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Jonathan E. Iversen is an Alaska-based tax attorney with Stoel Rives LLP who provides tax planning and tax structuring advice and represents clients in tax audits and appeals. His practice emphasizes Alaska state and local taxation. Before joining Stoel Rives, Iversen served as director of the Tax Division of the Alaska Department of Revenue. He also worked as an assistant attorney general representing the Alaska DOR in tax matters and the Alaska Department of Natural Resources in royalty cases and other oil and gas concerns.

In this installment of Alaska Tax: The Last Frontier, Iversen discusses the debate over the payment for outstanding Alaska oil and gas production tax credits.

As I write this article, we are pushing toward the end of summer in Alaska. It has been unseasonably hot this year in many areas of the state, and there have been several sizable wildfires. Temperatures seem to be normalizing though, although smoke still lingers from fires that continue to burn.

In addition to the fires that are smoldering throughout the state, there are several not-so-literal fires that have been flaring over the past few months, some more prominently than others. The debate over the payment for outstanding Alaska oil and gas production tax credits continues, as does the court action over the constitutionality of House Bill 331, which the Alaska Legislature passed in 2018 to establish the Alaska Tax Credit Certificate Bond Corp. (TCCB) in the Department of Revenue, to issue up to $1 billion in bonds to finance purchases of the oil and gas tax credits.[1] Alaska's budget struggles continue, and the lack of consensus among legislators and between the Legislature and the governor have led to damaging delays in passing operating and capital budgets as well as occasional panic and chaos for citizens of the state and the business community. And to pile it on, some legislators introduced bills to yet again change the oil and gas production tax, seeking to again raise taxes on the oil and gas industry on which the state so heavily relies.

H.B. 331

As discussed in the last installment, H.B. 331 was signed into law on June 21, 2018.[2] The bill created TCCB in DOR, a public corporation with the purpose of financing the purchase of tax credits under Alaska Statute (AS) section 43.55.028, which would include all rebatable Alaska oil and gas production tax credit certificates for credits under AS sections 43.55.023 and 43.55.025, as well as refunds and payments for Alaska corporate income tax credits for expenditures for gas storage facilities and in-state refinery infrastructure expenditures.[3]

A lawsuit was filed in superior court challenging the constitutionality of H.B. 331 on May 14, 2018.[4] Given that the lawsuit would affect marketability of the bonds, DOR has been unwilling to proceed with the bond program until the litigation is resolved, which left a balance of

[1] *See* Alaska Stat. section 37.18.010 et seq. The Senate version of the legislation was S.B. 176. This article refers to H.B. 331 because that was the vehicle that ultimately passed.

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[3] Alaska Stat. section 37.18.010.

[4] *Forrer v. State of Alaska*, 1JU-18-00699 Civil.

roughly $700 million in rebatable tax credits awaiting purchase by the state.[5] Figures previously issued by DOR indicated that the total amount outstanding was at least $100 million higher, but ostensibly some small producers and explorers have sold some tax credit certificates to large producers that can use the credits to offset production tax liability.[6]

The arguments raised by the plaintiff in the lawsuit can be boiled down to two general attacks on the constitutionality of the bill. The first is whether the bill would allow for a potential violation of Article IX, sections 7 and 13 of the Alaska Constitution, which prohibit the dedication of future revenues for a specific purpose. Withdrawals from the treasury must be done by annual appropriation. The second area of attack would be that the bonding debt would not be permissible under Article IX, sections 8 and 11 of the Alaska Constitution, which place limits on contracting for state debt, but provide an exception for debt incurred through the issuance of revenue bonds by a public corporation of the state.

There are several sections of the bill that are designed to make the bill survive these constitutional attacks. In particular:

> The bonds do not constitute a general obligation of the state and are not state debt within the meaning of art. IX, sec. 8, Constitution of the State of Alaska. Authorization by the legislature and ratification by qualified voters of the state is not required under art. IX, sec. 8, Constitution of the State of Alaska.[7]

The bill expressly states that funds for the purchase of tax credit certificates are subject to appropriation by the Alaska Legislature.[8]

The state of Alaska filed a motion to dismiss the complaint in late June 2018, contending that statutes carry a presumption of constitutionality and pointing out that the bill expressly provides that the bonds are not general obligations of the state and are not state debt under Article IX, section 8. The state also highlighted the fact that the bill provides that the funds are subject to legislative appropriation and does not create "state debt" as interpreted by the Alaska Supreme Court.

On January 2, 2019, superior court Judge M. Jude Pate granted the state's motion to dismiss for failure to state a claim upon which relief can be granted. The plaintiff appealed to the Alaska Supreme Court. The state moved for expedited briefing, and on April 23 the Alaska Supreme Court granted the motion in part, so the briefing has concluded and oral argument is tentatively scheduled for September 12. The court declined to set a date by which it must issue a decision, but the order states that "the court will decide the case expeditiously."

Budget Tensions

Because DOR is unwilling to proceed with the bond program authorized by the bill until the Alaska Supreme Court appeal is resolved, companies with oil and gas production tax credits in the purchase queue are left in limbo hoping for a quick resolution to the appeal or a meaningful appropriation to the oil and gas tax credit fund, which was established under AS section 43.55.028 and was historically the means through which credit certificates were purchased. Given Alaska's ongoing fiscal concerns, the operating and capital budgets received a tremendous amount of attention this legislative session, and any proposed appropriation for the purchase of tax credits was a target for debate.

In the operating budget legislation, H.B. 39, Gov. Michael Dunleavy (R) proposed a $170 million appropriation for fiscal 2020 and an additional $84 million to the fiscal 2019 appropriation of $100 million that was paid out earlier this year. The result of the additional fiscal 2019 appropriation would have put the total for that fiscal year at $184 million, aligned with DOR's calculation of the formula in AS section 43.55.028(c), which is based on oil prices and Alaska oil and gas production tax revenues. However, the substitute bill issued by the House of Representatives reduced the appropriation to

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[5] "Tax Credit Issue Plods Along Toward Supreme Court," *Alaska Journal of Commerce* (Jan. 26, 2019).

[6] *Id. See* Alaska Department of Revenue, Tax Division, "Fall 2018 Revenue Forecast," at 104; and Alaska DOR, Tax Division, "Spring 2018 Revenue Forecast," at 2.

[7] Alaska Stat. section 37.18.030(c).

[8] Alaska Stat. sections 43.20.046(e), 43.20.047(e), and 43.20.053(e); and Alaska Stat. sections 43.55.028(e) and 43.55.028(m).

$70 million but provided a placeholder appropriation for the H.B. 331 bond program of an estimated $700 million. In turn, the Senate removed any appropriation to the oil and gas tax credit fund, effectively doubling down on the H.B. 331 bond program by keeping the $700 million placeholder, and that was the provision that ultimately passed the Legislature.

While the governor vetoed over $400 million from the operating budget largely affecting the university system, Medicaid, payments on school bonds and construction, and senior benefits, the placeholder appropriation for the H.B. 331 bond program was left in the operating budget, ostensibly because it really has no budget impact — if the Alaska Supreme Court rules that the bill is constitutional, funding for purchases of tax credits under the program will come from the issuance of bonds.[9]

Another Attack on Tax Credits

As if the uncertainty surrounding the purchase of Alaska oil and gas production tax credits was not enough of a destabilizing influence on Alaska's business environment, some legislators continue to push for additional changes to the structure of the production tax. Senate Bill 14 was introduced last session to repeal oil and gas production tax credits under AS sections 43.55.024(i) and 43.55.024(j), which were both key components of S.B. 21, which the Legislature passed in 2013 and which took effect in 2014, to dramatically change the production tax and provide incentives for North Slope production.

AS section 43.55.024(i) provides credit (new oil credit) of $5 per barrel of taxable North Slope oil that qualifies for the "gross value reduction" (GVR). The GVR is generally a 20 percent reduction in the gross value at the point of production (GVPP), known as "wellhead value." At a high level, the GVPP is basically the sales price of the oil minus the transportation costs (marine costs and pipeline tariff to get the oil to market). Taxable barrels of oil that qualify for the GVR earn the new oil credit of $5 per taxable barrel. To qualify for the GVR and new oil credit, the taxable production must satisfy one of the following criteria under AS section 43.55.160(f):

- the oil or gas is produced from a lease or property that does not include a lease that was in a unit on January 1, 2003;
- the oil or gas is produced from a participating area established after December 31, 2011, that is within a unit formed before January 1, 2003; or
- the oil or gas is produced from acreage that was added to a participating area on or after January 1, 2014, if the producer demonstrates to DOR that the volume produced is from acreage added to an existing participating area.

Generally, the new oil credit can be used to reduce a producer's net production tax or the North Slope minimum tax, currently at 4 percent of GVPP. The new oil credit can be used only to reduce taxes for the year in which the oil is produced. It cannot reduce taxes below zero. Any unused credit is forfeited and cannot be carried back to a prior tax year or forward for use in a later year. It is not eligible for purchase by the state, nor can it be transferred to another producer.[10]

Because taxable barrels of oil that qualify for the GVR earn the new oil credit, the limitations on the availability of the GVR also limit the availability of the new oil credit. The GVR is only available for oil and gas produced from each property for a specific period. For oil or gas first produced from a lease or property after 2016, the reduction is available from the date of commencement of regular production from that lease or property and expires after three years (consecutive or nonconsecutive) in which the average annual North Slope West Coast price is more than $70 per barrel, or after seven years, whichever occurs first. For oil or gas first produced from a lease or property before 2017, the reduction ceases on the earlier of 2023 or after three years (consecutive or nonconsecutive) in which the average annual North Slope West Coast price is more than $70 per barrel.

As mentioned above, S.B. 14 would have also repealed the oil and gas production tax credit

[9] Andrew Kitchenman, "It Won't Be Easy: Universities, Medicaid Hit Hard as Dunleavy Vetoes Nearly $400 Million From Budget," *KTOO and Alaska Public Media* (June 28, 2019).

[10] Alaska Stat. section 43.55.024(h) and (i).

under AS section 43.55.024(j) (per-barrel credit), which was also a key component of the 2013 legislation. For taxable oil produced on the North Slope that does not qualify for the GVR and the new oil credit, a producer may apply the per-barrel credit, which is based on the average GVPP each month.

The amount of per-barrel credit decreases as oil prices rise, resulting in higher effective tax rates at higher oil prices. The maximum credit is $8 per barrel of taxable oil if the average GVPP for the month is less than $80 per barrel. If the average GVPP for the month is greater than $80 per barrel, but less than $90 per barrel, the credit is $7 per barrel. The amount of credit per barrel continues to drop by $1 for each $10 incremental increase in GVPP and is zero if the average GVPP for the month is $150 per barrel or higher. Thus, the per-barrel credit integrates an element of progressivity into the production tax.

The per-barrel credit can be used only to reduce taxes for the year in which the oil is produced. Any unused portion of the credit cannot be carried back to prior tax years or forward for use in a later year — it is forfeited. The per-barrel credit is not eligible for purchase by the state, nor can it be transferred to another producer. The per-barrel credit has an additional limitation: It may not be applied to reduce the North Slope minimum tax, which is 4 percent of GVPP.[11]

Although S.B. 14 did not pass this legislative session, its introduction is a clear signal that the debate about Alaska's tax structure will continue.

On the Horizon

The next installment will include an update on the constitutional challenge to H.B. 331, as well as further discussion about Alaska's revenue outlook and legislative activity. The discussions about Alaska's fiscal regime will no doubt be ongoing, as will the uncertainty about payment to the explorers and small producers that invested in reliance on the rebatable tax credit program. ■

[11] Alaska Stat. section 43.55.024(h) and (j).