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HB 111(FIN)- Oil and Gas Production Tax and Credits Analysis of the Bill as passed by the House

Presentation to Senate Resources Committee

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April 14, 2017

Changes in Finance Committee Substitute

1. **General Overview- HB111 in Context**
2. **Specific Bill Provisions**
   - **Minimum Tax (Floor)**
   - **Treatment of North Slope NOLs**
   - **North Slope Production Tax**
   - **GVR / New Oil Provisions**
   - **Other (mainly non-fiscal) Provisions**
3. **Fiscal Analysis**

General Overview:
HB111 in Context

General Overview- HB111 in Context

HB111 resolves four high priority concerns identified by the governor:

1. Transition Alaska away from the business of providing cash credits / rebates to the oil and gas industry
2. Reduce the state’s liability related to potential large future investments
3. Defer the state’s direct participation in the cost of a new project until it comes into production
4. The oil industry should participate as part of the overall fiscal plan for Alaska

General Overview- HB111 in Context

1. Transition Alaska away from the business of providing cash credits / rebates to the oil and gas industry

- HB111 eliminates the Carried Forwards Operating Loss (NOL) credit for the North Slope beginning in 2018
- The NOL is the primary remaining credit on the North Slope
- Instead of cash credits, these losses are instead carried forward to offset future taxes

Moving away from Cash Credits

FY 2007 thru 2016, $8.0 Billion in Credits

North Slope

- $4.4 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- $2.3 billion repurchased credits
  - New producers and explorers developing new fields

Non-North Slope (Cook Inlet & Middle Earth)

- $0.1 billion credits against tax liability
  - Another $500 to $800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- $1.2 billion repurchased credits (most since 2013)

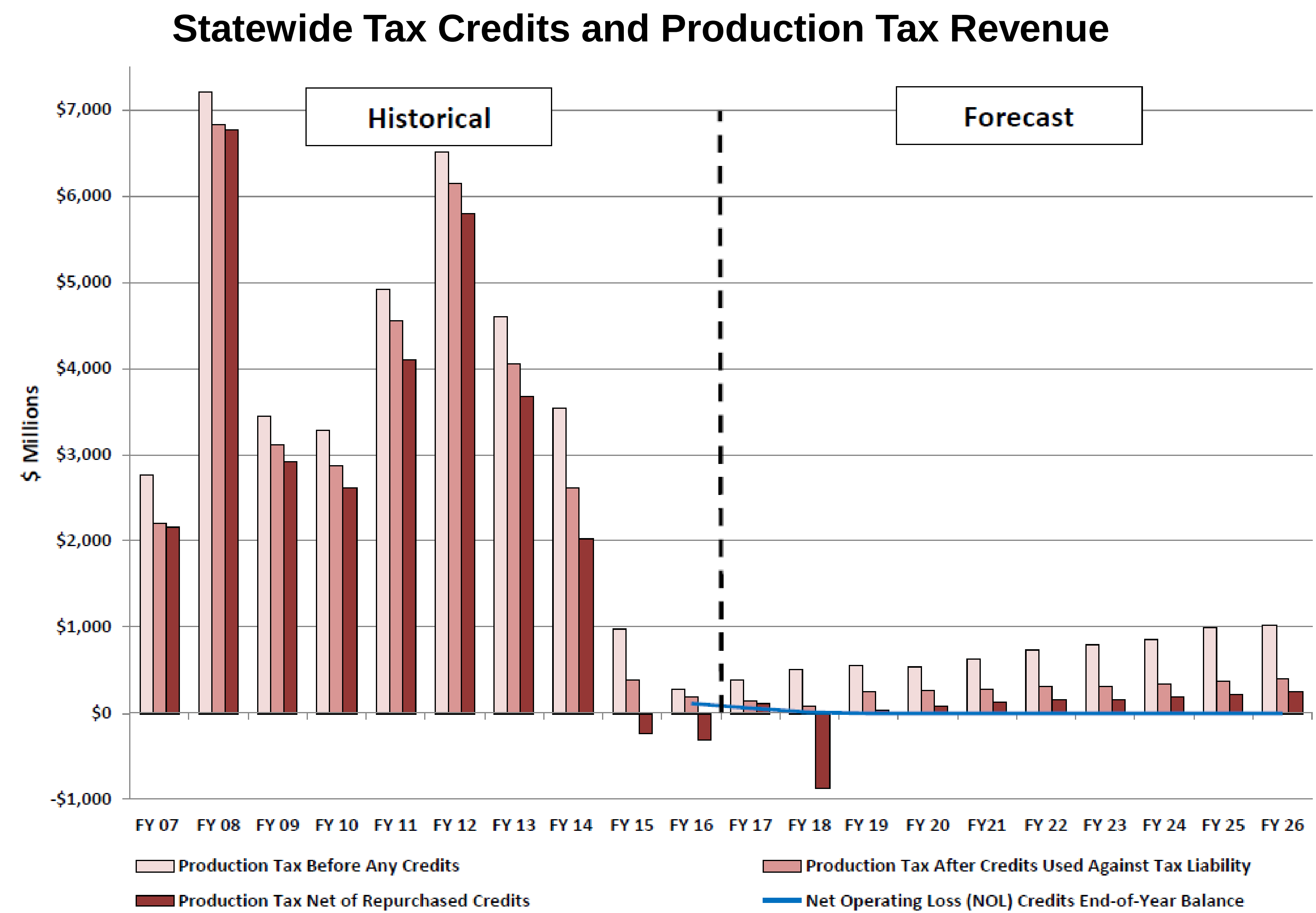
Moving away from Cash Credits

Providing some detail out of confidential data:

Of the nearly $3.5 billion in state-repurchased credits through the end of FY16:

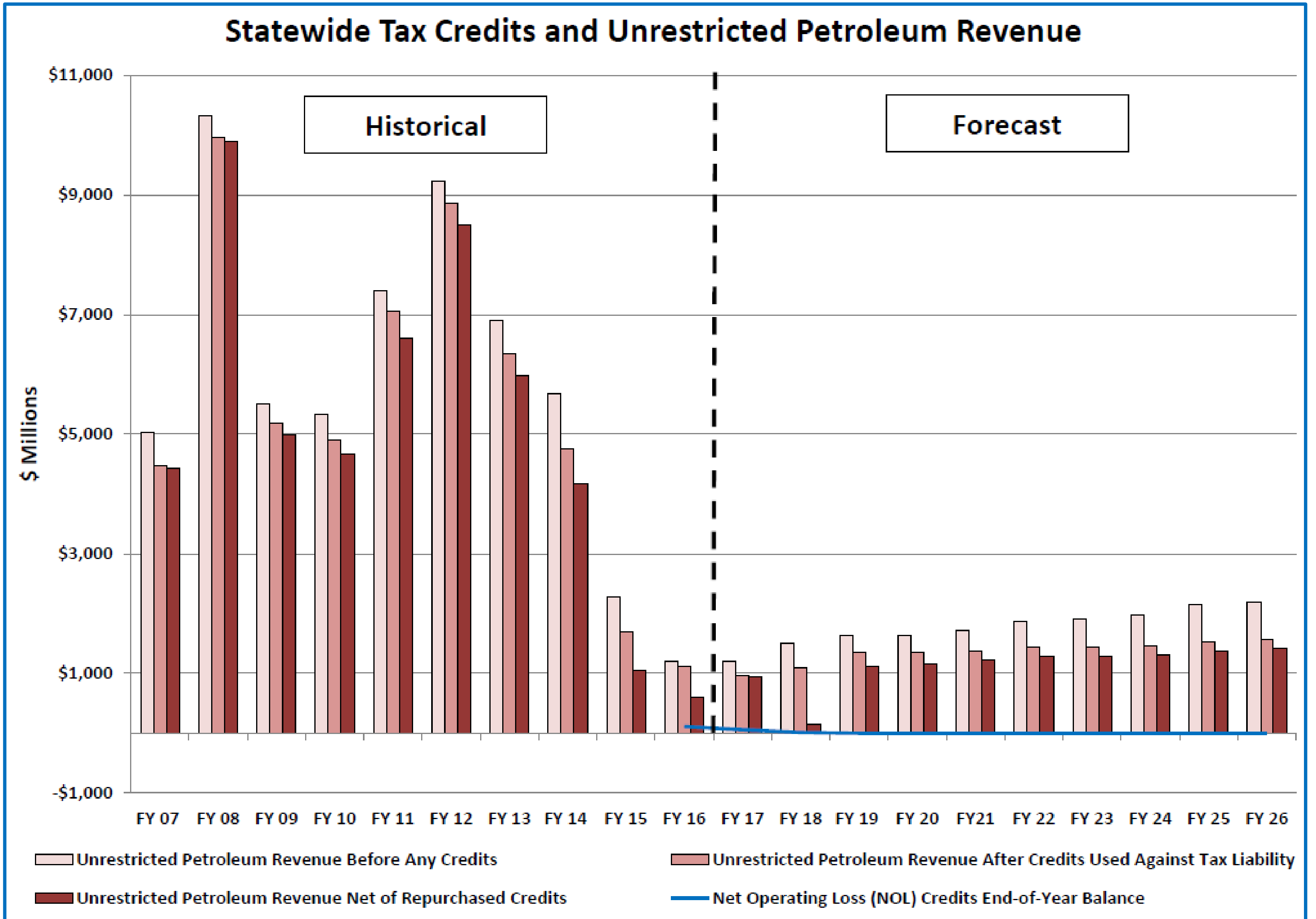
- $1.5 billion went to eight North Slope projects that now <u>have</u> production
- $0.8 billion went to 11 North Slope projects that <u>do not yet have</u> any production. Some of these are abandoned, and some are in process
- $0.9 billion went to eight non-North Slope projects that <u>have</u> production
- $0.3 billion went to eight non-North Slope projects that <u>do not yet have</u> any production

Moving away from Cash Credits



Note: Repurchased credits in the Fall 2016 RSB assume that all credits available for repurchase are funded in FY 18 and beyond.

Moving away from Cash Credits



Note: Repurchased credits in the Fall 2016 RSB assume that all credits available for repurchase are funded in FY 18 and beyond.

Moving away from Cash Credits

- FY2009-2015 Legislature used “open ended” appropriation language. All credit certificates presented were purchased
- FY16 Appropriation Capped at **$500 million**
  - $498 million paid out by end of June
  - About $211 million North Slope, $287 million non-NS
- FY17 Governor proposes **$1 billion** to clear credit liability as part of reform package and full fiscal plan
  - Legislature appropriated **$460 million** towards expected demand of $775 million
  - Governor vetoed all but **$30 million (formula calc.)**
  - Funds were paid first in-first out; most went to Cook Inlet capital and well lease expenditure claims
- FY18 budget contains $74 million (formula calc.)

Moving away from Cash Credits

- $600 million in certificates have been issued in FY17
  Of these, about $100 million have either been:
  - Paid (from the roughly $30 million available funds);
  - Transferred (to be used against another company's tax liability); or
  - Are ineligible for repurchase
- Total remaining awaiting repurchase ~$500 million
- Applications in-hand by 2/17 about $200 million
  - $50 million “023” credits (NOL and Cook Inlet drilling)
  - $150 million “025” credits (Exploration; have sunset)
- **So total known demand is roughly $700 million**
- Additional ~$400 million forecasted for FY18

General Overview- HB111 in Context

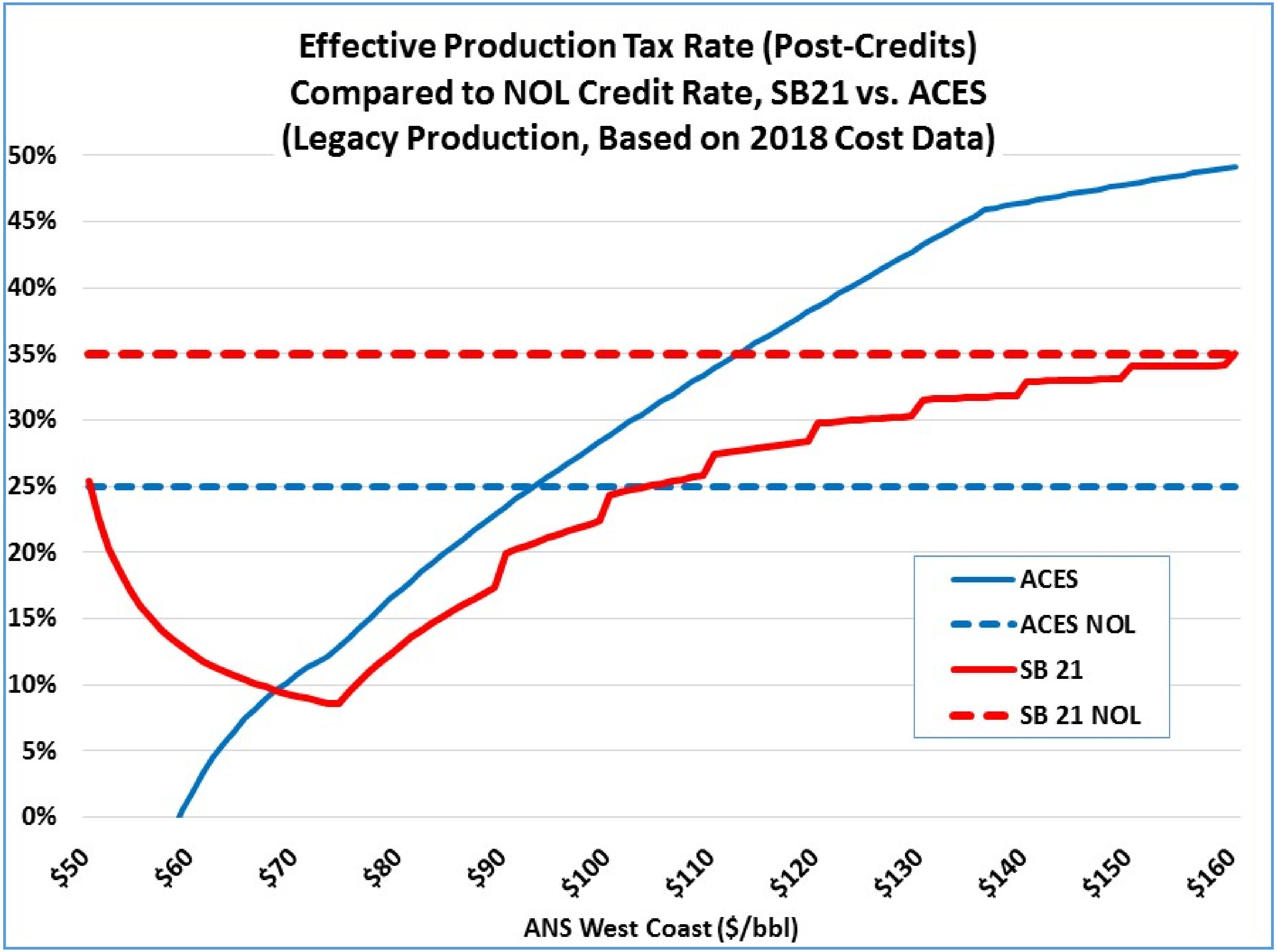
2. Reduce the state's liability related to potential large future investments

- With the reduction of the "base" tax rate from 35% to 25%, carried forward balances are only able to offset tax liability at the tax rate that will be actually paid when the project comes into production
- Approximately a 28% reduction in the state's future liability

Reduce State's Future Liability

- This issue derives from the fact that the state provides a benefit for operating losses at 35%, whereas the actual effective tax rate paid is generally well below 35%
- The primary reason for this distortion is the subtractive "per taxable barrel" credit added by SB21 in 2013
- The LB&A consultant, Rich Ruggiero, started the discussion of how to align the loss / credit rate with the effective tax rate earlier this session.
  This is completely separate from and could be done with or without a change in actual tax collections

Reduce State's Future Liability



General Overview- HB111 in Context

3. Deferring the state's direct participation in the costs of a new project until it comes into production

- This is primarily done through the addition of a "ringfence," in which carried foreword costs are attached to the specific lease or property where they are incurred
- Protects against the possibility of a struggling project being sold to an existing producer, who would be able to use the losses against existing production without having to complete the project and bring it into production

Specific Bill Provisions

Minimum Tax (Floor)

Rate

- HB111(FIN) keeps the current minimum tax:
  Zero below $15 oil; 1% above $15; 2% above $17.50; 3% above $20, and 4% above $25
- Due to other changes in the bill, the “crossover” between the gross and net taxes moves from about $75 to $50

“Hardening” versus Credits

- HB111(FIN) prevents most credits from being used to reduce taxes below the minimum tax. It does not harden the floor vs. the small producer credit
- For GVR-eligible oil, HB111 creates a hard “adjusted” minimum tax where the 20% GVR reduction is applied before calculating the minimum tax. This results in an effective gross minimum tax rate of 3.2% (80% of 4%)

Treatment of North Slope NOLs

Carry-Forward

- The 35% "Net Operating Loss" credit for the North Slope is eliminated, and replaced with a carry-forward structure
- HB111(FIN) allows for 100% of losses to carry forward, to be subtracted from future Production Tax Value
  - After seven years, carried forward value begins to decrease by 10% per year
  - Carried forward expenditures can only be used to offset value from the lease or property where they were incurred ("ringfence")

North Slope Tax Rate

- Current (SB21) law is 35% of Production Tax Value (PTV) less a per-barrel credit between $0 and $8
- HB111(FIN) reduces the base tax rate to 25% and eliminates the sliding scale per barrel credit
  - Matches the original proposal for SB21 (flat 25% net tax) at oil prices below about $90-$95
  - Tax increase of $100-$300 million at oil prices in the $50-$100 range
- Adds a bracket of “progressivity,” with a 15% surtax on only that portion of PTV greater than $60
  - The “bracketed” structure is very different from ACES, without marginal tax issues. More like HB110 (2011)
  - Effective tax rates closely track SB21 above $100 oil
  - Aligns value of carry-forward with the effective tax rate

Gross Value Reduction (GVR)

- HB111(FIN) keeps the 3.2% modified hard floor introduced in CSHB111(RES)
- Keeps the $5 per barrel credit. The comparable per-barrel credit for legacy production was eliminated
  - Effect is a tax increase at lower prices (due to the hard floor) and a tax cut at higher prices (due to the lower 25% base rate while maintaining the $5 per barrel credit)
- Eliminates the 30% GVR for high royalty fields. All GVR-eligible production will only receive the 20% benefit

Other Changes

Interest Rates

- Eliminates the “zero after three years” provision for delinquent production taxes which was added by HB247

Transparency & Reporting

- Annual DOR report expanded to include credits earned but not cashed, as well as more lease expenditure information
- Reporting of lease expenditures by lease is the basis of the data used to build the “ringfence”

GVPP can’t go below zero

- Protection of state from losses at high tariff fields at very low prices. Has been in all versions of HB111

Other Changes

Assignment

- Repeals ability to assign certificates to a financer in AS 43.55.029

Cook Inlet Working Group

- Although CSHB111(FIN) does not address any Cook Inlet tax or credit issues, it establishes a new legislative working group to look at possible future changes

Fiscal Analysis

Fiscal Analysis

Impact of North Slope Tax Rate Change at Different Prices

per one barrel of taxable non-GVR oil; FY18 costs per Fall 16 RSB

Status Quo

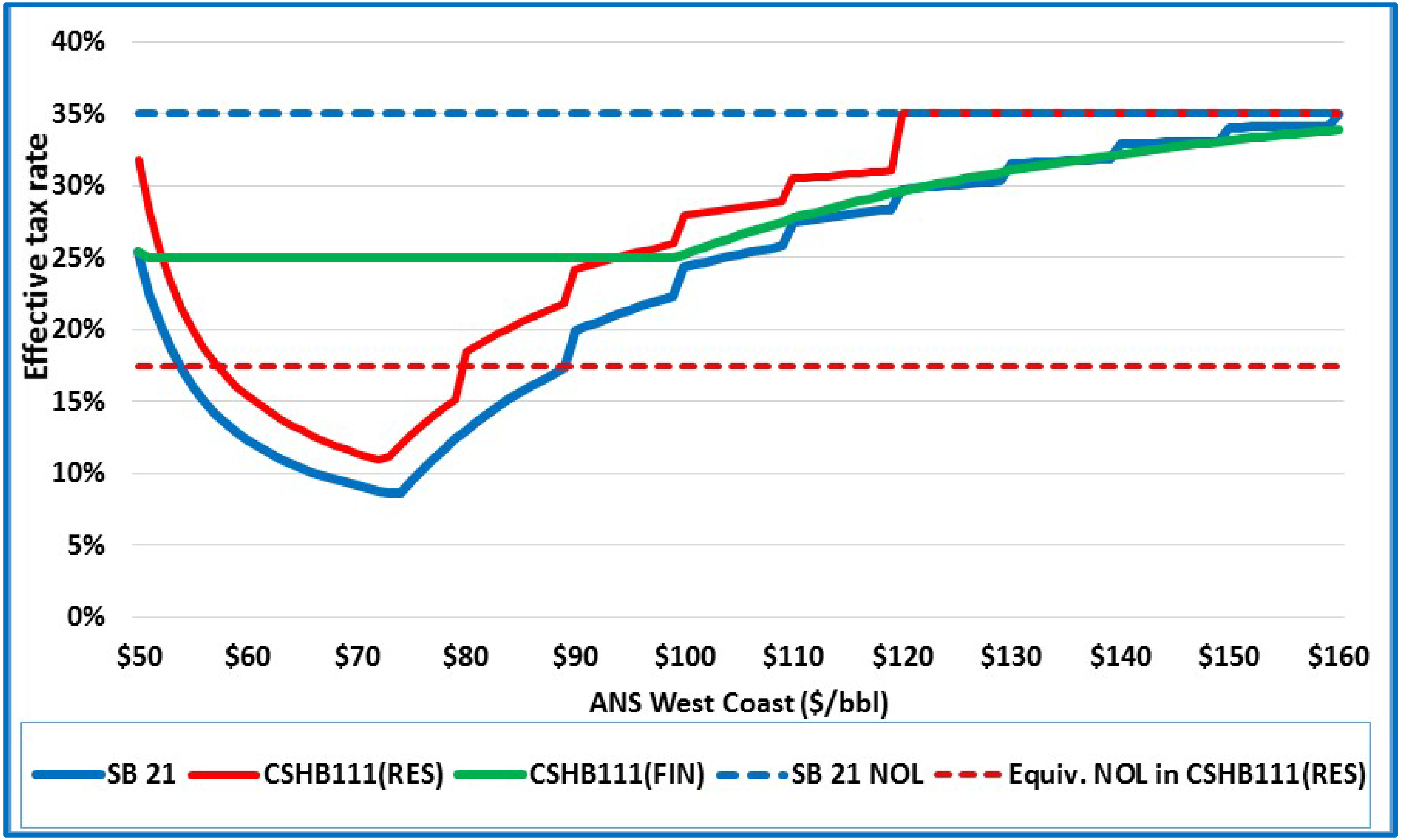
Price	**$60**	**$120**
Transport	$9.77	$9.77
GVPP	$50.23	$110.23
Lease Expend	$33.64	$33.64
PTV (net)	$16.59	$76.59
Tax at 35%	$5.81	$26.81
Per-BBL Credit	$8	$4
Tax per Net	-$2.19	$22.81
Minimum Tax	$2.01	$4.41
Higher Of	**$2.01**	**$22.81**
Tax as % of Price	3%	19%
Tax as % of GVPP	4%	21%
Tax as % of PTV	12%	30%

HB111

Price	**$60**	**$120**
Transport	$9.77	$9.77
GVPP	$50.23	$110.23
Lease Expend	$33.64	$33.64
PTV (net)	$16.59	$76.59
Tax at 25%	$4.15	$19.15
Surtax at 15%	$0.00	$2.49
Tax per Net	$4.15	$21.64
Minimum Tax	$2.01	$4.41
Higher Of	**$4.15**	**$21.64**
Tax as % of Price	7%	18%
Tax as % of GVPP	8%	20%
Tax as % of PTV	25%	28%

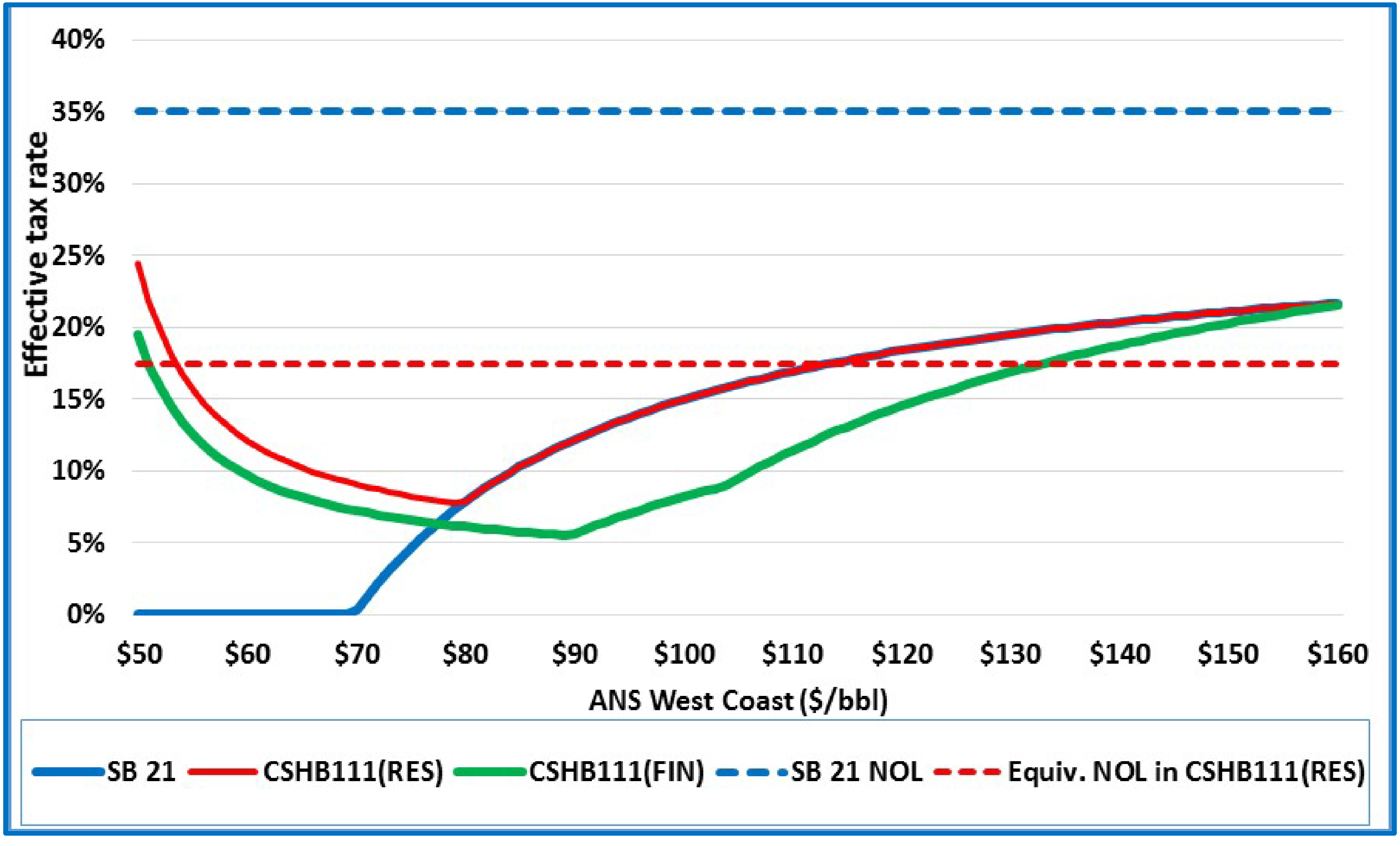
Fiscal Analysis

Effective Tax Rates (Legacy / non-GVR oil)



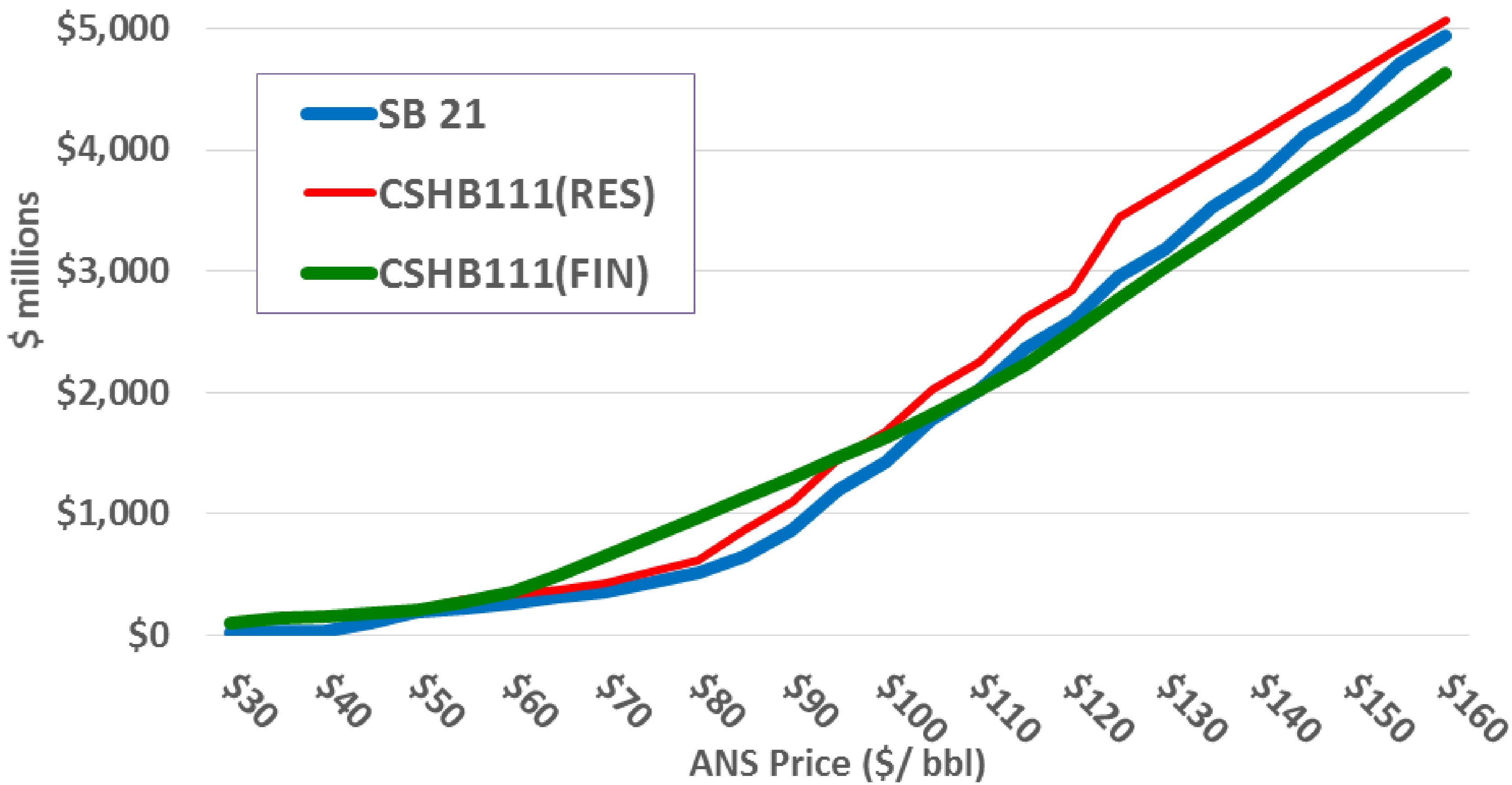
Fiscal Analysis

Effective Tax Rates (New / GVR oil)



Fiscal Analysis

Total Production Tax Revenue (FY2019)



Based on Fall 2016 forecast for FY 2019. Does not include impact on credits available for purchase, or lease expenditures available for carry forward.

Fiscal Analysis

Fiscal Note Summary- Tax

- The tax impact is concentrated in the $50 to $100 oil price range
  - o Difference between the current effective tax rates, based on 35% of net less the per-barrel credit, and a flat 25% of net
  - o “Crossover” between gross and net taxes moves substantially lower, from about $75 to about $50
- Comparably minor revenue impact at higher prices- actually a small tax cut

Fiscal Note Summary- Budget

- Additional impact due to near-total elimination of cash payments for tax credits (reduced spending)
  - Long term forecast for cash credits is $150 million / year; reduced to less than $20 million
  - Does not include what "would be" the liability for possible future large projects
  - The associated projects don't come into production during the fiscal note period

Fiscal Analysis

Fiscal Note Table- impact at forecast prices

Provisions in CSHB 111 (FIN) \M and their Estimated Fiscal Impact based on Fall 2016 Forecast ($millions) - Fall 2016 FC PRICE

Revised 4-7-17 by Dept. of Revenue

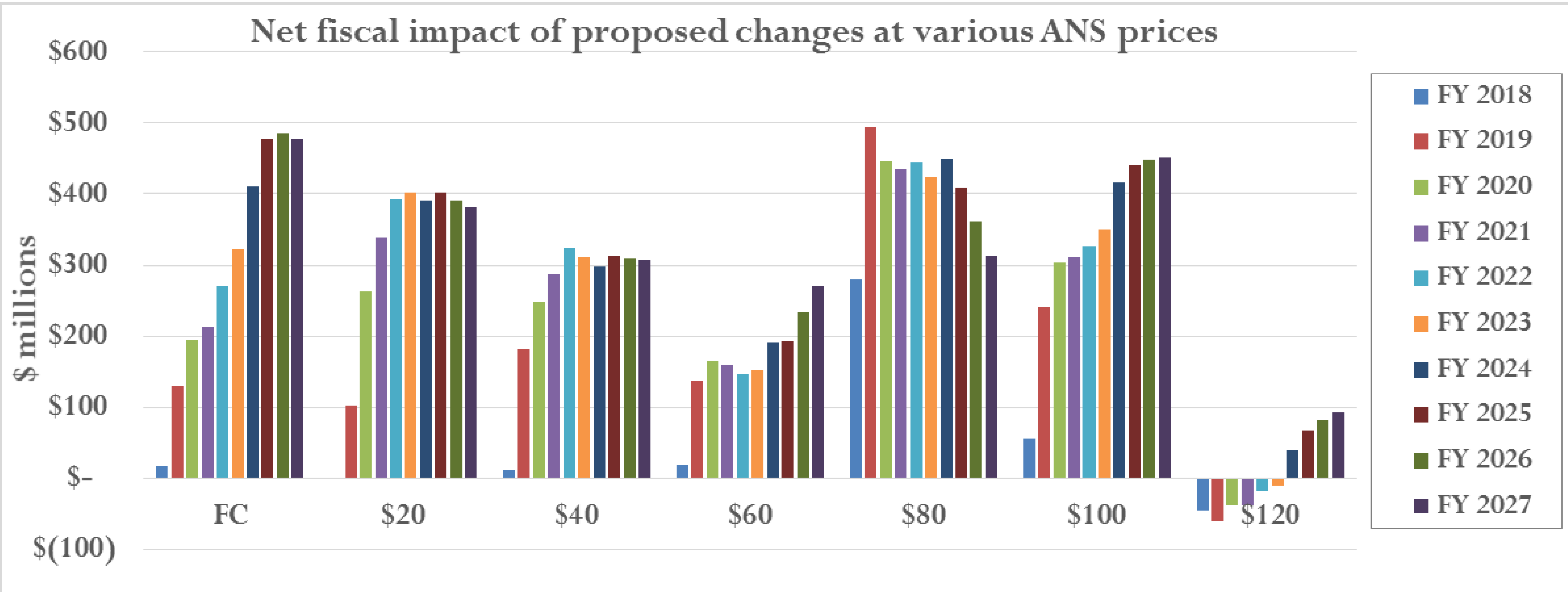
Description of Provision	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
1. Effective 1/1/18, Operating loss credit eliminated for North Slope and replaced with carry-forward lease expenditures provision. A company may carry forward 100% of North Slope lease expenditures not deducted against tax, but can only use to offset gross value from the lease or property whre earned. After 7 years, carry-forward reduced by 10% of original value each year.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
2. Only small producer credits can reduce tax below the minimum tax effective 1/1/18.	$20	$15	$0	$0	$0	$0	$0	-$10	-$25	-$5
3. Existing minimum tax rates retained, and GVR reduces basis for minimum tax, effective 1/1/18.	$0	$0	$0	$0	-$5	-$5	$0	$0	$0	$0
4. Effective 1/1/18, base tax rate for North Slope changed from 35% of PTV to 25%; an additional 15% progressive surcharge applies to that portion of PTV above $60 per barrel.	$0	-$10	-$10	-$15	-$20	-$20	-$35	-$45	-$60	-$70
5. Sliding scale per-taxable-barrel credits eliminated, effective 1/1/18.	$5	$210	$185	$250	$340	$405	$510	$610	$630	$620
6. Gross value at point of production (GVPP) cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
7. Interest on delinquent taxes continues to accrue after 3 years, retroactive to 1/1/17.	Indeterminate - likely positive for state.									
8. Eliminate 30% GVR option effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone.	-$5	-$130	-$85	-$135	-$170	-$190	-$200	-$215	-$200	-$210
Total Revenue Impact	**$20**	**$85**	**$90**	**$100**	**$145**	**$190**	**$275**	**$340**	**$345**	**$335**
A. Budget impact of operating loss and carry-forward lease expenditures changes effective 1/1/18.	$0	$45	$105	$115	$125	$135	$135	$140	$140	$140
B. Budget impact of only small producer credits can reduce tax below minimum tax effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
C. Budget impact of minimum tax changes effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of North Slope tax rate changes effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
E. Budget impact of eliminating sliding scale per-taxable-barrel credits, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
F. Budget impact of GVPP cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
G. Budget impact of interest accrual changes, retroactive to 1/1/17.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
H. Budget impact of eliminating 30% GVR option effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Budget Impact	**$0**	**$45**	**$105**	**$115**	**$125**	**$135**	**$135**	**$140**	**$140**	**$140**
Total Fiscal Impact - (does not include potential changes in investment)	**$20**	**$130**	**$195**	**$215**	**$270**	**$325**	**$410**	**$480**	**$485**	**$475**

Tax impact of carry-forward lease expenditure balances - current law	$14	$0	$0	$0	$0	$0	$0	$0	$0	$0
Tax impact of carry-forward lease expenditure balances - proposed	$90	$150	$225	$280	$335	$390	$455	$520	$580	$640
Change in year-end balance due to proposal	**$76**	**$150**	**$225**	**$280**	**$335**	**$390**	**$455**	**$520**	**$580**	**$640**

NOTE: The fiscal impact of this proposal is an estimate based on the Fall 2016 revenue forecast. Estimates shown here are draft / preliminary based on our interpretation of possible changes, and do not include any changes in company behavior as a result of this proposal. We reserve the right to make modifications to estimates for any forthcoming fiscal notes.

Fiscal Analysis

Fiscal Note Table- impact at range of prices



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Thank You!

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