Alaska State Legislature
House Resources Committee

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SPONSOR STATEMENT

HB 111: OIL AND GAS PRODUCTION TAX; PAYMENTS; CREDITS

HB 111: "OIL AND GAS PRODUCTION TAX; PAYMENTS; CREDITS" was introduced to reform the oil and gas production tax regime as a component of protecting Alaska's fiscal future. This legislation builds on the passage of HB 247 in 2016, which primarily scaled back tax credits available in Cook Inlet. If the oil and gas tax structure is left untouched it is estimated by the Alaska Department of Revenue that there will be $1.6 billion in purchasable credits outstanding in 2026.

The House Finance committee substitute includes the following major provisions:

*** Eliminates North Slope Purchasable Tax Credits**

Net operating loss (NOL) credits occur when an oil and gas company has insufficient tax liability against which to apply allowable cost deductions (lease expenditures). Unique to Alaska, the state may pay cash for NOL credits long before there is taxable production. At continuing low oil prices, the program is not affordable and is being eliminated.

*** Allows 100% of Net Operating Losses to Carry Forward to Production**

In place of the NOL credit program, companies will be allowed to carry forward 100% of their losses to when they have taxable production. Companies can then use their accrued NOLs to offset their production tax obligation. This is more in line with other oil and gas regimes.

*** NOL 10% Reduction Starting After Seven Years**

As an incentive for companies to get to production sooner, the carried-forward NOLs are reduced by 10% of their original value each year after seven years. Example: a company carries forward a $1 million loss from its first year of activity and $1 million its second year; if taxable production is not achieved by year eight, the first million becomes $900,000; if no production by year nine, the first million becomes $800,000 and the second is worth $900,000, and so on.

*** NOL Carry Forwards Apply Only to a Field Where Earned**

Known as “ring fencing,” carried forward NOLs may only be applied against production tax obligations generated by the field where the loss accrued. Without ring fencing, a major producer could purchase a non-producing field and use the carried-forward expenditures associated with that field to offset their tax obligations from productive fields, reducing their production tax obligation without necessarily producing additional oil from the purchased field. Ring-fencing is an incentive to bring new fields into production because production is the means to recover costs for that field.

*** Repeals Sliding Scale Per Barrel Credit**

The sliding scale per barrel credit applies to fields that do not qualify for “new oil” incentives. The credit changes the effective tax rate depending on the price of oil. This is an unusual and mild form of progressivity; as oil prices decrease, the tax reduction increases and the effective tax rate decreases. Repeal of the credit simplifies the tax system and is more in line with other oil and gas tax regimes.

*** Lowers the Tax Rate from 35% to 25%**

The current 35% tax rate was a component of the reverse progressivity provision created by the per barrel tax credit; the 35% percent tax rate would be reached only at very high oil prices starting at around $160 per barrel. To adjust for the repeal of the sliding scale per barrel credit, the tax rate is lowered to 25 percent of net profits.

*** Adds 15 percent bracketed supplemental tax**

By eliminating the per barrel tax credit, HB 111 removes the subtractive progressivity factor. In its place, the bill adds a more standard bracketed supplemental tax. The base tax rate is set at 25%. The additional tax is 15% triggered at a production tax value of $60. For example, at ANS oil prices of $120, after $40 in transportation costs and lease expenditures are deducted, the production tax value is approximately $80. When the production tax value is above $60, the tax would be 25% of the first $60 plus 40% of the $20 difference.

*** Hardens minimum floor**

When the state instituted a net profits production tax in 2006, a minimum tax was included to ensure that the state would not receive less revenue than it would under the prior gross value tax system. The minimum tax rate is 4% of the gross value at the point of production when oil prices are above $25; the rate steps down as oil prices decline to zero. HB 111 hardens the minimum tax floor so that no credits can bring the tax rate below the current minimum production tax rate. An exemption is made for the small producer credit, which is in the process of sunsetting.

*** Repeals extra 10% gross value reduction for higher royalty fields**

In 2013, SB 21 added a gross value reduction (GVR) to exempt 20% of new production from the production tax. An additional 10% GVR was provided to fields with a royalty rate of more than 12.5% for a total GVR of 30%. Royalty is Alaska's ownership interest in oil and gas production and a negotiated term in the leases. The tax system should not be a mechanism for reducing the value of our ownership interest.

*** Repeals third-party assignments of credits**

An amendment to the production tax in 2013 allowed companies to use tax credits as collateral for loans or sell credits to a bank or investment institutions with no requirements for where or how the money was spent. To protect the state's interests moving forward, the provision is repealed. With the repeal of the North Slope NOL credit, only activities in the area outside the North Slope and Cook Inlet (Middle Earth) will have tax credits eligible for cash purchase so the impact of this repeal is minimal.

*** Allows certain taxpayer information to be publicly disclosed**

Due to taxpayer confidentiality requirements, the Department of Revenue is often hampered in how much otherwise publicly available tax information can be discussed with legislators and the public. HB 111 allows disclosure of otherwise publicly available oil and gas production tax information; or tax credit information related to credits for gas storage facilities, liquefied natural gas storage facilities; oil and gas service industries; in-state manufacture of urea, ammonia, or gas-to-liquid products; or instate oil refinery infrastructure.

*** Adds new information requirements for tax credits and lease expenditures**

In order for decision-makers and the public to have a better understanding of how and where tax credits and lease expenditures are incurred and how successful they might be at incentivizing production, HB 111 requires taxpayers to report information to the Department of Revenue; credit and basic lease expenditure information will be made public in an annual report. Taxpayers shall file a description of the expenditure and a description of the lease or property for which the expenditure was incurred. The lease and property descriptions will assist in implementing the ring fencing requirement.

*** Fiscal Impact**

The bill increases revenues by $100 to $200 million at oil prices between about $40 and $100. At higher prices, total revenue is nearly unchanged from the current tax based on SB21. The fiscal impact for FY 2018 is approximately $20 million. Additionally, nearly all future obligation for cash credit appropriations is eliminated.