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In this installment of Alaska Tax: The Last Frontier, Iversen discusses 2019 tax and fiscal developments in Alaska including litigation over a bond program, regulatory cleanup, and an initiative with the potential to radically change taxation on the state's North Slope.

As I write this article 2020 has arrived in the blink of an eye. Although Alaska taxpayers have not had to adapt to yet another change in Alaska's tax statutes (in contrast to the last few years), there has still been a lot of activity. And with the second regular session of the 31st Alaska Legislature starting January 21, 2020, this is a good opportunity to catch up on a few key subjects to prepare for what may be a tumultuous year.

House Bill 331

As discussed in the last article, H.B. 331 was signed into law June 21, 2018.[1] The bill created the Alaska Tax Credit Certificate Bond Corp. in the Alaska Department of Revenue — a public corporation with the purpose of financing the purchase of roughly $700 million in outstanding rebatable tax credits under Alaska Stat. section 43.55.028, which would include all rebatable Alaska 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 Alaska corporate income tax credits for expenditures for gas storage facilities and in-state refinery infrastructure expenditures.[2]

A lawsuit was filed in superior court challenging the constitutionality of H.B. 331 on May 14, 2018, and the DOR has been unwilling to proceed with the bond program until the litigation is resolved.[3] On January 2, 2019, 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 plaintiff appealed to the Alaska Supreme Court. The state moved for expedited briefing, and on April 23 the court granted the motion in part so that briefing has concluded and oral argument was held in September. The court declined to set a date by which it must issue a decision, but the order partially granting expedited consideration states that "the court will decide the case expeditiously."

Although rumors are swirling about a forthcoming decision, once the court does issue a decision — assuming it upholds the bond program — it will likely take several months for

[1] 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.

[2] Alaska Stat. section 37.18.010.

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

the DOR to get the program up and running and then likely a few more months to actually start purchasing tax credits. Given that the Legislature appropriated an estimated $700 million for purchases through the bond program this fiscal year, it would be a tremendous boost to tax credit holders and Alaska's economy and reputation for the tax credits to be purchased before July 1, 2020. But the clock is ticking and the prospects of that happening are becoming increasingly dim. Accordingly, the uncertainty surrounding the purchase of the outstanding tax credits continues.

Budget Tensions Continue

Alaska recently hit a historic milestone: The 800-mile Trans Alaska Pipeline System that moves oil from the Alaska North Slope to tidewater at Valdez has moved 18 billion barrels.[4] This is about twice the amount originally forecast to be produced from the North Slope.[5] Prudhoe Bay itself has produced over 13.6 million barrels and — if brought online — new discoveries should keep the pipeline operating for years to come.[6]

But higher costs, the threat of production declines, and current oil prices continue to affect state revenues, which are hugely dependent on the oil and gas industry, specifically from 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. These revenue sources make up about three-quarters of unrestricted general fund revenue (the revenue that funds the bulk of government activity in Alaska), excluding transfers from the permanent fund earnings reserve.[7] The DOR recently issued "Revenue Sources Book: Fall 2019," in which it stated that unrestricted general fund revenue, excluding transfers from the permanent fund earnings reserve, was $2.6 billion in fiscal 2019 and is expected to be $2.1 billion in fiscal 2020 and $2 billion in fiscal 2021, which starts July 1, 2020.[8]

Alaska oil and gas production taxes, royalties, and corporate income taxes are all sensitive to prices and production volumes. The DOR predicts that prices will drop from an average of $69 per barrel in fiscal 2019 to $64 in fiscal 2020 and $59 in fiscal 2021.[9] Alaska North Slope production volumes are expected to decrease modestly but stay relative stable, decreasing from an average of 496,900 barrels per day in fiscal 2019 to an average of 490,000 barrels per day in fiscal 2021, although new developments offer great potential to increase production a few years down the road.[10] In any event, the overall result of prices and production for fiscal 2021 is a reduction in the forecast of unrestricted general fund revenue (excluding transfers from the permanent fund earnings reserve) of about $200 million from the March 2018 forecast.[11]

Alaska has been plagued with budget deficits in recent years. The revised forecast will be front and center in debates over Alaska's fiscal regime and budget dilemma in the upcoming legislative session. This is a divisive issue and, indeed, DOR Commissioner Bruce Tangeman recently submitted his resignation to Gov. Mike Dunleavy (R), noting that the governor needs a commissioner "100 percent aligned with his vision."[12] His departure is by all appearances on good terms and the governor spoke highly of his "dedication," "leadership," and "outstanding work."[13] Tangeman has not publicly cited specific areas of disagreement, but hinted that his departure has to do with Alaska's fiscal situation and the role that the DOR plays in any discussions about the budget and taxes.[14]

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[4] Tim Bradner, "TAPS to Move Its 18th Billion Oil Barrel, Twice What Was Originally Forecast From North Slope," *Mat-Su Valley Frontiersman*, Dec. 6, 2019.

[5] *Id.*

[6] *Id.*

[7] Alaska Department of Revenue, Tax Division, "Revenue Sources Book: Fall 2019," at 6 (Dec. 6, 2019).

[8] *Id.*

[9] *Id.* at 10.

[10] *Id.*

[11] Alaska Department of Revenue, Tax Division, "Spring 2018 Revenue Forecast," at 4 (Dec. 6, 2019); *see* Elwood Brehmer, "Revenue Forecast Down on Lower Oil Prices, Production," *Alaska Journal of Commerce*, Dec. 6, 2019.

[12] Sean Maguire, "Alaska Revenue Commissioner Resigning, Cites Difference of Opinion With the Governor," KTUU, Nov. 15, 2019.

[13] *Id.*

[14] *Id.*

Mike Barnhill has been appointed as acting DOR commissioner.[15] He was most recently the policy director for the Alaska Office of Management and Budget, and it appears that his appointment is temporary and the search for a permanent commissioner has commenced.[16]

Regulations

Dunleavy has asked executive branch agencies to examine regulations for areas of simplification and reduction. To that end, the DOR issued several packages of changes to regulations in 2019. Several of the proposed changes were proposals to repeal regulations that are obsolete, essentially copy existing statutes, are unnecessary, have been superseded, or are otherwise no longer in effect, and to make conforming changes. These included:

- a package issued for public comment August 5 concerning regulations governing tax appeals and protests;[17]
- a package issued for public comment August 23 that included changes to regulations applicable to state taxes under title 43 of the Alaska Statutes, and changes to corporate income tax and oil and gas production tax regulations;[18] and
- a package issued November 22 for public comment that proposed changes to regulations for the motor fuel tax, tobacco tax, transportation tax, excise tax on alcoholic beverages, and mining license tax.[19]

In general, the proposed changes were well received, as they were intended to clarify complex regulatory regimes through the repeal of unnecessary regulations. These proposals represent steps toward reducing the sheer volume of regulations and the confusion caused by duplicative or irrelevant regulations.

Also, on October 4 the DOR proposed other changes to the oil and gas production tax regulations that affect the calculation of transportation costs in the tax calculation.[20] Alaska's production tax is levied on the net revenues of oil and gas production from leases or properties in the state, except for the federal and state royalty share and oil and gas used in drilling or production operations, or for repressuring.[21] The calculation starts with destination value, generally the higher of the sales price or a calculated prevailing value.[22] The costs of pipeline and marine transportation are subtracted from the destination value to obtain the gross value at the point of production.[23] Operating and capital costs for oil and gas exploration, development, or production upstream of the point of production (called lease expenditures) are subtracted from the gross value at the point of production to reach net revenue, known as production tax value.[24]

The October 4 package of regulations concerned aspects of the transportation costs used in the calculation of the gross value at the point of production regarding depreciation and return on investment or the weighted average cost of capital for transportation of oil by a vessel and for liquified natural gas. The proposed changes were driven by the complexity of existing regulations and a cost of capital calculation that required thousands of inputs. The proposed regulations would simplify the calculation and reduce inputs by removing calculations over multiple time periods. These proposed changes should substantially reduce the administrative burden on taxpayers and the DOR and, importantly, appear to be revenue neutral.

Alaska 'Fair Share Act' Initiative

As if the uncertainty created by the state's lack of meaningful payment for Alaska oil and gas production tax credits and frequent changes to

[15] *See* Andrew Kitchenman, "Dunleavy Names Barnhill as Acting Revenue Commissioner," KTOO, Dec. 3, 2019.

[16] *Id.*

[17] The public notice is available at the Alaska DOR's oil and gas production tax news archive.

[18] The public notice is available at the Alaska DOR's tax news archive.

[19] *Id.*

[20] The public notice is available at the Alaska DOR's oil and gas production tax news archive.

[21] Alaska Stat. sections 43.55.011(e) and 43.55.020(e).

[22] 15 Alaska Admin. Code 55.151.

[23] Alaska Stat. section 43.55.150. The point of production is generally the point at which oil or gas is accurately metered and tendered into a carrier pipeline or other transportation carrier in a condition of pipeline quality. Alaska Stat. section 43.55.900(21).

[24] Alaska Stat. section 43.55.160.

the oil and gas production tax weren't enough, a group has proposed the "Fair Share Act" initiative to amend existing oil and gas production tax laws, Alaska Stat. section 43.55.

The initiative would be a dramatic tax increase to North Slope oil producers. It would apply to North Slope properties that have produced more than 400 million barrels of oil in total and more than 40,000 barrels of oil in the previous year. The initiative would substantially increase the North Slope minimum tax rate and the tax rate applied to production tax value, limit the use of credits and losses, further complicate the production tax regime, and provide for public access to highly sensitive and otherwise confidential taxpayer information.

Both the Alaska Constitution and statutory law contemplate a process by which voters can enact laws directly without action by the Legislature.[25] The procedure for putting an initiative before the electorate by statewide ballot is set out at Alaska Stat. section 15.45.010 and in 6 Alaska Admin. Code 25.240.

To start the process, an initiative's proponent must file an application with the lieutenant governor.[26] There are several elements required of the proposed bill and it must contain the signatures of no fewer than 100 qualified voters, who are identified as "sponsors" of the legislation.[27] Once the application is filed, it is up to the lieutenant governor to review it and either certify the application or notify the initiative committee of the grounds on which the application is being denied.[28]

The lieutenant governor certified the initiative October 15, so its supporters have until the start of the next legislative session to gather enough signatures to get it on the 2020 ballot.[29] Alaska taxpayers are watching the process closely. If successful, it would mean a substantial tax increase — and likely years of litigation over various provisions that are unclear, ambiguous, and potentially subject to equal protection and due process challenges.

On the Horizon

The next article will include an update on legislative and agency activity surrounding Alaska's fiscal regime and any tax measures, and a status report on the Alaska Supreme Court appeal concerning the constitutionality of the tax credit bond program. Depending on how much traction the Fair Share Act initiative gets, the article may include a more in-depth discussion about the initiative process in Alaska and the proposal itself. As usual, the first half of the year is likely to be intense for Alaska taxpayers. ■

[25] Alaska Const. Art. XI; Alaska Stat. tit. 15, ch. 45.

[26] Alaska Stat. section 15.45.245.

[27] Alaska Stat. sections 15.45.040 and 15.45.030.

[28] Alaska Stat. section 15.45.070.

[29] *See* Brehmer, "Tax Initiative Certified; Legal Opinion Cites Possible Problems," *Alaska Journal of Commerce*, Oct. 16, 2019.