

The Department of Revenue (“Department” or “DOR”) provides its response below to recent questions received. The responses are not binding on the Department for any position of law. Any final regulations will be adopted after consideration of the comments received.

1. **15 AAC 55.206(b)**

The last sentence of the subsection adds the reference “and AS 43.55.160(e).” Since AS 43.55.165(a)(3) already states the lease expenditures must have “met the requirements of AS 43.55.160(e) in the year in which the lease expenditures were incurred,” the reference to AS 43.55.160(e) appears to be redundant. Is there is a specific reason for inserting “and AS 43.55.160(e)?”

DOR Response:

The Department agrees with the comment that AS 43.55.165(a)(3) states that the lease expenditures must meet the requirements of AS 43.55.160(e). The Department will review other regulations that may include similar language and determine if it would be appropriate to remove the reference to AS 43.55.160(e).

2. **15 AAC 55.206(c)(3) and (c)(4)**

Subsection (c)(3) sets forth the segments for oil produced for the calculation of production tax value (PTV). The introductory language provides that it is “for oil, or oil and gas produced.” This is unusual language compared to other sections in the regulations — the reference to “oil and gas produced” also covers oil, without the need to separately reference oil. Is there a particular reason why oil is mentioned separately (and apparently redundantly) in the introductory language? And presumably, the reference to “gas” is only intended to capture the premise that lease expenditures for gas will be used in the calculation of PTV for oil starting in 2022, but please confirm.

DOR Response:

AS 43.55.020(e) provides that “Oil or gas used in the operation of a lease or property in the state in drilling for or producing oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and Gas Conservation Commission to be waste, is not considered, for purposes of AS 43.55.011 – 43.55.180 as oil or gas produced from a lease or property.” While, for example, casinghead gas may be “produced” along with oil the Department does not consider gas as being produced until it meets one of the conditions regarding the point of production in AS 43.55.900(21)(B)(i)-(iii) as being produced and sold.

15 AAC 55.206 deals with calculating the production tax value of oil and gas produced after June 30, 2007. However, beginning January 1, 2022, the proposed new paragraph at 15 AAC 55.206(c)(3) identifies segments in subparagraphs (A) – (E) that are relevant to the calculation of production tax value after 2021. Nevertheless, and as provided in AS 43.55.160(h) the lease expenditures to produce both oil and gas outside of the Cook Inlet sedimentary basin, with certain limited exceptions as provided for in AS 43.55.011(p), shall be attributable to the production tax value of oil beginning on and after January 1, 2022.

As for subsection (c)(4), the first part of the introductory sentence seems to conflict with the second part of the sentence. The regulation states, “[f]or oil and gas produced,” and then states,

“if a producer or explorer does not produce any oil.” In addition, does (c)(4) apply only to a gas producer, or only to an explorer with no production, or both? Further, this regulation provides for two segments: north and south of 68 degrees North latitude. One can assume that this relates to the fact that lease expenditures for oil and gas are allocated to oil starting in 2022 and to clarify that lease expenditures for explorers or producers that are not producing oil are split between the two segments for purposes of calculating losses. Please confirm, as that rationale seems to gloss over the fact that although losses are available for expenditures incurred for activities south of 68 degrees, they are not available for expenditures incurred for activities in the Cook Inlet sedimentary basin.

DOR Response:

The Department agrees that the introductory sentence seems to conflict with itself and will address this in the final adopted regulations.

The commentor also correctly points out that subparagraph (B) lacked clarity and may have improperly included Cook Inlet, when the intent by the Department was to address lease expenditures incurred outside of the Cook Inlet sedimentary basin no part of which is north of 68 degrees North latitude.

3. **15 AAC 55.213(e)**

The first sentence states, “[a] methodology must provide for excluding any gas produced before 2022 that is used in state and any gas produced after 2021.” This is also reiterated at the end of the subsection. While we do not have a specific question on this, it may be clearer to have one sentence for gas used in the state and a separate sentence for gas produced after 2021. For example, leave .213(e) as-is and add a sentence or a new subsection that states “[a] methodology must provide for excluding any gas produced on and after January 1, 2022.”

DOR Response:

The Department will consider providing additional clarity in the final regulation.

4. **15 AAC 55.215(b)**

In addressing the applicability of lease expenditures, prior to the proposed amendments, 15 AAC 55.215(b) addressed the allocation of lease expenditures for Cook Inlet oil and Cook Inlet gas for tax years prior to 2022. The proposed amendment moves the previously existing regulation to .215(b)(1).

The new language at .215(b)(2) clarifies that lease expenditures for oil and gas are applied to the production tax value for oil. However, the new language divides lease expenditures between North Slope and everywhere else. This language raises similar questions to those raised above concerning 15 AAC 55.206(c)(3) and (c)(4), and we would appreciate clarification of DOR's intent.

DOR Response:

15 AAC 55.215 is in regard to the *applicability* of lease expenditures. The section does not define segments for determining the calculation of production tax value which is the subject of 15 AAC 55.206. Additionally, an "area" of the state as used in 15 AAC 55.215 is not synonymous with a segment which is used for calculating production tax value as described in 15 AAC 55.206.

The proposed changes at 15 AAC 55.215(b)(1) and (2) must be read in conjunction with 15 AAC 55.215(a)(2)(B). 15 AAC 55.215(a)(2)(B) first acknowledges the change in accounting for lease expenditures beginning on and after January 1, 2022, to produce both oil and gas as provided for in AS 43.55.160(h) ("after the latest of 2021"). Next, subparagraph (B) recognizes that certain exceptions may apply for the so called "Middle Earth" (Interior Basins; land outside of the Cook Inlet sedimentary basin no part of which is north of 68 degrees North latitude) for (1) tax credits in AS 43.55.024(a), and (2) leases or properties subject to the limitation of tax as provided for in AS 43.55.011(p) continuing after 2021.

After 2021, the levy of tax for gas and oil produced from the Cook Inlet sedimentary basin will still be limited as provided in AS 43.55.011(j) and (k), respectively. And, certain leases or properties that are outside of the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude may also be the subject to the limitations of tax as provided for in AS 43.55.011(p).

5. **15 AAC 55.215(d)**

This subsection addresses the applicability of lease expenditures for leases or properties outside the Cook Inlet sedimentary basin, other than non-North Slope leases or properties that avail of the tax ceiling in AS 43.55.011(p). Subsection (d)(1) concerns the allocation of lease expenditures to gas used in the state before 2022. The proposed subsection (d)(2) addresses lease expenditures incurred on and after January 1, 2022, "or" carried-forward annual losses regardless of when the cost was incurred and provides that either may apply to the production tax value of oil beginning in 2022 (excluding leases or properties subject to AS 43.55.011(p)). Please confirm whether this is the correct reading of the proposed language.

DOR Response:

The Department agrees that 15 AAC 55.215(d) deals with lease expenditures incurred on and after January 1, 2022, and carried-forward annual losses incurred before January 1, 2022, and that either of these may be attributable to the production tax value of oil beginning in 2022 for leases or properties outside the Cook Inlet sedimentary basin, other than leases or properties subject to AS 43.55.011(p).

6. Example 1.B

It appears the first step in this example, to determine if the taxpayer has adjusted lease expenditures that exceeded the North Slope gross value at the point of production, was assumed (or skipped), such that the test at 15 AAC 55.217(b)(3)(D) would occur. The math in this example would have \$4,340 in adjusted lease expenditures for this step. Is this observation correct? If so, we recommend either (i) stating that the example assumes that adjusted lease expenditures exceeded the gross value at the point of production for the North Slope, or (ii) adding the step with the math.

Subsection (3) appears to have inadvertently stated “including gas used in the state” rather than “excluding gas used in state,” since gas used in state will not have a production tax value on or after January 1, 2022. Please confirm whether that observation is correct.

DOR Response:

For the first part, AOGA asks if it was “assumed (or skipped), such that the test at 15 AAC 55.217(b)(3)(D) would occur.” This is illogical as 15 AAC 55.217(b)(3)(D) applies to situations in which there is no carried-forward annual loss for the segment as the gross value at the point of production is greater than the adjusted lease expenditures in (b)(2)(A), segment leases or properties from which oil or gas *is* produced; (b)(2)(B), segment leases or properties from which *no* oil or gas is produced; and (b)(2)(C), to explore for oil or gas deposits north of 68 degrees North latitude *other than* the producer's leases or properties.

However, the Department does agree that adjusted lease expenditures in the amount of \$4,340 is equal to the sum of lease expenditures for Properties (A) \$400 + (B) \$1,800 + (C) \$2,000 = \$4,200 of adjusted lease expenditures from producing properties, plus the \$140 of adjusted lease expenditures to explore for oil or gas deposits north of 68 degrees North latitude, resulting in total adjusted lease expenditures of \$4,340. This is stated in example 1.B. as:

“Adjusted lease expenditures applicable to this segment are the sum of \$400 from Property A, plus \$1,800 from Property B, plus \$2,000 from Property C, plus \$140 from the seismic exploration.” However, the Department can add language to summarize the total amounts of adjusted lease expenditures in the example.

In addition, the Department would recommend AOGA and its member companies review the Excel spreadsheet that accompanied the proposed regulations to see visually the Department's presentation of Example 1.B. This is shown in the first tab named “.217(c) Example 1.B.”

Last, the Department agrees with AOGA that paragraph (3) should say “excluding gas used in the state,” rather than “including gas used in state” since gas used in the state will not have a production tax value on or after January 1, 2022.

7. **Example 2**

The new language at the end of the example uses the word “neither” which may be read to tie the carried forward annual loss for Property D and the unrelated “seismic exploration on the North Slope” together. We presume that was not DOR’s intention, but please confirm.

DOR Response:

The Department will revise the language for the final adopted regulations to make clear that the carried-forward annual losses for Property D are unrelated to the “seismic exploration on the North Slope.”