Fiscal Impact of Cook Inlet Production Tax Limitations, 2007-2013

This analysis provides estimates of the amount of production tax revenue that could have been collected under the ACES production tax regime in Cook Inlet, but that was not collected due to the Cook Inlet tax limitations in place for calendar years (CY) 2007 through 2013. The estimates provided in this analysis are approximations, provided in ranges to reflect several assumptions made in the calculations and to reflect a level of uncertainty as to the completeness of the data.

Oil and gas production tax changes enacted with the Petroleum Profits Tax (PPT) in 2006 and with Alaska's Clear and Equitable Share (ACES) in 2007 contained provisions limiting the production tax for oil and gas produced in Cook Inlet. These provisions generally limited the production tax to the lower of the tax calculated under PPT and later ACES, and the tax calculated under the ELF tax regime as it existed in the year prior to April 1, 2006. These limitations went through several changes in the years since PPT's passage, with the largest changes occurring with the Cook Inlet Recovery Act in 2010. The Cook Inlet Recovery Act eliminated certain ring-fencing provisions, and provided additional credits for Cook Inlet, which in turn increased and the value of Cook Inlet credits by allowing more of them to be used elsewhere and/or be redeemed for cash from the State.

Due to the numerous changes in law from year to year, we calculated these estimates to the best of our ability using primarily annual estimates of tax liabilities and credits, without regard to certain specific credit provisions and details about taxing jurisdictions specific to Cook Inlet. Data and reporting inconsistencies also hampered our confidence in the estimates. To reflect this uncertainty, we have provided the production tax estimates in terms of ranges of revenue.

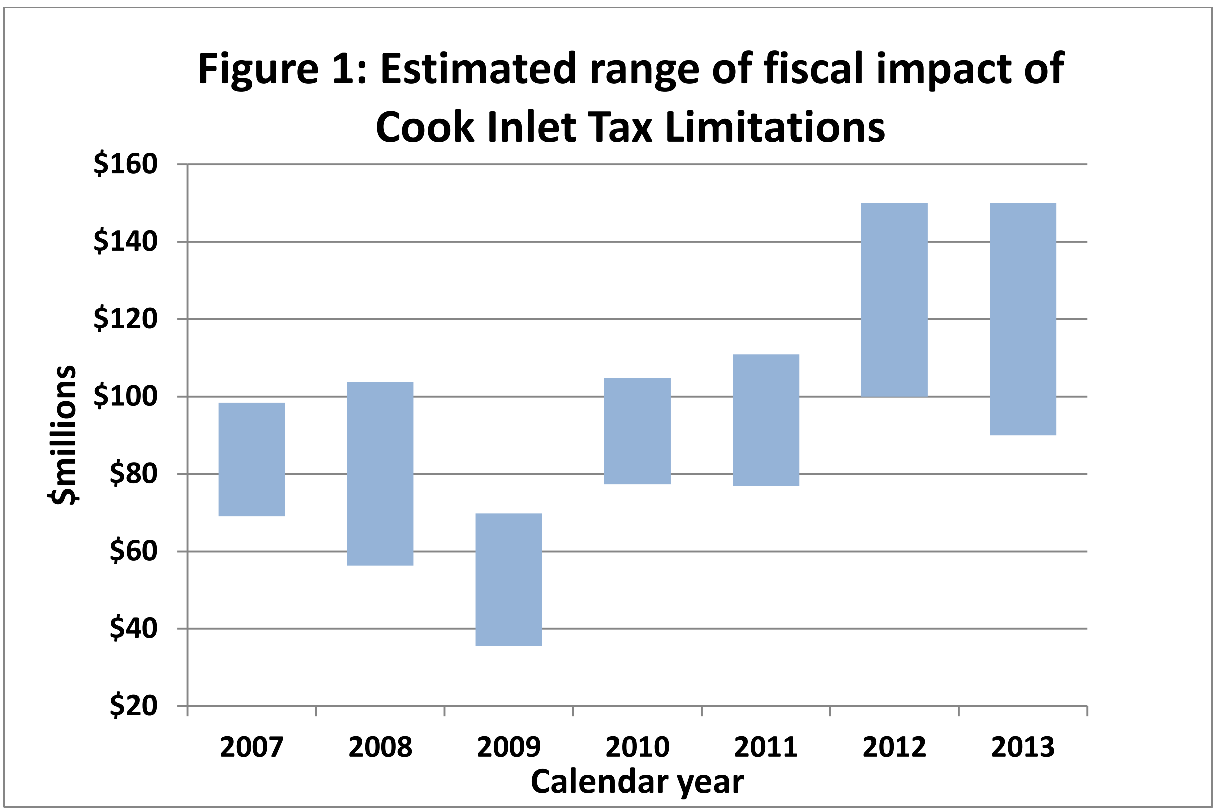
It is important to note that while Cook Inlet producers enjoy very low tax rates under the ELF production tax limitations, if taxed under ACES, many of these same producers would have their entire production tax liability eliminated by the small producer credit under AS 43.55.024(c). The small producer credit, worth $12 million each year, is a use-or-lose credit that most Cook Inlet producers earn each year. Because the tax liability of many of these small producers, even under ACES, is less than $12 million, most of them are unable to take full advantage of the credit. Further, in any given year, up to one half of the producers in Cook Inlet spend more in oil and/or gas lease expenditures than they take in revenues. These producers qualify for net operating losses under the production tax credit system.

In the seven years that this analysis covers, the number of companies reporting that they are exploring for and/or producing oil or gas in Non-North Slope areas of the state increased significantly, from 7 companies in 2007 to 21 companies in 2013. The increase in the number of companies with activity in Non-North Slope areas is shown in the table below.[1]

[1] For purposes of public reporting the Department of Revenue combines Cook Inlet figures with those from other Non-North Slope areas in so-called "middle earth." The primary reason for this is the relatively small number of companies and projects in the middle earth area, which could not be reported separately due to confidentiality restrictions. Therefore, to ensure complete statewide data, we combine these few middle earth companies with the much larger Cook Inlet data set. Since there is no commercial oil or gas production in "middle earth," all production and production tax liabilities in this analysis are from Cook Inlet producers.

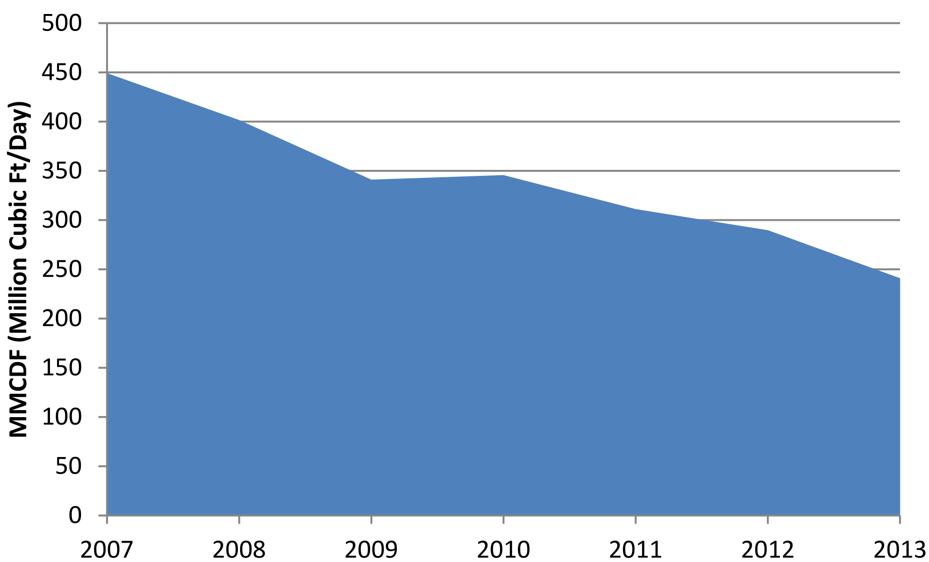
Companies Reporting Production and Companies Receiving Refunded Credits in Non-North Slope Areas of Alaska							
Calendar Year	2007	2008	2009	2010	2011	2012	2013
Count of Producers reporting production in Cook Inlet	7	7	8	9	13	14	13
Count of Companies Receiving Refunded Credits in Non-North Slope	0	0	1	8	12	13	17
Count of Total Non-North Slope Companies	7	7	9	16	18	18	21

Figure 1 below illustrates ranges of estimated foregone revenue of Cook Inlet companies. Unrealized production tax revenue dipped from 2007 to 2009, due primarily to lower oil and gas prices, then steadily began increasing, growing even more in 2012 and 2013. The total fiscal impact of these limitations over the seven years analyzed is estimated to be between $550 million and $800 million.



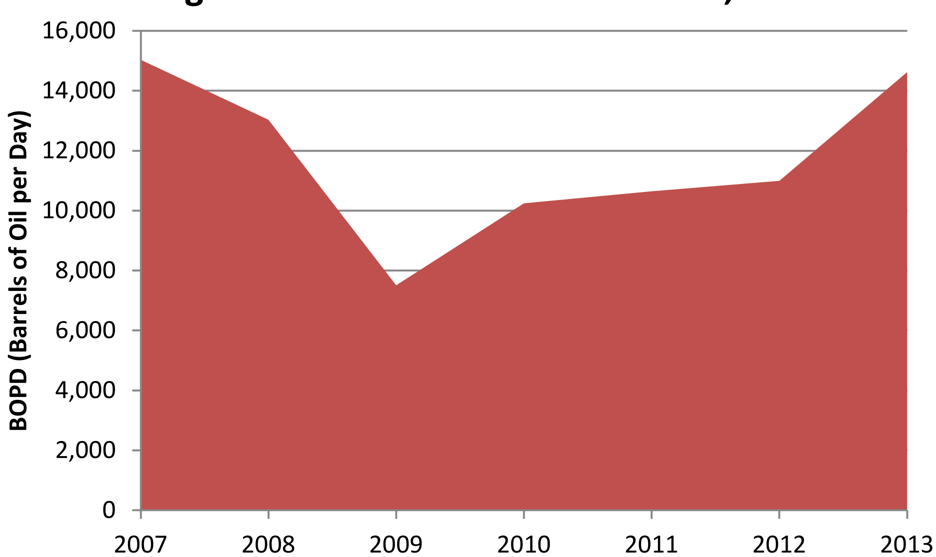
The results in Figure 1 can be partially explained by commodity prices and partially explained by production volumes. Oil prices varied from the $60 per barrel range in 2007 to over $100 per barrel in 2008, to lows of $40 per barrel in 2009. The lower values contribute to lower tax liabilities in 2009. With regard to production volumes, although Cook Inlet gas production has been declining since 2008 (see Figure 2), Cook Inlet oil production almost doubled from lows of 7,500 barrels per day in 2009 to close to 15,000 barrels per day in 2013 (see Figure 3). During this time, capital lease expenditures for Non-North Slope more than tripled from around $120 million in CY 2010 to close to $400 million in CY 2012, and increased further to close to $500 million in CY 2013. Refunded credits to Non-North Slope companies increased from around $15 million in CY 2010 to around $94 million in CY 2012, then doubling to around

Figure 2: Cook Inlet Gas Production, 2007-2013



Source: Department of Natural Resources, Oil and Gas Division

Figure 3: Cook Inlet Oil Production, 2007-2013



Source: Department of Natural Resources, Oil and Gas Division

$191 million in CY 2013.

Because many Cook Inlet companies do not incur a tax liability, or their tax liability is eliminated by non-refundable credits, any remaining credits are generally cashed out by the State. The table below shows the amount of credits that were earned by oil and gas activity in Non-North Slope areas of the state that were redeemed for cash from the State treasury. Note the significant increase beginning in CY 2011, for a total of over $300 million over the seven years. Refunded credits for Non-North Slope activity in CY 2014 are even higher, estimated to be in excess of $300 million.

Historical Refunded Credits in Non-North Slope

($millions)	CY 07	CY 08	CY 09	CY 10	CY 11	CY 12	CY 13
Non- North Slope Refunded Credits							
Credits under AS 43.55.023[1]	0	0	*	*	34	*	*
Credits under AS 43.55.025[2]	0	0	*	*	3	*	*
Credits under AS 43.20[3]	0	0	0	0	0	0	15
Total Non-NS Refunded Credits	***0***	***0***	*****	***15***	***36***	***94***	***191***

***An asterisk indicates that a number is confidential.

[1]Credits under AS 43.55.023 include the Qualified capital expenditure, the Carried-forward annual loss, and the Well lease expenditure Credit.

[2]Credits under AS 43.55.025 include the Alternative Credit for Exploration, the Frontier Basin Credit, and for Cook Inlet only, the Cook Inlet Jack-up Rig Credit

[3]Credits under AS 43.20 include the Gas Exploration and Development Credit, Gas Storage Facility Credit, the In-State Gas Refinery Credit, and the LNG Storage Facility Credit.