taxnotes® state

Volume 100, Number 4 ■ April 26, 2021

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Reprinted from *Tax Notes State*, April 26, 2021, p. 397

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In this installment of Alaska Tax: The Last Frontier, Iversen examines the delayed payment of rebatable oil and gas production tax credits and recently introduced legislation to increase taxes in Alaska.

This is the second year in which Alaskans have faced the pandemic during winter. Those of us who have lived here for a while know that it is vital during the long (and often dark) winter to take time to look after the well-being of loved ones, friends, and oneself. Get outside for a ski, walk the dog, build a snowman with the kids (or your spouse!), and do what one can to enjoy the season. After all, winter is nearing its end — temperatures are rising, snow is melting, and the days are getting much longer and often sunnier. Of course, socializing has its challenges, but the "walking meeting" has become much more popular. And we all hope that we are pushing toward the end of COVID-19 as Alaska aggressively pushes out vaccinations. The end of COVID-19 is undoubtedly much more uncertain than the end of winter, but in a real way, Alaska seems to be digging its way out.

Thanks to rising oil prices, Alaska also *seems* to be — little by little and bit by bit — digging its way out of its budget crisis. The oil and gas industry is the backbone of Alaska's fiscal regime. The combination in 2020 of the Saudi-Russian price war, which increased supply, and COVID-19, which pounded demand, resulted in a substantial drop in oil prices and, in turn, state revenue. Also, exploring and producing oil in Alaska can be logistically challenging and expensive, and workers are often located in remote areas and must often endure harsh conditions, particularly on the North Slope, where most of Alaska's oil is produced. COVID-19 has added an unforeseen layer of complexity, but the industry has done an incredible job managing it to protect its workers.

In spite of this apparent progress, Alaska taxpayers still face the threat of tax hikes and fiscal uncertainty. Although a ballot initiative ironically called the Fair Share Act, which would have dramatically increased production taxes on oil produced from Alaska's largest fields, was rejected by Alaska voters in November 2020, several bills have been introduced this legislative session to increase taxes.

What's more, holders of over $700 million in rebatable oil and gas production tax credits have not received any payment for them over the past two years. Many of these credits were earned before 2017. Not only does this reflect poorly on Alaska as a place to do business, but it also intensifies the financial duress felt by oil and gas explorers and producers that invested in Alaska with the expectation that the credits would be paid, and it is an important consideration for companies evaluating whether to invest in the state.

A Shot in the Arm From Oil Prices

It is no secret that Alaska is hugely reliant on oil revenues. Alaska's revenue streams are characterized as "unrestricted" and "restricted." Restricted revenues are used for a specific purpose or for reserves. Unrestricted revenues are available to fund general state operations and capital projects, and thus unrestricted revenues have historically been the focus of the budget debate. Unrestricted revenues are driven in part by oil royalties for oil produced from state leases and by three types of taxes:

- 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 the remainder going to the state;[1]
- corporate income tax: a net income tax of up to 9.4 percent on an oil and gas corporation's Alaska taxable income, determined by apportioning its 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;[2] and
- oil and gas production tax: a production (severance) tax levied on oil and gas produced in the state with a base tax rate of 35 percent of the net proceeds of production.[3]

Alaska's oil and gas production taxes, royalties, and corporate income taxes are all sensitive to prices and production volumes. The Alaska Department of Revenue issues revenue forecasts in the fall and spring of each year. DOR said this spring that its forecast of oil prices rose compared with its fall 2020 forecast by $7.73 per barrel for fiscal 2021 (which started July 1, 2020) and by $13 per barrel for fiscal 2022.[4] Oil and gas production is forecast to increase over the fall forecast by 0.9 percent and 4.6 percent, respectively, for these fiscal years.[5] The result of these anticipated price and production increases is an expected increase in unrestricted general fund revenue of $332 million for fiscal 2021, composed of a $299 million increase in petroleum revenue and a $33 million increase in non-petroleum revenue. The delta between the fall and spring forecasts for fiscal 2022 is even greater, with anticipated unrestricted general fund revenue expected to increase by $460 million, with an increase of $478 million in petroleum revenue and an $18 million decrease in non-petroleum revenue.[6]

Payment for Tax Credits

Oil and gas explorers and producers earned Alaska oil and gas production tax credits for investment in oil and gas exploration and development under Alaska Stat. sections 43.55.023 and 43.55.025. Companies that meet specific criteria, including that they do not produce more than 50,000 barrels in the preceding calendar year and do not have an outstanding liability to the state, can obtain cash from the state for these credits.[7] For almost the first decade of the program, the credits were generally paid in full with appropriations to the oil and gas tax credit fund, but when oil prices dropped a few years ago, appropriations for the program were cut substantially. Fiscal 2020 and 2021 saw no appropriation from the Legislature for purchase of the credits from the oil and gas tax credit fund. As of March 15, $744 million in tax credits awaits purchase, and almost half this queue dates to credits earned before 2017.[8]

As discussed in my last article, the Legislature passed H.B. 331 in 2018 to establish the Alaska Tax Credit Certificate Bond Corp. in the DOR to issue up to $1 billion in bonds to finance purchases of the oil and gas tax credits.[9] But a lawsuit was

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

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

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

[4] Alaska Department of Revenue, Tax Division, "Spring 2021 Revenue Forecast" at 18 (Mar. 15, 2021).

[5] *Id.* at 19.

[6] *Id.* at 2.

[7] Alaska Stat. section 43.55.028.

[8] "Spring 2021 Revenue Forecast," *supra* note 4, at 18. *See* January 29, 2020, report from DOR to the Alaska Legislature.

[9] *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.

brought challenging the constitutionality of the law, and on September 4, 2020, the Alaska Supreme Court ruled that the bond program violated the Alaska Constitution.[10]

Accordingly, holders of the tax credits awaiting purchase must again rely on the means by which tax credits were previously purchased, an appropriation to the oil and gas tax credit fund under Alaska Stat. section 43.55.028. The statute governing the oil and gas tax credit fund states that the fund consists of appropriations to the fund, "including" appropriations based on a statutory formula.[11] The formula is based on production tax revenues 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 when oil prices are forecast to be less than $60 per barrel.[12] Although the Legislature is not confined by the statutory formula, and in fact has appropriated more or less than the result of the formula in some years, the operating budget bill introduced by the governor that is being considered by the Legislature includes a proposed appropriation of $60 million for tax credit purchases in fiscal 2022 based on the formula.[13] Because the governor released the proposed budget legislation on December 11, 2020, the inputs that yielded $60 million came from DOR's fall forecast.[14]

However, on March 15 DOR released its spring forecast, and because of higher production tax revenues, the formula would yield $114 million.[15] Applicants for purchase of tax credits are hoping that at the least, the operating budget will include the revised figure, and there is always the potential for an even greater appropriation as well as a supplemental appropriation to cover the lack of any appropriation for fiscal 2021. In any event, the final figure will not be known until the budget is passed by the Legislature and approved by the governor, which typically happens late in a legislative session, with the current session scheduled to end in mid-May.

Tax Uncertainty Lingers

Not only is the payment for tax credits uncertain, there also have been several moves to increase Alaska taxes.

The Legislature adjourned last year without any changes to the oil and gas tax regime. As noted earlier, a group proposed the ironically named Fair Share Act initiative to amend existing oil and gas production tax laws, Alaska Stat. chapter 43.55. The initiative posed a substantial threat to the Alaska oil and gas industry and the economics of large oil fields in Alaska. It would have applied to North Slope properties that have produced more than 400 million barrels of oil in total and more than 40,000 barrels in the previous year. The initiative would have substantially increased the North Slope base tax and minimum tax rates, limited the use of credits and losses, further complicated the production tax regime, and allowed public access to highly sensitive and otherwise confidential taxpayer information.

Voters rejected the initiative in the November 2020 election, but that hasn't stopped some Alaska legislators from pushing to increase taxes on the oil and gas industry and taxpayers in general.[16] Notwithstanding the initiative's rejection by voters, S.B. 107 would make many of the same changes to the Alaska oil and gas production tax. Like the initiative, S.B. 107 would apply to oil produced from major fields, meaning fields that have produced 400 million barrels of oil in total and more than 40,000 barrels in the previous year. It would increase the base tax and minimum tax rates, limit the application of tax credits, complicate reporting requirements, and make sensitive tax and other information publicly available.

Legislators have also introduced several bills to increase Alaska corporate income taxes. For instance, H.B. 130 would expand the applicability of Alaska's corporate income taxes beyond corporations so that it would tax an "oil or gas

[10] *Forrer v. State*, 471 P.3d 569 (Alaska 2020).

[11] Alaska Stat. section 43.55.028(b).

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

[13] *See* H.B. 69. The budget bill and related documents are published by the Alaska Office of Management and Budget on its website.

[14] Alaska DOR, Tax Division, "Revenue Sources Book Fall 2020" at 74 (Dec. 11, 2020).

[15] "Spring 2021 Revenue Forecast," *supra* note 4, at 18.

[16] *See* Elwood Brehmer, "Oil Tax Increase Defeated, but Revenue Issue Remains," *Alaska J. Com.*, Nov. 18, 2020.

business entity," 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." The bill would limit the application of credits and remove some exemptions. Although the Alaska corporate income calculation starts with the federal return with some adjustments, H.B. 130 would make inapplicable the Coronavirus Aid, Relief, and Economic Security Act provisions allowing carryback of net operating losses arising in a tax year beginning after December 31, 2017, and before January 1, 2021, for all (not just oil and gas) state corporate income taxpayers filing for a tax year beginning after December 31, 2017, and before January 1, 2021. Taxpayers should watch this and other bills designed to increase corporate income tax revenues.

Another piece of legislation, S.B. 13, would dramatically increase the state property tax on oil and gas exploration, production, and transportation properties. This bill would increase the tax from 20 mills to 30 mills.

On the Horizon

The Legislature still has ample time to help — or harm — Alaska taxpayers and holders of rebatable tax credits. This is a stressful and uncertain time for Alaskans and companies doing business here. When it comes to stability for taxpayers and fairness to holders of rebatable tax credits, it is clear that Alaska still has a lot of digging to do. ■