DOR SCOPING MEETING – PRODUCTION TAX REGULATIONS
12 AUGUST 2016

1) SELF-INTRODUCTION

Good morning. My name is Thomas K. Williams. I am a tax attorney for BP and the chair of the Tax Committee of the Alaska Oil and Gas Association ("AOGA"). The points I offer today have been shared with the members of the AOGA Tax Committee, but since there is nothing specific on which to offer comments today, my comments today are not AOGA's, but my own. The same is true for BP.

2) Interest

AS 43.05.225(a)(1)(C) – interest (compounded quarterly) accrues "for [only] the first three years after [the] tax becomes delinquent"

How will "for the first three years" work for taxes that become delinquent —

- for compound interest that had accrued before 1/1/2014 —
  - for more than 3 years?
  - for less than 3 years?
- after 12/31/2013 and before 1/1/2017 when interest is simple?
- after 31 December 2016?

3) Tax cap for "(o) gas"

- How does the repeal of the 31 December 2021 expiration date for the tax cap on "(o) gas" under AS 43.55.011(o) affect, (or not affect) —
  - the 13% tax on GVPP under AS 43.55.011(e)(3)(B) for gas produced after 2021, and
  - a producer's election under AS 43.55.014 to pay gas after 2021 with physical gas?
- Similarly, how will post-2021 installment payments under AS 43.55.020(a)(7)(G) and -.020(a)(10) be affected that include gas?

4) Carryforward of unused $5/bbl "non-legacy" oil

For portion of the $5/bbl tax credit under AS 43.55.024(i) that "may not reduce a producer's tax liability … under AS 43.55.011(3) below zero" for a particular calendar year, can the unused portion of that credit be applied in a subsequent year if doing so would not reduce the later year's tax liability under AS 43.55.011(e) below zero for the producer?

5) How will "allocating available money in the fund" be done for purchasing tax credit certificates under AS 43.55.028 —

- pro rata in proportion to the total amount tax credits being tendered for purchase?
  - if so, what period (month, calendar quarter, year) will be used in making the allocation?
- essentially on a first come, first paid basis?

6) For purposes of giving preference between applicants under AS 43.55.028(g)(2), what specific documentation will be required or allowed in order to show the percentage of resident workers in an applicant's or its direct contractors' workforce? Is preference to be determined under AS 43.55.028(g)(2) only on the basis of pairs of applicants (taking "between two applicants" literally) or among all applicants, and if the former, how will the pairings be determined?

7) With respect to a claimant's "outstanding liability to the state" for purposes of AS 43.55.028(j) —
    - if interest is still accruing on the underlying tax or royalty liability, as of what date is that interest portion of the "outstanding liability" determined?
    - Conversely, if a state demand for payment is abated in whole or in part, as of what date is that abatement recognized for purposes of AS 43.55.028(j)?

8) For purposes of AS 43.55.160(f) and (g) —
    - by what process will the AOGCC "determine" the date of the commencement of regular production (as defined in AS 31.05.170) of oil and gas?
    - what kind of documentation of such a "determination" by AOGCC will be required?
    - are AOGCC's existing rules or regulations sufficient and acceptable for DOR, or will new rules or regulations be necessary? And if new rules are necessary —
        - will DOR adopt the rules for this or will AOGCC?
        - if AOGCC, must industry or individual companies petition AOGCC to adopt appropriate or necessary regulations for this purpose, or will DOR ask AOGCC to adopt them?

9) For purposes of calculating "a separate annual production tax value" for each lease or property under AS 43.55.160(h)(4)(A) or (B) —
    - does DOR intend to calculate each such value and publish the results of its calculations, or will the taxpayer determine them with DOR auditing the calculations?
    - what evidence will be allowed or required for these calculations?
    - if DOR calculates them,
        - what will the procedure be for doing so and for providing the results to the respective WIOs in each lease or property?
        - will DOR use confidential tax information from one taxpayer to calculate these separate values for another taxpayer?
            - in what circumstances would/could DOR do so?
            - will the second taxpayer be allowed to see the first taxpayer's information in order to verify DOR's calculation? and if so —
                - what will the safeguards be to ensure the second taxpayer does not illegally disclose the first taxpayer's information?
                - if the safeguards are inadequate, will DOR violate AS 43.05.230?
        - could DOR use a taxpayer's information for one lease or property to calculate a separate annual production tax value for that taxpayer's production from a different lease or property
            - if so, could DOR use that taxpayer's information to calculate "separate annual production tax value[s]" for other lessees/tax-payers in the latter lease or property?

10) Surety bonds under AS 43.70.022
    - What are the requirements that a "surety" must meet in order for its "surety bond" be acceptable to DOR under AS 43.70.025?
        - Is licensure to do business as a surety in Alaska sufficient?
    - What proof will be required to show that a "surety" meets those requirements?

11) Suppose the 7-year term for the GVR for "new" production occurs mid-month,, and the stair-step credit for "legacy" production is —
    - greater than the flat $5/bbl credit for "new" production, which credit applies?
    - less than the flat $5/bbl credit for "new" production, which credit applies?

12) "Resident hire" priority under AS 43.55.028
    - How will the annual "resident worker" percentage be determined for purposes of AS 43.55.028?
    - What documentation will be required for —
        - a taxpayer?
        - for a contractor?
        - of the taxpayer?
    - What if an entity is created that acts in the role of a "direct" contractor, but the actual contactors whose employees are doing the work are shielded by the resident-hire percentage of that entity?
    - If a credit certificate is redeemed for less than face value, will the remaining amount be re-certificated for redemption in subsequent years?

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August 16, 2016

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

Re: Department of Revenue, Notice of Scoping for Potential Changes to Regulations
15 AAC 05 Administration of Revenue Laws
15 AAC 55 Oil & Gas Production Tax

Dear Mr. Larsen:

This letter responds to the Department of Revenue's ("Department") request for ideas and suggestions for possible changes and additions to the regulations at 15 AAC 05 and 15 AAC 55 prior to the Department drafting specific revisions for public review and comment.[1] ConocoPhillips participated in the public hearing on August 12, 2016, reviewed the Department's Notice, and submits, in addition to testimony at the public scoping meeting, the enclosed ideas, comments and suggestions.

General Comments and Suggestions for Regulation Scoping

Workshop: We recommend the Department follow its past practice of holding a public workshop to review the draft regulations prior to formally noticing the regulations so that we can all work from the proposed wording. The workshop forum allows the administration and public an opportunity to converse over the proposed regulation language, work through example facts and discuss varying interpretations. While the formal regulation process will provide the taxpayers and public the opportunity to provide verbal and/or written comments, the formal process does not lend itself to

[1] The Department of Revenue issued a Notice of Public Scoping and Workshop for Possible Updates and Revisions to DOR Regulations 15 AAC 05 (Administration of Revenue Laws) and 15 AAC 55 (Oil and Gas Production Tax) on July 27, 2016.

discussion; it is typically a one-way conversation. It is our belief that the workshop environment facilitates knowledge sharing, eliminates misinterpretations or misunderstandings thereby leading to better regulations which may then be followed by the formal process.

Examples: We suggest the Department provide examples or illustrate a regulation similar to the federal income tax regulations. This would enable taxpayers to efficiently identify difficulties encountered with inputting information into the Revenue On-Line ("ROL") system. Since AS 43.55 is a self-administered tax, a taxpayer may interpret and apply a statute or regulation differently than the Department. Due to ROL programming the taxpayer discovers the difference of interpretation through trial and error. Examples and illustrations incorporated into the regulations would allow efficient identification of differing interpretations that may either be resolved through a discussion or identified and set aside.

Repealed Statutory Sections: HB 247 repeals several statutory sections and portions of statutory sections. To the extent the Department anticipates it will repeal the corresponding regulations, we recommend the Department create a reference document on its webpage for the repealed sections of statutes and regulations. For instance, HB 247 repeals AS 43.55.011(m) and the audits for tax years by those statutory sections are not complete. Further, the exploration incentive tax credits expire and the audits on those tax credits will likely continue for a lengthy period of time. It would save the administration and the taxpayer's time to have a reference document for repealed and/or expired statute and regulation sections.

Specific Comments Suggestions for Regulation Scoping

Defining Required Communications: A couple of new statute sections, part of HB 247, lead to the question of whether the Department will provide forms or would prefer the taxpayers to simply send a letter or an email.

The first change is in Section 1 of HB 247, AS 31.05.030 where the "[u]pon 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)." The second change is in Sections 32, 33 where new statutory sections were added requiring anyone applying for an Alaska Business License who is engaged in the "business of oil or gas exploration, development, or production" to file a surety bond in the amount $250,000. However, in lieu of the surety bond, the business license applicant may file a cash deposit with the commissioner or other acceptable security which remains in effect until the surety cancels it "or the commissioner finds that the business is producing oil or gas in commercial quantities..."

We recommend the Department consider a shortened process for those companies that are currently Alaska Business License holders and obviously producing oil or gas in commercial quantities. We do not have a preference whether a form, letter or email is required or whether the choice is left to the taxpayer. It is our recommendation that the Department define the process in regulation to eliminate confusion and inefficient use of time in meeting the effective date of January 1, 2017. For example, a regulation like the following would be helpful:

> 15 AAC 70.XXX. Oil or Gas Business Requirement for Bond, Cash Deposit or Finding Production of Commercial Quantities for Business' with Existing Licenses.
>
> A person is not required to file a surety bond or make a cash deposit, if the person requests by letter or email the Department of Revenue's Commissioner find that the business is producing oil or gas in commercial quantities. The request to the Commissioner must include the Alaska Business License number and basis for the person's belief that the business is producing oil or gas in commercial quantities. The Commissioner shall make a finding of production of oil or gas in commercial quantities or state a basis for no finding within 30 days.

Returning to Section 1 of HB 247, which addresses the requirement that the taxpayer request the Department's commissioner communicate with the AOGCC to determine regular production for purposes of the gross value reduction, we do not have a preference between a form, letter or email or setting out in regulation that the taxpayer may choose. The number of entities likely to request a finding for regulation production is going to be significantly less than those entities required to file a surety bond and therefore it may be better for the Department to set forth a regulation like the following:

> 15 AAC 55.XXX. Taxpayer Request for AOGCC Determination for Gross Value Reduction.
>
> Upon the taxpayer filing a letter or email communication with the Department of Revenue's Commissioner that a determination from the commission is needed for AS 43.55.160(f) or (g) purposes, the Commissioner shall, within 10 days of receiving the communication, request the commission make the determination. The taxpayer communication must include the date commencement of regular production began or is anticipated to begin and a description of the lease or property for which the determination is requested.

Defining A Process for Resolution: In light of the HB 247's new requirements in Section 1 (AOGCC Determination of Commencement of Regular Production) and Sections 32, 33 (Alaska Business License Applicant Requirements for Oil or Gas Business for Bond, Cash Deposit or Production of Commercial Quantities), it is likely a disagreement will arise at some point. In this scoping phase for the regulations, the

Department may want to consider the appeal process to resolve any disagreements and whether a process for expedited resolution is appropriate.

Interest: Section 8 of HB 247 changed the interest for "a delinquent tax under AS 43.55." Based on the Department's historical interpretation and application, a tax is delinquent beginning on the date it was due. Hence, a tax due on March 31, 2011 that is later determine underpaid by an audit assessment began its delinquency on April 1, 2011. If this tax remains unpaid on and after January 1, 2017, then it has been delinquent for over 5 years and 9 months and the taxpayer should anticipate that interest on any additional amount assessed upon audit will be calculate from April 1, 2011 through March 31, 2014, at the rate now established in the statute. It appears this new interest will also apply to surcharges levied at AS 43.55.201 and AS 43.55.300.

If Department plans to interpret and apply the statute differently, then this would be an ideal time to address the issues that may arise. The interest regulations may benefit from the incorporation of examples as mentioned above.

Gross Value Reductions

In considering new regulations pertaining to the changes made in Sections 26 and 27 (AS 43.55.160(f) and (g) of HB 247, the following arise:

Defining "Regular Production": AS 31.05.170(14) defines "regular production" as "continuing production of oil or gas from a well into production facilities and transportation to market, but does not include short term testing, evaluation, or experimental pilot production activities that have been approved by permit or order of the commission[;]..." If regular production is determined by well, then it also appears appropriate for the taxpayer to track the commencement of the applicable time period for a gross value reduction by well. By affirmatively stating that this is a well by well analysis will lessen confusion, create certainty and limit controversy in later periods.

Calculating the Average Annual Price: An average annual price per barrel for Alaska North Slope crude oil sold on the U.S. West Coast is used to determine whether the gross value reduction is applicable. Is it appropriate to calculate the average annual price beginning in the month that regular production commences? By clarifying the start date of the 12-month period that will comprise the annual price calculation period certainty is created, and confusion and/or controversy in later periods hopefully lessened.

In considering existing regulations for AS 43.55.160(f) and (g), we make several recommendations to the Department:

Existing Timing Requirements: 15 AAC 55.211(d) provides that for purposes of applying a gross value reduction, "the date that (1) a participating area is established is the effective date specified in the written decision of the commissioner of natural resources approving the establishment of the participating area or, if no effective date is specified, the date of the decision;..."

As we previously discussed with the Department, production may begin before the participating area is approved. In practice, the timing requirements established by the Department in the regulations do not work with the reality of oil and gas operations. This timing is now even more impractical in light of the AOGCC's statutory obligation to determine that the gross value reduction applies upon finding "regular production." The legislature enacted the gross value reduction to encourage oil and gas development and production that is to incentivize oil and gas companies to approve the final investment decision. The final investment decision is made years and years before a participating area is created or regular production is commenced therefore the regulations, as drafted, remove the incentive created by the legislature because a company does not know whether it will receive the gross value reduction until years after the final investment decision. In order to illustrate the timeline for oil and gas development and production, please see the enclosed.

We recommend reworking this regulation to comport with the legislature's intent when it enacted gross value reductions with consideration to nature of oil and gas development and production.

<u>Requirements for Expanding Participating Areas</u>: 15 AAC 55.211(e) excludes an expanded participating area from gross value reduction qualification if the acreage added had previously been included in a participating area. While the Department expressed that it added this language to prevent gaming the system, the statute did not limit a gross value reduction if land was previously in a participating area. In some instances, participating areas are contracted at the request of the Department of Natural Resources or for other practical reasons in the best interests of field development. We recommend and believe this regulation should be reworded to properly implement the statutory language and that it can be worded in a manner that prohibits contractions for the sole purpose of qualifying for a gross value reduction.

> The statute provides a gross value reduction where "the oil or gas is produced from acreage that was added to an existing participating area by the Department of Natural Resources on and after January 1, 2014, and the producer demonstrates to the department that the volume of oil or gas produced is from acreage added to an existing participating area."[2] The statute does not disqualify acreage based on its history. The only requirement is the DNR approves adding the acreage after January 1, 2014. Therefore, the regulation does not need to state "unless the portion had previously been excluded from the participating area after having been included in the participating area." In order to address the Department's concerns that taxpayers will game the system and allow for acreage the DNR

[2] AS 43.55.160(f)(3).

required contracted out of a participating area the regulation could be reworded to use the statute date as a cut-off.

For example, 15 AAC 55.211(e)(3) could state:

"acreage added to an existing participating area is the portion of a reservoir or reservoirs that an existing participating area is expanded to include unless the portion was contracted out or excluded from the participating area after January 1, 2014."

If the statute date does not address the Department concerns about gaming, then the regulation could state:

"acreage added to an existing participating area is the portion of a reservoir or reservoirs that an existing participating area is expanded to include unless the portion was contracted out or excluded from the participating area less than five years ago or pursuant to the Department of Natural Resources request."

Metering Requirements: 15 AAC 55.213 sets out metering requirements that do not comport with standard oil and gas operations. For example, at 15 AAC 55.213(b) the regulation appears to assume that all producing intervals are within acreage added to a participating area and fails to consider that wells may cross. Next, the viability of measurement and metering standards is not considered by requiring "continuous metering of the oil and of the gas." We recommend the Department rework the regulation to reflect current practices and requirements of oil fields on the North Slope. We will provide engineering professionals to meet with the Department to discuss actual North Slope metering and related technologies.

Vague and Subjective Standards: 15 AAC 55.212(g) and 15 AAC 55.212(k) requires a determination by the Department approving a taxpayer's methodology where a taxpayer expanded a participating area and seeks to qualify for a gross value reduction.

Transportation Regulations

The existing transportation regulations are incomprehensible and prohibit a taxpayer from timely calculating their production tax due. In light of the requirements at AS 43.55.075, a taxpayer is required to recalculate and re-file production taxes upon receiving changes to the cost of transportation. We recommend the Department of Revenue reconsider the need for the existing transportation regulations, and at a minimum rework for simplification and clarification.

If the Department would like to discuss the above recommendations, please feel free to contact me.

Sincerely,

Marie P Evans

Marie P. Evans

GLACIER

August 16, 2016

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

Re: Comments Related to Potential Draft Regulations Under 15 AAC 05 and 15 AAC 55

Mr. Larsen:

Glacier Oil and Gas Corporation (Glacier) appreciates the public scoping workshop held on August 12, 2016 to solicit ideas, suggestions and comments related to potential new and amended regulations required as a result of the passage of HB 247. Glacier respectfully submits the following comments for the Department of Revenue (DOR) to consider as part of their regulatory review.

The formula for ranking of priority for tax credit cash refunds is based, in part, on the percentage of Alaska resident workers hired by an applicant company. Glacier believes that the definition of "workers" should not be limited only to workers in the direct employ of the applicant company, but also should include independent contractors directly contracted by the applicant company.

The statutes instituted as a result HB 247 will go into effect on January 1, 2017. The legislature made a conscious decision to provide that changes to the tax credit regime would have a prospective effect. Glacier therefore requests that, consistent with legislative intent, any application submitted to the DOR, whether deemed complete or not, be adjudicated and paid under the tax regime in place at the time of the submittal. Applying the new tax regime, which does not have an effective date until January 1, 2017, to applications filed in 2016 under the old tax regime, would violate the legislature's intent and due process.

Glacier also requests that any new regulations clarify that the payment of cash purchases for a tax credit certificate be paid when that specific certificate has been satisfactorily adjudicated by the DOR, and not be held pending the results of adjudication, audits, or other issues that may exist with any other application submitted by a company. Each application and the adjudication of that application should stand on its own.

Again, thank you for the opportunity to participate in the public process and give input into the drafting of potential new regulations. If you have questions or need any clarification on our position on these matters, please do not hesitate to contact me.

Sincerely,

Carl L Giesler, Jr

Carl Giesler
CEO
Glacier Oil and Gas Corp.

601 W 5th Ave., Suite 310, Anchorage, AK 99501

Scoping Comments for AS 43.55 Regulations
8/16/16
Dan E Dickinson

I am submitting this in response to DOR's July 28, 2016 request for input regarding regulations that may be required for AS 43.05 and AS 43.55. I represent multiple clients, each of whom may be affected differently by any proposed rules – or may be affected in unknown ways (in particular those on the North Slope, where there is no sunset on the ability to use the AS 43.55.023(b) credit). The following discussion is not advanced on behalf of any specific investor, explorer, developer or producer but aims more at simplicity and certainty.

The credits were created as incentives. I believe it is clear that work was undertaken as a consequence of the credits that would not have been started without the credits. However if their payoff is delayed by many years, the net legacy of the credit program may not be so positive. Lenders are "spooked" and next steps are being put on hold as certificate holders cannot pay back loans that were predicated on the historical funding patterns. I hope the certificate purchases occur sooner rather than later and much of the discussion below becomes irrelevant. The fact that DOR needs to write regulations that will only take effect if there is delay, should not imply that delay is acceptable or appropriate, or an endorsement of any legislative or administrative actions that have the effect of spreading the payments out over multiple years.

With that backdrop, I offer the following suggestions on implementing AS 43.55.028(g)(2) and (3):

(1) Using the statutes and regulations currently in effect all outstanding applications for cash made before January 1, 2017 which are unpaid will be considered made on December 31, 2016, and thenceforth will only be paid (relative to each other) -- proportionally to the amounts outstanding. If AAC 55.325(d) needs to be modified as a consequence of new language in AS 43.55.023(g)(2), that modification should only affect "purchases applied for on or after [January 1, 2017]." The modification should not affect purchases applied for before that date.
(2) All applications for cash made on or after January 1, 2017 will be subject to the language of AS 43.55.028(g)(2).

The result of this treatment would be to clearly track the applicability language in section 35 of HB 247, such that applications for cash made before January 1, 2017 are not impacted by the resident hire preference provisions found in AS 43.55.028(g) through pro-rata treatment with cash purchase applications that are subject to the resident hire preference provisions.

Here is one method of applying that principle. AS 43.55.028(g)(2) requires that the department "grant a preference" based on resident hire. Although I have not examined the legislative record, the language suggests to me that the preference is not absolute. AS 43.55.023(g)(2) does not require that a company with (for example) an 85.0001% local hire percentage be completely paid before a company with an 85.0000% local hire percentage. One way of granting a preference would be to prorate between all applications based on the local hire percentage. So for example, assuming that the two companies in the example above had each applied for 1 million dollars in cash, they would receive essentially the same amount of money: one would receive 850,001 and the other 850,000. Both applicants would receive more than twice as much in payments as a company with a 31.4159265% local hire.

Another advantage to this method is that it could be integrated easily with the pre-1/1/2107 applications, while accommodating the applicability language in HB 247. Each of the pre-1/1/2017 applications would be represented at 100%. Thus, a company with 100% local hire and an application submitted in 2017 would be treated the same as a company that had applied for cash in 2016. Consider the following example.

Example of allocation of 30 Million Dollars Payment in Calendar Year 2018							
Company	Year Cash Out Application Submitted	Application Total**	Local Hire Percentage	Preference Factor	Extension (D*E)	Normalized Shares	Payment: 30.00
A	B	C	D	E	F	G	H
A	2016	80	n/a	100.000000%	80.00	34.4%	10.33
B	2016	40	n/a	100.000000%	40.00	17.2%	5.16
C	2017	40	100.000000%	100.000000%	40.00	17.2%	5.16
D	2017	40	85.000010%	85.000010%	34.00	14.6%	4.39
E	2017	40	85.000000%	85.000000%	34.00	14.6%	4.39
F	2017	40	10.000000%	10.000000%	4.00	1.7%	0.52
G	2017	4	10.000000%	10.000000%	0.40	0.2%	0.05
Sum		284			232.400004	100.0%	30.00
** AS 43.55.028(g)(3) should not affect the amount in Column C, rather the amounts in Column H.							

Other related issues this approach might address are summarized below.

Who are direct contractors?

The statute includes "workers employed by the applicant's direct contractors" in the calculation of resident workers. As the department is surely aware, it is not uncommon for a developer or explorer to employ one direct contractor, and that contractor is responsible for all the subs. Under the statute, the one direct contractor would be the only point of reference as far as contractors are concerned and the resident workforces employed by the various subcontractors should have no bearing on this calculation. While this model already exists, I would expect it to become even more prominent to the degree it will affect credits. If that single direct contractor was 100% resident, it would of course make for a good outcome under the test , but more importantly it would greatly simplify the calculation.

My fear is that the number of rules, and the requirement to audit the documentation and the nuances of who is a resident worker in any number of companies that provide services to even the smallest of well or seismic acquisition project could quickly outstrip the amount of resources spent on actually investigating the applications substantive dollar claims. One way the department could simplify the amount of bureaucratic work required to implement this is to indicate in regulations that these arrangements with a single direct contractor were acceptable. For example the department could state that payment guarantees or other secondary contractual relationships between the explorer, developer, or producer and the direct contractor's subs, would not be grounds for the department to reclassify subcontractors as direct contractors.

Under this approach, an outside company investing in Alaska would be encouraged to keep that one direct contractor on contract during the out years of credit payment, even if no actual exploration, development or production was continuing, which would further the policy behind the resident hire provisions. Still, the department might have to create a special rule to calculate the "the percentage of resident workers" which might otherwise be an undefined term where it would involve division by zero, as there was no workforce in Alaska.

I understand from various DOR presentations that the dollar amounts in outstanding purchase applications expected at the end of the 2016 calendar year (absent any further appropriations) to be roughly half to three quarters of a billion dollars. If that amount is not appropriated sometime in CY 2017, but only a smaller amount, that smaller amount will be used to fund purchase applications submitted in CY2016. In that case, it does not appear that the AS 43.55.028(g)(2) rules will be applicable to any purchases completed in CY 2017. Hence the new rules under AS 43.55.028(g)(2) are not likely to be applicable until CY 2018. It appears clear that that the percentage of resident workers for the "previous calendar year" will be pertinent "when allocating money available in the fund." Thus in 2018, the department will be looking at the CY 2017 resident hire percentages. If regulations are in place as to what is or is not an acceptable direct contractor by 1/1/17, then companies can act on that portion of the incentive during the year. It also appears that in each year that funds are paid out to purchase certificates, a new determination will have to be made as the local hire percentage in the previous year.

Intersection of AS 43.55.028(g)(3) and AS 43.55.028(e)

The department should make explicit that the language in AS 43.55.028(g)(3) that the "credit repurchase limit for each person under (e) of this section" refers to the $70,000,000 limit added to section (e) by HB 247 and not some other " repurchase limit" found in (e). Since neither of the words "repurchase" or "limit" are found in section (e), this clarification is appropriate.

Furthermore, that limit is not on what can be applied for, but rather on what the department may purchase (or repurchase). So long as the amounts actually being purchased in any calendar year from any person is below $35 million, AS 43.55.028(g)(3) should not have any effect. If the amount exceeded $35 million, then the amount over $35 million but less than $70 million would be purchased at the 75% discount.

Status of unpurchased credits

The department might wish to make it explicit that if only a portion of a certificate is purchased, that the rest remains in the queue to be purchased later. The department might also wish to distinguish that general situation from the specific case set forth in AS 43.55.028(g)(3), (if indeed it is different) when a portion of a certificate representing an amount between 35 and 70 million is purchased at 75% of face value. Is the remaining 25% available for a later purchase, or is it considered "purchased" and removed from the electronic database of certificates?

In line with the discussion above, it would be appropriate to make explicit what may currently only be implicit in regard to cash purchase of certificates. That is, at any time, a taxpayer can withdraw a request for purchase, or modify a request, withdrawing some, but not all of the requested certification. After making such a withdrawal, a taxpayer should also be free to resubmit the request. However, such a resubmission would be considered as a new request, and would take up the appropriate new place in any queue for purchasing. A taxpayer might wish to make such a withdrawal to avoid the discounting down to 75%, or perhaps because it had other options, such as holding on to the certificate for use against taxes, whether levied on it , or on a third party who would purchase and use the certificate. Although I believe it is not now prohibited and therefore implicitly allowed, DOR could make clear that if a request for cash is languishing with the state and a taxpayer comes up with a better alternative, the application for cash can be withdrawn as to any amounts that have not been purchased.

In closing I encourage you clarify the many potential ambiguities brought up by other speakers in the Scoping meeting. I will reiterate three where I may have been the only person speaking on the issue:

The rate change for the 20% credit under AS 43.55.023(a)
The changes in HB 247 to the percentages of credits available in 2016, 2017 and 2018 under AS 43.55.023(b) and (*l*) expressly refer to when a cost is incurred for the transition date. So do the changes under AS 43.55.023(a) as to when costs must be incurred by (before 1/18) to qualify. However, the changes to the AS 43.55.023(a) rate do not expressly refer to when a cost is incurred so DOR should clarify that the reduction from 20% to 10% of the credit is effective for costs incurred on or after 1/1/17, as opposed to applications received on or after 1/1/17

Completion costs for a middle earth well
It is clear that as a consequence of the changes to AS 43.55.025(m), in general exploration costs incurred for work performed before July 1, 2017 will qualify for a credit under this section. However, there is an exception: it appears to be for completion costs, and those (a) may be incurred after July 1, 2017, and (b) there is no limit on when they can be incurred, and thus also when the exploration project would be complete and might trigger the AS 43.55.025(f) requirement for application for the whole project to be made within six months of project completion (when the well is completed, suspended, or abandoned.).

Interest

Finally, although several aspects of the interest calculation were discussed, this may not have been: AS 43.55.023(g) states that any adjustment for a certificate arising from an audit is treated like taxes due and "the increase bears interest under AS 43.05.225 from the date the transferable tax credit certificate was issued." So presumably an audit of a certificate is limited to three years of interest.. But what three years: from when the audit is issued, that is from "delinquency" per as 43.05.225 – which requires notification. Or do the older but more specific words in AS 43.55.023(g) prevail, so from when the certificate was issued? And does that apply to audits issued after January 1 2017? Or only to certificates issued after January 1, 2017?

I thank you for your consideration and am available to clarify any points raised here at your convenience.

Regulatory Approach to Methanol Production Tax Issues
August 16, 2016

I am the founder and president of Prudhoe Bay Chemical, an Alaskan company I formed in 2014 to pursue the development of small-scale methanol production plants on the North Slope.

Methanol (CH_3OH) is the highest-volume chemical used by operations on the North Slope, excluding fuel. Despite being derived from natural gas, methanol has always been imported to the North Slope. PBC's core business is the construction of efficient, appropriately scaled plants suitable for conversion of North Slope natural gas and water into methanol. PBC will either charge a toll to an oil & gas unit to transform that a unit's natural gas into methanol for use in unit operations or will purchase natural gas and manufacture methanol to oil and gas companies to support operations.

Every oil and gas province in the world recognizes that allowing the "free use" of oil or gas in oil and gas production operations ultimately benefits the sovereign. In Alaska tax law this provision is found at AS 43.55.020 (e) where it states "…Oil or gas used in the operation of a lease or property in the state in drilling for or producing oil or gas … is not considered … as oil or gas produced…" As production tax is levied on oil and gas "produced", saying it is not produced is saying it is not taxable. PBC believes that upgrading an oil and gas unit's natural gas into methanol for use in unit operations fits squarely within this definition, and exclusion from tax.

While I understand that PBC would not incur the obligation to pay production tax on natural gas that was tolled through one of its facilities, the anticipated tax treatment is critical to the working interest owners in a Unit so they can compare the net cost of methanol produced by PBC in this proposed project to the cost of importing methanol.

PBC would like the Department to use the current AS 43.55 regulations process to delineate three potentially ambiguous tax questions relating to free use of gas in PBC's particular situation:

1. if and when a production tax would be owed under AS 43.55.011 on gas upgraded at or sold to a PBC plant,
2. if and whether the fees that the unit's working interest owners pay to PBC to upgrade their natural gas into methanol would be treated as lease expenditures that are deductible for purposes of calculating and assessing each working owner's production tax; and
3. when transactions by the working interest owners with PBC might generate taxable adjustments under AS 43.55.170

PBC proposes the following solutions to each of these questions:

1. The gas used to make methanol used in upstream operations is free of production tax (i.e. treated like miscible injectant). This could be accomplished by expanding the list of items not subject to production tax in 15 AAC 55.151(e) to include gas delivered to a methanol facility if that methanol is used to support oil and gas operations in the state of Alaska.

2. The cost of upgrading gas to methanol should be considered a "lease expenditure", just as purchasing methanol is. This would assure that the toll to upgrade gas to methanol could be deducted by a producer in calculating its net tax. This could be done for instance by adding language into the list of allowable lease expenditures in15 AAC 55.250(c)(9).
3. While the use of the methanol in oil and gas production would not require an adjustment through AS 43.55.170, if some of the plant or products of the plant were used for purposes other than supporting oil and gas production in the State of Alaska, then there would be appropriate recovery by the state through of the benefits of that alternative use. This could be done for instance by adding language to 15 AAC 55.280 stating an adjustment is required for gas delivered to a methanol facility if the methanol is not used to support oil or gas production in Alaska.
4. These changes might be made clearer by including a definition of a Methanol Facility in 15 AAC.900(a).

I appreciate your time, and would be happy to provide any further information that may be useful to the Department, should it find that any of these issues are appropriate to address in revising AS 43.55. I can be reached at (907) 310-2637 or jr.wilcox@pbchemical.com.

Sincerely,

JR Wilcox
President
Prudhoe Bay Chemical