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Special session brief:

Gasline grind: Third time around

The Legislature failed to pass HB 381, the gas pipeline tax abatement bill, and there's a lot of finger-pointing including a House leader blaming oil producer Hilcorp Energy for pressuring Glanfarne, the pipeline developer, to oppose the bill. However, the fundamental problem is the attempt to indirectly tax Hilcorp by extending the state corporation income tax to pass-through "S" corporations in petroleum, like Hilcorp Energy. But, aside from the policy question, the tax language appeared hastily drafted and if passed would pose implementation problems for the Department of Revenue, tax experts say. The bill passed the Senate narrowly, 11-9, but failed in the House, 19-19 July 16. The second special session on the bill has adjourned and Gov. Mike Dunleavy has now called a third special session to begin July 27.

The S Corporation language needs more work, experts say. Some examples of contradictions in the final HB 381: The bill exempts the "Alaska LNG Project" from the special tax on pass-through entities. This would exempt Glenfarne as developer but also possibly firms doing business with Alaska LNG which could, ironically, include Hilcorp as a gas supplier. This isn't clear. Hilcorp could be taxed on one hand and relieved of tax on the other. Another example: Entities owned by "natural persons" are exempted, but entities operated by sole proprietors (individuals) are not. By definition a sole proprietor is a person, a natural one. Dealing with those kinds of conflicts would

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Fiscal/budget:

- North Slope oil at $76.62/barrel (July 16)
- Down from $81.46/barrel (July 1)
- Spring forecast: $75.86 (average for FY 2027)

Here's a quick recap of what the S Corporation debate is about

Here's what the S Corporation issue is about: Most corporations are organized as ordinary "C" Corporations under federal tax laws and pay the Alaska corporate income tax. However, businesses can also operate as "S" Corporations with the corporate income tax paid by the shareholders, not the business. But Alaska has no personal income tax, so no business income tax is paid to the state. For several years legislators have tried to change things so that large businesses organized as S Corporations pay tax.

Targeting Hilcorp has led to complications

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would be difficult through regulations by the revenue department and would likely have be resolved in new legislation. Problems in the bill stem mainly from the effort to go after Hilcorp, a major oil producer now exempt from the state corporate income tax, but not to burden Glenfarne, the pipeline developer that is an S Corporation like Hilcorp. However, the only way to enact the tax on Hilcorp was to apply the new tax to all companies in oil and gas production who are S Corporations. This brings in HEX Alaska, a small Cook Inlet gas producer, and Armstrong Oil and Gas, a North Slope explorer and possibly a new producer with its recent discoveries. Developing a new class of oil taxpayers can be done, tax specialists say, and has been done before in Alaska (the current 20-mill tax on oil properties is one example). However, the legislation must be drafted carefully to avoid unintended consequences.

Two-year delay allows time to work on language, but it still leaves uncertainty

The House-Senate conference committee on the bill attempted to deal with this by granting a two-year delay on the S Corporation provision in the final version of HB 381. Sen. Bert Stedman, R-Sitka, a member of the committee, supported giving the revenue department two years to work out problems, although there would have to be new legislation to enact changes. Many felt a delay just leaves the issue dangling and adds to uncertainty for Glenfarne in raising Alaska LNG financing, however. The final version of the bill would also have required potentially affected S Corporations like Hilcorp and HEX to develop *two* tax returns, one under the S Corporation tax exemption (current law) and a second "informational" return put together as if the state corporate income tax would be applied. This would be useful, it was argued in the conference committee, because state revenue officials now have no information on S Corporation financials and the informational returns would provide some of that.

If all this seemed messy, it was.

A more fundamental problem is that the S Corporation tax sections of HB 381 were vague in many places, which means the revenue department would have to write regulations to clarify things, in effect rewriting the statue. If all this seemed messy, it was. Tax experts say statutes on taxation should be clear with only minor clarifications left to regulations. Staff to the conference committee members worked hard on the final draft as did the Legislature's legal staff but it is unclear to what extent the Department of Revenue was consulted. Although legislative attorneys and legislators' staff did the best they could, drafting tax legislation requires specialized expertise and this was not provided to the Legislature. In past years when lawmakers dealt with complex oil and gas tax issues special consultants and advisors were retained and the final review of language was extensive. In this case the Legislature was on a short time-fuse. The governor did not introduce the bill until March 20 and it took weeks for legislators to develop an understanding of the overall bill, which again dealt mainly with the pipeline tax abatement.

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House floor debate on adopting the final bill was short, but sharp

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The House floor debate on adopting the final bill was short, but sharp. Rep. Mike Prax, R-North Pole, complained that he and most other House members had just received final bill that morning and needed more time to read and understand it. *(Our note: This isn't unusual as the Legislature rushes toward adjournment)*. Rep. Justin Ruffridge, R-Soldotna, who was on the conference committee, said he had asked to have the revenue department available to answer questions on the final draft. The request was not granted. On the other side of this, Rep. Andrew Gray, D-Anch., said during the floor debate that the S Corporation exemption basically happened by accident in 1980 when the Legislature repealed the state personal income tax. In the rush to do that, the related change in the S Corporation status flew under the radar for legislators, Gray told his House colleagues.

S Corporation tax change an add-on to HB 381, done in Senate

The S Corporation tax change is basically an add-on made in the Senate to HB 381, which has as its core purpose enacting tax abatement for Alaska LNG from the state 20-mill property tax, which is widely agreed in the Legislature to be an impediment for the gas project. The add-on is basically political. Key senators have been gunning for Hilcorp for years and tacking the tax for Hilcorp onto the gas pipeline tax bill was seen as a way to do it. Unfortunately the effort brought other entities like HEX, Armstrong and possibly others under the tax. This now seems the only issue in HB 381 that is controversial. The solution would seem to be to take out the S Corporation language out of the bill, but Senate supporters of the provision seem dug in. Without it no HB 381, they say. The governor, however, continues to say he will veto a bill with the S Corporation language in it. This apparent impasse sets the stage for the new third special session, which starts July 27.

No one know what will happen on July 27

No one know what will happen on July 27. Two possibilities are seen: One is that the Legislature buckles down again to get the S Corporation language right, and takes time to do it. However, while that might clean up a revised bill it still leaves the policy question on whether there should be a new tax on pass-through S Corporations in oil, like Hilcorp. Unless one side in this fight gives in, the impasse continues. The governor's veto threat is also a problem.

Second possibility we've heard: Legislature just digs in, does nothing

A second possibility we've heard of is that with the raw feelings now between the governor and the Legislature the lawmakeres may just dig in and refuse to take up the bill in the new special session, preferring to wait it out until there's a new governor in December. Under this scenario the Legislature could conduct required periodic technical sessions and allow most members to go home for reelection campaigning. This might involve more 30-day special sessions, but while cumbersome it is doable. There is nothing the governor could do. But that delays the gas line question into 2027, and possibly longer.

. . . Special session . . .

Despite the problems, legislators came to agreement on most of the gas pipeline bill

While the gas pipeline bill was high-centered on the S Corporation section, the Legislature did come to agreement on the main parts of the bill, which dealt with abatement of property tax for the Alaska LNG Project. This creates a framework to move forward if the S Corporation issue can be resolved.

Here are some key point agreed on in both the House and Senate:

• The gas project would no longer be subject to the state 20-mill property tax on oil and gas facilities. A new tax based on the volume of gas moved, the "Alternative Volumetric Tax," or AVT, would be substituted. This would be a substantial reduction of the tax burden for a period of time. In 10 years the AVT tax rate would be doubled. In 2060 it would be doubled again.

• The pipeline developer, Glenfarne, would make payments into a special state fund to help municipalities along the pipeline route deal with impacts of construction.

• A new fund paid from 20% of natural gas royalty income to the state would be created to help Alaska communities not connected with the gas pipeline deal with high fuel oil costs. This kind of fund has long been sought by rural legislators. The current Power Cost Equalization fund deals with electricity costs but not fuel oil for heating of homes.

• A Project Labor Agreement will be concluded. This will encourage maximum employment of Alaska workers.

• Alaska LNG will sell gas to utilities during a "phase one" (pipeline only) for no more than $16 per thousand cubic feet. Gas prices in Southcentral Alaska are expected to approach this level soon due to declining Cook Inlet gas reserves.

• Alaska LNG will facilitate construction of a "spur" pipeline to get gas to Fairbanks. The cost of the spur line will be "rolled into" the overall cost of moving gas through the pipeline, so that Interior consumers do not pay for the spur line by themselves.