



THE STATE
of **ALASKA**
GOVERNOR SEAN PARNELL

Department of Revenue

COMMISSIONER'S OFFICE
Bryan Butcher, Commissioner

333 Willoughby Avenue, 11th Floor
PO Box 110400
Juneau, Alaska 99811-0400
Main: 907.465.2300
Fax: 907.465.2389

February 21, 2013

The Honorable Eric Feige and the Honorable Dan Saddler
Alaska State Representatives
Co-Chairs, House Resources Committee
State Capitol Room 126 and 104
Juneau, AK 99801

Dear Co-Chairs Feige and Saddler:

The purpose of this letter is to provide you with a response to questions to the Department of Revenue and Econ One, during their presentations to the House Resources Committee on February 11 and 13, 2013. Please see questions in italics and our responses immediately below the questions.

1. *Is governor committed to \$60 million / year community revenue sharing even if the state is in deficit?*

This question is best answered by the Governor's office or the Office of Management and Budget.

2. *Provide information on the detail with which DOR tracks actual activity performed in relation to credits. Is it possible for companies to spend money and claim credits in advance of actual work or equipment? That is, qualified capital expenditure credits are allowed at the time the expenditure is made and not at the time work is done. Is DOR tracking the "frontloading issue?"*

Capital expenditures qualify for the Qualified Capital Expenditure (QCE) credit when the expenditure is made. However, our audit staff are not aware of any significant "frontloading of capital expenditures," i.e. paying money up front for capital expenditures before work is done. Conversely, general accepted accounting principles allow for the recognition of costs being incurred for work done prior to actual payment for the activity. In accrual basis accounting, a company recognizes the fact that a capital asset has been incurred by recording work in progress accruals and thus charging capital accounts prior to the actual money for the work being paid. There are occasions when companies will order and pay for long lead items such as drill pipe in the instance of an anticipated extensive drilling program, however, in those cases, the cost of the pipe prior to being used in the drilling of wells, is recorded in inventory accounts which at that point do not constitute capital expenditures. The costs are charged out to the various drilling projects, i.e. capital accounts, when the pipe is actually used in the wells, and the cost is transferred from inventory to the project. At that point, the cost would then qualify as capital expenditures eligible for the production tax credit. In the event that a company does pay in advance for work to be done at a future date,

generally accepted accounting principles would dictate that the upfront payment be recognized as a prepaid (a non-capital account) in the accounting records and amortized to either capital or expense when the actual work is done.

DOR's ability to track capital expenditures is limited to the performance of due diligence reviews or audits of supporting documentation submitted with production tax credit applications and review of capital expenditure documentation requested during assessment of tax filings. We have not experienced this frontloading issue, and would not allow this type of activity to be included as expenditures eligible for production tax credits.

3. *Provide information about "sustained production" and whether a company could stop producing, and restart to gain a Gross Revenue Exclusion (GRE) under HB72.*

A company could not stop producing from a currently producing participating area and then restart production to gain a GRE under HB 72, section 24. Section 24 of the bill does not contain any language regarding "sustained production" as necessary to qualify for the GRE. To qualify for the GRE, oil or gas production must qualify under either or both of the following provisions: (1) production from a lease or property that does not contain land that was within a unit on January 1, 2003; or (2) production from a participating area established after December 31, 2011, that is within a unit formed under AS 38.05.180(p) before January 1, 2003, if the participating area does not contain a reservoir that had previously been in a participating area established before January 1, 2012. To qualify a participating area must be a new one, and not part of a reservoir previously in production. The 20 percent reduction for the gross value at the point of production only applies for the new unit production or from the new participating areas.

4. *Slide 5-6 of Econ One presentation: provide the portion of each category that would qualify for GRE.*

Slide 5 in Econ One's presentation from February 13, 2013 presents five categories of Alaska North Slope production and resources: "Historical Production," "Conventional Resources – Discovered," "Conventional Resources – Undiscovered," "ANWR," and "Unconventional Resources." The category "Historical Production" would not be eligible for the GRE. "Conventional Resources-Discovered" would include some oil that may be eligible for the GRE, and some that would not be eligible, depending on the location of the oil. "Conventional-Undiscovered," "ANWR," and "Unconventional Resources" would all be eligible for the GRE.

5. *Slide 8 of Econ One presentation: provide estimated effective tax rate by decade.*

As illustrated in slide 8 of Econ One's presentation to House Resources on February 13, 2013, Alaska's production tax underwent extensive change between the former production tax under the Economic Limit Factor (ELF) and the current production tax under ACES. Under the ELF system, the production tax was paid on the gross value at the point of production (GVPP) as modified by the ELF. As such, minimal information was collected on the expenditures made to find and produce oil.

The effective tax rate during the years in which ELF was in place was therefore, the production tax paid divided by the GVPP.

With the passage of PPT and then ACES, production tax was levied on the net value of oil after the expenditures to find and produce oil were deducted. The effective tax rate under PPT and ACES then, is the production tax paid divided by the net value of production, commonly referred to as the production tax value (PTV).

To give an apples-to-apples comparison, we prepared effective tax rates on the gross value at the point of production. Note that this is a different metric than the effective tax rates on net commonly shown when comparing ACES to other net profits-based alternatives.

Shown below are estimated effective tax rates on gross by decade from start of Alaska North Slope production in FY 1978 through FY 2012. Also provided for context are average daily oil production and average wellhead value. As evidenced in the data, the effective tax rate on gross increased significantly under ACES.

Average Effective Tax Rates on Gross,* by Fiscal Year Decade				
	FY 1978-87	FY 1988-97	FY 1998-2007	FY 2008-12
	ELF tax system	ELF tax system	ELF tax system**	ACES tax system
Average ANS daily production, in MMbbls	1.519	1.707	0.990	0.647
Average tax rate*	12%	14%	10%	26%
Average wellhead value in \$/barrel	\$14.19	\$12.06	\$28.35	\$84.24
Average production tax payment in \$M	\$957	\$907	\$837	\$4,701
*Average tax rate calculated by dividing production tax paid by estimated gross value at point of production, averaged over decade.				
**ELF tax system was in place from FY 1998 through FY 2006; PPT was in place in FY 2007				

6. *Slide 23 of Econ One presentation: Provide at \$60/bbl.*

Slides from Econ One with the requested information are attached.

7. *Add HB72 comparison on slides 20-23 of the Econ One presentation using \$60 / barrel oil on the low end and \$140 / barrel oil on the high end*

Slides from Econ One with the requested information are attached.

8. *Show the impact on revenue if 50% of oil produced received a GRE under HB72.*

Our Fall 2012 forecast does not anticipate 50% of oil being eligible for the GRE under HB72 in any of the years under our forecast. For purposes of this question, however, we have calculated what the

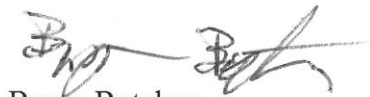
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difference in revenue would be if 50% of oil received the GRE in FY 2022 – the last year of our forecast. It should be noted that this is a purely hypothetical exercise.

In FY 2022, we are forecasting total ANS production to be 338.5 thousand barrels per day. Without any changes in production, under HB72, the total production tax revenue would be approximately \$2 billion in FY 2022. If half of the 338.5 thousand barrels per day were subject to the GRE, the impact on production tax revenue would be a reduction of approximately \$300 million. As stated above, this is not a realistic scenario under HB72 and is calculated for illustration only.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Bryan Butcher', with a stylized flourish extending to the right.

Bryan Butcher
Commissioner

Attachments: Revised slides 20-A, 20-B, and 23 from Econ One