Alaska Oil and Gas Association

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Mr. John Larsen, Audit Master
Tax Division, Alaska Dept. of Revenue
550 West 5th Avenue, Suite 500
Anchorage, AK 99501

Re: Second Set of Proposed Regulations Affecting the Oil and Gas Production Tax to implement Ch. 3 SSSLA 2017 (HB 111)

Dear Mr. Larsen:

The Alaska Oil and Gas Association ("AOGA") appreciates the opportunity to provide comments in response to the Department of Revenue's (DOR) second set of proposed tax regulations implementing HB 111. For nearly half a century AOGA has been the trade association of the petroleum industry in Alaska, and our members actively continue to explore for, develop, produce, transport, and refine oil and gas in the state. In keeping with our practice regarding tax matters, all our members have had the opportunity to review and contribute to these comments, and they have been approved without dissent.

Our comments below on the proposed regulations are in addition to our comments previously submitted on December 5, 2017 in response to the DOR's discussion draft of these proposed regulations. We again thank the DOR for having allowed industry the opportunity to provide advanced comments on the proposed regulations in their draft form. AOGA and its members are also pleased to acknowledge the DOR's acceptance of several of our prior comments as reflected in the second set of proposed regulations. We believe the process of the DOR and industry exchanging questions and concerns in advance of the issuance of the second set of proposed regulations resulted in proposed regulations that are significantly clearer and which should result in reduced misinterpretations and potential audit disputes.

While the second set of proposed regulations are overall clearer and less ambiguous, AOGA believes there remains several areas of proposed regulation 15 AAC 55.217 where additional guidance or clarity should be provided. As always, AOGA would request wherever possible the

DOR provide more detailed examples in the regulations to avoid any confusion or misunderstandings on how a specific regulation is supposed to be applied and affect a taxpayer's production tax return.

I. 15 AAC 55.217(c)(2):

Section (c)(2) provides that if a producer wishes to disclaim the right to use in a future year any carried forward annual loss, such disclaimer will be binding on any transferee of such an interest or any person that may acquire the producer. Under what circumstances does DOR envision a "disclaimer" of a loss and how would that work with respect to any assigned tax credits or tax credits that have been or may be transferred?

II. 15 AAC 55.217(e)(1):

Section (e)(1) provides that geological or geophysical exploration, other than a stratigraphic test well, that is within twenty-five miles of land that later becomes part or all of a lease or property of a producer shall be considered reasonably related to that lease or property for purposes of the determination and application of any carried forward annual loss. While AOGA appreciates the DOR expanding the geographic limitation from the originally proposed three-mile limitation to twenty-five miles, we remain concerned as to the genesis of that limitation? Where in HB 111 does that restriction appear? In addition, how will that twenty-five mile limitation be determined or measured? By surface well location, production facilities, bottom-hole, or other? Additional guidance and specifics by the DOR should be provided to avoid any boundary or audit disputes.

III. 15 AAC 55.217(e)(5):

Section (e)(5) provides that a lease or expenditure incurred by a producer by means of a stratigraphic test well will be considered reasonably related to a lease or property acquired by the producer if the producer "relies on information gained from the well in evaluating that lease or property for acquisition." How will this standard be established or even proven to the satisfaction of the DOR or an auditor? What information will the taxpayer be required to provide and in what time frame? How long will the DOR have to provide its acceptance of the taxpayer's reliance? Unless more guidance is provided in the regulation, how will a taxpayer reasonably know if the DOR has approved the use of the carried forward annual loss from such stratigraphic test well before the taxpayer files its production tax return(s)? How will the Division ensure consistency of audit position from one taxpayer to the next, especially when auditing the same project?

IV. 15 AAC 55.217(h)(1):

Section (h)(1) provides that if a producer acquires an interest in a lease or property that producer may use the unused carried forward annual loss established by lease expenditures previously incurred by the transferor provided, among other things, that the transferor of the interest provides the acquiring producer with a description and documentation of the lease expenditure which established the carried forward annual loss with sufficient specificity to distinguish those prior

incurred lease expenditures from other lease expenditures incurred by the transferor and to justify on audit the deduction of the carried forward annual loss.

A carried forward annual loss is determined on a segment by segment basis, not on a lease or property by lease or property basis within the same segment. What authority is the DOR citing to allow the establishment of this new lease by lease requirement? Without sufficient statutory authority, it would appear the proposed regulation is inconsistent with HB 111 and, at least to that extent, would be invalid under AS 44.62.030.

Assuming proposed 15 AAC 55.217(h)(1) is valid, what information or documentation would the DOR accept as sufficient specificity to allow justification on audit? What guidelines will the DOR provide taxpayers in advance to allow them to be able to provide the necessary information? How would the application of this new audit justification standard work in practice? Different taxpayers could be at risk to different interpretations by different auditors as to the type or amount of information or specificity to justify the use of any acquired carried forward annual loss with all of the risk falling on the taxpayer.

Suppose a producer acquires an interest in a qualified lease or property with a carried forward annual loss from a transferor who provides what the transferor believes is sufficient information and specification to allow the use by the acquiring producer of the carried forward annual loss. Suppose the acquiring producer wishes to use that carried forward annual loss in one or more of its production tax returns for a tax year occurring before the transferor's lease expenditures which generated the carried forward annual loss have been audited by the DOR, what rules or procedures will be applied? How would the acquiring producer be made aware that the acquired carried forward loss may have to be adjusted? Will the acquiring producer be able to challenge the decision? Will the acquiring producer be subject to potential penalties or interest if one or more of its production tax returns have to be amended to reflect an adjustment to the acquired carried forward annual loss due to no fault of the acquiring producer?

Without specific guidelines set forth in the proposed regulations, these are but a few of the potential issues, concerns and inequities that the proposed regulation could create.

V. 15 AAC 55.217(i):

Section (i) provides that if a taxpayer acquires another producer or explorer the tax benefit of the acquired entity's unused carried forward annual loss may not exceed "the value of the consideration paid for the acquisition." This limitation is not in the statute and was never intended by the Legislature so where is the DOR's authority for it? Without sufficient statutory authority the proposed regulation is inconsistent with HB 111 and, at least to that extent, would be invalid under AS 44.62.030.

Moreover, what is the DOR's or the Administration's policy reason justifying it?

Assuming the proposed regulation is valid, how will a taxpayer know what the DOR will accept to determine "the value of the consideration paid for the acquisition"? How will the DOR let the taxpayer know of its determination of the value of the consideration? By when? What rules or valuation standards will the DOR apply? Will the DOR publish those rules or standards?

Without specific guidelines or rules within the proposed regulations, taxpayers be subjected to a risk of a case by case/taxpayer by taxpayer inconsistent treatment under audit.

VI. 15 AAC 55.217(j):

Section (j) provides that a taxpayer must provide a written request to the Commissioner of the DOR to request the AOGCC to determine whether, and if so, when, regular production of oil or gas has commenced from a lease or property to allow of any gross value reduction under AS 43.55.160(f) and (g) but also in the determination and application of any carried forward annual loss. While we appreciate the DOR adding this procedural guidance to the proposed regulation, the proposed regulation still leaves many potential questions or concerns unaddressed.

What standards will the DOR or AOGCC use to determine the commencement of regular production? How long will the determination by the AOGCC or DOR take? Shouldn't there be a specified period of time in which the AOGCC and/or DOR must act?

What remedies would a taxpayer have if it disagreed with the AOGCC's or DOR's determination?

What would happen if a lease or property previously determined to be in regular production ceases production for some prolonged period of time, would the taxpayer be required to submit another request for the AOGCC or DOR to determine if and when that lease or property is still or has resumed regular production? If so, how long must the cessation of production be to require a determination of regular production?

Thank you again for allowing AOGA and its members to provide comments on these proposed regulations. Please contact me if the DOR has any questions or would like to meet to discuss these comments.

Very truly yours,

ALASKA OIL AND GAS ASSOCIATION

Kara Moriarty

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