

## Alaska's Perfect Storm

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In this installment of Alaska Tax: The Last Frontier, Iversen discusses the effects of the COVID-19 pandemic on Alaska's oil and gas industry.

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### Tough Times

Not to overstate the obvious, but this has been a strange and difficult year. Although Alaska, like Hawaii, has the benefit of geographical separation, as I write this article in my home office Alaska has reopened and the number of COVID-19 cases has reached a new high.<sup>1</sup> The fallout from the pandemic has been staggering. Tourism has been hit hard, and one-economy towns like Skagway that would normally be bustling with tourists are eerily quiet as major cruise lines cancel

<sup>1</sup>Tegan Hanlon, "Health Officials Worry Alaskans Have 'Coronavirus Fatigue' as Active Cases Reach New High," Alaska Public Media – Anchorage, June 11, 2020.

sailings.<sup>2</sup> The fishing industry has had to scramble to implement protocols to bring in the workers required for the fishing season.<sup>3</sup>

Alaska's oil and gas industry has faced a one-two-three punch this year. Many of Alaska's oil patch workers must travel to remote North Slope fields, and the conditions are extreme. The industry has worked closely with state officials, and producers have put numerous plans in place to prevent the coronavirus from infecting workers in remote production facilities and camps.<sup>4</sup> While the Saudi-Russian price war fueled supply, the pandemic strangled demand, leading to a crushing drop in oil prices that has forced producers to cut production and lay off workers.<sup>5</sup> In April, Alyeska Pipeline Service Company, which operates the 800-mile-long trans-Alaska pipeline, announced a 10 percent reduction to avert a storage concern that was anticipated in late May.<sup>6</sup> At an average daily throughput of around 500,000 barrels, the reduction amounted to 50,000 barrels per day.<sup>7</sup> Alyeska eliminated the throughput restriction on May 22.<sup>8</sup>

And to add a fourth punch to the oil and gas industry, a ballot initiative that is ironically called the "Fair Share Act" is slated to be voted on in the November general election. If successful, this change in law would dramatically increase

<sup>2</sup>Becky Bohrer, "Alaska Tourist Town Plans Aid to Locals Hit by Virus Fallout," *Associated Press*, June 12, 2020.

<sup>3</sup>Laine Welch, "Fever Pitch: Alaska Implements New COVID-19 Mandates for the Fishing Industry," *National Fisherman*, Apr. 28, 2020.

<sup>4</sup>Alex DeMarban, "Prudhoe Bay Worker Tested Positive for COVID-19, BP Alaska Says," *Anchorage Daily News*, Mar. 31, 2020.

<sup>5</sup>Jonathan Garber, "Plunging Oil Prices, Coronavirus Fuel Budget Crisis in Petroleum-Rich Alaska," *Fox Business*, May 9, 2020.

<sup>6</sup>Nathaniel Herz, "Alyeska Imposes 10% Cut to North Slope Production as COVID-19 Hammers Oil Demand," Alaska Public Media, Alaska's Energy Desk – Anchorage, Apr. 24, 2020.

<sup>7</sup>*Id.*

<sup>8</sup>Steve Sutherland, "Alyeska Lifts Flow Restrictions; Prorations Ended: Noon, May 22," *Petroleum News*, May 31, 2020.

production taxes on oil produced from Alaska's largest fields.

Meanwhile, over \$700 million in rebatable oil and gas production tax credits remains unpaid by the state, intensifying 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 of course, the pandemic and the precipitous drop in oil prices have wreaked havoc on Alaska's economy and have exacerbated the ongoing concerns about the state budget.

In the last article I noted that the first half of 2020 was likely to be intense for Alaska taxpayers. That may have been the understatement of the year.

### Alaska's Budget Crisis

Alaska has been plagued with budget deficits in recent years, and the recent drop in oil prices has had a tremendously negative impact on the state budget, which relies heavily on the oil and gas production tax; the exploration, production, and pipeline transportation property tax; the state corporate income tax on petroleum businesses; and oil and gas royalties. The Alaska Department of Revenue stated in its fall 2019 revenue sources book that unrestricted general fund revenue, excluding transfers from the permanent fund earnings reserve, was expected to be \$2.1 billion in fiscal 2020 and \$2 billion in fiscal 2021, which starts July 1.<sup>9</sup> On April 6, DOR issued its spring 2020 revenue forecast, in which it substantially revised these forecasts downward to \$1.6 billion for fiscal 2020 and \$1.2 billion for fiscal 2021.<sup>10</sup> The percentages of revenue from petroleum for these years are 60 percent and 62 percent, respectively.<sup>11</sup>

Alaska's oil and gas production taxes, royalties, and corporate income taxes are all sensitive to prices and production volumes. Last fall, DOR predicted that oil prices would be \$64 per barrel in fiscal 2020 and \$59 per barrel in fiscal 2021.<sup>12</sup> The spring 2020 revenue forecast predicted

oil prices dropping to \$52 per barrel for fiscal 2020 and \$37 per barrel for fiscal 2021.<sup>13</sup> DOR's new forecast also predicted a drop in statewide production volumes by 7,700 barrels per day for fiscal 2020 (to 500,700 barrels per day) and by 3,700 barrels per day for fiscal 2021 (to 502,400 barrels per day).<sup>14</sup>

### 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 Statute sections 43.55.023 and 43.55.025. Companies that meet certain criteria, including that they did 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.<sup>15</sup> 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. As of January 1, oil and gas explorers and producers had requested \$726 million in credit purchases, mostly for credits that were issued in 2016 and 2017.<sup>16</sup>

House Bill 331 was signed into law on June 21, 2018, to create the Alaska Tax Credit Certificate Bond Corporation in DOR to finance the purchase of the outstanding rebatable tax credits.<sup>17</sup> A lawsuit was filed in superior court challenging the constitutionality of H.B. 331 on May 14, 2018.<sup>18</sup> The superior court granted the state's motion to dismiss for failure to state a claim upon which relief can be granted, and the plaintiff appealed to the Alaska Supreme Court. The case was fully briefed last summer and oral argument was held in September 2019. Although the court stated in an order partially granting expedited

<sup>13</sup> Alaska DOR, Tax Division, "Spring 2020 Revenue Forecast," at 18 (Apr. 6, 2020).

<sup>14</sup> *Id.* at 19.

<sup>15</sup> Alaska Stat. section 43.55.028.

<sup>16</sup> Letter from Acting Commissioner of the Department of Revenue Michael A. Barnhill to Cathy Giessel, Alaska Senate President, and Bryce Edgmon, Alaska Speaker of the House of Representatives (Jan. 9, 2020).

<sup>17</sup> The Senate version of the legislation was S.B. 176. This article refers to H.B. 331 because that was the bill that ultimately passed.

<sup>18</sup> *Forrer v. State of Alaska*, 1JU-18-00699 Civil.

<sup>9</sup> Alaska DOR, Tax Division, "Revenue Sources Book Fall 2019," at 6 (Dec. 6, 2019).

<sup>10</sup> Alaska DOR, Tax Division, "Spring 2020 Revenue Forecast," at 10 (Apr. 6, 2020).

<sup>11</sup> *Id.*

<sup>12</sup> Alaska DOR, Tax Division, "Revenue Sources Book Fall 2019," at 10 (Dec. 6, 2019).

consideration that “the court will decide the case expeditiously,” a decision has not been issued.

DOR is unwilling to move forward with the bond program before the court issues a decision upholding it, and unfortunately the Alaska Legislature adjourned on May 20 without making an appropriation to the oil and gas tax credit fund. The Legislature did appropriate an estimated \$700 million for purchases through the bond program if the court upholds the program. However, the Legislature did not appropriate any funds for debt service on the program — which will be necessary for the purchases to happen — and in any event it will likely take several months for DOR to get the program up and running if it is approved by the state supreme court.

Under the circumstances, purchase of the outstanding credits by the state would be a tremendous boost to tax credit holders and Alaska’s economy and reputation. But for now, this is still a waiting game.

### Alaska Fair Share Act Initiative

The oil and gas industry is the backbone of Alaska’s economy and the primary source of the revenues that fund government operations. The COVID-19 pandemic’s effects on oil and gas operations and demand for oil, the Saudi-Russian price war, and Alaska’s failure to make meaningful payment for outstanding tax credits would each in isolation pose a challenge for the industry. All those factors have come together in a perfect storm.

Although the Legislature adjourned this year without making any changes to the oil and gas tax regime, yet another threat looms. A group has proposed the Fair Share Act initiative to amend existing oil and gas production tax laws, Alaska Statutes chapter 43.55. The initiative is a substantial threat to the Alaska oil and gas industry and would be detrimental to the economics of large oil fields in Alaska.

Lt. Gov. Kevin Meyer (R) certified the initiative on October 15, 2019, which put the onus on its supporters to gather enough signatures to get it on the 2020 ballot.<sup>19</sup> Three quantitative

thresholds must be met for the petition to succeed. First, it must be signed by qualified voters equal in number to 10 percent of the number of voters who voted in the preceding general election.<sup>20</sup> The signers must reside in at least three-fourths of the 40 House districts in Alaska.<sup>21</sup> Finally, in each House district, the signers must comprise at least 7 percent of those who voted in the preceding general election.<sup>22</sup> The lieutenant governor concluded that the initiative supporters had gathered enough signatures to place it on the ballot.

For the next step in the process, the lieutenant governor worked with the state attorney general to prepare a ballot title and proposition. The ballot title must not exceed 25 words, and it must indicate the general subject of the ballot proposition. The proposition must provide a “true and impartial statement of the intent of the proposed measure.”<sup>23</sup>

Tensions around the initiative are understandably high on all sides. Initiative supporters brought a lawsuit objecting to several aspects of the petition summary.<sup>24</sup> Once the lieutenant governor concluded that the initiative supporters had enough signatures to place it on the ballot, the supporters added an objection to the ballot summary. The objection concerns section 7 of the initiative, which provides: “Public Records. All filings and supporting information provided by each producer to the Department relating to the calculation and payment of the taxes set forth in Section 3 and 4 shall be a matter of public record.” The summary’s explanation of this provision stated that this meant that “the normal Public Records Act process would apply,” which would mean that the current statutory exceptions to disclosure would apply, including

<sup>20</sup> Alaska Stat. section 15.45.140(a)(1). “Upon request of the initiative committee, the lieutenant governor shall report to the committee the number of persons who voted in the preceding general election.” Alaska Stat. section 15.45.090(b).

<sup>21</sup> Alaska Stat. section 15.45.140(a)(2).

<sup>22</sup> Alaska Stat. section 15.45.140(a)(3).

<sup>23</sup> *Planned Parenthood of Alaska v. Campbell*, 232 P.3d 725, 731 (Alaska 2010) (citation omitted) (holding that the lieutenant governor’s summary of a ballot initiative was inaccurate, but the court allowed the initiative to be placed on the ballot after it was corrected).

<sup>24</sup> *Vote Yes for Alaska’s Fair Share v. Meyer, Lieutenant Governor of the State of Alaska, and State of Alaska, Division of Elections*, Case No. 3AN-19-11106 CI.

<sup>19</sup> See Elwood Brehmer, “Tax Initiative Certified; Legal Opinion Cites Possible Problems,” *Alaska Journal of Commerce*, Oct. 16, 2019.

the exception for taxpayer information in DOR's possession.<sup>25</sup> The initiative's sponsors disagreed, arguing that the intention was not for the Public Records Act process to apply.

The superior court ruled for the initiative's sponsors, reasoning that the ballot summary was not "a true and impartial statement of the intent of the proposed measure" as required by statute. The court ruled that the ballot summary was not impartial because it interpreted the initiative to mean that the Public Records Act would apply.<sup>26</sup> The court ruled that the sentence in the ballot summary should be stricken.

It is worth noting that the initiative cannot appear on the ballot for the primary election, which is scheduled for August 18, because 120 days must have expired since the adjournment of the legislative session before it can appear on the ballot.<sup>27</sup> The initiative is slated for the November 3 general election ballot.

### On the Horizon

The next article will include a status report on the Alaska Supreme Court appeal concerning the constitutionality of the tax credit bond program and a more in-depth discussion about the initiative. This is a nightmarish time for the oil and gas industry in Alaska. ■

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<sup>25</sup> Alaska Stat. section 40.25.100.

<sup>26</sup> Hanlon, "Alaska Superior Court Judge Orders State to Correct Its Summary of the Oil Tax Initiative," Alaska Public Media, Alaska's Energy Desk – Anchorage, June 11, 2020.

<sup>27</sup> Alaska Stat. section 15.45.190.