ALASKA DEPARTMENT OF REVENUE, TAX DIVISION
ADVISORY BULLETIN 2017-01

Re: Application of tax credits under AS 43.55.024(j), as implemented by 15 AAC 55.375(c) and 15 AAC 55.335(g), to a taxpayer's tax liability under AS 43.55.011(e).

The Department of Revenue (Department) has received inquiries from various taxpayers and holders of tax credit certificates regarding the application of tax credit certificates against a taxpayer's tax liability under AS 43.55.011(e), and specifically, under what circumstances, if any, a tax credit certificate may be used to reduce a taxpayer's tax liability below the minimum amount of tax levied by AS 43.55.011(e), and as limited by AS 43.55.011(f).

Background- prior statute and regulation regarding ordering of credits:

In 2006, HB 3001 (PPT) was passed that included legislation creating a new and expanded tax credit incentive program, including tax credits for qualified capital expenditures and carried-forward losses under AS 43.55.023; the "additional nontransferable tax credits" (e.g., the "small producer credits") under AS 43.55.024; and also extended the "alternative tax credit for oil and gas exploration" at AS 43.55.025 that had been scheduled to sunset on July 1, 2007.

As an alternative to the base tax PPT established a "minimum tax" of 4 percent of the gross value of the point of production for North Slope oil and gas, as established in AS 43.55.011(f).

Pursuant to the passage of HB 3001, the Department developed regulations, including those at 15 AAC 55.375, that among other things, prescribed a recommended order of applying tax credits against a producer's tax liability under AS 43.55.011(e). The regulations at 15 AAC 55.375(c) regarding the order of applying tax credits were constructed with the intent to provide the maximum benefit of available tax credits to the taxpayer. This was done by recognizing that, in all likelihood, a taxpayer would prefer to first use any tax credits that would expire in the current period and could not be carried-forward into future periods, and then subsequently, apply against any remaining tax liability, available tax credits that could otherwise be carried forward into future periods, subject to the limitations of the existing statutes. Each of the enabling statutes for tax credits contained similar language describing that a tax credit or credit certificate could not be used to reduce a taxpayer's tax liability under AS 43.55.011(e) for a "calendar year" to an amount "below zero." Credits were not limited by the minimum tax, a topic that was addressed in an earlier advisory bulletin. [Ref. AS 43.55.023(c); AS 43.55.024(g); AS 43.55.024(h); AS 43.55.025(i); Tax Division Advisory Bulletin 2011-02].

Additionally, new 15 AAC 55.375(c) also provided that, if a taxpayer believed a greater benefit could be obtained by a re-ordering of the credits, the regulation would allow that reordering. To do so, the producer must indicate their preferred ordering with the statement required under AS 43.55.030(a). Otherwise, tax credits must be applied in the order listed in 15 AAC 55.375(c).

Before the time HB 3001 was passed the statutes did not contain any provisions for the purchase of tax credit certificates directly from the explorers by the State of Alaska (State). For explorers, this meant that their most likely alternative for obtaining any benefit from their tax credit certificates would have been to sell them to a producer with a tax liability under AS 43.55.011(e) against which the tax credit certificates could then be applied. However, this was likely not without some measure of loss for the explorers. A taxpayer would not be expected to pay face value to the explorer, although a purchased tax credit certificate retains 100% of its value when applied against the taxpayer's liability under AS 43.55.011(e). Explorers were left to sell their tax credit certificates, most likely at varying discounts, to a very limited market of producer taxpayers.

HB 3001 established the practice of the State repurchasing, with certain restrictions, tax credit certificates at up to $25 million per applicant per year. Among the restrictions was a requirement that the amount expended for the repurchase would be reinvested in capital expenditures or additional leases on State land within 24 months.

In 2007 this practice of State repurchase was expanded upon, and the annual $25 million limit removed, as part of HB 2001 (ACES). This legislation added a new section to the statutes at AS 43.55.028, "Oil and gas tax credit fund established; cash purchases of tax credit certificates." The restrictions from PPT were generally reestablished at AS 43.55.028(e).

Subsequently, in 2010 under Section 12 of SB 309, paragraphs (e)(2) and (3) of AS 43.55.028 were repealed, eliminating the reinvestment requirement for credit repurchases from the oil and gas tax credit fund.

Background- implementation of the sliding scale credit in SB 21

During the 2013 legislative session the Legislature repealed much of the previously enacted PPT and ACES statutory provisions and replaced them with SB 21. As a part of the changes, the Legislature eliminated the "progressivity" calculations implemented under HB 3001 and HB 2001 and made other significant changes to the oil and gas production tax code. Included in these changes were two new additional tax credits based on taxable barrels of North Slope oil production. Per AS 43.55.024(i), oil production that qualified for the Gross Value Reduction (GVR) "new oil" benefit could receive a $5 per barrel constant dollar credit. Per AS 43.55.024(j), "legacy" oil production that did not qualify for GVR could receive a "floating" or "sliding scale" credit that ranged from $8 - $0, based on the average monthly gross value at the point of production. Both of the "per barrel" credits could only be used in the calendar year earned, could not be carried forward, and were ineligible for State repurchase.

The sliding scale credit was added in the committee substitute introduced in the House Resources Committee. Initially in CSSB 21(RES), both the constant $5 credit under AS 43.55.024(i) and the "sliding scale" credit under AS 43.55.024(j) were also able to be used to reduce taxes to zero. However, during committee debate, modeling done by Econ One Research revealed that under certain price conditions the sliding scale credit at AS 43.55.024(j) could potentially reduce a taxpayer's liability to an amount that was less than the minimum tax. To address this concern, Co-Chair Representative Feige introduced Amendment #33 which included language to the effect that, "A tax credit under this subsection may not reduce a producer's tax liability for a calendar year under AS 43.55.011(e) ***below the amount calculated under AS 43.55.011(f).***"

[Emphasis supplied.] In response to an objection from Representative Hawker for discussion on the amendment, Co-Chair Feige replied as follows:

- "When we instituted the floating per barrel credit, one of the results was that the tax below [$60 per barrel] – if you remember from the [Econ One Research] slide Mr. Pulliam showed yesterday evening – the tax actually went to zero. What this amendment will do is make sure that the floating per barrel credit does not, because it is applied after the tax is assessed and calculated, this will make sure that the floating per barrel credit does not run the total tax bill below the minimum tax. **So it insures that our 4 percent minimum tax on the gross is retained – *no matter what* – within the legacy fields.**"[1] [Emphasis supplied.]

Representative Hawker then removed his objection and Amendment #33 was adopted. The Department believes the plain language of the statute that "A tax credit under this subsection may not reduce a producer's tax liability for a calendar year under AS 43.5.011(e) below the amount calculated under AS 43.55.011(f)," in addition to the explanation offered by Co-Chair Feige as the amendment sponsor, provides evidence that regulations promulgated by the Department are supported by legislative testimony in committee hearings for SB 21.

In the summer of 2013, subsequent to the passage of SB 21 the Department engaged in a substantial regulations project to make conforming changes to implement the new law's sweeping changes, particularly for oil and gas produced starting in January 2014. Additionally, SB 21 did not provide any provisions for retroactivity of regulations. One of the required changes was to add the new tax credits under AS 43.55.024(i) and (j) to the "order of applying tax credits" under 15 AAC 55.375(c). As before, and since neither of these new credits were allowed to be carried forward into future periods, the regulation sequenced both of these credits ahead of other existing credits that could be carried-forward.

During the regulations process, DOR focused on how to adopt regulations necessary to implement and give effect to the plain language of AS 43.55.024(j) consistent with the legislative intent, including Representative Feige's explanation that "no matter what" the State's "4 percent minimum tax on the gross is retained ... within the legacy fields," while still honoring the intent to allow a taxpayer the maximum benefit of the credits. The Department recognized the possibility that, given the option, a taxpayer with legacy production would almost certainly apply the AS 43.55.024(j) credit "first" to reduce their tax liability to the amount limited by AS 43.55.011(f) and then apply any other remaining tax credits after that, potentially to zero. This would defeat the plain language of the statute and the purpose of Amendment #33 as stated by the sponsor Rep. Feige.

Mathematically, under the commutative property, it does not matter in which order the credits are applied. If AS 43.55.024(j) credits are included in the calculation to reduce the amount of a producer's tax obligation to less than the amount limited by AS 43.55.011(f), that would not meet the plain language of the statute and the intent of Amendment #33, regardless of whether the AS 43.55.024(j) credit is included "first," or "last," in the calculation.

[1] House Resources Committee minutes, April 4, 2013, at 1:53 a.m.

The solution proposed, and eventually codified in the final regulations adopted by the Department became the "subject to" language in 15 AAC 55.375(c):

- Except as provided under (a) and (b) of this section, **and subject to 15 AAC 55.335(g)**, a producer may apply tax credits in any order...." [Emphasized language in original and as shown in the Department's proposed regulations.]

At the same time, the Department also proposed and adopted a new subsection 15 AAC 55.335(g), [2] in order to give effect and meaning to the plain language in AS 43.55.024(j) and the intent of amendment #33:

- "If a producer's application of tax credits other than a tax credit under AS 43.55.024(j) against a tax levied by AS 43.55.011(e) reduces the producer's tax liability to the amount calculated for a calendar year after 2013 under AS 43.55011(f) or less, the producer may not apply a tax credit under AS 43.55.024(j) against the tax for that calendar year. If a producer's application of tax credits other than a tax credit under AS 43.55.024(j) against a tax levied by AS 43.55.011(e) does not reduce the producer's tax liability to the amount calculated for a calendar year after 2013 under AS 43.55.011(f) or less, the producer may apply against the tax no more than the portion of a tax credit under AS 43.55.024(j) that is equal to the difference between the amount calculated for the calendar year under AS 43.55.011(f) and the tax liability after reduction by application of tax credits other than a tax credit under AS 43.55.024(j). In calculating that reduction, if the tax credits to be applied include one or more tax credits subject to a percentage limitation under AS 38.05.180(i) or AS 43.55.023(e), calculation of the percentage limitations under 15 AAC 55.375(a) must take account of any tax credit or portion of a tax credit under AS 43.55.024(j) that the producer will apply against the producer's tax, to the extent allowed under this subsection."

Analysis and Conclusion:

The Department's regulations at 15 AAC 55.375(c) and 15 AAC 55.335(g) clarify, and give meaning to, the statutes by describing how, and under what circumstances certain tax credits may be applied to reduce a taxpayer's obligation under AS 43.55.011(e) or whether application of those credits, or combinations thereof, would be constrained by the limitations of AS 43.55.011(f).

Taken on their own, or in combination with each other, and subject to the limitations of the statutes and regulations, tax credits under AS 43.55.023(a), (b), and (*l*), AS 43.55.024(a), (c), and (i), and AS 43.55.025, are not subject to the limitations of AS 43.55.011(f). In the absence of a

[2] Note, the reference in the regulation as initially proposed was to 15 AAC 55.335(f), otherwise, the language was unchanged from the initial proposal to the final regulation. The change from subsection (f) to (g) was made to accommodate unrelated changes to other subsections between the proposed, and final adopted regulations.

credit under AS 43.55.024(j), all may be used to reduce a taxpayer's tax liability under AS 43.55.011(e) to zero.

None of the tax credits in statute are mandatory and "must" be taken or used by a taxpayer, including a tax credit under AS 43.55.024(j). Each of the authorizing statutes contain permissive language regarding the use of the credit. For example:

- "...<u>may</u> be applied against a tax levied by AS 43.55.011(e)." [AS 43.55.023(b)]
- "A producer <u>may</u> apply against the producer's tax liability for the calendar year ..." [AS 43.55.024(j)]
- "Subject to the terms and conditions of this section, a credit against the production tax levied by AS 43.55.011(e) <u>is allowed</u> ..." [AS 43.55.025(e)] [Emphasis supplied.]

If a taxpayer chooses to use the tax credits under AS 43.55.024(j) for production within the legacy fields, the use of the AS 43.55.024(j) credit creates a "hard floor" as limited by AS 43.55.011(f) to the effect that, "no matter what," the "4 percent minimum tax on the gross is retained." A tax credit under AS 43.55.024(j) may still be used in concert with any other tax credits as allowed by statute, but only to the extent that any combination of AS 43.55.024(j) tax credits and any other available credits do not reduce a taxpayer's tax liability under AS 43.55.011(e) to an amount below the limitations at AS 43.55.011(f), as described in 15 AAC 55.335(g). This circumstance applies both to credits generated by a taxpayer's own activities, as well as a transferred tax credit certificate under AS 43.55.023(e) or AS 43.55.025(g)

However, a producer/taxpayer is not obligated to include the AS 43.55.024(j) tax credit in determining the amount, if any, of that producer's tax liability. Rather, in periods of extended low prices, a taxpayer that is also a producer in the "legacy" fields is allowed to make a determination:

1. Does the taxpayer use any combination of credits under AS 43.55.024(j) and other available credits to take their tax liability under AS 43.55.011(e) down to the minimum tax described at AS 43.55.011(f), pay the minimum tax, and carry forward, as allowable, any remaining credits; or
2. During periods of extended low prices, and during which the tax credit under AS 43.55.024(j) may be at or near the limitation described at AS 43.55.011(f), does the taxpayer rather choose to forego the AS 43.55.024(j) tax credit in its entirety for the calendar year? In that circumstance, a taxpayer would be able to use other available credits, including purchased credit certificates, to reduce their tax liability below the limitation described in AS 43.55.011(f), and, potentially all the way down to, but not less than zero.

When the levy of tax under AS 43.55.011(e) is at or below the amount in AS 43.55.011(f) before application of any credits, then no credits under AS 43.55.024(j) are allowed.

Scope and non-binding nature of this bulletin: This advisory bulletin is issued for the information and guidance of producers, explorers, and other interested persons. Opinions expressed here are strictly limited to the proposed conditions as presented above interpreted in accordance with existing Alaska oil and gas production tax law. These interpretations do not address other possible effects under other scenarios or types of tax laws, and as provided in AS 43.55.110(g), interpretations stated in this advisory bulletin are not binding on the Department or others.

Ken Alper
Director, Tax Division
Department of Revenue

Issued: March 31, 2017