Alaska Tax Credits Promote Financing Opportunities

By Jonathan E. Iversen

We Alaskans are blessed with bountiful natural resources and an iconic landscape. To promote economic growth and create financing opportunities made possible by these resources, the state of Alaska provides businesses with a series of tax incentives. This article will focus on two of the most widely known incentives, the film production tax credit and the oil and gas production tax credits.

Alaska's Film Production Tax Credit

Alaska's majestic landscape and its adventurous people are a strong draw for documentary and commercial movie-makers. The film production tax credit provides an additional economic incentive. The credit has a base rate of 30% for eligible expenditures with an additional 20% for local hire, an additional 6% for filming in rural areas and an additional 2% for off-season filming. The maximum possible credit is 58%. Eligible projects are films, documentaries, and commercial and video productions with a minimum of $75,000 in qualified expenditures in Alaska.

To qualify their project for the film tax credit, applicants must submit to the Alaska Film Office an application that includes estimated Alaska expenditures, a budget, a distribution plan and a description of the project, as well as evidence of an Alaska business license. The Alaska Film Incentive Review Commission must approve the application.

The applicant must have its expenditures reviewed by a CPA that has Alaska CPA and business licenses and is located in Alaska. Once production is complete, the applicant can file the application for tax credit. The Alaska Film Incentive Review Commission must approve the application before the credit certificate is awarded. Once awarded, the applicant may transfer the certificate to an entity that can apply the certificate against its tax liability under eight tax types, including corporate income tax, oil and gas production tax, oil and gas exploration tax, production and pipeline transportation property tax and mining license tax. The Alaska Department of Revenue (DOR) may purchase the certificate for 75% of the amount of credit.

Alaska's Oil and Gas Production Tax Credits

Alaska's oil and gas production tax credits are a very hot commodity, with recent program changes having helped incentivize exploration and production companies to invest in the state.

Several types of production tax credits are available. Certificates for these credits can be obtained from DOR and can be transferred to another entity or purchased by the state of Alaska. The credits vary depending on the area of operations in the state. Companies with operations on the North Slope may be eligible for a 45% carried-forward annual loss credit and 30% or 40% exploration credits for exploration drilling and seismic exploration. For areas other than the

North Slope, the credits include: 30% or 40% exploration credits; 20% credits for capital expenditures; 40% credits for intangible drilling costs, as defined by the federal tax rules, and seismic projects within the boundaries of a production or an exploration unit; and a 25% carried-forward annual loss credit. There are also "frontier basin" credits specific to particular areas of the state for the lesser of $25 million or 80% of eligible drilling expenditures and for the lesser of $7.5 million or 75% of eligible seismic exploration expenditures. Cook Inlet also has the unique "jack-up rig" credit for up to $25 million for exploration drilling with a jack-up drilling rig. The same expenditure can, in many instances, serve as the basis for more than one credit.

Typically, each entity with an interest in the project that incurs expenditures applies for its own credits. However, for the 30% or 40% exploration credits, a designated joint applicant files the application when more than one entity has an interest and incurs expenditures.

Depending on the credit, DOR will review or fully audit the application for credit before issuing the certificate. Some credit certificates are often issued within 120 days of the application, but timing can vary based on a number of factors and issuance can take much longer – sometimes well over a year. There are statutory deadlines that require DOR to grant or deny an application within a certain period of time for some credits, whereas no such deadlines exist for other credits.

Once the applicant receives a credit certificate, it may either

(1) transfer the certificate to an entity that can apply the certificate against its production tax liability; or

(2) if the applicant does not have any production tax liability or delinquent state taxes and produces a daily average of not more than 50,000 BTU equivalent barrels, apply to DOR for cash purchase of the credit certificate at 100% of the certificate's value.

The tax credit certificate resides on DOR's database, and DOR issues a notification to that effect. The applicant may appeal any adjustments to the credit application and can transfer the credit certificate or apply for cash purchase of it regardless of any appeal.

Tax Credit Finance

Alaska tax credit certificates can be used as a financing mechanism. The transactions may be as simple as a purchase and sale of a tax credit certificate to allow the seller to obtain cash from a third party immediately rather than wait for DOR's review or audit. The credits may also serve as collateral and a source of repayment for revolving and term loan transactions, as well as project financing transactions that may involve multiple investors and debt and equity financing.

A lender willing to loan against the credits typically requires a security agreement granting the lender a security interest in the credit application, the credit certificate and the proceeds. Lenders often look to other assets as security, including fixtures and as-extracted collateral (i.e., oil and gas production). Should a lender wish to take a mortgage on all or some of the applicant's oil and gas leases in Alaska, a deed of trust will be necessary. This deed of trust will give the lender a security interest in and lien on the applicant's interests in the relevant leases, and also, if desired, a security interest in all fixtures on, in or under said leases and a security interest in all future oil and gas production and the proceeds therefrom.

For oil and gas production tax credits, there is also an assignment mechanism that was passed by the legislature last year as Senate Bill 83. The statute allows the applicant to make a present assignment of the production tax credit certificate expected to be issued. The notice of assignment must be filed with DOR when the application for credit is filed or no later than 30 days thereafter. Once a notice of assignment is filed with DOR, the assignment is irrevocable and cannot be modified absent written consent of the assignee. If a tax credit certificate is issued to the applicant, the notice of assignment remains effective and must be filed with DOR with the application for cash purchase of the certificate.

The assignment of an oil and gas production tax credit certificate does not need DOR consent to be effective, but the statute sets forth the basic criteria for a valid assignment. For instance, the assignment must state "the interest in the production tax credit being assigned, expressed as either an amount in dollars, which may not exceed 90 percent of the credit applied for, or a percentage of the credit to be issued" (up to 100%) by DOR. The assignment must also specify an account with a bank located in Alaska, with information for an electronic transfer of funds to receive proceeds from the purchase of the certificate by the state of Alaska. Once DOR approves the cash purchase, the state will send the funds to an account designated by the applicant. The account may be a lender's account or the applicant's account that is controlled by the lender under an account control agreement.

An assignment of an oil and gas production tax credit certificate that complies with the statute creates a property interest owned by the assignee in the credit application, the credit certificate issued by DOR and future proceeds. The statute also provides that a valid and enforceable security interest in that property may be created as otherwise provided by law. The statute also provides that to the extent permitted under federal law, an assignment that complies with the statutory requirements for a valid assignment gives the assignee a first priority claim that is not dischargeable in bankruptcy, against the proceeds received by the applicant (including its estate, trustee or representative) from the tax credit application that is the subject of the assignment if the assignee has taken the steps needed under state and federal law to perfect a security interest in the assignment.

Jonathan E. Iversen is a partner with Stoel Rives LLP whose practice focuses on state and local tax law, including transactional and tax controversy matters. He regularly advises clients regarding Alaska state and local tax incentives, legislative projects, and financing associated with Alaska's oil and gas production tax credits. You can reach him at jeiversen@stoel.com.