditures incurred before July 1, 2017." While we recognize that Sections 20 and 21 of HB 111 do not appear to be consistent in this regard, DOR should take this opportunity to craft regulations that are clear and consistent, such that the determination is made based only on when expenditures are incurred, which aligns with current regulations and protocols that have evolved over time. There is no need to depart this relatively clear and well understood standard when it is an option under the statute. Also, the criteria for purchase set forth in the proposed 15 AAC 55.525(*l*) and (m) could be read to all apply to the AS 43.55.023(b) loss credit. Section 38 of HB 111 shows that the legislature understood that the loss credit is calculated on an annual basis and intended that half of the certificate would be purchased. We do not believe that the legislature intended additional limitations for purchase of the loss credit based on when a cost was incurred or when activity was performed.

Finally, we commend DOR for making it clear through the proposed 15 AAC 55.365(e) that the 2017 loss credit under AS 43.55.023(b) can be assigned under AS 43.55.029.

Thank you for considering these comments.

Best regards,

Toby Stoeber

Toby Stoeber
Accounting Director

October 20, 2017

VIA EMAIL: John.Larsen@alaska.gov

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

Re: Response to proposed regulations implementing HB 111

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 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.

If we read the proposed regulations at 15 AAC 55.305(c) and (d) correctly, we commend DOR for not interpreting Sections 6, 9, and 16 of HB 111 differently from what is required under Article IX, section 17(a) of the Alaska Constitution as construed by the Alaska Supreme Court in the *Hickel v. Halford* case.[1] In other words: (i) the "administrative proceeding or litigation" would directly involve the production tax, and would not include indirect matters that impact the production tax calculation, such as FERC tariff decisions; and (ii) the "administrative proceeding" commences when DOR issues an assessment/notice of demand for payment. We believe that this is the correct interpretation and it appears that DOR agrees, based on 15 AAC 55.305(c) and (d) and in particular on Example 1 in 15 AAC 55.305(d). For example, if a taxpayer files an amended return due to FERC Opinion 544 and DOR has not issued a notice and demand for payment for that year, the taxpayer may carryback tax credits for use against the additional liability. We request written confirmation on this point.

However, 15 AAC 55.305(c) inappropriately restricts the use of credits against taxes from prior years when the result would be a refund. Sections 6, 9, and 16 provide that credits can be used against taxes from a prior year regardless of whether the result is a refund. There is simply no basis in the statute for the limitation that DOR is attempting to impose and the fact that the legislature considered such a limitation and did not include it means that it was rejected.[2]

We also note that 15 AAC 55.305(c) and (d) refer to using tax credits against taxes and interest, but not penalties. Yet Sections 6, 9, and 16 of HB 111 specifically include "penalty, fee, or other charge" related to production taxes for a prior year. DOR

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[1] *Hickel v. Halford*, 872 P.2d 171 (Alaska 1994).

[2] "While every word of a statute must be presumed to have been used for a purpose, . . . every word excluded from a statute must be presumed to have been excluded for a purpose." *Ganz v. Alaska Airlines, Inc.*, 963 P.2d 1015, 1019 (Alaska 1998).

cannot disregard this language—the legislature is presumed to have included it for a purpose.[3]

In making these comments we do not in any way concede that Advisory Bulletins 2016-01 and 2017-01 are correct, and we note that the proposed regulations do not mitigate the harm done by Advisory Bulletin 2017-01. The legislature voiced its intent through sections 6, 9, and 16 of HB 111 to revive the secondary market for tax credit certificates, so regulations must be promulgated or modified, including 15 AAC 55.335(g) and 15 AAC 55.375, to implement that intent. 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 against the minimum tax calculated under AS 43.55.011(f). As a closing comment regarding Advisory Bulletin 2017-01, we detrimentally relied at great expense on a number of communications from DOR before the bulletin was issued—including presentations made to the Alaska legislature—stating that taxpayers that use the sliding scale tax credit can use other credits to drive production tax liability below the minimum tax. DOR must consider the damage that it has done through Advisory Bulletin 2017-01 and take corrective action.

The secondary market for tax credits is vital to the health of Alaska's oil and gas industry and any constriction of that market will result in lost investment and lost jobs for Alaskans. We urge you to consider and act on these comments.

Best regards,

Jeff Hastings

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Jeff Hastings
Chairman/CEO
SAExploration Inc.

[3] *Id.*