

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 13, 2017

1:47 p.m.

DRAFT

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative Dean Westlake, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative David Talerico

MEMBERS ABSENT

Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 111

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 111

SHORT TITLE: OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

SPONSOR(S): RESOURCES

02/08/17	(H)	READ THE FIRST TIME - REFERRALS
02/08/17	(H)	RES, FIN
02/08/17	(H)	TALERICO OBJECTED TO INTRODUCTION
02/08/17	(H)	INTRODUCTION RULED IN ORDER
02/08/17	(H)	SUSTAINED RULING OF CHAIR Y23 N15 E2
02/08/17	(H)	RES AT 1:00 PM BARNES 124
02/08/17	(H)	Heard & Held

02/08/17	(H)	MINUTE(RES)
02/13/17	(H)	RES AT 1:00 PM BARNES 124
02/13/17	(H)	Heard & Held
02/13/17	(H)	MINUTE(RES)
02/17/17	(H)	RES AT 1:00 PM BARNES 124
02/17/17	(H)	Heard & Held
02/17/17	(H)	MINUTE(RES)
02/20/17	(H)	RES AT 1:00 PM BARNES 124
02/20/17	(H)	Heard & Held
02/20/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 1:00 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 6:30 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/24/17	(H)	RES AT 1:00 PM BARNES 124
02/24/17	(H)	Heard & Held
02/24/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 1:00 PM BARNES 124
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 7:00 PM CAPITOL 106
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
03/01/17	(H)	RES AT 1:00 PM BARNES 124
03/01/17	(H)	Heard & Held
03/01/17	(H)	MINUTE(RES)
03/01/17	(H)	RES AT 6:00 PM BARNES 124
03/01/17	(H)	Heard & Held
03/01/17	(H)	MINUTE(RES)
03/06/17	(H)	RES AT 1:00 PM BARNES 124
03/06/17	(H)	Scheduled but Not Heard
03/06/17	(H)	RES AT 6:30 PM BARNES 124
03/06/17	(H)	Heard & Held
03/06/17	(H)	MINUTE(RES)
03/08/17	(H)	RES AT 1:00 PM BARNES 124
03/08/17	(H)	Heard & Held
03/08/17	(H)	MINUTE(RES)
03/08/17	(H)	RES AT 6:00 PM BARNES 124
03/08/17	(H)	Heard & Held
03/08/17	(H)	MINUTE(RES)
03/09/17	(H)	RES AT 5:00 PM BARNES 124
03/09/17	(H)	-- MEETING CANCELED --
03/10/17	(H)	RES AT 1:00 PM BARNES 124
03/10/17	(H)	Heard & Held
03/10/17	(H)	MINUTE(RES)

03/11/17 (H) RES AT 12:00 AM BARNES 124
03/11/17 (H) -- MEETING CANCELED --
03/13/17 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

ED KING, Legislative Liaison
Office of the Commissioner
Department of Natural Resources (DNR)
Juneau, Alaska

POSITION STATEMENT: Offered information regarding fiscal notes during the hearing on HB 111.

ACTION NARRATIVE

[1:47:17 PM](#)

CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 1:47 p.m. Representatives Tarr, Birch, Parish, Talerico, Rauscher, Drummond, Johnson, Westlake, and Josephson were present at the call to order.

^#hb111

HB 111-OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

[1:48:41 PM](#)

CO-CHAIR TARR announced that the first order of business would be HOUSE BILL NO. 111, "An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date." [Before the committee was the proposed committee substitute (CS) for HB 111, Version 30-LS0450\N, Nauman, 3/10/17, adopted as a working document during the 3/10/17 House Resources Standing Committee meeting.]

[1:48:45 PM](#)

CO-CHAIR TARR said there were some technical problems with Version N. She referred to a handout in the committee packet and said one problem was the concept of "uplift" and the manner in which the committee had decided to approach it. She said [the state's consultant], Richard Ruggiero, Managing Partner, Castle Gap Advisors, Castle Gap Energy Partners, had advised that since consideration is being made for the state to replace a cash credit system with deductions, uplift is something the state could use to level the playing field for the non-

producers. She explained that currently producers generally use their losses within the year in which they are earned because they have a tax liability. This method allows the producers to have 100 percent of their losses used against their tax liabilities. She mentioned a calculation of a seven-year average "from start to ... first production" and said non-producers would just be accumulating losses.

CO-CHAIR TARR said the handout shows a comparison of "the two different opportunities." She said that with a 50 percent carry forward, with 8 percent interest, by year seven "those individuals" have recovered 85 percent of their costs. She said [the state] also offers the gross value reduction (GVR) provision, so the individuals not in production after year seven will not only get to carry forward all losses, but from the first year will also have the GVR provision. She said that if the state is too generous, then all the value will be eroded. For example, allowing a 100 percent of losses to go forward with a 10 percent interest equates to giving 200 percent of the value by year seven. That, plus the GVR, plus the per barrel credit results in total erosion of value. She reminded committee members that Mr. Ruggiero had recommended a bracketed tax based on profit, with elimination of the per barrel and GVR provisions. She said the state has not done this but has made modest modifications on the per barrel credit. She cautioned the need to be careful of "how all of these sort of stack up against each other." She explained, "That is why we felt like this is [an] appropriate way to apply this uplift, because we're not, at the same time, doing away with the GVR provisions that apply once they become a producer."

[1:51:57 PM](#)

CO-CHAIR TARR explained the proposed change to the per barrel credit: Version N would maintain a 4 percent floor when prices are below \$50 per barrel, and would raise the floor to 5 percent when per barrel prices are above \$50. By doing this there would be a value to the state when the price is in the range of \$50-\$70 per barrel. She provided an example based on 500,000 barrels per day, wherein a 12.5 percent royalty share is backed out to arrive at 437,000 barrels, and that number is multiplied by 365 days of production to equal 160 million barrels annually. Based on this scenario the minimum tax, at 4 percent, results in the state receiving only \$1.80 per barrel, because of the other deductions/costs involved, which include \$10 for transportation, a \$45 gross value at point of production (GVPP), \$30.88 for lease expenditures, and \$14.12 for production tax value (PTV).

Then applying the 35 percent tax leaves \$4.94. Subtracting the generous \$8 per barrel credit from that, she said, results in a minimum tax zone. She indicated that the current tax is between 9-13 percent, which she opined is too low. It's important to maintain value in this mid-price range, she stressed, because that has become the normal per barrel value. Raising the tax credit to 5 percent of the production tax value, although a modest change, is crucial at the mid-price per barrel rate, about \$65.00, and maintains an effective tax rate of 10-15 percent, up from the current minimum tax of 9-13 percent.

CO-CHAIR TARR, recalling a suggestion from the consultant, said, "One of the ways that we can be a little more generous on the low side is if we take a little bit more on the high side." The problem with the current structure is that a credit is available when oil is \$160 per barrel; however, oil prices have never exceeded \$147 per barrel. Reliance should not be placed on a windfall that will probably never occur, she opined; the new windfall level has been shifted to \$120 per barrel. She urged members to run the equations for themselves, pointing out that the mathematics are not complicated. She reported that the four price scenarios she calculated were very insightful and she reviewed the results.

CO-CHAIR TARR said an understanding of the per barrel price and how it affects oilfield operations provides a clear understanding of what happens when a discovery, such as Smith Bay, occurs and why development requires an environment enjoying a very high price of oil. She pointed out the importance of remembering to appropriately insert the per barrel credit, as it has "a lot of power" in the equation. One allowance included in Version N is for the entire percentage of a company's deductions to be carried forward. That is 100 percent of the infrastructure depreciation value, with losses, may be carried forward, she underscored, thus, there is generosity built into the proposed legislation.

[1:59:39 PM](#)

REPRESENTATIVE JOHNSON referred to the recent Armstrong/Repsol discovery and asked whether the announcement has changed the co-chair's view of how the previous regime was working.

CO-CHAIR TARR said the announcement was what prompted her to do the math and bring the committee members' attention to the amount of loss the state is allowing to be carried forward and the value recovery. The proposed HB 111 would provide

attractive opportunities to industry for the first 14 years of work on a new project. She said it is important to amend the GVR and per barrel credit structure in order to remove the stackable credits. Due to the stackable credits, to which the state has paid 85 percent of the work thus far conducted at Smith Bay - a generosity she opined the state can no longer afford. She compared the recent find to the expensive Point Thomson development and said: "If the state is going to be ... a co-investor by allowing these expenses to be deducted, I think we want to be as strategic as possible in the dollars that the state invests."

2:03:04 PM

REPRESENTATIVE RAUSCHER asked about the requirement under Version N that the Department of Natural Resources (DNR) preapprove the costs and how that action would work to relieve the net operating loss.

CO-CHAIR TARR responded that currently plans must be submitted to DNR for development, as well as production; however, the documents are provided late in the process. The proposed bill would empower DNR to draft appropriate regulations, on which the public, stakeholders, and industry would have an opportunity to comment. Industry incentives would be available under Version N, and giving DNR oversight of the costs would ensure that every dollar is spent in a strategic manner, she assured.

REPRESENTATIVE RAUSCHER asked whether DNR views the proposal as workable and if the agency would want to accept this new role.

CO-CHAIR TARR reported that DNR is interested in having better oversight. The state has no ability to turn down the work once it's begun, she said. If, for example, industry isn't able to stay on schedule, the proposal would allow DNR the oversight to determine why the delay occurred and take appropriate measures, which could result in cost savings.

REPRESENTATIVE RAUSCHER suggested the committee have an opportunity to question DNR directly. If DNR is going to take up this responsibility, then a fiscal note may be involved, and it would be important to have the opportunity to understand the agency's needs. He surmised that the work may be handled in concert with the Department of Revenue (DOR).

CO-CHAIR TARR said that DOR would receive the taxes and DNR would draft the regulations. When the regulations go out for

public comment, the industry would also have an opportunity to comment and there is value in allowing that process. Additional staffing was not discussed with DNR, she recalled, and she agreed that it would be good to have the agency weigh in, perhaps today while the meeting is in progress.

REPRESENTATIVE RAUSCHER questioned who would have control over the allowable lease expenses: DOR or DNR.

CO-CHAIR TARR responded that currently, the state has no control, and Version N would empower DNR to create a standard system.

REPRESENTATIVE RAUSCHER asked whether a taxpayer would be required to submit an annual lease expenditure estimate on January 1, of each year, to get preapproval.

CO-CHAIR TARR explained that DNR would be required to develop regulations via the public process, which would involve industry participation.

REPRESENTATIVE RAUSCHER queried what the consequences would be if the taxpayers erred in their estimates.

CO-CHAIR TARR assured that the proposed bill does not propose punitive action; however, the measure would provide DNR the opportunity to identify and correct overspending.

REPRESENTATIVE RAUSCHER predicted that auditing procedures may be challenging, particularly in the field, and could also prove to be expensive.

CO-CHAIR TARR said the measure would allow DNR to become involved prior to a project incurring expenses, and DOR would become involved after the fact.

[2:14:03 PM](#)

The committee took an at-ease from 2:14 p.m. to 2:19 p.m.

[2:19:34 PM](#)

REPRESENTATIVE JOSEPHSON commented that with Senate Bill 21 [passed in the Twenty-Eighth Alaska State Legislature] there was the belief of a 4 percent hard floor and, in fact, that did not exist.

[Due to technical difficulties the remainder of Representative Josephson's comments were not recorded and the committee took an at-ease to relocate to another room.]

[2:34:17 PM](#)

CO-CHAIR TARR called the House Resources Standing Committee back to order.

[2:34:30 PM](#)

CO-CHAIR JOSEPHSON recalled that in early February of last year the legislature learned that the credits, when stacked in a low-price environment, could bring the taxable value beneath zero. He asserted that this was a source of real concern. He mentioned that the media accounts at the time suggested that this consequence of Senate Bill 21 was neither well understood nor had it been vetted well by either chamber. He added that this concern was somewhat remedied by House Bill 247 [passed in the Twenty-Ninth Alaska State Legislature]. He stated that DNR's involvement would bring in more public participation, with the belief that the public is entitled to more information about the investments Alaska has made. He offered that under Version N, those investments would no longer be cash investments. He opined that the public is entitled to be informed when deductions are taken against liability and there are some net operating losses. He added that in this situation, preapproval is warranted, which would involve delegating to DNR. He mentioned that when the operators make a decision in the field to invest, they have already met with approval internally. He reiterated that the public is entitled to know and understand the investments through their elected officials, to ensure against ring fencing or a company using a single unprofitable location to make the company unprofitable in total.

[2:37:41 PM](#)

REPRESENTATIVE BIRCH posed the question of whether the proposed legislation would attract investment and exploration in order to put more oil in the Trans-Alaska Pipeline System (TAPS). He asserted that the fiscal note reflects \$190 million in expense in fiscal year 2018 (FY 18) and another \$190 million in expense in (FY 20). He lamented that the state royalty share has not been included in the discussion of Version N and expressed his desire to obtain DNR's input. He asserted that the 120,000 barrels-per-day prospect with Armstrong and Repsol, at a one-sixth royalty share, constitutes 20,000 barrels of oil per day

for Alaska. He added that at \$50 per barrel, this one discovery would bring to the state \$1 million per day in royalty and between \$300 million-\$400 million per year in royalty. He maintained that legislators not be dismissive of the royalty share but to do what they can to attract investment, put oil in TAPS, and fulfill their fiduciary responsibility to the favorable development of Alaska's resources. He asked if adding close to \$200 million a year in cost would attract the investment Alaska needs to realize its oil and gas potential.

2:39:52 PM

REPRESENTATIVE PARISH asserted that before he became an 85 percent investor, he would need to know the nature of the investment and the likelihood of it paying off in the near or distant future. He opined that under the current system, legislators do not have that insurance or the necessary level of oversight of the investments. He added that subsidizing behavior at 85 percent skews behavior and encourages behaviors which may not be economical or rational if there were no generous subsidy. He expressed his hope that through the proposed legislation, DNR will provide the needed oversight. He added that he supports Version N, and he reminded the committee that the initial development of the North Slope oilfield was not subsidized.

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REPRESENTATIVE TALERICO questioned the 85 percent figure mentioned by Representative Parish except in regard to Cook Inlet, which will be reduced by 50 percent by July 1, as a result of House Bill 247, and disappear completely by July 1, 2018. He stated throughput in January was about 554,000 barrels per day; throughput in February was 553,000 barrels per day. He maintained that even with low prices, Alaska has seen an increase in throughput both this year and last year, and the trend is an increased throughput. He added that Alaska does well off of royalty, and increased throughput enhances state coffers.

REPRESENTATIVE TALERICO said that in regard to the tax credit discussion, the "elephant in the room" was the Cook Inlet tax credits, which represent \$411 million of the total \$648 million in tax credits. He added that since Alaska's royalties from Cook Inlet are nothing like those from the North Slope, the legislature addressed the Cook Inlet credits through House Bill 247. He mentioned that House Bill 247 affords the companies a

transitional period to adjust to the new provisions. He lamented that the legislature is considering a change to the oil tax regime before House Bill 247 is fully in effect. He said a bill had been introduced to increase production tax, and it would result in a predicted \$25 million deficit in production tax versus what is paid out, while House Bill 247 predictions show \$110 million production tax revenue increasing to \$136 million production tax revenue the year after. He asserted that House Bill 247 puts Alaska on the right track for more production and revenue, and he opined that unnecessarily decreasing throughput would create a disservice to Alaska. He opined that throughput in TAPS is the key, and he reiterated that House Bill 247 should be allowed to take effect. He mentioned that it is a matter of record that a few more people oppose the proposed legislation than support it.

[2:46:55 PM](#)

CO-CHAIR TARR agreed that Alaska wants to remain an attractive place for investment and increase oil into TAPS. She mentioned that Version N does not address Cook Inlet, in part because House Bill 247 addresses Cook Inlet, but it would establish a Cook Inlet working group to adjust the provisions of House Bill 247 as more information is available and would ensure that the opportunity for recovering costs is included.

CO-CHAIR TARR, in response to Representative Birch's previous comment on the fiscal note, referred to the DOR fiscal note, dated 3/3/17, page 1, line D, under "Total Revenue Impact," which read "Budget impact of no cash repurchase for net NOL credits earned after 1/1/18." She said that the credits owed by the state would be deducted from the revenue as the companies become producers instead of paid directly. She maintained that the investment is still there, but would be "realized on the other side of the equation." She referred to line 3 of the fiscal note, under "Description of Provision," which read "Minimum tax increased to 5% of GVPP at prices of \$50 and above," and she stated that for FY 18 that would be \$20 million. She mentioned that the benchmark of \$50 is a reduced amount from that of the original version of HB 111.

[2:49:49 PM](#)

REPRESENTATIVE BIRCH referred to [a page from the fiscal note, titled "Provisions in CSHB 111 (RES)\N and their Estimated Fiscal Impact based on Fall 2016 Forecast (\$millions) - Fall 2016 FC PRICE," revised 3/13/17 by DOR, included in the

committee packet]. He directed attention to the fiscal impact for FY 20, which he noted is \$190 million, shown in yellow. He asked if the \$190 million signifies \$190 million more [emphasis on "more"] that the state would take.

2:50:08 PM

CO-CHAIR TARR answered that on the aforementioned page, under FY 20, is a \$60 total revenue impact, highlighted in blue, which is added to a \$130 total budget impact, also highlighted in blue, and that equals the \$190 total fiscal impact, highlighted in yellow. She continued as follows:

The substantial portion of it comes in this ... second section of ... [the fiscal note], so we're looking at the letters ... A-J. And so, a big portion of that ... where we save money is by not writing the check. So, we won't be writing the check; however, when they become producers ..., it'll become reflected in reduced revenue to the state, as is the case with the big three right now, that ... taxpayers generally use their losses in the same year that they were earned.

REPRESENTATIVE BIRCH noted that the fiscal note shows an upward trend to a total fiscal impact of \$260 million in 2027. He asked again for confirmation that this would be additional revenue to the state above existing revenue.

CO-CHAIR TARR answered, "Yes and no." She explained that the revenue - new money coming into the state - is shown in the upper portion of the fiscal note; the bottom half shows "the budget impact of us not paying out money." She continued as follows:

It's just a little bit different, in that we're not writing a check; we're saying: "Carry forward your losses. Once you become a producer, that money will be deducted from your taxes. And so ... whenever those companies become producers, we'll see that dollar amount shown as a reduction in their tax liability to the state. So, not new dollars coming in, but us not paying dollars out.

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CO-CHAIR TARR noted there were two amendments for consideration.

[2:52:11 PM](#)

REPRESENTATIVE RAUSCHER moved to adopt Amendment 1, labeled 30-LS0450\N.3, Shutts/Nauman, 3/13/17, which read as follows:

Page 1, lines 1 - 7:

Delete all material and insert:

"An Act relating to the interest applicable to delinquent oil and gas production tax; relating to the net operating loss credit against the oil and gas production tax; relating to lease expenditures; creating a credit against the oil and gas production tax for certain exploration activity; and providing for an effective date."

Page 1, lines 9 - 13:

Delete all material.

Page 2, line 2:

Delete "**Sec. 2**"

Insert "**Section 1**"

Renumber the following bill sections accordingly.

Page 2, line 27, through page 15, line 31:

Delete all material.

Renumber the following bill sections accordingly.

Page 17, line 4, through page 19, line 17:

Delete all material.

Renumber the following bill sections accordingly.

Page 19, lines 22 - 30:

Delete all material.

Renumber the following bill sections accordingly.

Page 20, line 13, through page 23, line 31:

Delete all material.

Renumber the following bill sections accordingly.

Page 24, line 24, through page 25, line 2:

Delete all material and insert:

"(3) lease expenditures, as adjusted under (m) of this section, that

(A) met the requirements of AS 43.55.160(e) in the year that the lease expenditures were incurred;

(B) were deductible in the immediately preceding 10 calendar years, not counting the year in which the expenditure was incurred;

(C) have not been deducted in the determination of the production tax value of oil and gas under AS 43.55.160(a) in a previous calendar year;

(D) were not the basis of a credit under this title; and

(E) were incurred to explore for, develop, or produce an oil or gas deposit located north of 68 degrees North latitude."

Page 25, lines 3 - 23:

Delete all material and insert:

"* **Sec. 6.** AS 43.55.165 is amended by adding a new subsection to read:

(m) A loss carried forward under (a)(3) of this section shall increase in value at a rate of 10 percent, compounded annually. An increase in value under this subsection begins to accrue on January 1 of the calendar year immediately following the calendar year in which the loss was accrued and no longer accrues on December 31 of the calendar year immediately preceding the calendar year in which a carried-forward annual loss is applied. The increase in value accrued under this subsection has no value except as applied in this section. An increase in value may not accrue

(1) for a partial calendar year;

(2) for more than 10 calendar years, consecutive or nonconsecutive; or

(3) on a loss carried forward by a producer whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is more than 50,000 BTU equivalent barrels during the calendar year that the loss was accrued."

Page 25, line 24:

Delete "and 43.55.029 are"

Insert "is"

Page 25, line 25, through page 28, line 12:

Delete all material and insert:

"* **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to read:

APPLICABILITY. (a) AS 43.55.023(b), as amended by sec. 2 of this Act, applies to lease expenditures incurred on or after the effective date of sec. 2 of this Act.

(b) AS 43.55.165(a)(3) and 43.55.165(m), added by secs. 5 and 6 of this Act, apply to a lease expenditure incurred on or after the effective date of secs. 5 and 6 of this Act."

Renumber the following bill sections accordingly.

Page 28, line 15:

Delete "Section 2"

Insert "Section 1"

Page 28, line 16:

Delete "Sections 1, 2, 28, and 33"

Insert "Sections 1 and 9"

Page 28, line 18:

Delete "sec. 34"

Insert "sec. 10"

[2:52:16 PM](#)

CO-CHAIR TARR objected for the purpose of discussion.

REPRESENTATIVE RAUSCHER spoke to Amendment 1. He referred to previous mention that there has been increase in activity on the North Slope, which has led to finds; there has also been an increase in exploration. Further, there has been greater trust in the State of Alaska by producers who are putting a considerable amount of money into finding and extracting oil. A concern is that that trust and momentum could be lost. He said the proposed bill, as written, is not friendly to producers. He said Amendment 1 would delete "the lion's share of the bill" and leave the sections that address the dry hole credits and carry forward losses - the former unchanged and the latter changed from the 50 percent proposed under Version N to 100 percent. He said the state's aforementioned consultant, Rich Ruggiero, had said that unless the state allows for 100 percent of the development costs to be recovered, Alaska would be "at the bottom of the list." He said Amendment 1 would "get a good handle on that math." He related that the mathematical

explanation of 50 percent NOL carry forward and 7 percent uplift equaling 100 percent return on loss is confusing. He said he came up with only 80 percent when he did the calculations. He urged the committee to support Amendment 1.

[2:56:30 PM](#)

CO-CHAIR TARR responded that the number is about 85 percent. She said, "The reason we used that amount for uplift is that is linked to the interest rate associated with delinquent taxes that either the state would pay if the taxpayer overpaid or that we would charge if the taxpayer underpaid." She noted that Mr. Ruggiero had also included ways to do something with the GVR and the per barrel credit. She indicated having considered all suggestions, and she stated concern about "how many years ... these opportunities can be in place." For example: seven years of carry forward, becoming a producer, accumulated losses, a GVR provision for a 20 percent reduction, and a \$5 per barrel credit. She said by the time all that is combined, much of the value is eroded. She said for that reason, she cannot support Amendment 1.

[2:57:53 PM](#)

CO-CHAIR JOSEPHSON expressed concern that offering 100 percent carry forward "would be more impactful to the state than current law." Further, if a dry hole credit was added, along with some uplift, particularly at 10 percent, the problem would be compounded. He said he thinks Amendment 1 would put the state in a position more precarious than its current one.

[2:58:45 PM](#)

REPRESENTATIVE BIRCH expressed his support of Amendment 1. He said just about every regime is entitled to recover its costs, and the proposed amendment "sets that out," is reasonable, and "would encourage the option."

[2:59:07 PM](#)

REPRESENTATIVE PARISH stated that businesses typically recover costs by making a profit off of their product, and he thinks that is the way things have been done by the oil industry for a long time. He said he thinks it is fine if the state wants to provide these companies with a subsidy in the form of a write-off on their taxes, with a generous 8 percent rate of return; however, a 100 percent carry forward with 10 percent interest

may encourage companies to start up, drill a dry hole, and be confident that in seven years, their investment would have doubled, thereby enabling them to sell out to a larger company that is seeing a profit and transfer over nearly twice the value of the initial investment to that other company while making a "tidy profit." He stated, "It's a recipe for disaster and for really perverse market incentives. We should not be interfering ... this intensely and setting ourselves up for this level of failure." He stated his opposition to Amendment 1.

[3:01:06 PM](#)

REPRESENTATIVE JOHNSON said she would feel better about moving Version N out of committee if Amendment 1 were adopted, because Amendment 1 at least attempts to change the bill in response to public testimony and concerns that have been brought forth. She said she does not think the committee has had time to address Version N, but she supports Amendment 1.

[3:01:37 PM](#)

REPRESENTATIVE RAUSCHER stated, "There are different moving parts, and ... it's all not one big block." He continued as follows:

I understand where [the] Representative from District 17 was going there, but I think each one effect[s] different ... sections at different times; they're really -- get a full grasp of what we're saying there. And I don't know whether, you know -- if you're not really excited about 100 percent, I think somewhere in between the 50 percent you're leaving them short.

REPRESENTATIVE RAUSCHER said the Internal Revenue Service (IRS) allows people to use their costs incurred, and he is not certain whether [the State of Alaska] is letting [oil companies] use their entire costs. He said as a result, he is not certain the companies will be incentivized to "dig in, go forward, spend money."

[3:03:00 PM](#)

A roll call vote was taken. Representatives Birch, Johnson, Rauscher, and Talerico voted in favor of Amendment 1. Representatives Drummond, Parish, Westlake, Josephson, and Tarr voted against it. Therefore, Amendment 1 failed to be adopted by a vote of 4-5.

3:03:52 PM

REPRESENTATIVE RAUSCHER moved to adopt Amendment 2, labeled 30-LS0450\N.4, Shutts/Nauman, 3/13/17, which read as follows:

Page 24, line 24, through page 25, line 23:

Delete all material and insert:

"(3) lease expenditures, as adjusted under (m) of this section, that
(A) met the requirements of AS 43.55.160(e) in the year that the lease expenditures were incurred;
(B) were deductible in the immediately preceding 10 calendar years, not counting the year in which the expenditure was incurred;
(C) have not been deducted in the determination of the production tax value of oil and gas under AS 43.55.160(a) in a previous calendar year;
(D) were not the basis of a credit under this title; and
(E) were incurred to explore for, develop, or produce an oil or gas deposit located north of 68 degrees North latitude.

* **Sec. 26.** AS 43.55.165 is amended by adding a new subsection to read:

(m) A loss carried forward under (a)(3) of this section shall increase in value at a rate of 10 percent, compounded annually. An increase in value under this subsection begins to accrue on January 1 of the calendar year immediately following the calendar year in which the loss was accrued and no longer accrues on December 31 of the calendar year immediately preceding the calendar year in which a carried-forward annual loss is applied. The increase in value accrued under this subsection has no value except as applied in this section. An increase in value may not accrue

(1) for a partial calendar year;

(2) for more than 10 calendar years, consecutive or nonconsecutive; or

(3) on a loss carried forward by a producer whose average amount of oil and gas produced a day and taxable under AS 43.55.011(e) is more than 50,000 BTU equivalent barrels during the calendar year that the loss was accrued."

Page 27, line 23:

Delete "and (n)"

[3:03:54 PM](#)

REPRESENTATIVE TARR objected for the purpose of discussion.

[3:04:02 PM](#)

REPRESENTATIVE RAUSCHER spoke to Amendment 2. He maintained that HB 111 would not incentivize producers to "hurry up and get in the game with us," whereas plans the state has put in place in the past have inspired oil companies to do business with the state. He said he thinks the changes proposed under HB 111 are too severe and expect "a little bit too much from our partners" and will make them leery about the future. Each year brings another change and disappointment, yet those companies continue to work with the state. He emphasized the importance of keeping the companies as partners and working hand in hand "and not so much against." Representative Rauscher said Amendment 2 would reset the carry forwards from the 50 percent proposed under Version N to 100 percent. He reiterated that Mr. Ruggiero had said the state could find itself "at the bottom" globally. He said Amendment 2 would change the uplift from 7 to 10 percent and would expand the life of the carry forwards from 7 years to 10 years. He urged the committee to support Amendment 2.

[3:06:35 PM](#)

REPRESENTATIVE BIRCH stated support for Amendment 2. He said Alaska is an expensive place in which to do business, and long lead times have affected even such an established area as ConocoPhillips Alaska, Inc. operates. He said he thinks Amendment 2 is "on track." He opined that the state needs to provide the opportunity for oil and gas exploration companies to recover their costs.

[3:07:05 PM](#)

CO-CHAIR TARR said carrying forward losses is a typical feature of an income tax, and she indicated that the ability for [companies] to recover 100 percent of their losses on their corporate income tax would not be removed under Version N. She said the corporate income tax is a deduction against the federal taxes. She said there are several places where these losses are recovered, and Version N would make no adjustments in that respect. She posited that one of the challenges of the severance tax is that it is a combination of gross tax and net

profits tax and behaves in some ways like a corporate income tax. She opined that the combination does not work well and is a part of the current system. She mentioned being mindful of not being overcommitted. She expressed her point of view that the buildup of credits are obligations the state cannot meet, and "even if it's scaled back a little bit but we always meet that obligation, that would be beneficial to the industry, more than having something that ... potentially is supposed to be available and then is not available." She said while the legislature has the ability to make appropriations, the governor will always have the ability to veto any line items in the budget. If [the legislature and governor] are not in alignment, then "that puts the whole system at risk." She explained that she cannot support [Amendment 2], because she does not want the legislature "to be overcommitted to something that puts us in a position where we have to react again." She stated the intent of Version N is to provide stability to the system.

[3:09:21 PM](#)

REPRESENTATIVE RAUSCHER said Amendment 2 would take care of cashable credits, which he said he thinks everyone agrees need to be reevaluated. He characterized Co-Chair Tarr's remarks about not wanting [to react again] as being an excuse. He said that it is necessary to continually revisit the issues, because "nothing's perfect until you figure it all out." He stated his belief that Amendment 2 is good, tame, not large-scale, and needs no repeated analyzation or reaction, and he urged everyone to support it.

[3:11:21 PM](#)

[A roll call vote was taken, but subsequently voided for being incomplete.]

[3:11:58 PM](#)

The committee took an at-ease from 3:12 p.m. to 3:13 p.m.

[3:13:18 PM](#)

CO-CHAIR TARR announced that the roll call vote on Amendment 2, taken before the at-ease, would be voided, because one member had not been called.

[3:13:25 PM](#)

A roll call vote was taken. Representatives Talerico, Birch, Johnson, and Rauscher voted in favor of Amendment 2. Representatives Westlake, Drummond, Parish, Josephson, and Tarr voted against it. Therefore, Amendment 2 failed to be adopted by a vote of 4-5.

[3:14:11 PM](#)

ED KING, Legislative Liaison, Office of the Commissioner, Department of Natural Resources (DNR), said the department needs a couple days to figure out the implications of Version N to HB 111 on DNR. In response to Co-Chair Tarr, he said he anticipates a positive fiscal note, because Version N would require some things of the department that are outside of the scope of its normal function and would require the expansion of its accounting section. In response to a question from Representative Birch about the timing of the new information requested under Version N and how it would impact the oil and gas industry, he said it is typical for a regulation packet to take about year to be implemented; therefore, he speculated there may be a period of uncertainty that could "drive differences in behavior." He proffered the question would be best asked of the industry.

[3:16:11 PM](#)

REPRESENTATIVE BIRCH said he is keenly interested in the issue and would like an assessment by [DNR] - as a leaseholder "managing that relationship" - of the significant impacts of the proposed legislation.

[3:16:31 PM](#)

CO-CHAIR TARR asked for clarification concerning the amount of time Mr. King thought the department would need to create a fiscal note.

MR. KING said his staff is currently working on [a fiscal note] and making sure regulations could be written in a way that would not impede the ability of auditors in DOR to audit the tax returns after the preapproval process happens through DNR. He said he anticipates the process will take at least through today, and he said he would get a fiscal note to the committee as soon as possible.

[3:17:16 PM](#)

The committee took an at-ease from 3:17 p.m. to 3:18 p.m.

[3:18:46 PM](#)

CO-CHAIR TARR said she would allow DNR to the end of the day to work up some preliminary information "on that provision of the bill."

[3:19:03 PM](#)

REPRESENTATIVE WESTLAKE surmised that [Version N] would increase the workload of those in accounting, perhaps "on a monthly scale." He said, "I'd hate to set a precedent where we're doing exactly the same thing, where ... we've made a ruling here, and the State of Alaska, through no fault of industry, is years behind on this thing." He asked if there is a way the legislature can address the issue.

[3:19:37 PM](#)

MR. KING responded that he is not sure; however, he did confirm that [Version N] would require a different method of accounting from what the department currently has in place, and it would take time to implement such a process. He said DNR would, if possible, look to combine efforts with DOR and look for efficiencies; it is not interested in the expansion of its department unless absolutely necessary to meet the requirements of the proposed legislation.

[3:20:32 PM](#)

CO-CHAIR TARR said she had not anticipated the challenge the provision would create in terms of a fiscal note, and she appreciates the opportunity to "work that through."

[3:21:05 PM](#)

ADJOURNMENT

The House Resources Standing Committee meeting was recessed at 3:21 p.m. to a call of the chair. [The meeting reconvened at 3:20 p.m. on 3/14/17].