House Finance Committee CS for HB 111

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OIL & GAS: FUELING ALASKA'S ECONOMY

AOGA Alaska Oil and Gas Association

AOGA members

GLACIER

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CAELUS Energy Alaska

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Guiding Principles to Measure Progress

- Production
- Investment
- Competitiveness
- Revenue
- “Fair Share”

CS for HB 111 – Raises Oil Taxes & Increases Costs

HB 111 by Major Policy Section	Tax Increase	Credit “Reform”
Sec. 2 - Increases Interest	*	
Sec. 3-5, 20, 21, 22, – Confidentiality/Transparency	*	✔
Sec. 6 - Increases Minimum Tax	✔	
Sec. 7, 10, 12, 13, 16 - Hardens the Floor	✔	✔
Sec. 7 "Migrating" Credits	✔	✔
Sec. 9 - Eliminates NOL tax credit	✔	✔
Sec. 11, 18 - No cash payments for NOLs	✔	✔
Sec. 14 - Changes Per-barrel "credit"	✔	
Sec. 17 - New Dry Hole Credit		✔
Sec. 19 - Limits cash payment to $35M	✔	✔
Limits threshold to 15K/taxable bpd	✔	✔
Sec. 23 - Changes GVPP Determination	✔	
Sec. 24, 25 - Allows 50% of NOL to carry forward	✔	✔
Sec. 26 - "Uplift" of 7% points above the federal rate	✔	✔
Sec. 26 - New DNR Regulatory Pre-Approval Process	*	
Sec. 27 – Repeals assignability of tax credit certificates		✔
Sec. 28 - Cook Inlet Work Group		

**Not a tax increase, but will add cost to industry.*

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Section 2: Increases Interest Rate

- AOGA supports current interest structure & rates – especially considering the lengthy statute of limitations.
- Companies have repeatedly testified that resolution of open tax years should be accelerated, not delayed.
- It is in no one's best interest to delay resolution solely to avoid interest on an amount in dispute.
- Six years of compound interest will not be an incentive for State to finish audits.

Section 2 increases costs, and has nothing to do with tax credits.

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Sections 3-5, 20-22: Confidentiality/Transparency

- This is one of many sections that was just changed last year.
- The broad requirements for disclosure would also allow disclosure of commercially and federally protected sensitive downstream information.
- Department of Revenue would be allowed to request "other information" via regulation. This provides DOR with unfettered and unsupervised power to request and disclose virtually any information it desires.

These confidentiality/transparency sections increase costs, and go beyond information regarding cashable tax credits.

Section 6:
Raises Minimum Tax from 4% to 5%

- **Represents a 25% increase for each taxpayer subject to the minimum tax.**
- **"Infinite increase" for smaller companies/newcomers who do not yet pay the 4% tax; They go from 0% to 5%.**
- **Will mean more tax payments, and less money spent in development and/or exploration.**
- **Industry has testified that this type of increase alone would likely lead to the reduction of one drilling rig for at least 6 months.**

Section 6 is a tax increase and has nothing to do with tax credits.

Sections 7, 10, 12, 13, 16: "Harden the Floor"

- **For all companies, large & small, that may have credits from prior year investments, not allowing the credits to be applied to the minimum tax delays and possibly denies economic recovery.**

- **For some companies, using tax credits against the minimum tax is the <u>only way</u> they can continue to invest – especially in low price environments.**

- **Coupled with raising the minimum tax, will represent a significant increase.**

- **These changes are analogous to the federal and state government not allowing corporate losses to be applied against corporate income tax.**

These sections are a tax increase and they change a key provision of the purpose of credits.

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Section 7: "Migrating" Credits

- **Represents a tax increase.**
- **This provision would require a producer to file perfect monthly installments/estimates or run the risk of losing valuable tax credits.**
- **Makes the system more complex by moving the tax into more of a monthly tax versus what it currently is – an annual tax.**
- **This creates uncertainty for companies in estimating their tax burden.**
- **If credits are not allowed to be carried forward or transferred, they would be lost.**

Section 7 is a tax increase and changes a key provision of the tax system.

Section 11, 18: NOL credit no longer eligible for cash payment from the state

- **All current cashable North Slope credits are eliminated in this section.**
- **For companies exploring or with limited production, the NOL has served as the playing field leveler, attracting companies to invest in high-cost projects.**
- **This proposed change is a "double whammy" when combined with the change in the NOL, because it severely impacts smaller companies and explorers, especially those that have made significant discoveries.**
- **This is another section that was just changed last year.**

These sections tilt the playing field against new/small companies.

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Section 14: Changes the per-barrel credit

- **Tax increase on the core fields that underpin where just over 90% of North Slope production originates.**
- **Per-barrel was designed to add a progressive element to the tax system, so it is a structural component, not really a "credit".**
- **Legislative consultants, *enalytica,* described the per barrel credit as a "misnomer" – "The credit against the production tax is not really a credit; it has an explicit tax-rate-setting goal." – 6/17/15**

Section 14 is a tax increase and fundamentally changes the structure of SB 21.

Quotes from Tax Division Director Alper on per-barrel tax credits

"Some of them (credits) are integral parts of the tax regime; the 20% capital credit in ACES, the per-barrel credit in SB 21, those are very much offsets to what would otherwise be a very high tax rate." –
Senate/House Joint Resources – 6/17/15

"With SB 21 the credit is an offset to the tax and is designed to create a progressive element, a little bit lower tax rate at lower prices, a higher tax rate at higher prices, so it's hard to really consider them a credit in the context of an inducement to doing work. It's really what we are calling an integral part of the system." – **Senate/House Joint Resources – 6/17/15**

Section 14 is a tax increase and fundamentally changes the structure of SB 21.

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Sec. 17: New Dry Hole Credit

- The policy objectives behind this credit are unclear.
- There is very little eligibility & disregards production thresholds already in place.
- The credit can only be taken if the lease is surrendered to the state.

Section 17 is unclear and does not appear to provide value to industry or the state.

Section 19:Further restricts eligibility of cash payments

- It is unclear to industry how this would be applied and to which companies.
- Companies would be restricted to $35 million per year.
- Only those companies with fewer than 15,000 barrels per day of taxable production would qualify.
- Yet another section of tax law that was changed just last year.
- Restricting eligibility of cash payments severely affects liquidity and project economics for smaller companies.

Section 19 changes a key provision of the purpose of credits.

Section 23: Gross value at the point of production cannot go below zero

- **This impacts those fields with excess marine transportation or pipeline tariffs, such as those farther from TAPS.**
- **Would change the structure of the production tax.**
- **Disguised tax increase.**
- **Creates uncertainty as to how a producer is to evaluate potential investment opportunities or calculate its production tax.**

Section 23 is a tax increase and has nothing to do with tax credits.

Section 9, 24, 25: Net Operating Loss

- **Major change in policy by changing the net operating loss from a credit to a deduction.**
- **Companies would not be eligible for any NOL rebates after Jan. 1, 2018 on the North Slope if these changes are adopted.**
- **The NOL was established as an integral part of Alaska's net based tax system, from the beginning in PPT.**

NOL sections are a tax increase and represent a significant change in tax policy.

Section 9, 24, 25: Net Operating Loss

- **There is a difference between a credit and a deduction.**

	Company A	Company B	Company C
Gross Income	$1,000	$1,000	$1,000
Less: Tax Deductions	-0-	($200)	-0
Equals Taxable Income	$1,000	$800	$1,000
Tax @25%	$250	$200	$250
Less Tax Credits	-0-	-0-	$200
Final Tax Payable	$250	$200	$50

NOTE: This chart only a reflective example of a company generating income. NOL sections are a tax increase and a significant change in tax policy.

Section 9, 24, 25: Net Operating Loss

- **Changing NOL from a credit to a deduction was a recommendation of the legislature's consultant, however, the bill's current language does not reflect his recommendation.**
- **NOL as a deduction is an expense the taxpayer can't use because there is no revenue to deduct it from.**
- **Alaska would only be the second region in the world that would not allow the full value of that expense (50% reduction). (Trinidad & Tobago)**
- **"Uplift" provision is not as recommended by the legislative consultant. The provision as written would not be neutral to companies, and would in fact, negatively impact the economics for all companies in Alaska.**

NOL sections are a tax increase and a significant change in tax policy.

Section 9, 24, 25: Net Operating Loss

- **The NOL provisions as written do not follow the legislature's consultant's advice from March 1, 2017:**
  - ***"Every regime, everywhere you go, allows, especially with a development like Smith Bay, everyone who develops gets to deduct the cost of what it took them to get that production from future revenues from that project. Every regime."***
  - ***"To deny that would really move Alaska to the bottom of the competitive scale."***
  - ***"Various countries have different ways of dealing with this. Where there's a long lead time, between when the money is spent and when actual production comes on, they'll offer forms of uplift which another way of saying interest as it's carried forward so that way time value loss does not become a big kicker to their economics."***

NOL sections are a tax increase and a significant change in tax policy.

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Section 26: Creates one of the largest regulatory processes in state history

- New, undefined process would require pre-approval of any expenditure before it could qualify for a potential net operating loss deduction.
- Due to a variety of external factors, such as oil price, the industry does not know at the time of the expenditure if they will suffer a net operating loss.
- So essentially, this new requirement would mean almost every penny of proposed investment would need to be pre-approved by DNR.
- No definition of appeal process or resolution of potential conflict between DNR and DOR.
- No direct testimony/feedback from DNR in HRES. The agency issued "an indeterminate fiscal note", but it will be significant.
- This new process would cripple industry, result in enormous increase in state and industry staff, and result in prohibitive days.

Sec. 26 is a massive regulatory burden; increasing costs, uncertainty and instability.

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Section 27: Repeal Ability to Assign Tax Credits

- This section would repeal the statute that allows tax credit certificates and proceeds to be assigned to third parties.
- This current ability provides valuable liquidity in early-stage projects and improves project economics, with no negative financial impact to the state.
- The repeal has a retroactive impact and would significantly impact current commercial agreements.

Sec. 27 changes a key provision of the tax credits.

Would you invest in Alaska if tax policy changed 7 times in 12 years?

Dates	Tax Policy Change	Increase / Decrease?	AOGA Position
Feb. 2005- March 2006	Aggregated ELF – Administrative decision altering gross production tax	**Tax Increase**	**Opposed**
April 2006- July 2007	Petroleum Production Tax (PPT)	**Tax Increase**	**Opposed Final Version**
July 2007- 2013	Alaska's Clear and Equitable Share (ACES) *	**Tax Increase**	**Opposed**
2010	Cook Inlet Recovery Act	**Incentives for Industry**	**Supported**
2014	SB 21	**Both**	**Supported, with concerns**
2016	HB 247 – Gov. Walker's oil tax reform	**Tax Increase**	**Opposed**
2017	*Proposed HB 111 – House Resources*	***Tax Increase***	***Opposed***

*** Some provisions of ACES made retroactive to enactment of PPT, others to 1/1/2007**

Few other regions consider oil/gas changes more than Alaska.

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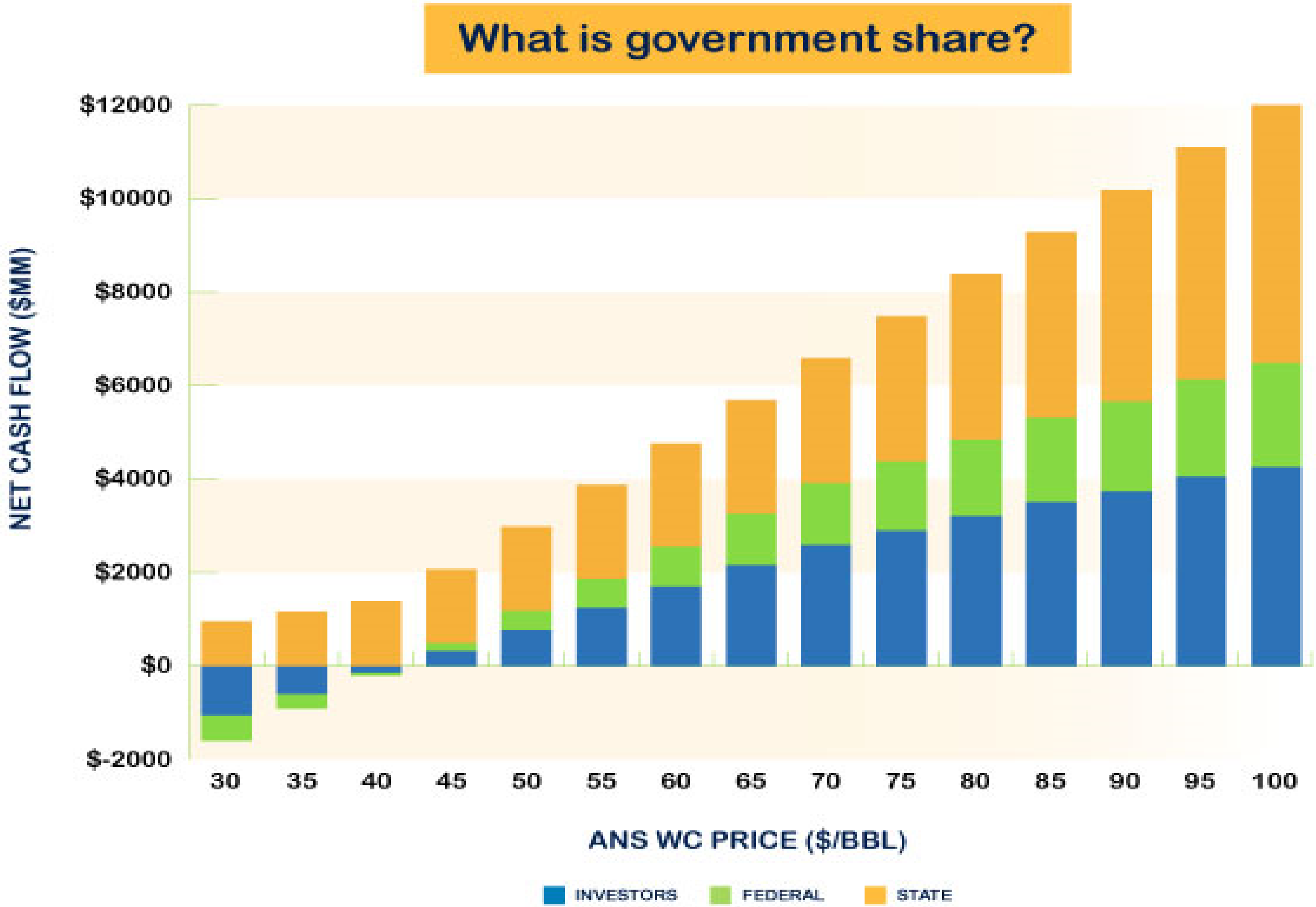
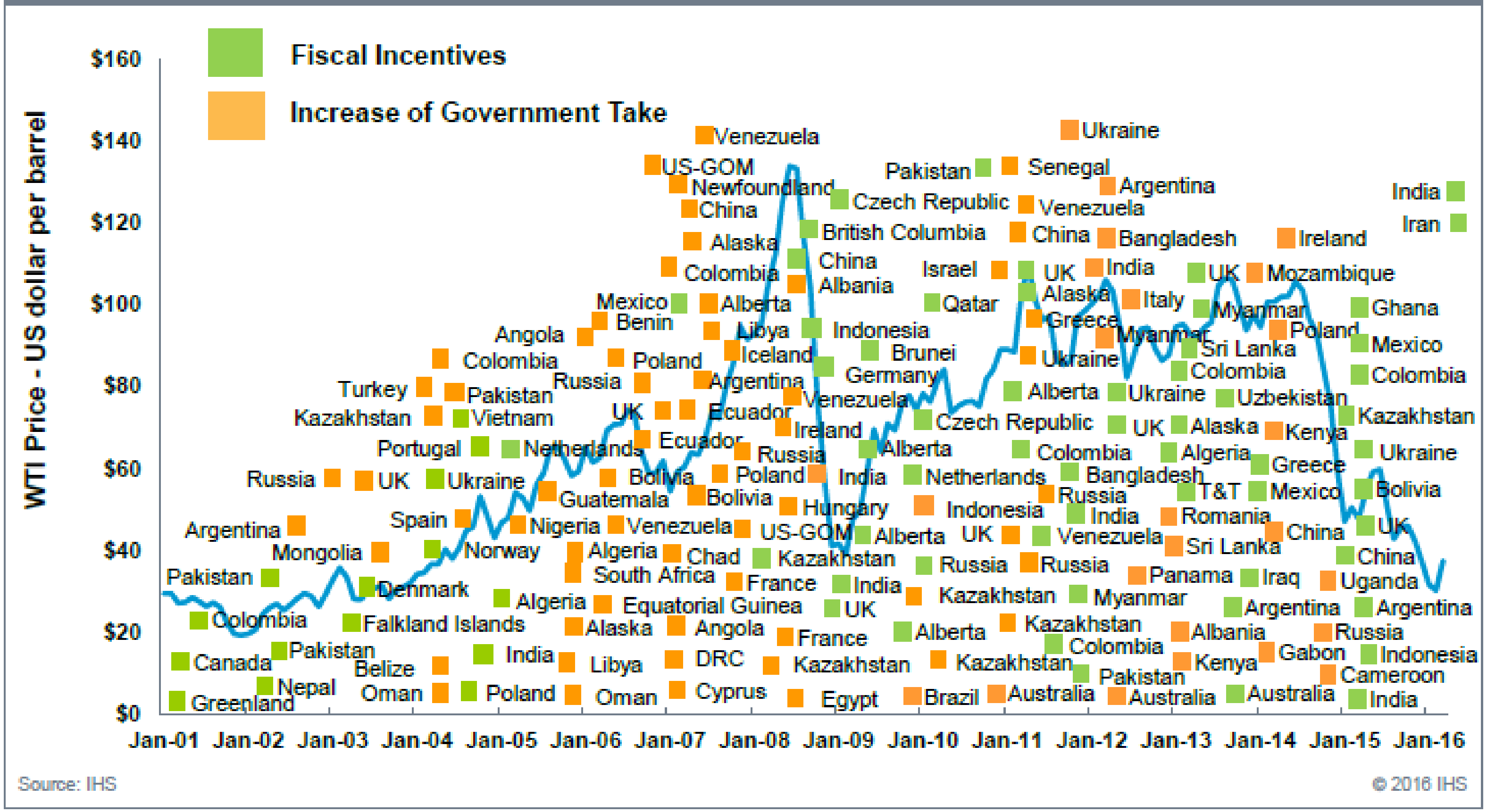
What is “Fair” Share?



Source: Department of Revenue, Fall 2016.

Government Reaction to Market Changes
Lookback to the Future?

Government Action v. Oil Price



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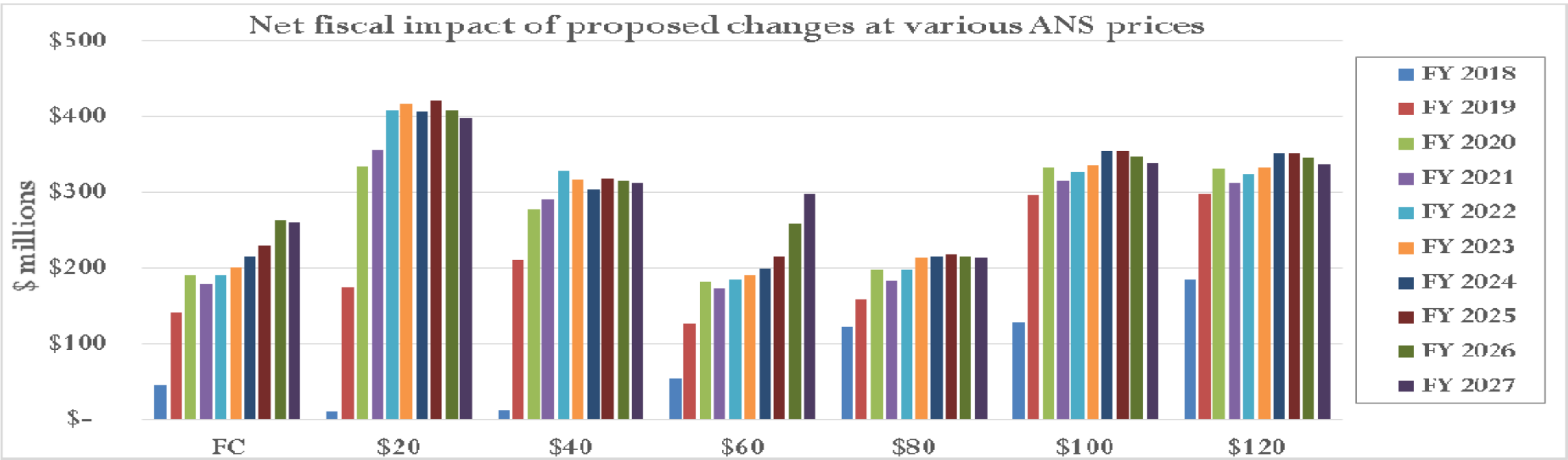
Presented to AK Competitive Review Board, May 2016

CS for HB 111 Raises Taxes on Industry at low & high prices

Net Fiscal Impact of CSHB111(RES)\N at Various Prices



Source: DOR

CS for HB 111 will push Alaska to bottom of competitive rung, force job loss, decrease production and deter investment.

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