THE STATE of ALASKA
GOVERNOR SEAN PARNELL

Department of Revenue

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April 7, 2013

The Honorable Representatives Bill Stoltze and Alan Austerman
Alaska State Representatives
Co-Chairs, House Finance Committee
State Capitol Rooms 515 and 505
Juneau, AK 99801

Dear Representative Stoltze and Representative Austerman,

The purpose of this letter is to provide you with a response to some of the questions that came up during the House Finance Committee meeting earlier this morning. This includes follow-up questions from the presentation by the Department of Revenue.

1. *Provide side-by-side comparison of bill versions.*

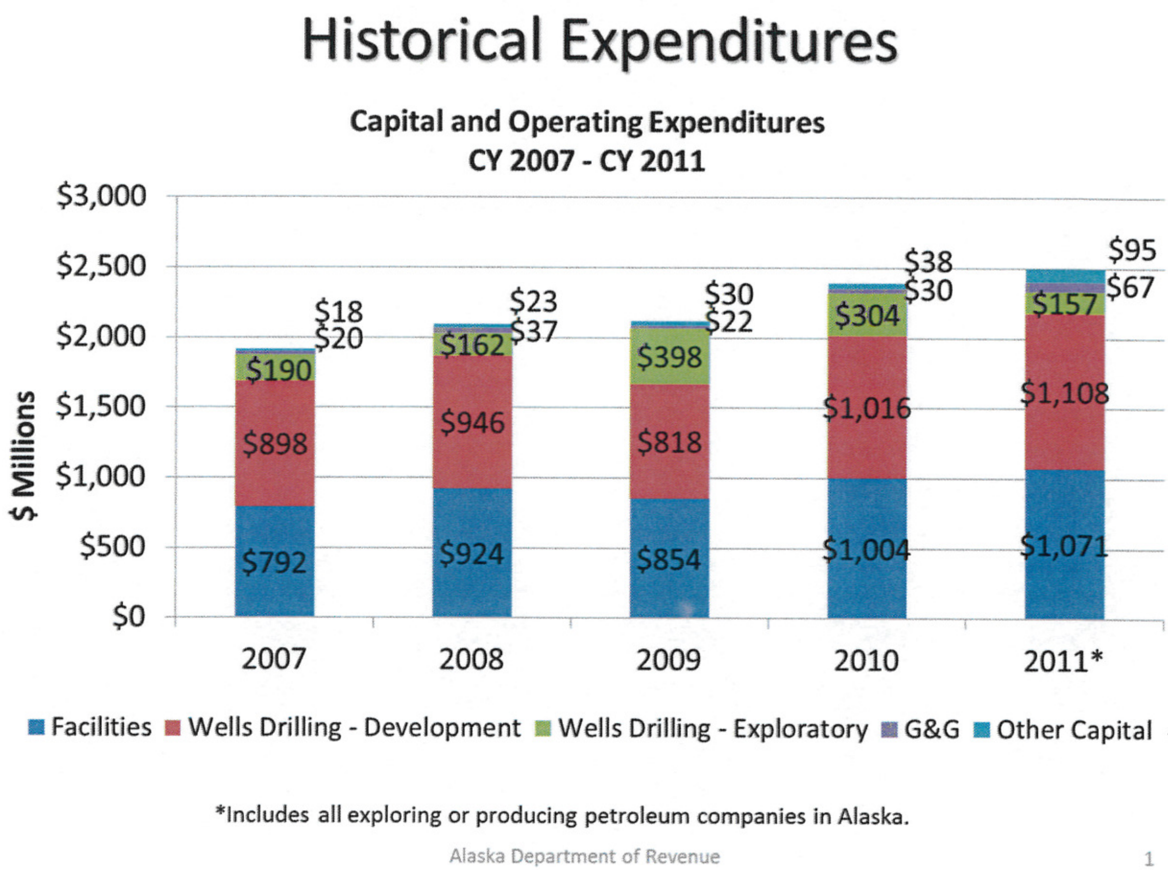
See attached chart comparing major provisions of ACES, and three versions of SB21. These include SB21 as introduced, SB21 at it passed the Senate, and SB21 as it passed House Resources.

2. *Provide information about the number of taxpayers for production tax.*

Our production audit group reported the following statistics for production tax: There were 19 producers, 6 of which had a net tax liability after application of credits. Additionally, there were 33 explorers filing for credit refunds for a total of 52 companies making production tax filings with the Department. This information is prior to receipt of the 2012 annual returns.

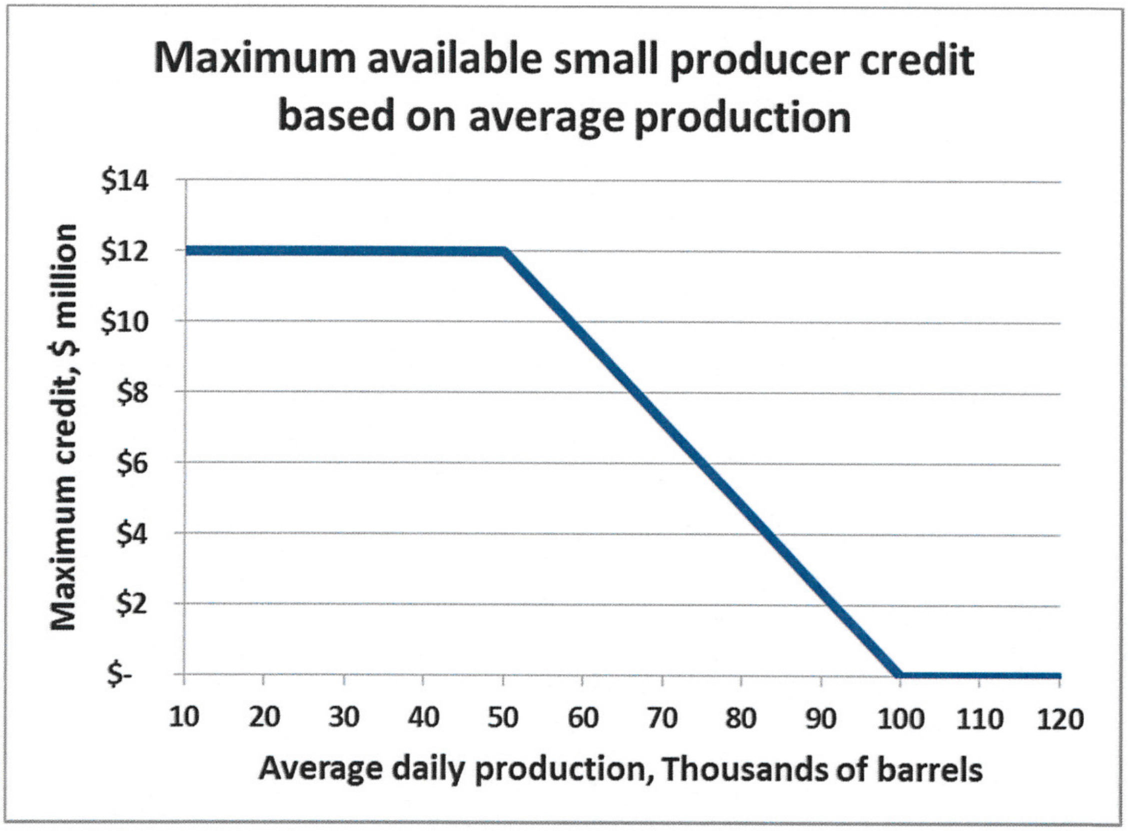
3. *Provide information about effectiveness of tax credits.*

The Department does not have the ability to determine what investment and / or production took place specifically as a result of tax credits. However, we do have some information about what types of investments were made as a result of company spending, which may quality for tax credits. The following figure is a summary of the "5-year look-back" information that has been collected by the Department. It shows the capital expenditures by major category: facilities, wells drilling for development and for exploration, geological and geophysical work, and other capital expenditure. Note that the historical information includes most but not all companies that were doing business in the state, and may not exactly match expenditure amounts reported elsewhere. However, at a high level, it is instructive as to the question of what types of projects companies have spent money on.



4. *Explain the phase-out provision of the small producer credit.*

The small producer credit under AS 43.55.024(c) is available for taxpayers with Alaska oil and gas production that is less than 100,000 BTU equivalent barrels per day. When average oil and gas production is no more than 50,000 barrels per day, the credit is $12 million per taxpayer, per year. When production exceeds 50,000 barrels per day, but is less than 100,000 barrels per day, the credit is allocated based on production volumes as illustrated in the following chart. The credit is only available against tax liability and cannot be transferred, refunded, or carried forward. Under ACES, this credit sunsets the later of 2016, or the ninth calendar year after the first year of production. Under SB21 as it passed House Resources, the credit is extended to sunset the later of 2022 or the ninth calendar year after the first year of production.



5. Explain logic and advantages and disadvantages of current structure of credits in HCS CSSB21(RES).

The current bill has been refined and adjusted throughout the committee process, and new credits have been added beyond the governor's original proposal. These include the per-barrel credits, and the refundable carry-forward loss credits. That being said, the suite of credits in the current bill is in large part consistent with the original policy goal of directly incentivizing production. The current bill still eliminates the North Slope 20% capital credits which are tied to spending, not production. The current bill adds the per-barrel credits which are directly tied to production, as are the small producer credits (only available against a tax liability).

The bill also retains exploration credits, and allows refund of net operating loss credits.

Advantages of the proposed system include that it reduces the state's exposure to refunded credits at low oil prices, and it more closely aligns credits with the policy goal of oil production. Disadvantages of the current bill are that credits are slightly more complex than the governor's original proposal.

6. Can production tax liability go below zero based on credits remaining in the bill?

The production tax liability can only go below zero using credits that can be monetized. The non-monetizeable credits under AS 43.55.024 (per-barrel and small producer) credits can only take liability to zero. A producer with monetizable net operating loss credits, exploration credits, or capital credits for areas outside the North Slope, could receive a net refund under the current version of SB21. According to the fiscal note, the total amount of credits refunded by the state is expected to be reduced by $120 million per year, compared to ACES. This is due to elimination of the 20% capital credit, partially offset by an increase in the rate of the net operating loss credit.

7. *Has the state ever collected less than 25% effective tax rate under ACES?*

The production tax rate is determined on a monthly basis, by company. Some companies have and currently do have an effective tax rate (after credits) of less than 25% under ACES. This occurs when a company's total credits exceed their total progressive surcharge. In the aggregate, however, the current effective tax rate exceeds 25% and is expected to continue to exceed 25%.

Historically, the effective ACES tax rate has been below 25% in some months when oil prices were low. For example, in late 2008 and early 2009 ANS oil prices were in the $30's and $40's for several months. During these months, no progressivity was triggered, and credits applied against the tax liability took effective tax rate below the nominal 25% rate.

We hope that the answers set forth above have addressed your questions. Please do not hesitate to contact me if you have further questions.

Sincerely,

Bruce Tang

Bruce Tangeman
Deputy Commissioner

Attachment: Comparison chart of SB21 provisions in different bill versions