tax notes state

Volume 102, Number 12 ■ December 20, 2021

2021 Runs From Frenzy to Fizzle

by Jonathan E. Iversen

Reprinted from *Tax Notes State*, December 20, 2021, p. 1341

2021 Runs From Frenzy to Fizzle

by Jonathan E. Iversen


Jonathan E. Iversen

Jonathan E. Iversen is an Alaska-based tax attorney with Stoel Rives LLP. He provides tax planning and tax structuring advice and represents clients in tax audits and appeals. His practice emphasizes Alaska state and local taxation. Previously, Iversen served as director of the Alaska Department of Revenue's Tax Division. He is the managing partner of Stoel Rives's Anchorage office.

In this installment of Alaska Tax: The Last Frontier, Iversen reviews tax bills introduced in the Alaska Legislature's 2021 legislative sessions and summarizes the DOR's preliminary revenue forecast for fall 2021.

As of this writing, we are making our way into the holiday season. Temperatures are dropping, the trees are stripped of their leaves, and snow has blanketed the mountains around Anchorage and is frequenting the city. It is a good time of the year to regroup, recharge, and look back at 2021 while speculating about what next year might offer.

This has been another tumultuous year filled with uncertainty for Alaska taxpayers. Now that the Legislature is finally out of session for the rest of the year, this feels like a good time to exhale and gather thoughts about what did — and did not — happen in 2021. This year has been characterized by great expense of time and energy, a frenzy of activity that appears to have fizzled out as the year moves to its conclusion.

2021 Legislative Sessions

The Legislature broke a record for days in session this year because of a 120-day regular session and *four* special sessions.[1] Prominent topics included the state budget, the Permanent Fund dividend, constitutional amendments to protect the Permanent Fund, a government spending cap, appropriations for payment of rebatable tax credits, and various measures to increase taxes.

Gov. Mike Dunleavy (R) did not introduce legislation to increase taxes, but several legislators did. Although none of the tax bills passed, bills that were introduced during the 2021 regular session carry over for consideration in the next regular session, which starts January 18, 2022:

- S.B. 13 would increase state property taxes on oil and gas exploration, production, and pipeline transportation properties (such as wells, pipelines, production facilities, and equipment) from 20 mills (2 percent of assessed value) to 30 mills (3 percent of assessed value). This increase would go entirely to state coffers, as opposed to being shared with the municipalities in which the properties are located.
- S.B. 107 is like the Fair Share Act Initiative proposal to overhaul the oil and gas production tax that voters rejected in the November 2020 election.[2] The tax increase would apply to oil produced from fields that have produced 400 million barrels of oil in total and more than 40,000 barrels of oil in the previous year. It would increase tax rates, limit use of tax credits, add

[1] *See* Andrew Kitchenman, "Alaska Legislature Breaks Record for Days in Session, With Frustration Rising to the Surface," Alaska Public Media and KTOO, Oct. 28, 2021.

[2] *See* Elwood Brehmer, "Oil Tax Increase Defeated, but Revenue Issue Remains," *Alaska Journal of Commerce*, Nov. 18, 2020.

complicated reporting requirements, and make sensitive information publicly available.

- S.B. 100 would impose an income tax on individuals equal to 5 percent of federal adjusted gross income.
- S.B. 106 would impose on any entity an income tax of 9.4 percent of income from oil and gas production or transportation in Alaska in excess of $4 million in a tax year. The tax would not apply to corporations already subject to corporate income taxes.
- H.B. 130 would make Alaska's income tax on corporations apply to any oil or gas business entity, which is defined as "a person engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state." This would include passthrough entities as well as individuals and joint ventures. H.B. 130 would also reject the changes made to the income tax net operating loss provisions by the Coronavirus Aid, Relief, and Economic Security Act so that Alaska's treatment of NOLs would follow the law as it read before the CARES Act was enacted (this section of the bill would apply to all corporate income taxpayers).
- H.B. 9 would create a graduated-rate income tax on individuals, partners in partnerships, and shareholders in S corporations, trusts, and estates.
- H.B. 37 would create a broad-based income tax applying to individuals, trusts, and estates, including partners or shareholders of partnerships or S corporations. The tax rate would be 2.5 percent of the taxpayer's federal AGI.
- H.B. 104 would double motor fuel tax rates.

Legislators also introduced several tax bills during the third special session (August 16-September 14) and fourth special session (October 4-November 2)[3]:

- H.B. 4002 and H.B. 3007 would substantially reduce an oil and gas production tax credit allowed per barrel of oil produced from most Alaska North Slope fields.
- H.B. 4004 and H.B. 3005 would increase the North Slope minimum oil and gas production tax to 6 percent of wellhead value for oil in 2022 and 2023 (current highest minimum tax rate is 4 percent of wellhead value) and would suspend current tax rates until 2024.
- H.B. 4005 and H.B. 3006 would create a 2 percent state sales and use tax.
- S.B. 3002 would:
  - substantially reduce an oil and gas production tax credit allowed per barrel of oil produced from most Alaska North Slope fields,
  - apply to any entity the corporate income tax of 9.4 percent on "qualified taxable income" over $4 million (entity includes a sole proprietorship, partnership, or S corporation), and
  - increase the motor fuel tax.

Another key topic was rebatable tax credits, most of which were earned for investment in Alaska oil and gas exploration, development, and production. Although the laws allowing companies to earn rebatable tax credits have since been repealed by the Legislature, as of March 15, $744 million in tax credits await purchase, and almost half this queue dates back to credits earned before 2017.[4] Companies that invested in the state in reliance on the rebatable tax credit program have been left without payment by the state for any portion of the credits for over two years.[5]

Several budget bills had appropriations for payment of rebatable tax credits, including H.B. 3003, which was introduced in the third special session. The version of H.B. 3003 voted upon by the House of Representatives included $114 million to align with the Alaska Department of Revenue's calculation based on a statutory formula. The formula is based on production tax

[3]Bills with numbers starting with 3 were introduced during the third special session, and those starting with 4 were introduced during the fourth special session. Several bills introduced in the fourth special session were substantively identical to bills introduced during the third special session.

[4]Alaska Department of Revenue, Tax Division, "Spring 2021 Revenue Forecast," at 13 (Mar. 15, 2021); *see* letter from the DOR to the Legislature (Jan. 29, 2020).

[5]*See* letter from the DOR commissioner's office to Senate President Peter Micciche (R) and the House clerk (Feb. 5, 2021).

revenue and oil prices forecast for the fiscal year when the appropriation is made: When oil prices are $60 per barrel or higher, the percentage of production tax revenues is 10 percent, whereas it is 15 percent of production tax revenue when oil prices are forecast to be less than $60 per barrel.[6] Of the $114 million passed by the House, $60 million of that was to be funded through the Constitutional Budget Reserve, and that portion required a three-fourths supermajority vote — which failed. The Senate passed the bill without amendment, and thus $54 million was approved in the third special session.

The fourth special session ended November 2 with none of the tax bills passing and without an additional appropriation for payment of rebatable tax credits. The governor has said he does not plan to call another special session this year. Regardless, the bills highlight tax issues that will likely be debated in 2022, and tax credit holders will be seeking additional appropriations.

DOR Regulations

The DOR's efforts in 2021 included two packets of regulations, both of which are still at play as of this writing.

The first package of regulations concerned the use of confidential information and several elements of the oil and gas production tax, including:

- products of a crude oil topping plant that are used in operations;
- the calculation of prevailing value of oil;
- the transportation of oil or gas by truck or rail car;
- direct charges eligible as "deductions" in the production tax calculation;
- monthly information reports; and
- conforming and clarifying changes.

The second package of regulations concerned changes made to the oil and gas production tax by the Legislature in 2014 through the passage of S.B. 138 that apply starting in 2022. These changes primarily address a fundamental change to the tax structure, through which gas will be taxed at 13 percent of wellhead value starting in 2022, as opposed to 35 percent of "production tax value" (essentially net revenue from production in Alaska). Upstream costs for oil and gas exploration, development, and production, including for gas used in the state, will be allocated to oil in the calculation of production tax value. Although the changes are conceptually straightforward, complexities arise because of the passage of subsequent legislation that allows for carried-forward annual losses.

The DOR solicited and responded to comments and questions about these packages of regulations. Neither package has been finalized yet.

Preliminary Revenue Forecast

As we start looking toward next year and the last half of fiscal 2022, the headline for Alaska's revenue picture is oil prices. Alaska heavily relies on revenue from the oil and gas industry, and it is a major employer. Revenue available to fund general state government is largely composed of royalties for oil produced from state leases and three types of taxes:

- Oil and gas production tax: tax levied on oil and gas produced in the state with a base tax rate of 35 percent of the net proceeds of production for oil and (starting in 2022) 13 percent of the wellhead value of gas.[7]
- Petroleum property tax: an ad valorem tax of 20 mills (2 percent) levied on the assessed value of oil and gas exploration, production, and pipeline transportation properties in the state; municipalities and boroughs receive proceeds based on their mill rates, with remainder to the state.[8]
- Corporate income tax: a net income tax of up to 9.4 percent on a corporation's Alaska taxable income. For oil and gas corporations, Alaska taxable income is determined by apportioning worldwide income to Alaska relative to the rest of the world based on (1) tariffs and sales, (2) oil and gas production, and (3) oil and gas property.[9]

[6] Alaska Stat. section 43.55.028(c).

[7] Alaska Stat. section 43.55.011, et seq.

[8] Alaska Stat. section 43.56.010, et seq.

[9] Alaska Stat. section 43.20.011, et seq.

Alaska's oil and gas production taxes, royalties, and corporate income taxes are all sensitive to prices and production volumes.

The DOR issued a preliminary fall 2021 forecast in late October to give a sneak peek of its revenue predictions in anticipation of the release of the governor's proposed fiscal 2023 budget in December and next legislative session.[10] Oil prices are front and center. While North Slope crude oil prices averaged $54.14 per barrel in fiscal 2021, the DOR is forecasting average prices of $81.31 per barrel in fiscal 2022 and $76 per barrel in fiscal 2023 and is assuming that nominal average prices will increase with inflation to $90 per barrel by fiscal 2031. The result would be an additional $1.2 billion in revenue this year and — if oil prices track the forecast — $1 billion per year of revenue into the future over the DOR's spring 2021 forecast.[11]

The increase in oil prices and concomitant increase in oil and gas production taxes would also yield larger appropriations for payment of the pending rebatable tax credits if the governor and Legislature follow the statutory formula discussed above. Although the DOR did not provide a forecast of what the formula would yield in its preliminary fall forecast, it is reasonable to assume that the substantial increase in production taxes would result in substantial increases based on the formula.

The full fall 2021 forecast will come out later this year with the DOR's *Revenue Sources Book*. Everyone with skin in Alaska's revenue game will be tuning in to see what the DOR predicts, and discussions about what those figures may mean for tax legislation and appropriations for payment of rebatable tax credits have already begun. Needless to say, the shot in the arm from oil prices will make legislation to raise taxes a heavier lift.[12]

On the Horizon

Although the increase in oil prices signals relief for Alaska's budget dilemma, much is still at stake. Taxpayers have an uneasy respite while holders of Alaska tax credits anxiously hope for additional appropriations for them. It will be important to regroup and recharge through the rest of 2021 because 2022 will likely be another tumultuous year. ■

[10] DOR, Tax Division, "Preliminary Fall 2021 Forecast" (Oct. 29, 2021).

[11] *See* Kitchenman, "Higher Oil Price Could Affect Debate on Alaska's Long-Term Budget Plan," Alaska Public Media and KTOO, Nov. 2, 2021.

[12] *See id.*