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PUBLIC TESTIMONY
OF THE
ALASKA OIL AND GAS ASSOCIATION
REGARDING
PRODUCTION TAX REGULATIONS
PROPOSED 21 SEPTEMBER 2016
(CORRECTED)

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Good morning. My name is Kara Moriarty and I am President of the Alaska Oil and Gas Association ("AOGA"). I am here today to present the collective comments of AOGA's membership regarding changes to the production tax regulations in 15 AAC 55 that the Department of Revenue ("DOR" or the "Department") proposed on 21 September 2016. As is our practice regarding public statements on tax matters, these comments represent the unanimous consensus of AOGA's membership.

The context for the Department's proposed regulations is the production tax legislation that Governor Walker introduced at the beginning of the Regular Session of the Legislature this year, which was eventually enacted in a substantially different form as chapter 4 of the Fourth Special Session Laws of Alaska of 2016 ("HB 247"). Many of these proposals, in fact, appear to have been made specifically to implement that legislation or to adapt to changes it makes.

Our testimony is organized by topic or issue in the order in which it appears in the proposed regulations, instead of addressing them individually in their numerical order in the Alaska Administrative Code. This allows us to address, in a single discussion, proposed regulations that share a particular issue or topic, instead of addressing it piecemeal.

But before discussing specific proposals, we'd like to acknowledge the considerable care in drafting that is reflected in many of these regulations — particularly by the way complex subjects are organized into their individual elements which are then formatted as paragraphs, subparagraphs or even smaller subdivisions. By their very layout on the page, they show clearly which elements are parallel to one another, and how some sets of parallel elements fit together as a part of a specific element within the next-higher level of elements.

Just one of many examples of this is 15 AAC 55.335(e) as it would be amended, where the existing three-paragraph structure reflecting the three steps in determining the amount of a producer's tax credits under AS 43.55.024(j) is unchanged. But within that overall structure, paragraph (e)(1) is divided into subparagraphs (A) and (B) which respectively deal with oil or gas produced before 2017 or after 2016, with (A) containing two subparts — (A)(i) and (A)(ii) — that deal with two different conditions: in (A)(i) the producer has not applied a gross value reduction ("GVR") under AS 43.55.160(f)(3) to the oil, while in (A)(ii) "the oil is not included in the volume of oil the producer is required under 15 AAC 55.212(*l*) to determine qualifies for a [GVR] under AS 43.55.160(f)(3)[.]" Simply by its organizational structure this proposed regulation makes it clear how all of its provisions fit together, and that in turn will help taxpayers determine -.024(j) tax credits correctly.

1. Disclosure of a taxpayer's information to another during an audit of the latter. 15 AAC 05.250 was adopted in 1984 and last amended in 1989. DOR now proposes to delete the language in 15 AAC 05.250(a) requiring that a taxpayer's information be at least a year old before it may be disclosed to another taxpayer. We do not see why this deletion is being proposed.

HB 247 certainly doesn't call for it. True, Section 9 of HB 247 does require DOR to publish by April 30 each year "the name of each person from which the department purchased a transferrable tax credit certificate … and … the aggregate amount of the tax credit certificates purchased from the person in the preceding calendar year." But the situation that Section 9 deals with is not an audit, but simply the publication of the names of those from whom DOR has purchased tax credit certificates and the total amount it bought from each of them during the prior year — which does not require disclosure of details about any particular credit and the certificate for it. So HB 247 does not justify or require this proposed amendment to a regulation that deals only with disclosures during audit.

In addition, the Department's proposed change to 15 AAC 05.250(a) would increase the risk that taxpayer confidential or commercially sensitive information would now in real time be made available to competitors of the taxpayer, thereby increasing the risk that the value of that confidential or commercially sensitive information could be undermined or compromised. While many companies actively pursuing or developing oil or gas resources in the state may be partners in various projects, they nonetheless are competitors, and as such are required under either federal law or prudent business standards to protect certain information from being released to competitors. Removing the restriction that any information disclosed under section 15 AAC 05.250(a) be at least a year removed from the release of the information eliminates a minimum level of safeguard to disclosure of taxpayer confidential or commercially sensitive information to potential competitors.

AS 43.55.040(1) — which was amended to its present form by section 21, chapter 2 of the Third Special Session Laws of Alaska of 2006 and left unchanged by HB 247 — provides DOR with specific and detailed authority, and procedural safeguards, for disclosing one taxpayer's production tax information to another. The procedural safeguards in 15 AAC 05.250(a) date from 1989, and while they may be similar in some respects to those in AS 43.55.040(1), they are not identical. And those differences open the door for error in applying the regulation when the statute provides for a different or more appropriate safeguard in a particular situation.

More fundamentally, the Department's notice describes all its proposed regulations as "change[s in] regulations affecting the oil and gas production tax[.]" But, with a few specific exceptions like the property tax under AS 43.56, 15 AAC 05.250 applies generally to taxes levied under Title 43 of the Alaska Statutes, not just the production tax. Accordingly, the notice is misleading with respect to this proposed amendment to 15 AAC 05.250, because taxpayers under other taxes who read it will have no indication whatsoever that the "one year" rule for disclosing *their* information to other taxpayers under those taxes would also be eliminated. Thus the notice does not meet the requirement under AS 44.62.200(a) that a "notice of proposed … amendment … of a regulation must include … (3) an *informative* summary of the proposed [amendment]" (emphasis added). Accordingly, the adoption of this proposed amendment in violation of AS 44.62.200(a)(3) would, in turn, make the amendment itself invalid under AS 44.62.300(a)(1).

Both on substantive and procedural grounds, we urge the Department not to amend 15 AAC 05.250(a).

2. Regulations proposed for amendment, but no change is shown. Page 1 of the set of proposed regulations states "15 AAC 05.250(b) is amended to read" and then sets out the text of that subsection. Similarly, pages 102-103 say "15 AAC 55.800(f) is amended to read" and sets out the text of that subsection. However, in both cases no deletions of existing text nor insertions of new text are indicated, although AS 43.55.040 is being added to the statutory authority cited for 15 AAC 05.250 that follows subsection (b). Our comparisons of the "amended" regulations to the Alaska Administrative Code shows no change between the "amended" versions and the present versions.

Accordingly, if the Department is in fact intending to change either regulation and simply failed to indicate what that change is in the subsection as set out, we believe the notice for that change would not meet the requirement that a "notice of proposed … amendment … of a regulation must include … (3) an informative summary of the proposed [amendment]" under AS 44.62.200(a), and accordingly, the adoption of that regulation in violation as 44.62.200(a)(3) would make the change itself invalid under AS 44.62.300(a)(1).

3. Disclosures by DOR under AS 43.05.230(*l*) regarding tax credit certificates it has purchased. Enacted by section 9 of HB 247, AS 43.05.230(*l*) specifies that:

> [for] tax credit certificates purchased by the department in the preceding calendar year under AS 43.55.028, the department shall make the following information public by April 30 of each year:
>
> (1) the name of each person from which the department purchased a transferable tax credit certificate; and
>
> (2) the aggregate amount of the tax credit certificates purchased from the person in the preceding calendar year

This requirement for publishing information "by April 30 of each year" about purchases during "the preceding calendar year" clearly contemplates that DOR will purchase tax credit certificates during more than one single calendar year, and not just during 2016 in particular.

By its literal terms, however, proposed 15 AAC 05.255(*l*) would apply only to certificate purchases during 2016. If DOR purchases even one certificate in 2017, AS 43. 05.230(*l*) would need to be amended to reflect that. This proposed regulation adds nothing to what the statute provides, except for this questionable limitation to purchases in 2016 only. We therefore recommend against adopting proposed 15 AAC 05.255*(l)*.

4. Interest on delinquent tax. Section 8 of HB 247 amended AS 43.05.225 to create a special rule under AS 43.05.225(1)(C) — applicable to production taxes only — with respect to interest accruing on and after January 1, 2017. For convenience, AS 43.05.225 as amended is set out in full as an endnote in the written copy of this testimony I have submitted.[1]

The computation of interest under the special rule in AS 43.05.225(1)(C) varies according to when the production tax becomes delinquent.

First, if it becomes delinquent after 2016, the rule is straightforward. Compound interest under (1)(C)(i) accrues quarterly at an annual percentage rate ("APR") equal to seven percentage points above the Fed's APR charged to member banks, and under (1)(C)(ii) interest stops accruing altogether after three years.

Second, consider the case where the production tax delinquency arose in 2010 or earlier, where at least three years of compound interest had accrued before 2014 under the rule in paragraph (1)(A), the substance of which was enacted by section 2, chapter 23 of the Session Laws of Alaska of 1991. Paragraph (1)(C)(i) says a delinquent production tax bears compound interest "for the first three years after [it] becomes delinquent," and (1)(C)(ii) says the tax "does not bear interest" "after the first three years after [it] becomes delinquent[.]" This does *not* mean that, if four or more years of compound interest under (1)(A) had accrued before 2014, then that compound interest would have to be wound back to just three years, — this is because the rule in (1)(C) applies to interest accruing after 2016, not to interest accrued in years before 2014. But it *does* mean that, under (1)(C)(ii), no additional compound interest can accrue after 2016 on a pre-2011 delinquency that has already accrued three years or more of compound interest under the provisions that are now designated as paragraph (1)(A).

Consistent with this, no compound interest under (1)(C)(i) can accrue after 2016 on the simple interest under (1)(B) that had accrued in 2014 – 2016 on that delinquency. This is because computing interest on the 2014 – 2016 simple interest would itself be compound interest on that simple interest, and in this situation the three-year limit on compound interest under

(1)(C) would have already been reached before the end of 2013.

Third, for pre-2014 production tax that became delinquent after 2010 and thus accrued less than three years of compound interest under (1)(A) as of January 1, 2014, compound interest under (1)(C)(i) can accrue after 2016 on both the delinquency and its pre-2014 compound interest, but this compound interest can only accrue until there is a total of three years of compound interest, and then (1)(C)(ii) ends the accrual of further interest. Consistent with the result above for a delinquency arising in 2010 or earlier, compound interest under (1)(C) does not accrue on the simple interest that accrued in 2014 – 2016, because that would be compound interest over and above the compound interest that (1)(C) allows.

Finally, with respect to a delinquency arising after 2014 and before 2017, only simple interest under (1)(B) would have accrued by the time compound interest under (1)(C) begins. If one considered this situation abstractly and in isolation, one might be able to read (1)(C) as allowing compound interest under (1)(C) to accrue after 2016 on both the delinquency and the simple interest that had accrued on it as of December 31, 2016. But this final situation does not exist all by itself: in the two previous situations involving pre-2014 delinquencies, compound interest does not accrue under (1)(C) on the simple interest that accrued during 2014 – 2016. For consistency — and in the absence of a logically compelling reason to deviate from those two situations — the simple interest accrued by the end of 2016 should not be included in the compounding under (1)(C) that begins in 2017.

The proposed regulation, 15 AAC 05.330(e), disregards the contexts to which the legislature intended the rule in (1)(C) to be applied as well as the words that were carefully chosen in drafting (1)(C) for application in those contexts. Instead, it charges blindly toward the interpretation that is the most punitive — namely, that compounding under (1)(C) will apply to "<u>any</u> accrued and unpaid interest that the taxpayer owes on [January 1, 2017]" (emphasis added). This is not what the words of AS 43.05.225(1) call for or allow, and we ask the Department to modify the proposed regulation for legal and for policy reasons so it reflects the proper application of the statute.

5. <u>Updates of references to external sources</u>. The Department proposes to change in the editor's note following 15 AAC 55.141, which would update the citation of the website

where data about Federal Reserve Bank interest rates can be found. Similarly, it proposes to

(1) update the references to Platt's and Reuters and delete the reference to Dow Jones Energy Service in 15 AAC 55.171(m) and in its editor's note, and in 15 AAC 55.193(d)(1)

(2) update the reference to Platt's in the editor's note to 15 AAC 55.191, and in 15 AAC 55.193(d)(1) and in its editor's note, and

(3) replace Morningstar Inc., *The Cost of Capital Yearbook* with Duff & Phelps, *Valuation Handbook, Industry Cost of Capital*, as the source for "cost of capital" information for purposes of 15 AAC 55.195(d)(18)(B)(i), -.195(f)(17)(A) and -.195(h)(16)(A)

It is a good idea to update the references to external sources that continue to be used. But where an external source like Dow Jones Energy Service ceases to be used, or where one source is replaced by another, we believe the respective editor's note should state the date as of which the change becomes effective for purposes of the respective regulation(s). This will save time for taxpayers and DOR personnel in the future, while avoiding opportunities for potential disagreements over such a date to arise.

6. <u>Repeal of seemingly outdated provisions</u>. The Department proposes to delete 15 AAC 55.151(b)(2)(A) in its entirety. Since subparagraph (A) by its terms pertains only to oil and gas produced "before July 1, 2007," one might argue that its deletion is justified because it has, in practical effect, become a dead letter that can be pruned from the regulations. We believe a similar purpose may underlie the Department's proposed repeals or deletions with respect to the following:

(1) the reference to AS 43.21 in 15 AAC 05.250(a),

(2) 15 AAC 55.173(i),

(3) 15 AAC 55.180, plus the cross-references to it that appear in 15 AAC 55.191,

(4) 15 AAC 55.205, plus the cross-references to it that appear in 15 AAC 55.275(a), 15 AAC 55.280(a),

(5) 15 AAC 55.223,

(6) 15 AAC 55.325,

(7) 15 AAC 55.330,

(8) 15 AAC 55.340, plus the cross-references to it in 15 AAC 55.370(b),

(9) 15 AAC 55.345(e), (f) and (g),

(10) 15 AAC 55.350,

(11) 15 AAC 55.355,

(12) 15 AAC 55.375(a)(2) and (b),

(13) 15 AAC 55.380,

(14) 15 AAC 55.410(b),

(15) 15 AAC 55.420,

(16) 15 AAC 55.430,

(17) 15 AAC 55.510,

(18) 15 AAC 55.520(f)(1)(H),

(19) 15 AAC 55.800(a)(2), (a)(4), (a)(10), (a)(14), (a)(15) and (a)(17),

(20) 15 AAC 55.800(c)(14), and

(21) 15 AAC 55.805.

A fair number of these other provisions to be repealed pertain to periods before 1 July 2007. Indeed, AS 43.21 – the former "separate accounting" income tax – was repealed by chapter 113 of the Session Laws of Alaska of 1981.[2]

Our concerns about these repeals and deletions are twofold. First, we are concerned whether the respective regulations are actually dead letters, or does any taxpayer still have an audit or an appeal pending for tax periods covered by one or more of these regulations? We would be stunned to learn that any taxpayer still has an audit or appeal pending under AS 43.21, which was repealed as of the end of taxpayers' 1981 tax years — almost 35 years ago. So, unless the Department knows of such an audit or appeal, deleting the reference to AS 43.21 in 15 AAC 05.250(a) would be appropriate.

But even when the three-year statute of limitations under AS 43.05.260 applied to production taxes, taxpayers commonly agreed to extend the statute of limitations in order to accommodate a DOR auditor for completing the audit, often extending it more than once. Since the six-year statute under AS 43.55.075(a) took effect, the extensions may be less frequent, but the audits are not materially shorter. We believe that audits approaching a decade in length have occurred in some cases. Thus, even though a regulation applies to periods before a date in 2006 or 2007, it is not clear to us that all production tax audits and ensuing appeals arising when the regulation applied have all been resolved and closed.

We are concerned that the repeal of a regulation under which audits or appeals are still pending might be argued by one side or the other as creating a change in the meaning or applicability of that regulation for purposes of those old pending audits or appeals. Even when such arguments are unmerited, it is wasteful for the parties to argue over whether such a change in meaning or applicability has resulted from the repeal.

Perhaps more importantly, once part or all of a regulation is repealed, it becomes increasingly likely as time passes that legal counsel or the person hearing the appeal may look at the then-current version of the regulation, will see that some parts of it have been repealed, and may conclude that they are not applicable to the issue(s) at hand without actually taking the time and effort to track down the regulation as it read before the repeal.

We do not want the repeal now of such a regulation to lead to either of these situations, nor should the Department. If any taxpayer still has an appeal pending that involves production tax for periods when the regulation applied, the regulation should stay on the books as it is. There is no harm, nor any administrative cost for DOR, in letting it stand.

Our second concern comes from the specific way the Department is proposing to make the repeal of some of the regulations. Take the proposed repeal of 15 AAC 55.151(b)(2)(A), for example. As it currently stands, paragraph (b)(2) has two subparagraphs — (A) (which applies to production before 1 July 2007) and (B) (which applies to production after 30 June 2017). The Department could simply repeal subparagraph (A) and replace its text with the notation "*repealed [effective date of the repeal]*" as it has done in the past with 15 AAC 55.191(b)(6) and (7), for example.[3] And even now, the Department is following that historic practice by inserting such notations for its pending proposed repeals of 15 AAC 55.345(e), (f) and (g). This practice preserves the existing organization of the regulation and its logic, while eliminating the text that has become obsolete.

But instead of this, the Department here proposes to delete all traces of subparagraph (A) and the "(B)" designation for the second subparagraph and collapse subparagraph (B) into paragraph (1) so it reads as if there never were any subparagraphs. This *does* alter the organization and logical structure of the regulation, which conceals the original.

We refrain from speculating why the Department now is proposing to repeal certain regulations differently from how it has done so in the past and is still doing for other proposed repeals that is has proposed. We say instead that changing the organization and logical structure of a regulation as proposed for 15 AAC 55.151(b)(2) — which is not the only example in the proposed regulations[4] — is unwise and unnecessary.

7. Amended definition of "utilities". The only proposed change to 15 AAC 55.173(a) is the insertion of the words "gas or electric" before the word "utilities" in the fourth line of paragraph (a)(2). We fail to see why the term "utilities" should be limited in this fashion.

For purposes of the Alaska Public Utilities Regulatory Act (AS 42.05), the term "utility" is defined along with "public utility" to mean:

> every corporation …, individual, or association of individuals, their lessees, trustees, or receivers appointed by a court, that owns, operates, manages, or controls any plant, pipeline, or system for
>
> (A) furnishing, by generation, transmission, or distribution, electrical service to the public for compensation;
>
> (B) furnishing telecommunications service to the public for compensation;
>
> (C) furnishing water, steam, or sewer service to the public for compensation;
>
> (D) furnishing by transmission or distribution of natural or manufactured gas to the public for compensation;
>
> (E) furnishing for distribution or by distribution petroleum or petroleum products to the public for compensation when the consumer has no alternative in the choice of supplier of a comparable product and service at an equal or lesser price;
>
> (F) furnishing collection and disposal service of garbage, refuse, trash, or other waste material to the public for compensation;
>
> (G) furnishing the service of natural gas storage to the public for compensation;
>
> (H) furnishing the service of liquefied natural gas storage to the public for compensation[.[5]]

One can plausibly imagine "utilities" under this broad definition — besides "oil and gas" utilities — that serve areas of the North Slope which might or would purchase gas from North Slope producers. Trash disposal by using gas to burn the trash is one possibility that comes to mind. A communications service on the Slope that purchases gas as fuel for its own electric generators is another.

Whether or not such utilities exist now, why preemptively exclude them or other utilities? For purposes of determining the prevailing value of gas on the North Slope under 15 AAC 55.-

173(a)(2), the price they pay for the gas they buy should be at least as reliable and at arm's length as the prices that an "oil utility" or "gas utility" on the Slope would pay.

We ask, therefore, that this proposed amendment to 15 AAC 55.173(a) not be adopted.

8. Gross value reductions ("GVRs"). As proposed, new 15 AAC 55.211(i) states that a GVR "is not optional" — which appears to be a result of existing language in 15 AAC 55.212(*l*) that "a producer elects" — or "has not elected" — "for any month to reduce under AS 43.55.-160(f)(3) the gross value at the point of production of any oil or gas produced during the month from the participating area[.]" The criterion set out in -.160(f)(3) is:

> (3) 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.

It is grossly inaccurate and misleading for 15 AAC 55.212(*l*) to represent that a producer's failure to "demonstrate[ ] to the department that the volume of oil or gas produced is from acreage added to an existing participating area" constitutes an "election" by the producer not to use the GVR for that "acreage."

If there is no GVR under (f)(3) for a lease or property that does not qualify under (f)(1) or (f)(2), it is almost surely because the "demonstrat[ion]" — if one is made — was not sufficient to establish clearly, under the stringent requirements of 15 AAC 55.211 and -.212, that the production is only from "acreage added to [the] existing participating area" in question, and not from any other acreage. Even in cases where a producer hasn't attempted to make such a "demonstrat[ion,]" there still is no "election" in that — they result from a belief or actual knowledge that the production does not come exclusively from the "added" acreage, or because there is no practical way to determine clearly how much production comes from "added" acreage and how much comes from the other acreage in the participating area.

With respect to the amendments to 15 AAC 55.212(*l*) that the Department proposes, they are made simply as part of the implementation of the provisions in Sections 26 and 27 in HB 247 about when GVRs begin, how long they last, and when they end. We have no objection to the proposed amendments themselves.

But we do object to the inappropriate and misleading "election" language that currently exists in 15 AAC 55.212(*l*), and we call upon the Department to remove it. And with the removal of the notion that producers make any "elections" or other voluntary acts regarding GVRs, there is no purpose for 15 AAC 55.211(i) and it should not be adopted.

This brings us, then, to 15 AAC 55.214, the new regulation being proposed to address the issues under HB 247 about when a GVR begins, whether it lasts for seven years or a shorter time, and the specific date when it ceases to apply.

Subsection (a) is a brief, three-line statement about what the regulation does. In an intricate and complex regulation like 15 AAC 55.214, such a description can provide a helpful overview of how the rest of the regulation fits together. Of course, as a technical matter, what the regulation actually does is determined by the substantive provisions in the other subsections, and a description in (a) cannot alter what those subsections actually do. So in this technical sense, subsection (a) is unnecessary. But, if the Department decides that (a) as currently written should remain in the regulation it adopts, we wouldn't expect any harm to flow from that.

Subsection (b) covers GVRs arising under AS 43.55.160(f)(1), as well as the additional GVR which that production might qualify for under AS 43.55.160(g).[6] We believe this part of the regulation does reflect what HB 247 provides, assuming "the alternative expiration date determined under (e)" of the regulation correctly reflects HB 247's provisions to end the term of a GVR once there are "three years, consecutive or nonconsecutive, in which the average annual price per barrel for Alaska North Slope crude oil for sale on the United States West Coast is more than $70" — which for convenience we'll call the "price-based expiration date", which we'll get to shortly.

Subsection (c) covers GVRs arising under AS 43.55.160(f)(2) for production from a participating area ("PA") established after 2011 that is in a DNR-approved unit formed before 2003 and does not contain reservoir that had previously been in a PA established before 2012.

It is not entirely clear to us how subsection (c) is intended to work. Structurally it parallels subsection (b) in terms of having an opening sentence prescribing the expiration date if a PA has GVR-qualified production before 2017, and a sentence beginning "Otherwise" that prescribes both a starting date and an expiration date. — which, while not explicit, we believe is applicable to PAs that first have GVR-qualified production after 2016. But then it continues:

> However, if before establishment of the qualifying participating area, regular production of oil or gas commenced from a well producing from a tract to be included in the participating area, the period begins on the date the participating area is established and ends on the earlier of the following dates: the seventh anniversary of the date the participating area was established, or the day after the [price-based expiration date].

We are not sure how this "however" sentence is supposed to interface with the two sentences preceding it. Is it an alternative only to the "Otherwise" sentence preceding it, which we read as applying to PAs whose first GVR-qualified production begins after 2016? Or does it also provide an alternative to the expiration date in the first sentence for a PA with pre-2017 GVR-qualified production?

We are also not sure if we understand the "However" sentence correctly. As we read it, the term of the GVR runs from the date the PA is established, rather than from the date the first well began producing from a tract that is included in the PA once the latter is established. Under this interpretation, it is possible for a PA, formed before the enactment of the GVR provisions, to have qualified production receiving less than the statutory required seven years of GVR in absence of the application of the price-based expiration date. If this is what the Department intends, the proposed amendment would appear to be inconsistent with the amendments to AS 43.55.160 enacted in HB 247. We also do not understand the policy reasons behind the proposed regulatory language. Why shouldn't that tract well's pre-PA production have a GVR, with the expiration date of the GVR being the seventh anniversary of the formation of the PA? The tract is indeed "acreage … added to an existing participating area", which is all that AS 43.55.160(f)(3) calls for in order to qualify, so its production should get a GVR under (f)(3).

Subsection (d) for GVRs under AS 43.55.160(f)(3) has a parallel structure to that in (c), except that it does not have a counterpart to the second sentence (c) that begins with "Otherwise." This is what makes us think the "However" sentence in (c) is applicable to both of the two sentences preceding it instead of just the "Otherwise" sentence. In subsection (d) the "However" sentence is much more complex than the one in (c), but that complexity is clearly organized and laid out as two paragraphs in the subsection, and it shouldn't be an issue in comparing subsections (c) and (d).

This brings us to subsection (e) of the regulation, dealing with price-based expiration dates. HB 247's amendment to AS 43.55.160(f) and the parallel one to -.160(g) speak in terms of GVRs "expir[ing] after three years, consecutive or nonconsecutive[.]" The levies of tax under AS 43.55.011 are all on calendar year basis. This regulation, however, chooses to define "year" amendments as any "sequence … of 12 consecutive months" for purposes of determining the duration of a GVR under the HB 247 amendments.

We acknowledge that the word "year" could be interpreted to mean 12 consecutive calendar months. But we believe this interpretation is inappropriate for a tax that is levied on a calendar year basis with monthly estimated installment payments of tax that are trued-up by March 31 of the following calendar year to reflect the actual prices and lease expenditures for the calendar year when the oil and gas is produced.

We would remind the Department that GVRs exist to provide an incentive for explorers and producers to seek, develop and produce new fields in Alaska. If and as those efforts prove successful, the resulting new production adds to the tax base for the production tax, increases royalties, creates infrastructure subject to state property tax under AS 43.56, and increases the "extraction" and "sales" factors for purposes of apportioning those companies' worldwide net business income to Alaska under the state corporate income tax. Any new oil production will increase the throughput through TAPS as well as each North Slope pipeline through which it may pass en route to Pump Station No. 1, which lowers pipeline transportation costs per barrel for all North Slope production, thereby increasing the netback value of the oil in the field for royalty and production tax purposes, while lowering the economic hurdles for any other prospects that might be on verge of development and production. In other words, Alaska and Alaskans are better off by growing the size of the total revenue pie, rather than trying only to increase the size of the production-tax slice in that pie. Proposed 15 AAC 55.214(e) runs against the grain for all of this, and that's why it should be changed so that a "year" is a calendar year.

Subsection (f) of this proposed regulation addresses situations where a GVR has started for production from certain land and then later that land is combined with other land and the combination is treated as a lease or property qualifying for a GVR under AS 43.55.160(f)(1), (2) or (3). In such a situation, the expiration of the GVR for the original land, and for the land that is combined with it, is to be determined as if the combination had not occurred. This seems reasonable.

Finally, 15 AAC 55.214(g) would provide that a GVR "is not allowed for oil or gas produced on the day that a period specified under (b) – (d) of this section ends." While we recognize the value in having a clear, unambiguous termination date for each GVR, we note that this clarity can be provided just as well by saying the GVR "is not allowed for oil or gas produced *after* the day that a period specified under (b) – (d) of this section ends."

The Department should let the statutory incentives from GVRs have their fullest effect. The symbolism of its choice as reflected in -.214(g) promises to have a greater cumulative negative impact on Alaska over time, than the additional production tax that the State stands to collect for each of those extra days.

9. Outstanding liabilities under AS 43.55.028(j). Enacted by section 25 of HB 247, AS 43.55.028(j) provides in pertinent part:

> (j) If an applicant or claimant has an outstanding liability to the state directly related to the applicant's or claimant's oil or gas exploration, development, or production and the department has not previously reduced the amount paid to that applicant or claimant for a certificate or refund because of that outstanding liability, the department may purchase only that portion of a certificate or pay only that portion of a refund that exceeds the outstanding liability …. [emphasis added]

15 AAC 55.320(c), 15 AAC 55.345(i) and 15 AAC 55.525(a)(1) and (g) apparently reflect how the Department intends to implement this new statute, since each of them deals with an applicant's or claimant's "outstanding liability" to the state.

Proposed 15 AAC 55.320(c) requires "a producer or explorer [when applying for or requesting payment of a tax credit certificate] … to provide the department with certain information and documentation related to *any* outstanding liabilities which may be due from the applicant to the department or another department" as well as a "certification, under oath, of the amount of *any* outstanding liabilities with the department or another department of the state …" (emphasis added). Proposed 15 AAC 55.345(i) similarly requires "information and documentation" and a "certification, under oath" for "*any* outstanding liabilities" to the state (emphasis added). Proposed 15 AAC 55.525(g) requires that "an outstanding liability to the State of Alaska … be deducted from the value of the tax credit certificate or portion of the tax credit certificate being requested for purchase[,]" but does not require any certifications under oath. None of these reflects the language in AS 43.55.028(j) expressly limiting the scope of "outstanding liabilities" to just those that are "directly related to the applicant's or claimant's oil or gas exploration, development, or production[.]"

Proposed 15 AAC 55.525(a)(1) applies to "an outstanding liability to the State for unpaid delinquent taxes …." While this, at least, is *some* limitation on the "outstanding liabilities" it applies to — unlike the others just mentioned — it is not the limitation that AS 43.55.028(j) calls for.

AS 44.62.030 provides that "a regulation adopted is not valid or effective unless consistent with the statute" that it is implementing, interpreting, making specific, or otherwise carrying out. None of the proposed regulations implementing AS 43.55.028(j) reflects its limitation on the kinds of "outstanding liability" to be considered. And accordingly, if the Department adopts them as proposed, none of them could withstand judicial challenge to their validity.

10. Tax credits under AS 43.55.024(a) or (c). A $6 million a year credit under subsection (a) is available if a qualified producer's pre-credit tax liability under AS 43.55.011(e) for non-North Slope, non-Cook Inlet basin production ("Middle Earth" production) during the respective calendar year is greater than zero. AS 43.55.024(c) offers a $12 million a year credit for qualifying producers whose average statewide production during a calendar year is 50,000 BTU equivalent barrels a day or less, and for a qualifying producer's average daily production is more than 50,000 but less than 100,000 BTU equivalent barrels a day, the $12 million is reduced in direct proportion to how far up it lies in the range between 50,000 and 100,000 BTU equivalent barrels a day. If a producer has credits under both subsections, the credit under (c) is applicable only against the tax liability remaining after the subsection (a) credit is applied. These credits are nontransferable, and any unused portion of either credit does not carry forward from one year to another. HB 247 did not amend either of these subsections of AS 43.55.024. The full text of these subsections appears as endnote 7 in the written copy of this testimony.

The Department proposes to amend 15 AAC 55.335(a) to read as follows:

> (a) For any calendar year the maximum tax credit that a producer may

> take under AS 43.55.024(a) or (c) is equal to the percentage expressed as the number or days in a calendar year during which the producer had commercial production during the calendar [*sic*] divided by the number of days in that calendar year.

We believe the words "during the calendar" remain from an earlier draft and accidentally were not deleted when the present draft was prepared. Hence, we understand the proposal to mean that if a producer has production on, say, 45 days during a non-leap year, the amount of its credit would be 45 three-hundred-sixty-fifths, or 12.3287671%, of $6 million or $12 million (or as reduced for producers in the 50,000 – 100,000 BTU equivalent barrels-per-day range).

We object, first, that even if this were appropriate for the $12 million credit under (c) — which it is not — the proposal is totally inappropriate for the $6,000,000 credit. AS 43.55.024(a) requires only that a producer's "tax liability under AS 43.55.011(e) on oil and gas produced [in Middle Earth] exceeds zero before application of any credits under this chapter[.]" That's all. It says nothing about days of production, nor even daily averages. The statute says this credit is "not more than $6 million" because, if the tax for Middle Earth production is less than $6 million, the credit is simply the amount that reduces that liability to zero and there is no remaining or left-over credit. The statute creating the $6 million credit simply does not contemplate — and thus does not authorize — any scaling-down of the credit on the basis of how many days during a year a producer is producing oil and gas in Middle Earth.

Second, with respect to the $12 million credit, AS 43.55.024(c) already addresses the matter of daily production by the way it sets the amount of the credit on the basis of the producer's "average amount of oil and gas produced a day[.]" In other words, the total amount produced during a calendar year is divided by 365 — or 366 in a leap year — and the result determines how large the producer's credit is. If it averages 50,000 a day or less, the credit is $12 million, and otherwise it's scaled down to zero on the basis of how far the average exceeds 50,000. In doing this the legislature has already addressed the Department's concern — i.e., the degree to which the producer's production is continuous or intermittent during a calendar year — and it has done so in a way that is different from the one DOR is now proposing. But the legislature, having already fully addressed this topic, has preempted DOR from addressing it a second time as it is proposing with this regulation.

> As a sidebar to this second objection, if DOR intends to adopt a regulation as proposed, then it should define "day" as a calendar day, not as a period of 24 consecutive hours. The Alaska Oil and Gas Conservation Commission has already defined "day" in 20 AAC 25.990(17) as a calendar day for its purposes, and using the same "day" would allow production reports to AOGCC to be used for DOR's purposes as well. In addition, some small producers may have many production days, but very little tax to offset with the credit due to small working interest percentages or ceiling rates under AS 43.55.011(o) or (p). Accordingly, DOR should allow such producers to simply show that the AS 43.55.024(c) credit taken is not disproportionate to its days of production, rather than create unduly burdensome production tracking and reporting requirements. For instance, a producer taking $1 million in credit could simply show that it had 31 calendar days of production in that year (even though it may have had 200 days).

Third, the legislature's purpose in having these two credits is to provide incentives to encourage smaller producers to come to Alaska and explore, develop and produce more oil and gas, instead of leaving that entirely to larger corporations. Even though they are ineligible for them, the larger members of AOGA support these credits and have welcomed the new players coming to Alaska — competition is good, and no one can say when or how, or by whom, some of the challenges for producing Alaska's hydrocarbon resources will be overcome, or who might make an important discovery in a place like Smith Bay.

DOR's proposal here would hamstring the effectiveness that these credits have as incentives for new players to come to Alaska — how? by cutting the incentive on the basis of things that are outside the control of an explorer or producer: things like equipment turnarounds and temporary shutdowns that are necessary events, as well as unexpected problems that come out of the blue. Frankly, if the state government truly needs the modicum of additional revenue that these proposals would bring in, there are a whole lot of other choices available that are less damaging to the business and economic climate of this state and its competitiveness against other places that are dying to get more petroleum activity.

For all these reasons, we ask the Department not to adopt its proposed revision of 15 AAC 55.335(a).

11. <u>18-month-from-spud-date limit on expenses qualifying for credits under AS 43.55.-025(m)</u>. The proposed amendment to 15 AAC 55.351(d) would require, for "a well spud before July 1, 2017[,]" that only "expenditures incurred within 18 months of the date when the well was

spud" are eligible for the alternative oil and gas exploration tax credit under AS 43.55.025(m). A similar 18-month limitation would also be adopted in the amendments to 15 AAC 55.356(g) and 15 AAC 55.360(a)

In pertinent part AS 43.55.025(m), as amended by HB 247, provides:

> (m) … Notwithstanding (b) of this section, exploration expenditures eligible for the credit in this subsection must be incurred for work performed after June 1, 2012, and before July 1, 2017, except that <u>expenditures to complete an exploration well that was spudded but not completed before July 1, 2017, are eligible for the credit under this subsection</u>. [emphasis added]

There is nothing in the emphasized language quoted above that suggests any deadline after spudding by which a well must be completed. All that is required is that it be "spudded by July 1, 2017" and that it "not [be] completed before July 1, 2017". The Department would effectively be amending the statute by adopting a regulation about how soon after spudding a well must be completed, when the statute itself does not even imply – much less prescribe – any such deadline.

Moreover, suppose a well is spudded on 15 May 2017 and is being diligently drilled and on schedule to be completed by 1 November 2018 (i.e., within 18 months of the spud-date), and then there is an accident shortly before breakup in 2018 that seriously damages the drilling rig. The heavy parts to fix it cannot be brought in until after freeze-up in the fall of 2018, and as a result the well is not completed until 15 March 2019. Through no fault of its own, the explorer/-producer drilling the well, under the proposed regulation, won't be able to include any of the costs incurred after 15 November 2018 for this well. Why is that right or fair?

12. <u>Including GVR in installment payment calculation</u>. Proposed 15 AAC 55.511(c) would be amended by turning part of the present text into paragraph (1) in the subsection and by adopting a new paragraph (2) that provides for installment payments to reflect the GVR when one applies the production. We concur in this.

13. <u>HB 247's time-based changes to percentages allowed for AS 43.55.023 credits</u>. Just three subsections of AS 43.55.023 actually establish tax credits — subsection (a) for a "qualified capital expenditure" ("QCE"), subsection (b) for a "carried-forward annual loss" ("NOL"), and subsection (*l*) for "lease expenditures incurred … in connection with geological or geophysical

exploration or in connection with an exploration well[.]" Even before HB 247 the percentages for the credits under -.023(b) were different, depending on when or where the underlying expenditure was "incurred[.]"

Section 17 of HB 247 amended the QCE credit for Cook Inlet and Middle Earth under subsection (a) from 20% to 10%, effective as of the general January 1, 2017 effective date for HB 247. Section 18 amended the NOL credit for Cook Inlet and Middle Earth, making it 25% of an NOL "[f]or lease expenditures *incurred* … before January 1, 2017[,]" but only 15 % of an NOL "[f]or lease expenditures *incurred* on or after January 1, 2017[.]" Further, the credit is allowed for an NOL in Cook Inlet "only if the expenditure is *incurred* before January 1, 2018." And Section 19 of HB 247 amended AS 43.55.023(*l*) to make the credit "40 percent of th[e] lease expenditure *incurred* before January 1, 2017 [but only] 20 percent of th[e]] expenditure *incurred* on or after January 1, 2017." In the hard copy of this testimony, the word "incurred" is in italics, but it is not italicized in the statute.

In the interest of consistency among the AS 43.55.023 credits, we suggest that the Department clarify by regulation that the QCE transition from 20% to 10% is based on when the expenditures are incurred, as it is with the other two credits. Accordingly, the regulation would provide that the QCE is 20% for qualified capital expenditures incurred before January 1, 2017, and 10 % for qualified capital expenditures incurred on or after January 1, 2017.

14. <u>Purchases of tax credit certificates</u>. Proposed 15 AAC 55.525 is the regulation that would govern purchases of tax credit certificates with cash from the Oil and Gas Tax Credit Fund ("Credit Purchase Fund" or "CP Fund"). Its approach is to divide the universe of applications into two parts: those "received by the department prior to January 1, 2017" and those it receives in 2017 or later. It will purchase all of the ones in the earlier group before it begins buying any of those received in later group. When it does start buying certificates from the later group, it will first buy only the ones whose applications were received during 2017, and they will be "prioritized based upon …the date upon which the application was submitted" — which could be different from when they were "received" by the Department: a drafting flaw we note in passing. Once those are all purchased, the Department will start buying those with applications "received" during 2018 with a similar prioritization among them, and so on year by

year.

Prioritization based upon when an application for purchase of a certificate is received by the Department makes sense as a broad proposition, given that those who invested in Alaska earlier deserve to benefit from the resulting tax credits ahead of those who invested later. However, there are problems in both parts of this divided universe of applications under 15 AAC 55.525.

Subsection (a) of this regulation — having divided the universe using the principle of when applications are received — incongruously casts that principle aside in favor of "allocat[-ing] funds proportionally" among applicants "based on the balance of tax credits certificates [they had] requested … as of December 31, 2016." The Department doesn't propose any similar system of proportional allocation among those whose applications it received the very next day or later, and there is no reason we can see to warrant such a disparity in treatment. The only time it might be appropriate to allocate proportionately between two or more pre-2017 applicants would be to break a tie among applications the Department received on the same day — and even then, it would only be to use the last of the money remaining in the Credit Purchase Fund. The unpaid remainder of those applications, as well as all the other pre-2017 applications still in line, would carry over for the following year in their respective positions in line for pre-2017 applications, before payments start being made to those whose applications are received by the Department in 2017.

Things are scarcely better for applicants in the part of the tax credit universe lying on the other side of midnight of December 31, 2016. In particular, 15 AAC 525(b) does not expressly prioritize the criteria as between the date of an application for cash purchase is received versus an applicant's percentage of resident workers. Accordingly, the regulation should explicitly provide that the determination of priority for cash payment should be made in the first instance based on when the application is received. Then the need to look to resident worker percentages would only arise if two applications for cash purchase are received on the same date. This would clarify priority, prevent delay and narrow the uncertainty for all applicants about how high their resident-worker percentage is relative to the rest, and reduce the Department's own administrative effort related to the resident hire determination.

The priority issue can be addressed in the proposed 15 AAC 55.525(f). Subsection (f)(1) recapitulates subsection (a), so we won't repeat what we've already said about it. The opening words of subsection (f)(2) are clear that each year's tranche of applications will be paid off before the next year's tranche is considered.

We believe the Department intends for priority to be determined as described above. If that is true, subsection (f)(2)(A) and (B) should be rewritten to provide that applications will be prioritized based on:

(A) first, the date upon which the application for purchase of the tax credit certificate or portion of the certificate was received, with earlier-received applications paid in full before later-received applications are paid, except that

(B) among applications for purchases received on the same day, the department will grant a preference to the applicant with the higher percentage of resident workers, such that the applicant with the higher percentage of resident workers is paid in full before applicants with lower percentages of resident workers are paid.

The current proposal says that the Department will consider both the timing of applications and an applicant's percentage of resident workers, but does not prioritize the criteria. Revising it as we have just described clarifies the resident worker preference, which in turn resolves the ambiguities that arise in subsection (d). Otherwise (d) creates a mass of questions, including the following examples.

For applications for purchase received after December 31, 2016, subsection (d) sets out a series of tests to rank the applications based on the applicants' respective percentage of resident workers. But paragraph (d)(2) calls for this ranking to be done twice a year, which mechanically brings into the analysis the order in which applications were received. The Department could still make this work by a provision saying that for any re-ranking in the second half of a year, priority is given to the remaining applications ranked in the first half of the year and not purchased then. But (d)(2) speaks specifically about the Department "ma[king] a final determination of funds to be allocated[,]" implying each ranking stands alone. If this "determination" is indeed a "final" ranking, does it mean the applications in the first ranking are all paid before the Department begins paying the applications in the second ranking ? If not, then are the first-half and second-half rankings ever compared, and what happens if they are different? Paragraph (d)(3) makes all this even more confusing by saying that two or more "applications … during a calendar year" by an applicant "shall be … considered to be submitted as a single application." When applications become "considered" as one, what is their application date: the earliest one, the latest one, or is there some kind of date-averaging?

15. Credit repurchase limits — implementing AS 43.55.028(e) and (g)(3). AS 43.55.-028(e) limits the amount of tax credit certificates that the Department may buy from a person during a calendar year to $70 million. Under AS 43.55.028(g)(3), the Department must purchase "the first 50% of the credit repurchase limit for [a] person … at a rate of 100 percent of the value … requested to be purchased … and … the next 50% … at a rate of 75 percent of the value requested to be purchased." With respect to this limitation and its implementation, we suggest that, even though the "credit purchase limit" for purposes of AS 43.55.028(g)(3) should logically be the $70 million in subsection (a) of that statute, the Department should — in order to foreclose now all potential disputes down the road — include the following as a new subsection at the end of 15 AAC 55.525: "For purposes of AS 43.55.028 and this section, 'credit purchase limit' means the $70,000,000 limitation in AS 43.55.028(e)."

16. Credit repurchases —amending requests in response to matters under AS 43.55.-028(g) and (j). When a person (a "certificate-presenter") presents a tax credit certificate to the Department and requests a repurchase of only portion of that certificate with money in the Credit Purchase Fund, it is possible that the Department may have found, or may believe there exists, some "outstanding liability to the state directly related to the [person's] oil or gas exploration, development, or production" with respect to which it "has not previously reduced [an] amount paid to that [certificate-presenter.]" This means that the amount the Department pays for the certificate or portion of it under AS 43.55.028(j) would be less than what the certificate-presenter expected at the time it made the repurchase request.

It is also possible under AS 43.55.028(g) that the amount paid to a certificate-presenter is less than the requested amount because other certificate-presenters with higher percentages of resident workers in their workforces were paid so much for their certificates that the amount left for those with resident-worker percentages equivalent to that of this certificate-presenter is not enough to pay their requests fully.

In such a circumstance it is quite possible that a certificate-presenter would want to amend its request downward in order to optimize its amount of the certificate that can be repurchased at 100% and leave the rest to carry-forward into the next year (as 15 AAC 55.-525(c)(2) proposes), when it might then be repurchased at 100%. The Department therefore should have a provision in 15 AAC 55.525 allowing a certificate-presenter to amend its request just before the repurchase of part of it is made.

17. <u>The Alaska-resident preference</u>. AS 43.55.028(g)(2) requires the Department, when allocating available money in the Credit Purchase Fund, "grant a preference, between two applicants, to the applicant with the higher percentage of resident workers in the applicant's workforce[.]"

It is the role of the Attorney General of Alaska, not AOGA, to advise the Department on any legal questions, especially those involving the constitutionality of a provision that was of significant importance to members of the Alaska Legislature when they voted to enact the statute. Nor do we mean to offer any advice or opinion now about the constitutionality of AS 43.55.028(g).

The Supreme Court of the United States in *Hicklin v. Orbeck*, 437 U.S. 518 (1978), struck down former AS 38.40 enacted in 1972, which created a preference for Alaska residents in the hiring of people to work in the construction of the Trans Alaska Pipeline System ("TAPS"). A unanimous Court held that this preference violated the "Privileges and Immunities Clause" in section 2 of Article IV of the U.S. Constitution. The Court found that Alaska's historical unemployment problems before and while the law was enacted did not justify the hiring preference, nor did the State of Alaska's ownership of the oil and gas to be transported through TAPS.

The 1972 hiring preference was made through a provision in the lease contract giving TAPS a right-of-way across state lands, which created the preference and required each lessee to include a similar "Alaska Hire" provision in all its contracts with companies to build TAPS, including a clause requiring those primary contractors to put the same provisions into all their TAPS-related contracts with subcontractors, who in turn had to include the provisions in contracts with their sub-subcontractors, and so on down the line. That legal source for creating the preference is significantly different from the one now in AS 43.55.028(g)(2), which is a preference in the order for having tax credit certificates paid from the Credit Purchase Fund.

Assuming the Department remains committed to implement AS 43.55.028(g)(2), it may be prudent to have the Attorney General carefully review, before their formal adoption, the final regulations that implement AS 43.55.028(g)(2) so that the Department can have the strongest possible case for defending the preference from constitutional attacks.

Having noted this, our concern is that the Department's regulations to implement the preference need to be as clear and open as possible, so that certificate-presenters will know as clearly and as early as possible in the process, where — in terms of money remaining available in the Credit Purchase Fund — they will be in the line for presenting certificates to the Department for payment. Otherwise, unfairness to certificate-presenters may taint the defense against challenges by nonresidents.

Proposed 15 AAC 55.525(e) provides:

> For purposes of AS 43.55.028(g)(2) an applicant shall report the percentage of resident workers, including direct contractors, to the department and shall retain the necessary documentation to support those percentages for a period of three years following the purchase of the tax credit certificate.

We agree with the Department that a regulation is necessary to address how "the percentage of resident workers" in someone's "workforce" is to be shown and documented. But proposed -.525(e) is not merely inadequate for this purpose, it doesn't even take a stab at being adequate.

To begin with, it does not address what "documentation" is "necessary" — not even a description of the kinds of documents and records that are or could be "necessary".

It does not address whether — and if so, how —a certificate-holder is supposed to safeguard the integrity of "documentation" for the resident-worker percentage of its "workforce[.]" Nor does it address whether "documentation" about the certificate-holder's own "workforce" must be kept separately from any "documentation" from contractors — or further, whether contactors' "documentation" must remain separate for each contractor.

It does not address how a certificate-holder is supposed to get this residency "documentation" from its contractors; nor how the certificate-holder must maintain the security and integrity of "documentation" it receives from its contractors — or alternatively, if the contractors keep it, how the certificate-holder is to make each contractor "retain [it] … for a period of three years following the purchase of the tax credit certificate" so the Department can review it. Nor does it address what a certificate-holder is supposed to do if a contractor refuses to adhere to the Department's requirements about the contractor's residency "documentation."

It does not address whether the "documentation" may be generated in the ordinary course of business for a certificate-holder or its contractors, and if so, whether it must be kept in hard copy or can be an electronic document. Nor does it address the matter of which "documentation" – if any – must be made under oath.

It does not address by what process or legal proceedings the Department — as part of "verify[ing] an applicant's claimed percentage or resident workers" — plans to get access to or obtain copies of "documentation" from contractors. Nor does it address how — and in which legal forum — DOR intends to meet and (presumably) overcome objections based on the confidentiality of employee records that the contractors keep.

It does not address whether a certificate-holder can use "information from the Department of Labor" to substantiate part or all of the resident-worker percentage of its workforce — nor the follow-up question about whether it may use "documentation" or "information" that it (or its contactor) provides to the Department of Labor upon which Labor relies for purposes of compiling its "information" that DOR intends to use.

It does not address the question whether "documentation" — even if not "necessary" for verification purposes — may still be used to "verify" the resident-worker percentage of someone's workforce. Consequently, it does not attempt to describe or categorize what this relevant — albeit non-"necessary" — "documentation" might be.

Further, while unrelated to the matter of "documentation," there is the matter of what happens if the resident-worker percentage in an applicant's "workforce" (including contractors) changes from year to year while the applicant is waiting for the Department to reach its application. If the percentage is higher when the Department reaches the application, does the applicant move forward in that year's line, or backward if its current percentage is lower? Or does the percentage stay the same during the waiting period? Whichever way the Department wants to address this issue, it needs to put that answer into the regulations.

We note, in addition, that — at a different level — there is a problem with Revenue Online. Based on actual experiences with the batches of certificates that the Department processed last summer, apparently certain settings in Revenue Online were required in order for applicants to receive an email notification that their applications were ready for payment, and if those settings weren't right, they didn't get a notification. Regardless of what the regulations end up saying about how an applicant finally gets to the front of the line for certificate repurchases, the Department must either make Revenue Online more transparent about what needs to be entered in order to be notified that one's certificate is ready for cashing-out, or it must provide a bypass around Revenue Online that allows applicants who reach this position to get notice of it.

By these failures and others, the proposed regulation disregards basic concepts of Due Process and the principle that government *must* inform people about what they need to do or show in order to receive benefits that the law has entitled them to.

We opened our comments about the resident-worker priority with a discussion of a landmark court decision, and we now close this part of our testimony with another landmark court decision, this time by the Alaska Supreme Court.

U.S. Smelting, Refining and Mining Co. v. Local Boundary Commission, 489 P2d 140 (Alaska 1971), involved a statute governing the Commission which had two subsections — subsection (a) listing functions that the Commission "shall" perform and subsection (b) listing functions it "may" perform. The court wrote:

> Since under AS 44.19.260(a) <u>the legislature required the commission to develop standards</u> in order to recommend boundary changes, <u>and the commission had not developed standards</u> prior to the Nome annexation proceedings, <u>we hold that the commission lacked the power to recommend the Nome boundary changes in question</u>. [489 P.2d at 142 (emphasis added, footnote omitted)]

In the first line of AS 43.55.028(g) in the amendment in Section 24 of HB 247, the legislature changed the opening of subsection (g) by replacing the existing word "may" to "shall[;]" it now reads: "The department *shall* adopt regulations to carry out the purposes of this section [including, in paragraph (2) thereof, the resident-worker preference]" (emphasis added).

The word ""shall" in legislative drafting is still mandatory in nature, and "may" is still permissive. *See* Legislative Affairs Agency, *Manual of Legislative Drafting* (Juneau 2015) at 65:

> Use the word 'shall' to impose a duty upon someone. … Use the word 'may' to grant a privilege or discretionary power.

Thus, if there were any doubt, the *Manual* makes it clear that HB 247 has explicitly made it mandatory for the Department to "adopt regulations to carry out the purposes of [AS 43.55.-028(g)(2).]" Those "purposes" include the evidence and "documentation" that is appropriate or necessary to establish the resident-worker percentage of someone's "workforce" for purposes subsection (g)(2).

The Department so far has not attempted to do this. But if it does not adopt regulations that *do* address – and sufficiently answer – the issues and questions we described a few minutes ago, the *U.S. Smelting* decision says the Department will "lack[] the power" to disregard, overrule or rely on different kinds of evidence in place of whatever relevant information or materials a person may present about the resident-worker percentage of someone's "workforce[.]"

18. <u>Parties' undoing of an assignment of a tax credit certificate</u>. We concur with the requirement in proposed 15 AAC 55.525(i) that both the assignor and assignee must consent to a withdrawal of an application for a cash payment of an assigned certificate or an assigned portion of it. But we object to the last sentence of that subsection, requiring the assignor and assignee to revoke the assignment itself that they made.

This objection is based, first, on policy grounds. If the assignor and assignee have both consented to the withdrawal of the request payment of the assigned certificate or assigned portion of it, that is all the Department really needs to know at that time. It is quite possible that, having agreed to the terms of the assignment itself, the two parties may wish only to change the timing for the cash payment to be made, but not the assignment that will be cashed out at a new time — indeed, revoking the assignment may jeopardize the tax credit as collateral and a source of repayment upon which parties have arranged their financing. The Department should not keep them from making such arrangements, nor should it require the parties to take an action that imperils those arrangements, as would happen under proposed 15 AAC55.252(i).

Second, requiring revocation of an assignment would be contrary to the assignment statute, AS 43.55.029. The assignment statute clearly provides that the assignment remains effective after the certificate is issued, through the cash purchase process. AS 43.55.029(a) provides that "[i]f a production tax credit certificate is issued to the explorer or producer, the notice of assignment remains effective and shall be filed with the department by the explorer or producer together with any application for the department to purchase the certificate under AS 43.55.028(e)." The Department's proposed regulation would run directly contrary to this unambiguous language that "the assignment remains effective" regardless of the timing of the purchase application. The statute also clearly precludes the Department from preventing or undoing assignments — AS 43.55.029(b) provides that "[t]o be effective, the assignment does not require the approval or consent of the department."

Third, the impairment of the security arrangements for financing arrangements that have already been made is prohibited under the "impairment of contracts" clauses of the United States and Alaska constitutions.

19. Definition of "workforce". Proposed 15 AAC 55.900(a)(46) would define "workforce" to be "employees who are resident workers and workers who do not meet the definition of a resident worker." Literally, this grammatical structure defines "workforce" in terms of "employees" that are "resident workers and workers" who are not resident workers. But an "employee" cannot be both at the same time as the regulation is saying. To eliminate any question about this, we recommend changing the definition to read: "'workforce' means employees who are resident workers as well as employees who do not meet the definition of a resident worker."

20. Definition of "sells to another party". Proposed 15 AAC 55.900(b)(28) would read:

> (28) "sells to another party," when used in reference to oil or gas of a producer that is a municipal entity under AS 43.55.895, means sells to a person other than the producer.

This is ambiguous in situations where a municipal utility sells some of its oil or gas production to another utility of the same municipality. To avoid that ambiguity, we suggest replacing "the producer" at the end of the definition with the words "that entity".

21. Typos and manifest errors. As we reviewed the proposed regulations, we found a few typos and manifest errors in them. Instead of taking your time to present them orally now, we have outlined them in an endnote[8] in the hard copy of this testimony.

This brings me to the end of our testimony. On behalf of the members of AOGA, thank you for affording us this opportunity to testify today and share our thoughts and concerns with you.

ENDNOTES

1 As amended, AS 43.05.225 reads as follows:

Sec. 05.225. Interest. Unless otherwise provided,

(1) a delinquent tax

(A) under this title, before January 1, 2014, bears interest in each calendar quarter at the rate of five percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter, or at the annual rate of 11 percent, whichever is greater, compounded quarterly as of the last day of that quarter;

(B) under this title, on and after January 1, 2014, except as provided in (C) of this paragraph, bears interest in each calendar quarter at the rate of three percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter;

(C) under AS 43.55, on and after January 1, 2017,

(i) for the first three years after a tax becomes delinquent, bears interest in each calendar quarter at the rate of seven percentage points above the annual rate charged member banks by the 12th Federal Reserve District as of the first day of that calendar quarter, compounded quarterly as of the last day of that quarter; and

(ii) after the first three years after a tax becomes delinquent, does not bear interest.

(2) the interest rate is 12 percent a year for

(A) delinquent fees payable under AS 05.15.095(c); and

(B) unclaimed property that is not timely paid or delivered, as allowed by AS 34.45.470(a). [emphasis added]

2 The circumstance that — unlike other taxes under Title 43 — there are no taxpayers with ongoing audits or appeals under the now-repealed AS 43.21 means there is no one with standing to complain that the Department's public notice might be defective with respect to AS 43.21 taxpayers. So we doubt that deleting the reference to AS 43.21 in 15 AAC 05.250(a) would lead to an invalidation of that deletion on procedural grounds under AS 44.62.-300(a)(1).

3 We mention 15 AAC 55.191(b)(6) and (7) because the Department is also proposing to amend a different part of 15 AAC 55.191(b) at this time, and so an example of its historic practice is actually right in front of DOR now. A similar example is paragraph (7) in 15 AAC 55.191(j), which DOR is proposing to amend for an unrelated reason.

And the use of a "*repealed*" notation in both of these regulations refutes any argument that some kind of drafting convention makes the "*repealed*" notation appropriate only for repeals of subsections within a regulation, but not for further subdivisions with it. Common sense would say that whenever there is a series of two or more parallel subparts to a regulation, at whatever level within that regulation, the repeal of any one of those subparts should be shown by a "*repealed*" notation — and, in any event, the repeal certainly should not be done by dropping all evidence of that subpart from the regulation.

4 *See*, .e.g., the proposed amendment to 15 AAC 55.375(a), which would similarly erase all evidence that there was ever three paragraphs to that subsection.

5 Quoted from AS 42.05.990(6).

6 The condition for a 20% GVR under -.160(f)(1) is production "from a lease or property that does not contain a lease that was within a unit on January 1, 2003[.]" The condition under -.160(g) for an additional 10% GVR has two parts: first, that the production is from a unit "that does not contain a lease that was within a unit on January 1, 2003," and second, the "unit [is] made up solely by leases that have a royalty share of more than 12.5 percent...." Thus, if production qualifies for a 20% GVR under AS 43.55.160(f)(1), it meets first prong of the two-part condition for having the additional 10% GVR under -.160(g) as well. And the second prong, if it is met at all, was met when the last leases in the unit were issued, since this prong is purely a matter of what the State's royalty percentage is

under each of them. Proposed 15 AAC 55.214 (b) explicitly reflects this with its reference to a GVR "under AS 43.55.160(f)(1) or under AS 43.55.160(f)(1) and (g)."

[7] AS 43.55.024(a) provides:

> (a) For a calendar year for which a producer's tax liability under AS 43.55.011(e) on oil and gas produced from leases or properties outside the Cook Inlet sedimentary basin, no part of which is north of 68 degrees North latitude, exceeds zero before application of any credits under this chapter, a producer that is qualified under (e) of this section may apply a tax credit against that liability of not more than $6,000,000.

AS 43.55.024(c) provides:

> For a calendar year for which a producer's tax liability under AS 43.55.011(e) exceeds zero before application of any credits under this chapter, other than a credit under (a) of this section but after application of any credit under (a) of this section, a producer that is qualified under (e) of this section and whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is less than 100,000 BTU equivalent barrels a day may apply a tax credit under this subsection against that liability. A producer whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is
>
> (1) not more than 50,000 BTU equivalent barrels may apply a tax credit of not more than $12,000,000 for the calendar year;
>
> (2) more than 50,000 and less than 100,000 BTU equivalent barrels may apply a tax credit of not more than $12,000,000 multiplied by the following fraction for the calendar year:
>
> $$1 - [2 \text{ X } (AP - 50{,}000)] \div 100{,}000$$
>
> where AP = the average amount of oil and gas taxable under AS 43.55.011(e), produced a day during the calendar year in BTU equivalent barrels.

[8] Following is a list of errors and manifest errors that we have identified:

i. Proposed 15 AAC 5.315(b) has two references to provisions in 15 AAC 55.207, which is not an existing regulation and is not proposed for adoption at this time by the Department.
ii. Proposed 15 AAC 55.525(a) has a paragraph "(1)" but no paragraph "(2)" or higher.
iii. In the first line of proposed 15 AAC 55.525(b)(3), a verb — probably the word "is" — is missing between "an amount which" and "equal to 75 percent".
iv. In the proposed amendment to 15 AAC 55.360(a)(2), the new subparts being added to that paragraph should be formatted as subparagraphs and identified as (A) and (B).
v. In the first line of 15 AAC 55.525(h), "provide" should be "provided".
vi. In proposed 15 AAC 55.515(i), the wording immediately after the comma in the third line deals with a partially assigned certificate but not a certification that was fully assigned. The words "the portion of such certificate assigned" should be changed to "the certificate or such portion of it that has been assigned".
vii. *Passim*: The proposed regulations use "spud" for the past tense of the verb "to spud" in addition to its regular use for the present tense. To prevent confusion about whether a usage of "spud" as a verb is in the present tense or the past tense, we suggest that the better usage – and the one used by the legislature in AS 43.55.025 — would be to use "spudded" for the past tense and the past participle and to use "spud" only for the present tense.

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Rec'd 10/24/16
J.M.L.

October 24, 2016

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Re: Department of Revenue, 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 Notice of Proposed Changes on Oil & Gas Production Tax (Notice) in the Regulations of the Department of Revenue ("Department") issued September 21, 2016 which followed the scoping notice and workshop.[1] We provide the following comments and recommendations concerning the proposed regulation changes in the Notice pertaining to the Administrative and Production Tax Regulations.

General Comments and Suggestions for Regulation Scoping

Workshop and Brief Descriptions: Our letter response to the scoping notice recommended the Department follow its past practice of holding a public workshop to review the draft regulations prior to formally noticing the regulations. A workshop enables the taxpayers to understand the reason behind the proposed change rather than speculate. While the Brief Descriptions of each proposed regulation change in the Notice were helpful, the reason for some proposed changes is not intuitive and requires making assumptions which may not be correct. A public workshop facilitates knowledge

[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. ConocoPhillips participated in the public hearing on August 12, 2016, reviewed the Department's Notice, and submitted, in addition to testimony at the public scoping meeting, ideas, comments and suggestions in a letter dated August 16, 2016.

sharing, eliminates misinterpretations or misunderstandings thereby allowing taxpayers to provide relevant and constructive comments.

As an example, how is a taxpayer supposed to understand why the Department is removing the requirement from 15 AAC 55.250(a) – the requirement that the Department withhold releasing information from another taxpayer's file for a minimum of one year in certain circumstances? Nothing in HB 247 changed pertaining to this regulation and the Brief Description simply states "the proposed amendment will change the time period that currently limits disclosure of confidential information." Absent understanding "why" the proposed elimination of protecting current, commercially sensitive information, it is nearly impossible to provide relevant or constructive comments.

Examples: The Department's examples at proposed regulation 15 AAC 55.315(c) are appreciated. We encourage additional examples incorporated into the regulations. For example, taxpayers would benefit from examples or illustrations of the regulations at 15 AAC 55.214. At subsection (b), the second sentence of the regulation states:

> If any oil or gas was produced from a qualifying lease or property before January 1, 2017, the period for which oil or gas produced from the qualifying lease or property may receive a gross value reduction ends on the earlier of the following dates: January 1, 2023, or January 1 following the alternate expiration date determined under (e) of this section.

Here, it would be helpful if the Department provided an example for addressing expiration prior to January 1, 2023 and expiration on a date other than month end. With production tax calculations all based on a month, it is impractical for calculation and compliance to stop on anything but a month end.

If one attempts to work through the regulation, absent an example, questions immediately arise. For simplicity assume that production began on September 25, 2016 and for the next seven years the price never exceeds $70 per barrel. The alternate date in (e) does not apply and the third sentence starting with "[o]therwise does not appear to apply because this production began prior to January 1, 2017, therefore the expiration date is January 1, 2023. This does not make sense in light of the statutory change to seven years which ends on September 25, 2023. Further, a taxpayer's entire estimated payment calculation is based on a full-month so having 5 days to calculate differently is impractical.

Hopefully, the example above illustrates why both public workshops and examples are important and benefit both the Department and the taxpayer.

Repealed Statutory Sections: HB 247 repeals several statutory sections and portions of statutory sections and the Notice proposes to repeal a significant number of regulations. The audits and appeals involving the proposed regulations are on-going and likely will continue for many years. Hence, a full set of regulations as a reference on the Department's website, prior to the repeal would ease the administration for both the Department and the taxpayers.

Regulations Adversely Impacting Investment Decisions: During the promulgation of SB 21 regulations and in subsequent discussions with the prior administration as well as the current administration, ConocoPhillips discussed three regulations that do not implement legislative intent or comport with industry investment decisions.

The first regulation is 15 AAC 55.211(d)[2] which pertains to the timing requirements established by the Department for a taxpayer to know whether it will receive a gross value reduction for a new participating area. This regulation provides that a taxpayer only receives a gross value reduction when the Department of Natural Resources grants a new participating area. The Department of Natural Resources has its own statutes and regulations that govern the granting of a new participating area and those require an application at least 90 days before sustained production.[3] The legislature's objective in enacting the gross value reduction was incentivizing oil and gas development investment decisions, however, a company will make its final investment decision years prior to knowing whether a new participating area is granted by the Department of Natural Resources. With the regulation that a gross value reduction is contingent upon the Department of Natural Resources granting a new participating area, a company cannot include the gross value reduction in its economics since a company does not know whether it will receive the gross value reduction and thereby the regulation undoes the legislature's purpose of positively influencing investment decisions.

The second regulation is 15 AAC 55.211(e) which excludes an expanded participating area from gross value reduction qualification if the acreage added had previously been included in a participating area. The legislature did not enact any statutory language limiting the gross value reduction if land was previously in a participating area and we discussed with the prior and current administration that 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. Regulation 15 AAC 55.211(e) has no basis in statute and similarly, the third regulation is 15 AAC 55.213 which establishes metering requirements that do not comport with standard oil and gas operations and also is not founded in statute. Alaska Statute 43.55.160(f)(3) only requires the taxpayer demonstrate that the volume of oil or gas produced is from acreage added to an existing participating area. Nothing in the

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[2] 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;..."

[3] 11 AAC 83.351.

statute says the "acreage" could not previously been in a participating area and nothing in the statute required onerous metering requirements to demonstrate the volume of oil or gas was produced from the acreage added.

After the second and third regulations were promulgated, the hurdle to qualify for a gross value reduction with an expanded participating area was nearly impossible. With the addition of the complex, proposed regulations for calculating the gross value reduction duration at 15 AAC 55.214 any remaining incentive will be extinguished. At the time the legislature enacted a gross value reduction applicable to expanded participating areas, it intended to encourage oil and gas investments around the flanks of existing developments and the use of new technology like horizontal drilling to reach this oil, however, the regulations have eliminated the incentive.

We recommend the Department rework the gross value reduction regulations on the timing of new participating area approvals and expanded participating areas to reflect the legislative intent to influence investment decisions and reflect current practices and requirements of oil fields on the North Slope.

Specific Comments by Proposed Regulation

15 AAC 05.250. Use of confidential information in enforcement proceedings.

The existing language requires the Department's representatives only disclose confidential information "obtained from a taxpayer in an audit or investigation of another taxpayer under AS 43.21 and AS 43.55, if the information is relevant to a sale, exchange, disposition, or netback valuation of oil or gas ***that relates to a period at least one year before the Department's release of the information***." Emphasis added. The proposed regulation removes the bold language allowing the Department's representatives to release a taxpayer's current commercially sensitive information. It is unclear why removing protection of a taxpayer's current, commercially sensitive information is necessary or prudent and we object to adopting this proposed change.

15 AAC 05.330. Interest.

The proposed changes to the interest regulation are contrary to the statutory change, the legislative intent and case law by inappropriately rewriting the statute and re-characterize delinquent tax through regulation.

Section 8 of CCS HB 247, modifies interest at AS 43.05.225 for production tax to state:

(C) under AS 43.55, on and after January 1, 2017,

(i) for the first three years after a tax becomes delinquent, bears interest in each calendar quarter at the rate of seven percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter, compounded quarterly as of the last day of that quarter; and

(ii) after the first three years a tax becomes delinquent, does not bear interest;

Retroactive Application: The legislature plainly articulated interest applies "after a tax becomes delinquent."[4] Yet, the last sentence in the proposed regulations applies interest, retroactively, to both tax and interest at 15 AAC 05.330(e):

> "[f]or purposes of this subsection a delinquent tax consists of the balance of unpaid tax on January 1, 2017, including any accrued or unpaid interest the taxpayer owes on that date."

During a discussion in the House Resources Committee on HB 247, Mr. Alper requests to clarify that "interest rates are in no way retroactive."[5] However, the proposed regulation takes whatever exists – tax and interest - on January 1, 2017, and applies the new compound interest rate. This is retroactive application of the new compound interest provision and an unauthorized re-characterization of "delinquent tax."

Interest Application Period: The legislature purposely selected the three-year interest application period due to the lengthy time the Department takes to conduct production tax audits.[6] Yet, the proposed regulation is subjecting audit assessments and appeals unissued or unresolved prior to January 1, 2017 to an additional three years of now compound interest. The legislative intent was articulated during hearings on HB 247 and acknowledged by Mr. Alper that "after three years it goes to no interest."[7] The Senate Resources Committee who introduced the interest language that

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[4] See, AS 43.05.225(C)(i)..."under AS 43.55, on and after January 1, 2017, (i) for the first three years ***after a tax becomes delinquent***, bears interest in ..." Empahsis added.

[5] House Resources Committee, HB 247, February 12, 2016, 1:16-1:17.

[6] House Resources Committee, HB 247, February 12, 2016, 1:20-1:21.

> "Mr. Chairman, to answer Representative Hawker's question, I don't want to use the word "delinquent." We, we do have a delay, we do have a multi-year process to audit oil and gas production tax returns. The statutes give us six years as the statute of limitations. We have in prior years pushed fairly close to that deadline. By fairly close I mean weeks or even days. We are moving off of that deadline. The short answer is we, we can be up to six years behind. We are currently finalizing calendar year 2009, which those taxes were due and payable on March 31, 2010 so sometime between now and March 31st we will be completing the rest of 2009 and issuing the appropriate assessments.

[7] Mr. Alper speaking to the Senat Finance Committee on April 13, 2016 explaining SB 130, the companion bill to HB 247 and the changes that the House made to HB 247:

> "The interest rate that we sought of 7% plus the federal, something that roughly represents the State's opportunity cost. The feeling being if we're going to be straining down our savings and then our taxes get paid three years later because someone underpays, we want the interest to be earned to be roughly equivalent to what we

ultimately passed, clearly stated in its introduction of the change that a delinquent tax would only receive three years of interest when Akis Gialopsos, staff to Senator Giessel explained:

> 3. Language on page 2, line 31 to page 3, line 25 amends the previous Section. 7 of version A by changing the interest rate to 7 percent above the Federal Reserve rate. However, rather than the full six years of accruing a compounded quarterly rate, the interest will only accrue for only three years, and no interest after year three. However, the statute of limitations would be for the full six years.[8]

The proposed regulation is in direct conflict with the legislative intent by repackaging the tax and interest for tax years prior to January 1, 2017 and then subjecting those amounts to the new, compound interest rate for three years from that date, without regard to how much of the three-year period allowed for interest already has elapsed.

Interest Commencement: In reviewing the legislature's and the Department's discussions on interest, irrespective of the interest rate being proposed, both knew and intended for interest to commence on the original date a tax is due.

On February 12, 2016,[9] responding to Representative Hawker's inquiry whether interest commences on the date the assessment is made or whether it goes back to the date the original tax was due, Mr. Alper responded:

> "Through the chair, Representative Hawker, the interest begins accruing on the date the tax was due."

Contrary to the legislative intent and the Department's representations above, the proposed regulation applies an additional three years of interest to and for any period a tax was or will be deemed delinquent before January 1, 2017. For instance, a taxpayer awaiting its 2010 production tax audit that is found to owe additional tax will have six years plus an additional three years of interest for a total of nine years applied to its tax (plus the outstanding interest) under the proposed regulation.

Setting aside the legislature's and the Department's discussions, it is unclear how the proposed regulation's re-characterization of "delinquent tax" comports with

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would've earned on that money had it remained in our savings and our Permanent Fund for that period of time. That was granted in the previous committee, although only for the first three years. There is substantial industry push back to the State taking too long to do production tax audits. So, after three years it goes to no interest. So that gives us some incentive to get our work done faster."

[8] See Senate Resources Committee Minutes dated April 11, 2016, page 33. No audio or video of this meeting was available for transcribing therefore the minutes are cited.

[9] House Resources Committee, HB 247, February 12, 2016, 1:20-1:21.

case law. For self-assessed taxes, the Alaska Supreme Court has held that an underpaid tax is "due and owing" when the original tax return was due, amounts not paid are "delinquent" from that date.[10] And for a tax assessed by a governmental body, like in the instance of property tax, the Alaska Supreme Court implicitly determined the supplemental taxes were "delinquent" from the date the taxes from the initial assessment were due, even if a taxpayer had no way of knowing then that a later-imposed supplemental tax was due.[11]

After the hours of hearings and months that occurred on HB 247, the numerous times it was asserted the legislature inadvertently made an error in SB 21 regarding interest, the intent in HB 247 regarding what interest applies to – delinquent taxes -- and when it applies – for three years from of the original tax due date– is very clear. We request the proposed regulation is amended to comport with the statutory language and the intent of the legislature.

15 AAC 55.173(a)(2) Prevailing value for gas. We are curious why the specificity of "gas or electric utilities" was deemed necessary to calculate prevailing value for the gas delivered in the Alaska North Slope area.

15 AAC 55.211 Gross value reductions.

The Brief Description of 15 AAC 55.211 fails to properly describe what is actually proposed in the regulation for both subsection (h) and (i).

15 AAC 55.211(h). The first sentence of the proposed regulation does affect the gross value reduction when a taxpayer determines the amount of an annual carried-forward loss for the changes in Section 18 of HB 247. The changes by HB 247 to AS 43.55.023(b)(2) do not allow a gross value reduction when a carried-forward annual loss is calculated, therefore this proposed change comports with the statute. However, the proposed changes in the second sentence go far beyond the changes made by the legislature in HB 247 by disallowing the application of the gross value reduction to the gross value at the point of production for the minimum tax on a monthly and an annual basis. The legislature did not pass a statute nor did it authorize the Department to change the tax calculation and increase the minimum tax by regulation. We recommend the new language is removed from the second sentence as set forth below:

> The gross value at the point of production of oil is not reduced under AS 43.55.160(f) or (g) for the purpose of calculating an average gross value at the point of production of oil for a month under AS 43.55.024(j), **~~or for the~~**

[10] *Hickel v. Stevenson*, 416 P.2d 236, 239 (1966).
[11] BP Pipelines (Alaska) Inc. v. State, 325 P.3d 478, 495-496.

~~**purpose of calculating a gross value at the point of production under AS 43.55.011(f) or AS 43.55.020(a)(1)(B)(ii), (5)()(ii), or (7)(A)(ii).**~~

15 AAC 55.211(i). This new subsection mandates the application of the gross value reduction, except in limited circumstances where a participating area is expanded described at 15 AAC 55.212(*l*). Since the regulations permissively discuss the application of the gross value reduction elsewhere, the contradicting approaches are perplexing to understand.

15 AAC 55.214. Duration of gross value reductions.

15 AAC 55.214(a). Subsection (a) states that it "implements the time limits established by AS 43.55.160(f) and (g) for reductions...of oil and gas produced on or after January 1, 2017. Upon turning to subsection (b), its second sentence discusses "oil or gas...produced from a qualifying lease or property before January 1, 2017." We recommend the proposed regulations are reworded to eliminate the contradictions and clarify between "before" and "after" January 1, 2017.

15 AAC 55.214(b), (c) and (d).

Defining "Otherwise." The second sentence in both subsection (b) and (c) state "[i]f any oil or gas was produced...before January 1, 2017, the period for which oil or gas produced...may receive a gross value reduction ends on the earlier of the following dates: January 1, 2023, or January 1 following the alternate expiration date determined under (e) of this section." The third sentence in both subsections then states "[o] therwise, the period for which oil or gas produced...may receive a gross value reduction begins on the first day that regular production of oil or gas commences from a well...and ends on the earlier of the following dates..." What is meant by "[o]therwise?" Does this mean after January 1, 2017 or does it mean in any situation that does not fit in the earlier sentence? We recommend a date or other clarifying language is used.

GVR Start & Finish. In both subsection (b) and (c) "if any oil or gas was produced" from a qualifying lease or property or a qualifying participating area before January 1, 2017, then the expiration date is the earlier of "January 1, 2023, or January 1 following the alternate expiration date determined under (e) of this section."

The first concern is the phrase "if any oil or gas was produced" because that does not start the gross value reduction per the statute AS 43.55.160(f). Instead a gross value reduction is allowed for oil and gas produced "from the date of commencement of regular production of oil and gas." The application of the gross value reduction is not triggered by "any" production.

The second concern is the phrase regarding the expiration date, "the earlier of January 1, 2023, or January 1 following the alternate expiration date determined under

(e) of this section." For simplicity, assume the alternate date does not apply. If oil and gas received a gross value reduction prior to January 1, 2017, then it appears the gross value reduction will exceed the statutory seven years.

The third concern pertains only to subsection (c) with the statement, "[h]owever, if before establishment of the qualifying participating area, regular production of oil or gas commenced from a well producing from a tract to be included in the participating area, the period begins on the date the participating area is established and ends on the earlier of the following dates:..." The statute states that "regular production" determined by the AOGCC initiates the gross value reduction clock therefore the regulation is not authorized to prescribe that a different date, the date "the participating area is established" starts the gross value reduction clock.

The fourth concern pertains only to subsection (d) where the beginning of "regular production" is further conditioned by the proposed regulation's requirement that oil or gas comes from a well where "all of the producing intervals of the well are within that acreage." With this proposed regulation added to the existing, onerous metering regulations for expanded participating areas, it is difficult to imagine that any taxpayer would ever qualify for a gross value reduction under AS 43.55.160(f)(3).

15 AAC 55.214(e). This proposed regulation defines the "alternate expiration date" for gross value reduction where oil exceeds $70 a barrel for three consecutive or non-consecutive years. We request the Department consider the following comments:

(1) The phrase "or the first day of the period in question," lacks clarity and it is not intuitive to the taxpayer.

(2) The drafting of the first, second and third sequences does not require the first sequence to end before the second and third begin therefore the gross value reduction could expire in 14 months. We recommend ending the first sequence, then the second starting and ending before the third begins.

(3) Since the beginning of a gross value reduction will not necessarily be the last day or first day of the month, is it proper to assume the alternate expiration date will begin the 12 consecutive month calculation on the same date the gross value begins? Hence, for each gross value reduction that a taxpayer has the 12 consecutive months and the 7-year expiration date will be different. We recommend clarifying the start date of the 12-month period that will comprise the annual price calculation period to create certainty, and hopefully lessen confusion and/or controversy in later periods.

15 AAC 55.214(g). This proposed regulation states, "[a] gross value reduction is not allowed for oil or gas produced on a day that a period specified under (b) – (d) of the section ends." So, if a taxpayer's gross value reduction began on October 31st, then it ends on October 30th and the taxpayer has to calculate one day differently? We recommend the Department pick month-end since all calculations for production tax are based on a month or year.

15 AAC 55.335(e). It is difficult to glean whether the changes at subsection (e) and (g) do anything other than mirror the statutory language changes at AS 43.55.160. We recommend the Department's assistance in either a revised "Brief Description" or a statement on the record.

Other Comments Relating to Regulations

Defining a Process for Determining Regular Production. We recommend the Department guide the taxpayers on the process to initiate determination by the AOGCC that regular production has commenced.

> 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.

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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October 27, 2016

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

Dear Mr. Larsen:

On behalf of the Municipality of Anchorage d/b/a Municipal Light and Power ("ML&P"), this letter provides comments in response to the Notice of Proposed Changes on Oil & Gas Production Tax in the Regulations of the Department of Revenue ("Department") issued on September 21, 2016, and the Supplemental Notice issued on October 17, 2016. We provide the following comments and recommendations concerning the proposed regulation amendments.

The public notice indicates that the Department's stated purpose for the proposed regulations is to implement Ch. 4, 4 SSLA 2016, referred to as "HB 247," which enacts and amends various statutes affecting oil and gas production tax, and to repeal regulations that are no longer necessary to implement the production tax program. ML&P's focus in these comments is on proposed regulations that relate to the production tax treatment of "municipal entities," which are defined in AS 43.55.895(e) as "a municipality, municipally-owned utility, public corporation of a municipality, or entity established by more than one municipality."

To provide context for these comments, the taxation of municipal entities that are also oil or gas producers differs from other entities in one significant respect. In *State, Department of Revenue v. Municipality of Anchorage*, 104 P.3d 120 (Alaska 2004) ("*DOR v. ML&P*"), the Alaska Supreme Court determined that municipal "own-use gas"—gas that a municipality produces and uses itself, such as to generate electricity, is exempt from taxation.[1] Under the *DOR v. ML&P* decision, municipal own-use gas production is not taxable under AS 43.55.011(e), which levies a tax on all oil gas produced, "less any oil or gas the ownership or right to which is exempt from taxation[2] or constitutes a landowners' royalty interest or for which a tax is levied by AS 43.55.014."[3]

In 2007, the Legislature enacted AS 43.55.895. Subsection (a) explicitly stated that a municipal entity must pay tax on oil and gas "that it sells to another party." Subsection (b) specified that any municipality subject to payment of taxes under subsection (a) would be "eligible for all tax credits under this chapter to the same extent as any other party."

HB 247 amended AS 43.55.895(b) to limit municipal entities' entitlement to credits and require allocation of lease expenditures in proportion to taxable production sold to third parties, as follows:

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[1] The tax statute at issue in *DOR v. ML&P* was former AS 43.55.016(a). At that time the operative language of AS 43.55.016(a) stated: "There is levied upon the producer of gas a tax for all gas produced from each lease or property in the state, less any gas the ownership or right to which is exempt from taxation." In 2006, the legislature repealed former sections levying the oil tax (AS 43.55.011(a)) and the gas tax (AS 43.55.016(a)) separately and enacted AS 43.55.011(e), which levies the production tax on oil and gas together. The exemption for production "the ownership or right to which is exempt from taxation" was retained, and an exemption for oil and gas that constitutes a landowner's royalty interest was added. Thus, the rationale and holding of the *DOR v. ML&P* decision controls the taxation of municipal own-use gas under AS 43.55.011(e).

[2] "Ownership or right to which is exempt from taxation" is defined in AS 43.55.900(13) as "any ownership interest of the federal government or the state." Given the holding in *DOR v. ML&P*, there are three entities whose production is exempt from taxation under AS 43.55.011(e): the federal government and the state, as set forth in AS 43.55.900(19), and municipalities, as established by Alaska Supreme Court.

[3] AS 43.55.014 addresses production tax paid with gas in lieu of the tax that otherwise would be levied under AS 43.55.014(e).

> ***Sec. 30.** AS 43.55.895(b) is amended to read:
>
> (b) A municipal entity subject to taxation because of this section
>
> **(1)** is eligible for [ALL] tax credits **proportionate to its production taxable under AS 43.55.011(e); and**
>
> **(2) shall allocate its lease expenditures in proportion to its production taxable under AS 43.55.011(e)** [UNDER THIS CHAPTER TO THE SAME EXTENT AS ANY OTHER PRODUCER].

A number of the Department's proposed regulations implement the limitations of HB 247 on municipal entities' eligibility for tax credits. New 15 AAC 55.208 provides for the allocation of adjusted lease expenditure for purposes of determining production tax value and expenditures eligible to establish the AS 43.55.023(b)(1) carried-forward annual loss credit based on the ratio of oil or gas volumes sold to a third party to total production volumes less royalty. New 15 AAC 55.337 provides for the reduction of credits other than the AS 43.55.023(b)(1) credit based on the proportion of taxable production in the same manner. New 15 AAC 55.511(h) implements the allocation of lease expenditures in proportion to taxable volumes when calculating installment payments. These provisions appear appropriate to implement HB 247's revisions to AS 43.55.895(b).

In addition, the regulations amend the definition of "taxable under AS 43.55.011(e)" in 15 AAC 55.900(b)(22), as follows:

> 15 AAC 55.900(b)(22) is amended to read:
>
> (22) "taxable under AS 43.55.011(e)," when used in reference to oil or gas or both, means produced from a lease or property in the state but excluding any oil or gas the ownership or right to which is exempt from taxation or constitutes a landowner's royalty interest; **this paragraph does not apply to the determination of a municipal entity's eligibility for tax credits under AS 43.55.895(b)(1) or the allocation of a municipal entity's lease expenditures under AS 43.55.895(b)(2).**

It is not at all clear what the revision is intended to accomplish, and it is not necessary or appropriate to implement HB 247.[4] As noted above, AS 43.55.011(e) levies a tax on all oil and gas produced in the state, "less any oil or gas the ownership or right to which is exempt from taxation[5] or constitutes a landowners' royalty interest or for which a tax is levied by AS 43.55.014." With the exception of the reference to AS 43.55.014, the existing regulation simply parrots the language of AS 43.55.011(e). In HB 247, the Legislature directed that expenditures and credits be allocated in proportion to the production taxable under AS 43.55.011(e), and presumably did so with the understanding that AS 43.55.011(e), by its terms, exempted from taxation under that section production the ownership or right to which is exempt from taxation or constitutes a landowner's royalty interest.

The proposed regulation revision appears to attempt to eliminate both the general taxation language ("gas produced from a lease or property in the state") and exemption language from AS 43.55.011(e) when applying AS 45.55.895(b). Even if the regulation could be legally effective to alter the plain meaning of the statute, it would beg the question: if the very language of AS 43.55.011(e) and 15 AAC 55.900(b)(22) do not apply when implementing AS 43.55.895, what does? The proposed regulation revisions do not provide an answer to that question. Not only does the proposed revision fail to implement HB 247, to the extent that it attempts to alter the meaning of AS 43.55.011(e), it appears to run directly contrary to the Legislature's direction that municipal entities' credits and expenditures be allocated in proportion to production taxable under AS 43.55.011(e).

ML&P recommends that this amendment be eliminated. As is noted above, ML&P's own-use gas is exempt from taxation under AS 43.55.011(e). Gas that it sells to third parties is taxable. No revision to the definition of "taxable under AS 43.55.011(e)" is needed to implement HB 247's revisions to AS 45.55.895(b) and accomplish the allocation of expenditures and credits in proportion to taxable volumes.

As the Department knows, ML&P has requested informal conferences with respect to the Department's denials of certain AS 43.55.023(b), AS 43.55.023(a), and AS 43.55.023(*l*) credits from 2014 and 2015. The dispute in those matters centers on interpretations of AS 43.55.011(e) and AS 43.55.895, and implicates the legislative history of the

[4] AS 43.05.080 limits the Department's authority to issues regulation to those that are "necessary for the enforcement of the tax, license, or excise laws administered by it."

[5] "Ownership or right to which is exempt from taxation" is defined in AS 43.55.900(13) as "any ownership interest of the federal government or the state." Given the holding in *DOR v. ML&P*, there are three entities whose production is exempt from taxation under AS 43.55.011(e): the federal government and the state, as set forth in AS 43.55.900(19), and municipalities, as established by Alaska Supreme Court precedent.

revisions to AS 43.55.895(b) in HB 247. More specifically, the Department contends that ML&P's own use gas is in fact taxable under AS 43.55.011(e) and that the current AS 43.55.895(a) is the statute that somehow exempts ML&P's own-use gas from taxation. ML&P is concerned that the Department's proposed revision to 15 AAC 55.900(b)(22) may be an improper attempt to create or change the meaning or applicability of statutes and Supreme Court precedent at issue in ML&P's disputed credit denials. Even though such an argument would certainly be legally meritless, substantial resources would be wasted in addressing the issue.[6]

Finally, the Department proposes to add 15 AAC 55.900(b), defining "sells to another party" as "when used in reference to oil or gas of a producer that is a municipal entity under AS 43.55.895, means sells to a person other than the producer." In its comments at the October 19, 2016, public hearing, Kara Moriarty of the Alaska Oil & Gas Association observed that the use of the word "producer" at the end of the definition was ambiguous and recommended that the "the producer" be replaced with "that entity." ML&P expands on the recommendation and requests that "the producer" be replaced with "that municipal entity."

ML&P appreciates the opportunity to comment on the Department's proposed regulations.

Sincerely yours,

KEMPPEL, HUFFMAN AND ELLIS, P.C.
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d/b/a Municipal Light and Power

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[6] In its comments at the October 19, 2016, public hearing the Alaska Oil & Gas Association raised similar concerns regarding the proposed repeal of regulations that might be implicated by pending appeals.

Comments on Proposed September 2016 Changes to the 15 AAC 55 Oil and Gas Production Tax Regulations
Dan E Dickinson
October 28, 2016

These written comments reflect my oral comments made at the public meeting on October 19, 2016. While I represent many clients who will be affected by these proposed changes, these comments are my own. Some of these clients have already expressed their views on the proposed changes in the AOGA comments previously submitted. I will not repeat any of AOGA's observations, however the following four comments pick up where they left off:

1. Proposal to replace the current language pertinent to the small producer credit of 15 AAC 55.335(a) with different language reflecting a totally different concept.

Currently, 15 AAC 55.335(a) is specific to 2006, the first year in which the Alaska Legislature made the small producer credit effective. The credit grew from an overhaul of the State's production tax, wherein the ELF regime was replaced by the PPT regime. Most of the changes enacted in the overhaul became effective on April 1, 2006, and thus were in force for the remaining nine months of that year. Accordingly, 15 AAC 55.335(a) was adopted to make clear that in 2006, credits for nine of the 12 months (9/12ths of the year) could be used.

The Department of Revenue proposes to change the rule by introducing language that restricts the amount of small producer credit available based on the number of days of commercial production in a year reported by each producer. The statute provides no basis for this restriction.

Furthermore, I represent the majority of small producers that will be affected by this proposed change. While it will create work for both the Department and for small producers (as well as for their operators) it is not likely to have any discernable effect on the amount of small producer credits used in any year. Most of the small producers are so far below the maximum $12 million tax credit allowed that a currently a single day of production would be sufficient to generate all the small producer credit they are capable of using. The additional effort required to meet the proposed reporting will benefit no one.

I urge the Department not to adopt this change.

2. Proposal to add a new concept to 15 AAC 55.525, under which credits not purchased by the state simply disappear.

Elsewhere I have criticized the Department for ambiguity in the proposed regulations. Not so, here: 15 AAC 55.525 is clear and thorough in setting out procedures for applying the "repurchase limitation" in HB 247. Unfortunately, the Department also includes procedures not found in HB 247.

Using slightly different language, 43.55.023(c), (d) and (e) have, since 2006, each set forth the rule that "[a]ny portion of a credit, not used … may be applied in a later calendar year" and does not expire. While sections of HB 247 limit how much of a credit may be purchased (or repurchased) in a calendar year, AS 43.55.023 dictates that the unpurchased portion of the credit may be applied in a later year. In the proposed change, though, the Department introduces a concept whereby the amount above the HB 247 restriction simply disappears, and is no longer available for any purpose to the taxpayer who earned that credit.

There may be arguments from internal consistency within AS 43.55.028 limiting a taxpayer's ability to apply the amount of credit above the restriction towards a future cash purchase. However, the original purpose of the credits—for use against tax obligations—was not affected by HB 247, so I urge the Department not to adopt this rule, under which unused credits simply disappear.

3. An observation that the Department should keep in mind when drafting the final 15 AAC 55.525 regulations.

This is an observation rather than a specific request to adopt or not adopt a proposed change. It is warranted because, under 15 AAC 55.525 as proposed, new practices will emerge which ought to be addressed.

Consider, for example, a scenario sure to arise where an explorer or producer has more than $70 million in credit certificates. In Year One, the explorer/producer applies for $35 million of those certificates to be purchased by the state, holding off on applying for a cash-out of its remaining $35 million. The application is approved and, under the provisions then in effect, the explorer/producer receives $35 million from the state. Immediately after receipt of the money, the explorer/producer will then apply for the remaining $35 million of its certificates to be purchased by the state. The goal this time is not to receive more cash from the state immediately; rather, the goal of the explorer/producer is to stake out a front-of-the-line position to receive money from the next appropriation of cash to the Oil and Gas Tax Credit Fund, likely to occur no earlier than the following year.

It should be acknowledged that, within a given year, a certificate owner is likely to make a second application to the state after it receives payment from the first application. How this practice might meld with the Department's proposed language concerning multiple applications [15 AAC 55.525(d)(2)] is not clear.

4. The “resident worker” qualifications in the proposed 15 AAAC 55.525 are wholly inadequate to the purpose.

In sections 14 and 17 of its October 19, 2016, written and oral testimony, AOGA laid out many shortcomings in the Department’s proposed “resident worker” regulations. I concur with many of their criticisms. More positively, I believe that AOGA’s proposed redraft of 15 AAC 55.525(f)(2)(A) and (B) would go a long way towards clarifying some of the uses, if not the substance, of the new standard.

However, other questions remain. The new AS 43.55.028(g)(2) language found in HB 247 requires submission of data derived from the calendar year “previous” to the Department’s “allocation” of “available money in the fund.” It seems inappropriate to ask for the data as part of a purchase (or repurchase) application under AS 43.55.028: The applicant will not know for which year the data should be submitted. Indeed, if we experience several years of minimal appropriations to the Oil and Gas Tax Credit Fund, the required data might be for a future calendar year, for which the data is not yet known.

Will a distinct “resident hire” filing be required after the money is “available” but before the allocation has been made? Will the Department audit that filing, or will it provide a limited review under AS 43.55.023(d) standards so it is able to pay out the cash as it becomes available? Suppose such a limited review is subject to a later audit, and the audit adjusts the “resident hire” ranking, moving a taxpayer that had received cash behind a producer that had not received cash. Does the audit adjustment require the cash to be repaid? Will that repayment go back to the Oil and Gas Tax Credit Fund for redistribution?

What if an applicant disagrees with an action of the Department, in either review or audit? Surely an appeal would be appropriate. During the pendency of that appeal, how are others in the queue affected? Will applicants know where they stand relative to other applicants?

I request that these regulations be clarified to help taxpayers understand the mechanics of how this new criteria might work. For an explorer/producer I realize this may be secondary to the appropriation decisions made by the legislature and the governor. Nonetheless, it is within the power of the Department to clarify the former, if not the latter.

Thank you for your consideration in these matters.

LEADER in All We Do

DOYON Limited

October 28, 2016

VIA EMAIL: john.larsen@alaska.gov

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

Re: Proposed regulations regarding the oil and gas production tax

Dear Mr. Larsen,

Doyon, Limited ("Doyon") is submitting these comments regarding changes to the oil and gas production tax regulations in 15 AAC 55 that the Department of Revenue ("DOR") proposed on September 21, 2016 to implement House Bill 247 ("HB 247").

Doyon is the state-chartered Alaska Native Claims Settlement Act regional corporation for Interior Alaska. Doyon has over 19,300 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 over 400,000 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.

The oil and gas production tax credits—and the regulations that implement the tax credit program—are vital to Middle Earth exploration and development. Doyon's comments on specific portions of the proposed regulations are below.

<u>Prioritization of tax credit certificate purchases</u>. DOR has proposed 15 AAC 55.525 to govern the purchase of tax credit certificates by the state. The proposed regulation would in the first instance prioritize credit purchase applications based on the year in which the purchase application is received, such that applications received in 2016 have priority over those received in 2017. [1] Likewise, credit purchase applications received in 2017 would have priority over those received in 2018, and so on.

HB 247 makes several changes to the rules governing purchase applications made on or after January 1, 2017, including granting a preference "between two applicants, to the applicant with a higher percentage of resident workers in to the applicant's workforce." The proposed regulation, at 15 AAC 55.525(d) and (f) is unclear in regard to how the preference based on when an application is received interfaces with the preference based on an applicant's percentage of resident workers. This concern is heightened by the mechanics of subsections (d)(2) and (3), which provide, respectively, that purchase applications will be ranked semi-annually and that if an applicant submits more than a single purchase application in a calendar year, the applications will be summed and treated as a single application. The tension between these subsections raises a number of questions as to which application controls in terms of priority if an applicant submits applications throughout the year, and whether the tranche of applications evaluated in the first half of the year are prioritized over those evaluated in the second half of the year. It is also unclear whether these provisions apply to prioritization based on time, the percentage of resident workers, or both.

<u>Assignment of tax credit certificates</u>. Tax credit certificates can be assigned to serve as collateral and/or sources of payment in financings and other commercial transactions. DOR has proposed 15 AAC 55.525(i) to address the situation in which an assignor and assignee wish to withdraw an application for purchase of an assigned credit certificate.

It is clear that under the assignment statute, AS 43.55.029, both the assignor and assignee would need to consent to withdrawing the purchase application and thus the first sentence of the proposed 15 AAC 55.525(i) is reasonable.

However, the proposed regulation goes one step further, and provides that when all or a portion of a purchase application is withdrawn "[t]he assignor and assignee must also revoke their assignment for such portion of the cash purchase application." This proposal disregards the spirit and actual language of the assignment statute. AS

[1] We note that there are inconsistencies between the use of "received" versus "submitted" in the proposed 15 AAC 55.525, and we suggest that DOR revise the regulation to use only one of those terms consistently. For simplicity, we will use the term "received" for these comments.

43.55.029(a) states that the assignment is irrevocable "absent written consent of the assignee." DOR's proposed regulation would force the revocation of the assignment, regardless of the actual consent required by the statute. AS 43.55.029(a) also provides that once a credit certificate is issued, the "notice of assignment remains effective and shall be filed with the department by the explorer or producer together with any application for the department to purchase the certificate under AS 43.55.028(e)." DOR's proposal would negate the clear intention to have the assignment remain in place through purchase of the certificate, and the fact that the statute has no limitations regarding the timing (or number) of purchase applications for assigned certificates.

AS 43.55.029(b) also states that "[t]o be effective, the assignment does not require the approval or consent of the department." DOR cannot use a regulation to effectively disapprove an assignment based on the withdrawal of an application for purchase. This statutory limitation on DOR's authority has solid policy grounds—an assignment of tax credit certificates is based on a commercial arrangement between an assignor and an assignee, and DOR is not a party to that agreement. Nor does DOR have an interest in such an agreement, or how the parties choose to implement it, including delaying the timing of all or a portion of the anticipated payment. DOR's regulation could jeopardize financing and other commercial arrangements, contrary to this clear statutory limitation.

<u>Clarification of rate change for AS 43.55.023(a) credit</u>. HB 247 reduced the rates of all three credits available under AS 43.55.023. Section 18 of HB 247 reduced the carried-forward annual loss credit under AS 43.55.023(b) to 15% of the loss "[f]or lease expenditures *incurred* on or after January 1, 2017[.]" Likewise, Section 19 of HB 247 reduced the well lease expenditure credit under AS 43.55.023(*l*) to 20% of expenditures "*incurred* on or after January 1, 2017[.]" However, under Section 17 of HB 247, the rate change for the qualified capital expenditure credit under AS 43.55.023(a) to 10% was made effective as of the January 1, 2017 general effective date of HB 247, without reference to when an expenditure is incurred. (Emphasis added).

It is reasonable to assume that the rate change to the qualified capital expenditure credit would be based on when an expenditure is incurred, such that the credit is reduced to 10% for expenditures incurred on or after January 1, 2017. That transition would be consistent with the other two credits, and we suggest that DOR make that clarification by regulation.

Sincerely Yours,

James Mery
Senior Vice President
Lands and Natural Resources

AIX Energy LLC

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832-813-0900 Phone
832-585-0133 Facsimile

October 28, 2016

Mr. John Larsen, Audit Master
State of Alaska
Department of Revenue, Tax Division
550 W. 7th Ave., Ste 500
Anchorage, AK 99501

Dear Mr. Larson,

AIX Energy LLC ("AIX") is pleased to submit comments on the Department of Revenue's proposed oil and gas production tax regulations, specifically 15 AAC 55.335(a). The proposed regulation amends the current Small Producer Credit, AS 43.55.024(c). The proposed change has a direct impact on AIX and other small producers in Alaska.

Proposed regulation 15 AAC 55.335(a) would require additional reporting causing an added burden to limited resources as a small producer. In addition, the proposed regulation reduces the current statute limit in AS 43.55.024(c) by $3,000,000.

With the present downturn in the oil and gas industry coupled with the challenges faced by a small producer, I respectfully ask the Department of Revenue to reconsider adopting this proposed regulation amending the Small Producer Credit. Thank you for the opportunity to participate and for taking AIX's comments into consideration.

Regards,

Wendy M. Sheasby, CPA
CFO

APPLIED SEISMIC RESEARCH CORPORATION

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William G. Stern BA JD (Harvard)
President

28 October 2016

Mr. John Larsen, Audit Master
Alaska Department of Revenue
550 W. 7th Ave., Ste. 500
Anchorage, AK 99501
john.larsen@alaska.gov
Fax (907) 269-6644

Dear Mr. Larsen,

I am submitting this comment as part of the Department of Revenue Public Comment Period on its proposed oil and gas production tax regulations. I am asking you not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016.

I have a very small working interest in the Point Thomson unit, and pay taxes monthly under the provisions of AS 43.55.200 and AS 43.55.300, which cannot be offset by any credits. Dan Dickinson is a CPA who handles some of our work in Alaska. As he has explained this matter to me, the proposed regulation will (1) add work not likely of any value to me, or to the state as a revenue collector; while (2) theoretically (if not actually) decreasing the amount of Small Producer Credit [AS 43.55.024(c)] to which I am entitled to under the law.

The Small Producer Credit found at AS 43.55.024(c) in the Alaska statutes states that if I meet certain qualifications—and I don't think there is any question I do—I can qualify for up to $12 million in non-transferable tax credits every year for the nine-year period that just began. As explained to me by Mr. Dickinson, at current levels of production, if I have a single day of commercial production in each of the nine years, I would qualify for $32,872 in Small Producer Credits for each year. ($12,000,000 divided by 365 = $32,872.) While I certainly hope production increases, this amount is way, more credit than I anticipate using.

Dickinson could point to nothing in AS 43.55.024(c) that requires or permits this proposed change in the way Small Producer Credits are calculated. Furthermore, while the marginal adjustment to $12,000,000 a year is not likely to decrease my taxes; instead, the change would require an added expense to me, my operator, and the State to track, record, report, review and audit my Point Thomson production with no discernable benefit.

Cont…/2

Therefore, as I stated in the opening of this email, I am asking you not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016. Thank you for this opportunity to comment and your consideration in this matter.

Yours sincerely,

William G. Stern

Colt Alaska LLC
6400 South Fiddlers Green Circle
Suite 2100
Greenwood Village, CO 80111-4938

October 27, 2016

Via Fax; Email; USPS
907.269.6644
john.larsen@alaska.gov
Add Tracking No.

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

Dear Mr. Larsen:

Colt Alaska LLC is submitting this comment as part of the State of Alaska Department of Revenue Public Comment Period on its proposed oil and gas production tax regulations. Colt is asking the Department of Revenue not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016.

Colt has a very small working interest in the Point Thomson Unit on the Central North Slope and Colt pays taxes monthly under the provisions of AS 43.55.200 and AS 43.55.300, which cannot be offset by any credits. Dan Dickinson is a CPA in Alaska who handles some of our work in Alaska. As he has explained this matter to us, the proposed regulation will (1) add work not likely of any value to Colt, or to the state as a revenue collector; while (2) theoretically (if not actually) decreasing the amount of Small Producer Credit [AS 43.55.024(c)] to which Colt is entitled to under the law.

The Small Producer Credit found at AS 43.55.024(c) in the Alaska statutes states that if Colt meets certain qualifications – and we don't think there is any question we do – Colt can qualify for up to $12 million in non-transferable tax credits every year for the nine-year period that just began. As explained to Colt by Mr. Dickinson, at current levels of production, if Colt has a single day of commercial production in each of the nine years, Colt would qualify for $32,872.00 in Small Producer Credits for each year ($12,000,000 divided by 365 equals $32,872.00). While we certainly hope production increases, this amount is way more credit than Colt anticipates using.

Mr. Dickinson could point to nothing in AS 43.55.024(c) that requires or permits this proposed change in the way Small Producer Credits are calculated. Furthermore, while the marginal adjustment to $12,000,000 a year is not likely to decrease Colt's taxes; instead, the change would require an added expense to Colt, the Operator ExxonMobil and the State to track, record, report, review and audit Colt's proportionate share of Point Thomson Unit production with no discernable benefit.

Therefore, as Colt stated in the opening of this letter, Colt is asking the Department of Revenue not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016. Thank you for this opportunity to comment and your consideration in this matter.

Very truly yours,

Rusty Brusenhan
Land Manager

RB:amb

Colt Alaska LLC
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Suite 2100
Greenwood Village, CO 80111-4938

October 27, 2016

Via Fax; Email; USPS
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john.larsen@alaska.gov
Add Tracking No.

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

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The Small Producer Credit found at AS 43.55.024(c) in the Alaska statutes states that if Colt meets certain qualifications – and we don't think there is any question we do – Colt can qualify for up to $12 million in non-transferable tax credits every year for the nine-year period that just began. As explained to Colt by Mr. Dickinson, at current levels of production, if Colt has a single day of commercial production in each of the nine years, Colt would qualify for $32,872.00 in Small Producer Credits for each year ($12,000,000 divided by 365 equals $32,872.00). While we certainly hope production increases, this amount is way more credit than Colt anticipates using.

Mr. Dickinson could point to nothing in AS 43.55.024(c) that requires or permits this proposed change in the way Small Producer Credits are calculated. Furthermore, while the marginal adjustment to $12,000,000 a year is not likely to decrease Colt's taxes; instead, the change would require an added expense to Colt, the Operator ExxonMobil and the State to track, record, report, review and audit Colt's proportionate share of Point Thomson Unit production with no discernable benefit.

Therefore, as Colt stated in the opening of this letter, Colt is asking the Department of Revenue not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016. Thank you for this opportunity to comment and your consideration in this matter.

Very truly yours,

Rusty Brusenhan
Land Manager

RB:amb

Larsen, John M (DOR)

From:	Jan O'Neill <Jan@oneillpr.com>
Sent:	Wednesday, October 26, 2016 9:45 PM
To:	Larsen, John M (DOR)
Subject:	Proposed oil & gas production tax regulations

Mr. John Larsen, Audit Master
Alaska Department of Revenue
550 W. 7th Ave., Ste. 500
Anchorage, AK 99501
john.larsen@alaska.gov
Fax (907) 269-6644

Dear Mr. Larsen,

I am submitting this comment as part of the Department of Revenue Public Comment Period on its proposed oil and gas production tax regulations. I am asking you not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016.

I have a very small working interest in the Point Thomson unit, and pay taxes monthly under the provisions of AS 43.55.200 and AS 43.55.300, which cannot be offset by any credits. Dan Dickinson is a CPA who handles some of our work in Alaska. As he has explained this matter to me, the proposed regulation will (1) add work not likely of any value to me, or to the state as a revenue collector; while (2) theoretically (if not actually) decreasing the amount of Small Producer Credit [AS 43.55.024(c)] to which I am entitled to under the law.

The Small Producer Credit found at AS 43.55.024(c) in the Alaska statutes states that if I meet certain qualifications—and I don't think there is any question I do—I can qualify for up to $12 million in non-transferable tax credits every year for the nine-year period that just began. As explained to me by Mr. Dickinson, at current levels of production, if I have a single day of commercial production in each of the nine years, I would qualify for $32,872 in Small Producer Credits for each year. ($12,000,000 divided by 365 = $32,872.) While I certainly hope production increases, this amount is way, more credit than I anticipate using.

Dickinson could point to nothing in AS 43.55.024(c) that requires or permits this proposed change in the way Small Producer Credits are calculated. Furthermore, while the marginal adjustment to $12,000,000 a year is not likely to decrease my taxes; instead, the change would require an added expense to me, my operator, and the State to track, record, report, review and audit my Point Thomson production with no discernable benefit.

Therefore, as I stated in the opening of this email, I am asking you not to adopt the changes to 15 AAC 55.335 which were proposed in September of 2016. Thank you for this opportunity to comment and your consideration in this matter.

Jan D. O'Neill

Date 10-26-16

Mr. John Larsen, Audit Master
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Susan Jean Sears Collie