

Alaska Oil and Gas Association



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Mr. John Larsen, Audit Master
Alaska Department of Revenue
550 W. 7th Ave., Ste. 500
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AOGA Comments Regarding the Department of
Revenue's Proposed "Technical Corrections"
To 15 AAC 55.195 and 15 AAC 55.196,
To the Department's Publication Referenced
Therein, and To the Respective "Editor's notes" for
These Regulations Regarding "Tanker ROI"

Dear Mr. Larsen:

These comments are made on behalf of the members of the Alaska Oil and Gas Association ("AOGA"), who account for a majority of the oil and gas production and related operations in Alaska. They have been reviewed by the AOGA membership and approved with no dissent.

AOGA has no comments on 15 AAC 55.195, but does object to the amendments proposed to 15 AAC 55.196 by the Alaska Department of Revenue ("Department" or "DOR") — not so much with respect to their substance¹ — but with respect to the uncertainty about how these regulations as amended would actually operate.

¹ The "Notice of Public Scoping Request" dated 29 August 2018 regarding "Possible Updates and Revisions to Department Regulations 15 AAC 55: Oil and Gas Production Tax and Oil Surcharge" (the "Scoping Request") stated:

The department's current model for calculating return on investment for crude oil and LNG tankers dates to September 2003. The department is issuing this scoping notice in order that taxpayers and the ROI Model properly reference

In the online notice of these proposed amendments, there is a link (<https://aws.state.ak.us/OnlinePublicNotices/Notices/Attachment.aspx?id=114383> (hyperlink removed)) to a document titled “Identification of Proposed Changes to Tanker ROI Model Spreadsheet” (the “Identification”), the first page of which states:

In regards to the proposed changes to the Department of Revenue's ROI model instructions titled: "Computation of a Cost-of-Capital Allowance under 15 AAC 55.196 Incorporating Depreciation and Return on Invested Capital for Marine Vessels and Improvements," the following cells, as shown in yellow highlight in the attached Adobe.pdf file are the cells for which proposed changes are being made:

Tab: "InputSched1," cells E17:E26 have a new formula that applies the appropriate federal corporate tax rate from the Tax Cuts and Jobs Act of 2017 (P.L. 115-97) based on the year in question. The new formula is "=IF(A17<2018,0.35,0.21)" that enters the appropriate rate of 35% or 21%, based upon the year in question.

Tab: "InputSched1," cells C37:D51 have added the weighted average cost of capital for years 2004 – 2018.

Tab: "InputSched2," cells C12:C36 are also proposed for amending to include the appropriate federal corporate tax rate from the Tax Cuts and Jobs Act of 2017 (P.L. 115-97) based on the year in question. The new formula is "=IF(A17<2018,0.35,0.21 [2] that enters the appropriate rate of 35% or 21%, based upon the year in question.

-
- (i) a weighted average cost of capital (WACC) index used by the model because the current publisher is moving publication of the WACC index from a print publication to an online platform, and
 - (ii) corporate tax rate entries in the ROI Model to reflect new federal corporate tax rates effective for the 2018 calendar year. [emphasis added; reformatted for clarity]

Scoping Request at 1.

AOGA's response dated 12 September 2018 to the Scoping Request noted:

- [regarding item (i) above] “[c]hanging the reference in the regulations to the published source for the ‘weighted average cost of capital (WACC) index’ used in the ‘ROI Model’ will not change how the Model works since the source itself will not change[, and]
- [regarding item (ii) above] updating “corporate tax rate entries in the ROI Model to reflect new federal corporate tax rates effective for the 2018 calendar year” would only change an input for the Model as provided in 15 AAC 55.195(a) for those years to which the new rates apply, without changing the Model itself.

AOGA Comments to Response to the Alaska Department of Revenue's Notice of Public Scoping Published August 29, 2018 regarding Possible Updates and Revisions of Regulations in 15 AAC 55: Oil and Gas Production Tax and Oil Surcharge (12 Sept. 2018) (“AOGA’s Scoping Response”), at 1 (text reformatted to parallel the reformatting of the quotation from the Scoping Request). With respect to the updating of where the public can access WACC data from the same source, and updating the rates of the federal income tax, “AOGA ha[d] nothing to say at this time about these potential changes being considered by DOR.” *Id.*

² The text here has been cut-and-pasted from the website and does not have a closing parenthesis nor a closing quotation mark after the number 0.21 at the end of the expression:

"=IF(A17<2018,0.35,0.21

Tab: "InputSched2," cells D12:D36 have been changed to incorporate a "=VLOOKUP" function referencing the weighted average cost of capital (WACC) from tab "InputSched2."

Following is a link to an Adobe.pdf file showing the changes to the affected tabs of the ROI model spreadsheet: <http://tax.alaska.gov/programs/documentviewer/viewer.aspx?112n> [hyperlink removed³]

FEDERAL INCOME TAX RATE

"InputSched1" and "InputSched2" (as downloaded from the website given in the Notice) appear respectively in the upper and lower portions of the next page. In "col. 5 ("Regular Tax Rate")" in the upper table of InputSched1, one sees "0.35" in yellow highlighting. Since InputSched1 is for "Pre-Service" inputs, the years with this 35% rate run from -9 to -1. InputSched2 is for "Post-Service" and "0.35" is the "Regular Tax Rate" (col. 3) for "Tax Years" 0 to 24 in

Marine ROI model - 15 AAC 55.196(d)
(Confidential subject to AS 43.05.230 and AS 40.25.100)

Alaska Department of Revenue - Tax Division
 Tax Type: AS 43.55 Oil and Gas Production Tax

PRODUCER:
 NAME OF VESSEL:
 YEAR FOR WHICH TAX IS PAID:

INPUT CELLS

Input Schedule 1
 Producer Pre-Service Inputs

col 1	col 2	col 3	col 4	col 5	col 6	col 7	col 8	col 9	col 10
Year Prior to Service	CCP Deposits and Earnings	Capitalized Investment Basis	WACC	Regular Tax Rate	Other Revenues and Expenditures Taxable	Other Revenues and Expenditures Non-Taxable	Direct Revenues and Expenditures Tax Beneficial	Taxpayer's AMTI 1-Yes/0-No	AMT Tax Rate
enter #.any		enter #.dollars			enter #.any	enter #.any	enter #.any		
-9	0	0	0.0000	0.35	0	0	0	0	0.20
-8	0	0	0.0000	0.35	0	0	0	0	0.20
-7	0	0	0.0000	0.35	0	0	0	0	0.20
-6	0	0	0.0000	0.35	0	0	0	0	0.20
-5	0	0	0.0000	0.35	0	0	0	0	0.20
-4	0	0	0.0000	0.35	0	0	0	0	0.20
-3	0	0	0.0000	0.35	0	0	0	0	0.20
-2	0	0	0.0000	0.35	0	0	0	0	0.20
-1	0	0	0.0000	0.35	0	0	0	0	0.20
0	0	0	0.0000	0.35	0	0	0	0	0.20

Vessel capitalized interest other: 0

	WACC
2001	8.03%
2002	7.18%
2003	7.64%
2004	8.85%
2005	6.18%
2006	7.02%
2007	7.22%
2008	7.29%
2009	8.19%
2010	8.21%
2011	8.27%
2012	8.45%

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³ The "Adobe.pdf file" that this hyperlink links to is the same this webpage being quoted here, but without the sixth and final paragraph (which would link back to itself to form a loop).

Marine ROI model - 15 AAC 55.196(d)
 Confidential subject to AS 43.05.230 and AS 40.25.100

Alaska Department of Revenue - Tax Division
 Tax Type: AS 43.55 Oil and Gas Production Tax

Input Schedule 2
 Producer Post-Service Inputs

col 1	col 2	col 3	col 4	col 5	col 6	col 7	col 8	col 9	col 10	col 11	col 12
Tax Year	Portion of Year in Service	Regular Tax Rate	WACC <small>link each year from IS1</small>	Remaining Years	Allowance under 15 AAC 55.195	Capitalized Improvements	Number of Days in the Year <small>adj for leap year</small>	Previous Annual Cost of Capital <small>hard code each year</small>	Producer Choice to Expense First \$1mm of Improvements <small>1=Yes,0=No hard code year each</small>	Taxpayer in AMT? <small>1=Yes,0=No hard code each year</small>	AMT Tax Rate
0	0%	0.35	#N/A	24.00	0	0	365	#N/A		0	0.20
1	100%	0.35	#N/A	24.00	0	0	365	#N/A		0	0.20
2	100%	0.35	#N/A	23.00	0	0	365	#N/A		0	0.20
3	100%	0.35	#N/A	22.00	0	0	365	#N/A		0	0.20
4	100%	0.35	#N/A	21.00	0	0	365	#N/A		0	0.20
5	100%	0.35	#N/A	20.00	0	0	366	#N/A		0	0.20
6	100%	0.35	#N/A	19.00	0	0	365	#N/A		0	0.20
7	100%	0.35	#N/A	18.00	0	0	366	#N/A		0	0.20
8	100%	0.35	#N/A	17.00	0	0	365	#N/A		0	0.20
9	100%	0.35	#N/A	16.00	0	0	366	#N/A		0	0.20
10	100%	0.35	#N/A	15.00	0	0	365	#N/A		0	0.20
11	100%	0.35	#N/A	14.00	0	0	365	#N/A		0	0.20
12	100%	0.35	#N/A	13.00	0	0	365	#N/A		0	0.20
13	100%	0.35	#N/A	12.00	0	0	366	#N/A		0	0.20
14	100%	0.35	#N/A	11.00	0	0	365	#N/A		0	0.20
15	100%	0.35	#N/A	10.00	0	0	365	#N/A		0	0.20
16	100%	0.35	#N/A	9.00	0	0	365	#N/A		0	0.20
17	100%	0.35	#N/A	8.00	0	0	366	#N/A		0	0.20
18	100%	0.35	#N/A	7.00	0	0	365	#N/A		0	0.20
19	100%	0.35	#N/A	6.00	0	0	365	#N/A		0	0.20
20	100%	0.35	#N/A	5.00	0	0	365	#N/A		0	0.20
21	100%	0.35	#N/A	4.00	0	0	366	#N/A		0	0.20
22	100%	0.35	#N/A	3.00	0	0	365	#N/A		0	0.20
23	100%	0.35	#N/A	2.00	0	0	365	#N/A		0	0.20
24	100%	0.35	#N/A	1.00	0	0	365	#N/A		0	0.20

# days	=0
% for year	0.0000

“col. 1”. According to the Identification, the “new formula” in “col. 3” in InputSched2 will be “=IF(A17<2018,0.35,0.21)” (closing parenthesis after “0.21” added).

There are several material ambiguities in this statement, or alternatively, there are material errors and defects in the formula. The “Identification” says this formula “enters the appropriate rate of 35% or 21% [under P.L. 115-97], based upon the year in question.” Well, this can be true only if “A17” is the relevant “year in question.”⁴

But, in the spreadsheet, “A17” is the address for only one entry in column “A”, and that’s the entry in the 17th row of the column. So, if tax years are being listed in column “A”, then “A17” is the address for a tax year in column “A”, but it is not the address for any tax year in a row before 17, nor for a year in a row after it.

⁴ Public Law 115-97 changes the corporate tax rate from 35% to 21%, effective January 1, 2018, starting with the company’s 2019 tax year. So, the logic behind the formula “=IF(A17<2018,0.35,0.21)” is sound insofar as it could set the rate at 21% for tax years after 2017, and at 35% for 2017 and prior tax years. The defect comes from the “A17” in the formula, as the next paragraphs in the main text explain.

A second problem comes from the fact that the “Tax Year[s]” set out in “col. 1” in InputSched2 run from 0 to 24. Literally, that range of tax-year numbers is far removed from the year 2018 set out in the formula. Accordingly, one expects that, for a given vessel, the formula for cells in “col. 1” would reset Year “0” to the calendar year when the vessel is placed in service, but one would have to look at the actual cell formulas for column “A” in the spreadsheet to be sure. And we do not have any opportunity to examine the software directly.

And a third problem comes from the fact that the column in which “Tax Year[s]” will be listed is labeled “col. 1”, not column “A”. Of course, for a spreadsheet in Excel[®] or similar software, the left-most column is “A” and the addresses to cells in that column will all start with “A” followed by the line number of the respective address, regardless of the heading that may be given to that column. But we do not have any opportunity to examine the software directly to be sure, so we cannot offer comments on the mere assumption that such is indeed the case.⁵

WEIGHTED AVERAGE COST OF CAPITAL (WACC)

The second, lower table for InputSched1 has a column titled “WACC” with year-by-year entries for 2002 – 2012 and one for “prior”. And InputSched2 has “col. 4” with the heading “WACC” in which the respective WACCs presumably would be set out for the respective “Tax Year” in “col. 1”. However, the actual entries in the “WACC” column are all the same — “#N/A”. One might guess that “N/A” by itself stands for “Not Applicable”, but what does “#N/A” mean? If it is a code for a link to another place on the same spreadsheet or to a different spreadsheet, there is absolutely nothing about where to find that place, except perhaps the notation in red font beneath “WACC” in the heading for “col. 4”, which says “line each year from IS1”.

We have to take it on faith that the specific WACCs listed in InputSched1 somehow make it into their appropriate spots in InputSched2 so that the WACCs for any given tax year will be the same in both schedules. With no evidence at all that we can find in the Department’s online materials for these proposed changes, we have to take it further on faith the WACC’s

⁵ To the readers in DOR: We make these comments in the main text, not in order to make points about 2018 being outside the range 0 – 24 and “col. 1” being different from a column containing “A17” as an address in it, but to lay a predicate for a point that will be made below.

from Duff & Phelps, LLC's new online source will also make it into the right cells in InputSched2 in the future.

We're sorry, but we just can't stretch our faith that far because there are other calculations by the Department that we cannot replicate — most notably calculations of interest that the Department's auditors assess along with additional production tax under AS 43.55 claimed to be owed. It is the interest calculation that is the point here, not the tax claims.

Under AS 43.55.020(g) interest accrues on any “unpaid amount of [a monthly] installment payment ... until March 31 following the calendar year of production” at the “rate provided for an underpayment under 26 U.S.C. 6621 (Internal Revenue Code)[.]” Similarly interest accrues under AS 43.55.020(h) for an overpaid monthly installment payment “at the rate provided for an overpayment under 26 U.S.C. 6621 (Internal Revenue Code) “until March 31 following the calendar year of production[.]” After March 31 of the respective “following calendar year”, interest accrues on an underpayment under AS 43.05.225 and accrues on an overpayment under AS 43.05.275(a).

The rules under 26 U.S.C. 6621 for calculating interest prior to March 31 of the next production year are very clear and detailed, whether the interest is accruing on an under payment or an overpayment. Similarly, the calculation of interest accruing after that March 31 date under the applicable Alaska statute is also a purely mathematical exercise. Yet, to our knowledge, no taxpayer has been able to calculate the amount of interest under these statutes for assessed tax deficiency in the underlying production tax, and have that amount tie to the amount of interest that was assessed for that deficiency.⁶

We believe this is due to errors in the Department's software programs for its audits, and errors in the capture of data by those programs from the taxpayers' filings. Whether we are correct or not in this belief, we strongly urge the Department — before it amends 15 AAC 55.196 and its publication under that regulation — to conduct a forensic audit of its existing programs to

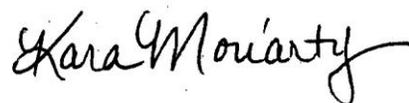
⁶ Unless required by AS 43.55.040(1) or similar law, taxpayers do not share details about Revenue's audit adjustments and assessments under AS 43.55. However, in the course of developing these Comments, we requested AOGA staff to poll our producer-members individually to see if any one of them has ever been able to calculate the same amount of interest that had been assessed by Revenue during any of their recent audit assessments under AS 43.55. No producer-member told AOGA staff that they had been able to calculate the same amount of interest that had been assessed.

ensure that they are calculating transportation costs correctly under 15 AAC 55.196 and AS 43.-55.150.

The scope of the present public notice to amend 15 AAC 55.196 and related material is not broad enough for us to propose formally here that the Department also conduct a forensic audit of its programming for auditing the taxes themselves under AS 43.55. But that wouldn't be a bad idea.

REGRET FOR DOR'S MISSED OPPORTUNITY

Before concluding, AOGA notes that the Scoping Notice that has led to these proposed amendments also stated, "Other minor changes proposed by the public or other interested parties may also be considered by the department." *Scoping Notice* at 1. In response to this we suggested a number of changes that are truly "minor" in the sense that they would reflect decisions and actions in the past year or so by the State of Alaska, the Department, and regulatory agencies like the Federal Energy Regulatory Commission and the Regulatory Commission of Alaska which are not reflected in the present transportation-cost regulations under AS 43.55.150. Those regulations were written before these decisions and actions were taken or while they were pending, and consequently they contemplate potential outcomes to these proceedings that the respective government authorities have not adopted. The regulations should be amended to reflect the choices that the governments have now made, and we are disappointed that the Department seems to have deliberately chosen not to apply its present knowledge and experience to make those changes.



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