

The Debate Over the Alaska Tax Credit Bond Program

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In this installment of *Alaska Tax: The Last Frontier*, Iversen discusses H.B. 331, which would establish the Alaska Tax Credit Bond Corp.

As I write this article we are in the middle of winter and Alaska is, well, dark — at least most of the time. But we are well past winter solstice with snow still on the ground and we are gaining additional minutes of sunshine every day.

Things seem to be brightening on other fronts, as well. The price of Alaska North Slope (ANS) crude has continued to stabilize in the \$60-\$70 per barrel range, and although a higher number would be cause for celebration, the fact that it has surpassed the lows of a few years ago does not go unnoticed. This is helpful for Alaska's fiscal health, which is hugely dependent on revenue from oil and gas production taxes and royalties, and from corporate income taxes spurred by corporate profitability. All of those revenue sources are sensitive to oil prices.

And while that additional revenue is welcome, oil and gas exploration and production companies that invested heavily in Alaska while relying on its rebatable production tax credit regime have yet to see a full payment against the tab of outstanding production tax credits. The credits were intended to spur investment in the state — and they worked. But when the price of oil dropped a few years ago, state revenue took a massive hit and policymakers took the course of shrinking payments on the credits rather than paying them in full, as had been done in prior years.

The State Legislature passed H.B. 331 to establish the Alaska Tax Credit Bond Corp. (the corporation) in the Department of Revenue, which would be authorized to issue up to \$1 billion in bonds to finance oil and gas tax credit purchases.¹ But as discussed in my last installment,² a lawsuit was brought in superior court challenging the constitutionality of the law.³ Given that the lawsuit would affect the marketability of the bonds, the DOR has been unwilling to advance the bond program until the litigation is resolved, which left a balance of more than \$800 million in the rebatable tax credit queue at the end of calendar year 2018.⁴

Fortunately, the DOR recently advanced a payment of \$100 million that the Legislature appropriated as part of the operating budget last legislative session. This appropriation was structured to be up to \$100 million if bonds were

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 version that ultimately passed.

² Jonathan E. Iversen, "The Battle of Payment for Alaska's Tax Credits," *State Tax Notes*, Sept. 10, 2018, p. 1071.

³ *Forrer v. State of Alaska*, 1JU-18-00699 Civil.

⁴ See Alaska Department of Revenue, Tax Division, "Fall 2018 Revenue Forecast," at 104; and Alaska Department of Revenue, Tax Division, "Spring 2018 Revenue Forecast," at 2.

not issued for purposes of purchasing the tax credits.⁵ By regulation, this payment was made against the pre-2017 queue of tax credits on a pro rata basis.⁶ Although that payment gives some relief to holders of pre-2017 credits, payment of the rest of the roughly \$750 million tab depends on the litigation over the bill and appropriations made through the budget process.⁷

H.B. 331

H.B. 331 was introduced in February 2018, and the Legislature passed the bill on May 11, 2018. Despite a lawsuit filed in May challenging the legislation, the bill was signed into law on June 21.

The bill creates the corporation in the DOR as a public corporation with the purpose of financing the purchase of tax credits under Alaska Stat. section 43.55.028, which would include all rebatable oil and gas production tax credit certificates for credits under Alaska Stat. sections 43.55.023 and 43.55.025, and refunds and payments for corporate income tax credits for expenditures for gas storage facilities and in-state refinery infrastructure expenditures.⁸ The corporation's three-member board of directors is comprised of the commissioner of revenue; the commissioner of administration; and the commissioner of commerce, community, and economic development.⁹

The corporation would be authorized to issue up to \$1 billion in bonds to finance tax credit purchases.¹⁰ The costs of issuing and administering the bond program would be covered by the bond proceeds, with the remainder disbursed to the commissioner of the DOR for purchases of the outstanding tax credit certificates.¹¹ The corporation may enter into agreements with other state agencies and may obtain contractual services from underwriters, financial advisers, counsel, and other services

necessary for the bond program.¹² The corporation's authority to issue bonds ends on December 31, 2021.¹³

The corporation is authorized to have a reserve fund for the purchase of tax credits as well as funds that are appropriated for payments of principal and interest payments to bond holders.¹⁴ The corporation is authorized to set the terms of the bonds issued, including amounts, times, and covenants in light of market conditions.¹⁵ Interest may be variable or fixed and maturity dates are set by the corporation.¹⁶ To issue bonds, the corporation must adopt and publish a resolution stating the terms of the issuance and sale.¹⁷ The bonds cannot be issued unless the tax credits are purchased at a discount rate of at least 1.5 percent greater than the true interest cost to be paid on the bonds.¹⁸ The bill also requires that any legal action must have been commenced within 45 days after the corporation adopts a resolution to issue the bonds.

There are several bill sections intended to head off constitutional attacks based on violations of the prohibition against dedicating future revenue for a specific purpose or the limitations on contracting for state debt. Of importance to the bill litigation is a provision stating: "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."¹⁹ Likewise, the bill states in several sections that funds for the purchase of tax credit certificates are subject to appropriation by the Alaska Legislature.²⁰

The bill also amended the statute governing purchases of the tax credit certificates, Alaska

⁵ H.B. 286 section 23(f).

⁶ 15 Alaska Admin. Code section 55.525(a), (h).

⁷ See "Fall 2018 Revenue Forecast," *supra* note 4, at 104.

⁸ Alaska Stat. section 37.18.010.

⁹ Alaska Stat. section 37.18.020.

¹⁰ Alaska Stat. section 37.18.030.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Alaska Stat. section 37.18.040.

¹⁵ Alaska Stat. section 37.18.050.

¹⁶ *Id.*

¹⁷ Alaska Stat. section 37.18.060.

¹⁸ Alaska Stat. section 37.18.080.

¹⁹ Alaska Stat. section 37.18.030(c).

²⁰ Alaska Stat. sections 43.20.046(e), 43.20.047(e), 43.20.053(e), 43.55.028(e), and 43.55.028(m).

Stat. section 43.55.028, so that the purchase program under the bill would operate concurrently with the traditional tax credit purchase program that uses the oil and gas tax credit fund, although the bill makes the latter an inferior option in several respects. First, the amount appropriated to the oil and gas tax credit fund would be reduced by the debt service paid for the bond program.²¹ Second, companies not participating in the bond program may not receive more from the oil and gas tax credit fund in a given year than they would have received had the bond program not existed.²² Third, there is an annual limitation of purchases from the oil and gas tax credit fund of \$70 million per company, with the first \$35 million paid at 100 percent of value and amounts over \$35 million discounted by 25 percent of the value of the certificate. This limitation does not apply to purchases under the bond program.²³ And fourth, after bonds are first issued by the corporation, the Legislature may appropriate funds to the oil and gas tax credit fund based on net production tax revenue received by the state after application of tax credits, which would result in a smaller appropriation than would have been calculated under the prior interpretation of the law, which did not net tax credits from the calculation.²⁴

The bill establishes a process through which companies holding tax credits for purchase would provide the DOR a notice of interest to participate in the program.²⁵ Participants must offer all of their outstanding credits for purchase through the bond program, and declining to participate precludes a subsequent purchase of those tax credits through the bond program (although new tax credits could be purchased as part of a future bond issuance).²⁶

The purchase amount of the tax credits would be their face amount discounted each year based on the expected timing of the purchase had it been made under the assumed appropriation to the oil

and gas tax credit fund based on the statutory formula.²⁷ In other words, the DOR forecasts the assumed appropriation under the statutory formula (which is 10 percent of production taxes levied if ANS crude is \$60 per barrel or higher, or 15 percent of production taxes levied at lower prices) and the assumed proration each company would receive annually to calculate the purchase offer based on the statutory discount rate.²⁸ The standard discount rate is 10 percent, although applicants that meet the eligibility criteria may obtain a lower discount rate down to the true cost of interest plus 1.5 percent. Participants must indicate, in their notice of interest in participating in the bond program, whether they intend to seek a reduced discount rate.²⁹ The reduced discount rate would be available if the applicant satisfies one of the following conditions:

- for a tax credit certificate for expenditures for seismic exploration for which the applicant submitted the seismic data and reports to the Alaska Department of Natural Resources (DNR) to obtain the credit, the applicant agrees as a condition of purchase under the bond program to waive the 10-year confidentiality period that would otherwise apply to the data;
- the grant of an overriding royalty interest to the DNR; or
- the applicant commits to incur qualified capital expenditures not later than 24 months after the certificate is purchased in an amount at least equal to the purchase amount, and
- the applicant provides a plan to use the capital expenditures to increase oil or gas production in the state and to maximize resident hire and use of state businesses, and
- if the applicant does not meet its spending obligations, the statute provides for a recoupment mechanism, potentially with interest.³⁰

²¹ Alaska Stat. sections 43.55.028(b) and 43.55.028(r).

²² Alaska Stat. section 43.55.028(e).

²³ Alaska Stat. sections 43.55.028(e) and 43.55.028(g).

²⁴ Alaska Stat. section 43.55.028(q).

²⁵ Alaska Stat. section 43.55.028(k).

²⁶ *Id.*

²⁷ Alaska Stat. section 43.55.028(l).

²⁸ Alaska Stat. sections 43.55.028(c) and 43.55.028(l).

²⁹ Alaska Stat. section 43.55.028(k).

³⁰ Alaska Stat. section 43.55.028(m).

Regarding a discount based on the grant of an overriding royalty interest, the DNR may enter into the agreement only if the anticipated net present value of the overriding royalty is at least as great as the value of the discount.³¹ An applicant requesting a discount must submit a proposed agreement describing the leases that would be subject to the overriding royalty and the percentage of overriding royalty interest.³² In evaluating the proposal, the DNR will consider the costs to administer the bond; the production or projected production from the subject leases; the timing, value, and likelihood of production; financial information; and any other burdens on the leases.³³

H.B. 331 Litigation

The timing of the bond program depends on how and when the lawsuit challenging the constitutionality of the bill is resolved.³⁴ There are two primary areas of constitutional attack. The first is whether the bill would potentially violate Alaska Constitution Art. IX, sections 7 and 13, which prohibit the dedication of future revenue for a specific purpose. In other words, 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 Art. IX, sections 8 and 11, which place limits on contracting for state debt, but provide an exception for debt incurred though the issuance of revenue bonds by a public corporation of the state.

The state filed a motion to dismiss the complaint in late June of 2018. It argued that statutes carry a presumption of constitutionality and in any event the bill expressly states that the bonds are not general obligations and are not state debt under article IX, section 8. Also, the bill provides that the funds are subject to legislative appropriation and do not create state debt as interpreted by the Alaska Supreme Court.

On January 2, Juneau Superior Court Judge M. Jude Pate granted the state's motion to dismiss for

failure to state a claim on which relief can be granted. The 44-page decision explained the bill itself, provided legislative history, and undertook substantial analysis of the relevant constitutional provisions. Although the plaintiff has not yet filed an appeal with the Alaska Supreme Court, public statements indicate that he will. Thus, the bond program remains in limbo.

On the Horizon

My next article will include an update on the constitutional challenge to H.B. 331 and a legislative update. Notwithstanding the multiple changes to the production tax over the last 14 years, including dramatic changes made through the passage of H.B. 247 in 2016 and H.B. 111 in 2017, the threat of additional tax changes looms — while the explorers and small producers that invested in reliance on the rebatable tax credit program continue to endure the lack of meaningful payment for them. ■

³¹ Alaska Stat. section 44.37.230(b).

³² Alaska Stat. section 44.37.230(c).

³³ Alaska Stat. section 44.37.230(f).

³⁴ *Forrer*, 1JU-18-00699 Civil.