SCS CSHB 111(RES)\C
Oil and Gas Production Tax Credits
Analysis of the Bill

Presentation to Senate Finance Committee

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Changes in Finance Committee Substitute

1. **Brief Tax Credit History and Status**
2. **Specific Bill Provisions**
3. **Fiscal Analysis**

Brief Tax Credit History and Status

Overview of Historic Credits

FY 2007 thru 2016, $3.5 Billion in Cash Credits

- $2.3 billion on North Slope
  - New producers and explorers developing new fields
- $1.2 billion non-North Slope (most since 2013)

In that time, $4.5 Billion Credits Against Liability

- $4.4 billion North Slope
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- $0.1 billion non-North Slope
  - Another $500 to $800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF

Overview of Historic Credits

Providing some detail while maintaining taxpayer confidentiality:

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. About 63 million bbl through 2015
- $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. About 73 million BOE through 2015
- $0.3 billion went to eight non-North Slope projects that <u>do not yet have</u> any production

Current Status and Balances

- 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
  - With no fiscal plan passed, governor vetoed all but **$30 million** (based on formula calc.)
  - Funds were paid first in-first out; most went to Cook Inlet capital and well lease expenditure claims
- FY18 budget contains **$77 million** (spring formula calc.)

Current Status and Balances

HB247 Credit Report Issued Tuesday 4/25

- $72.6 million repurchased in calendar year 2016: about $43 million in FY16 and $30 million in FY17

Taxpayer Name	Total Payments under AS 43.55.028 in 2016
ACCUMULATE ENERGY ALASKA, INC.	$ 99,060
APACHE ALASKA CORPORATION	10,537,635
BLUECREST ENERGY, INC.	2,343,795
CORNUCOPIA OIL GAS COMPANY LLC	39,865,868
DOYON, LIMITED	649,788
GREAT BEAR PETROLEUM OPERATING, LLC	180,232
HALLIBURTON ENERGY SERVICES, INC.	34,643
MILLER ENERGY RESOURCES, INC.	3,364,038
MUNICIPALITY OF ANCHORAGE	3,357,563
NORTH SLOPE BOROUGH	812,609
RENAISSANCE UMIAT, LLC	11,167,793
REPSOL E&P USA INC	200,000
Total	**$ 72,613,024**

Current Status and Balances

- $600 million in certificates have been issued in FY17

  Of these, about $132 million have either been:
  - Paid (from the $30 million appropriation);
  - Transferred (to be used against another company's tax liability); or
  - Are ineligible for repurchase
  - Had not yet requested repurchase by 12/31/16
- As of 1/1/17, total credit certificates awaiting repurchase $477 million
  - These have first priority, pro-rata, on next funding

Current Status and Balances

- Applications in-hand on 1/1/17 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 $670 million**
- Additional ~$400 million forecasted for FY18

Spring 2017 Revenue Sources Book demand for FY18 is $1,043 million

- Baseline long term forecast declines rapidly from $213 million in FY19 to $150 million in FY23+
- Does not include major new discoveries- only projects within production forecast

Specific Provisions of Senate Resources Bill

Elimination of Cash Credits- North Slope NOL

Eliminates the "Carried Forward Annual Loss" (NOL) credit by repealing AS 43.55.023(*b*)

- Instead of losses turning into cashable credits, the excess expenditures are carried forward to be used in a future year to offset revenue
  - When used, only enough is used to reduce liability to the equivalent of the minimum tax. The rest carry forward
  - Issue of interaction with GVR / multiplier effect
- Value that's carried forward receives an "uplift" or interest of 10% compounding for up to 7 years (only for companies without production)
  - 10% compound interest for 7 years roughly doubles value
  - Would like clarification on when the uplift begins

*** red text indicates technical concerns being addressed**

Elimination of Cash Credits- Middle Earth

Middle Earth credits were generally cut in half by HB247

- Currently has a 15% NOL. This can be stacked with either a 10% Qualified Capital Expenditure, a 20% Well Lease Expenditure, or (through 2021) a 40% Exploration credit.
- Bill deletes the NOL outright, so state support decreases from 25%-55% to 10%-40%
- Remaining QCE (023(*a*)) and WLE (023(*l*)) credits continue to be earned and turned into certificates, as do (through 2021) exploration credits
- Due to time language and fund repeal, these certificates would no longer be cashable and could only be either held to use against liability or sold (transferred)
- No uplift or carry forward, which are limited to North Slope losses

Elimination of Cash Credits- Credit Fund

Eliminate the tax credit fund by repealing most of AS 43.55.028

- This has much broader impact than simply eliminating the NOL credit
  - New Middle Earth credits are no longer cashable
  - Credits still outstanding after 1/1/18 would require specific appropriation to DOR for any repurchase
  - The “corporate income tax” credits (LNG Storage, Refinery) remain cashable by specific appropriation until they sunset
  - Repeals per-company “cap” language from HB247

One lesson of the 2006-2007 period was that running a cashable credit program without a fund is cumbersome

Expanded Ability to Use Credits- Explorers

Exploration credits can be used to offset Corporate Income Taxes in addition to Production Tax

- Limited to company-earned credits and the company's own taxes. Although not explicit in language, intent is to not have credits be transferable to other CIT taxpayers
- As written, potentially impacts about $200 million in current and pending applications, plus any new Middle Earth exploration credits earned through 2021
- Most explorers are not Alaska CIT taxpayers, so this change would not be a material issue for them
- Provides for separate specific appropriations to purchase remaining Corporate Income Tax (gas storage and refinery) credits before they sunset

Expanded Ability to Use Credits- Past Liability

Allows credits to be used to offset older tax liabilities

- Language appears three times, in Sec. 7 (use of 023 credits), 9 (use of transferred certificates), and 13 (transferred exploration certificates)
- Most older / amended liabilities result from an audit or other “administrative proceeding;” these taxes are generally paid to the CBRF so if credits can be used to offset it means less deposits into the CBRF
- This is the only context in which a credit or similar benefit is allowed to offset penalties or interest (as opposed to the tax)
- Could be used to offset conservation surcharges (AS 43.55.200-300) or private royalty tax (AS 43.55.011(*i*))
- Purchased 023 credits can currently offset only 20% of a current year tax liability. When used against past years, this is superseded, allowing use all the way to the minimum tax floor

Changes to Minimum Tax

- With NOL credits converted to carry-forwards, those carry-forwards cannot be used to reduce taxes below the minimum tax. Hardens floor at very low prices
- Most credits can be used below the minimum tax to zero per existing statutes, but are limited if the taxpayer is also using .024(*j*) (sliding scale per barrel) credits
- Senate Resources HB111 specifically exempts those other credits that are currently not cashable (GVR per-barrel credit in .024(*i*) and small producer credit in .024(*c*)) to be used below the minimum tax, to zero. This supersedes direction in advisory bulletin 2017-01
- Other credits are still limited by the advisory bulletin, although exploration credits used against corporate income tax can also reduce liability to zero

Other Exploration Credit Changes

- Exploration credits sunset on 7/1/16 for both North Slope and Cook Inlet. Credit had been previously extended for the rest of the state “middle earth” through 1/1/22
- New timetable to issue exploration credits to 120 days after receipt of application and data. This is not tied to a specific tax filing deadline, which is the way the 120 day deadline in the .023 credits is written
- Require clarification that the required data is submitted to DNR. Also, they typically take well more than 120 days to process especially seismic data. Unclear intent in this circumstance

Use of Carry Forwards

Senate Resources version of HB111 provides a partial or limited "Ringfence" of uplifted value

- The actual carried forward loss can be used to offset any taxable production tax income, at any time
  - So the value could potentially be used without the project in question being brought into production
- Use of the interest portion, or uplift, has additional limitations
  - Company must have North Slope production
  - Company must have some lease interest in the property where the expenses were originally incurred
  - Commercial production must have begun on the lease or property where the expenditure was incurred

Interest Rate Changes

- Removes zero interest provisions that were added in HB247, and restores oil and gas production to the SB21 rate (3% + fed) although with compound interest, and makes this change for all taxes
- Current federal discount rate is 1.5%; interest rate is 8.5% compounding (4.5% simple for other taxes). Senate Resources HB111 would make it 4.5% compounding for all
  - We testified in 2016 that interest rate should at least match the expected Permanent Fund rate of return, which is the state's opportunity cost for unpaid taxes
  - That is currently about 7%, or roughly 5.5% + fed

Fiscal Analysis

Fiscal Analysis

Fiscal Note Summary- Tax

- Senate bill makes no material changes to SB21 provisions
- Loosening of existing minimum tax protection against small producer and GVR credits results in ~$20-40 million less revenue per year through FY24
- Senate Resources bill provides certain limited "hardening" of the minimum tax floor to NOLs, since these are no longer "credits."
  - Provision has no fiscal impact at forecast prices
  - Modeling indicates a tax increase in the alternative price scenarios at $40 oil when major producers would be expected to have operating losses

Fiscal Analysis

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 essentially zero
  - Most of the associated projects don't come into production during the fiscal note period
- $1.325 billion in reimbursable credit obligation removed over the 10-year fiscal note period
  - Resulting "carried forward" balance, with uplift, is $1.785 billion in 2027 that can offset future taxes
  - Of this, about $460 million is accrued "uplift"

Impact of Advisory Bulletin

Many of the circumstances that show as a tax "decrease" are due to exceptions to the 3/31/17 advisory bulletin on ordering of credits

- For the most part, if the interpretation that many held prior to 3/31 was the actual legal status, this bill would be revenue neutral (no tax increase or decrease)
- Advisory bulletin tends to "push" certain cashable credits into future years, as companies can't use them in the year incurred. In the absence of the bulletin, it's likely that the "budget impact" (change in cash credit demand) of SCS CSHB111(RES) would be slightly higher in the near term and lower in the later years

Fiscal Analysis- impact at forecast prices

Provisions in **SCS CSHB 111 (RES) \C** and their Estimated Fiscal Impact based on Spring 2017 Forecast ($millions) - FC PRICE

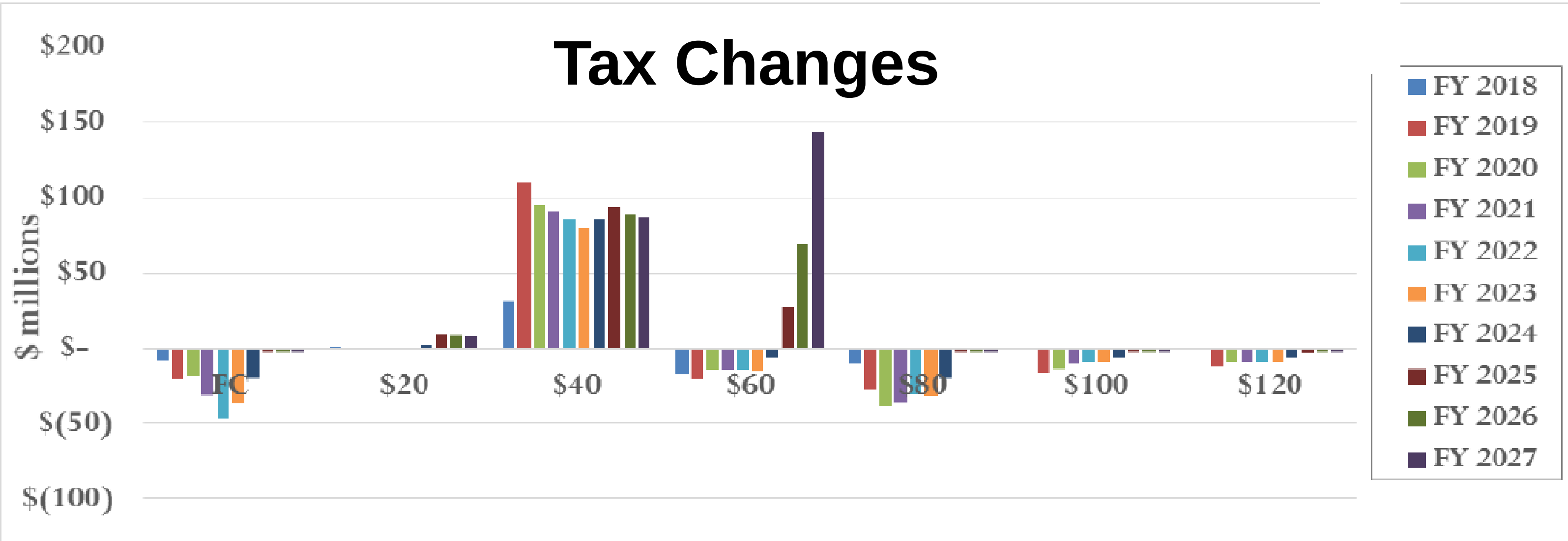
Revised 5-2-17 by Dept. of Revenue

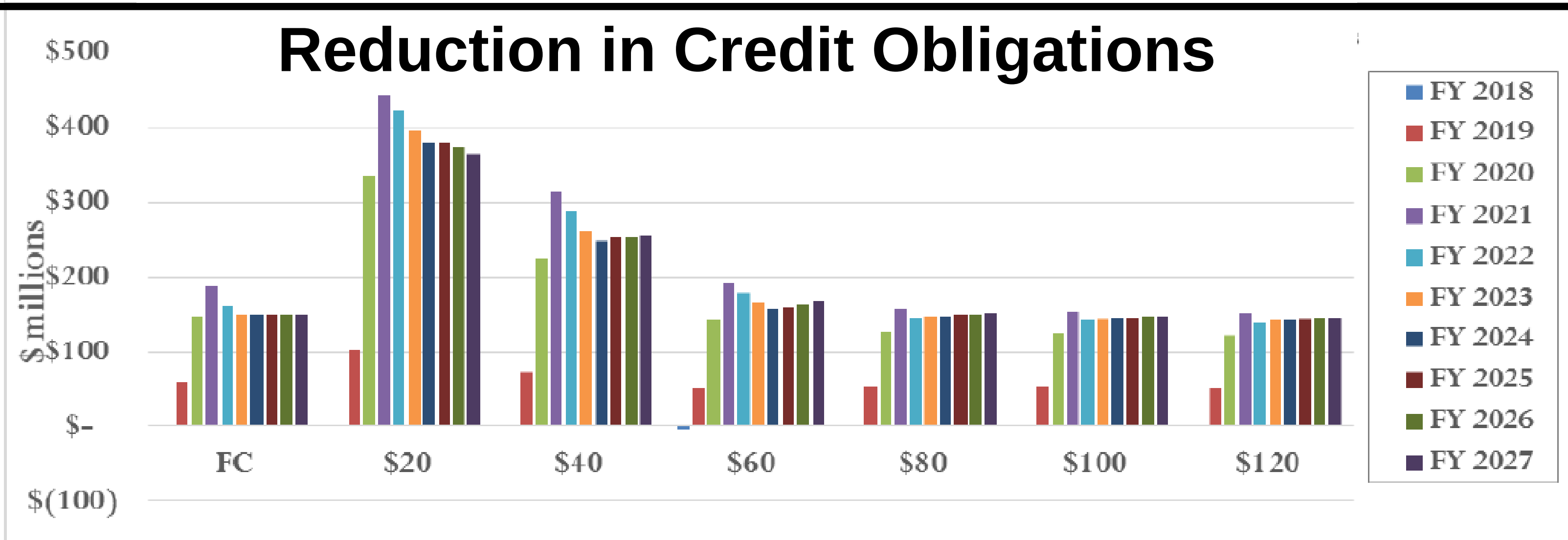
Description of Provision	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
1. Effective 1/1/18, Operating loss credit eliminated for North Slope and replaced with carry-forward lease expenditures provision. A company may carry forward 100% of North Slope lease expenditures not deducted against tax, and can use to reduce future tax down to minimum tax. Carry-forwards earned by non-producing companies earn uplift of 10% annually for up to 7 years.	$0	$0	$0	$0	-$10	-$5	-$5	$0	$0	$0
2. Effective 1/1/18, Operating loss credit and state repurchase of credits eliminated for Middle Earth. Retain capital expenditure, well lease expenditure, and exploration credits which can be carried forward or transferred. Also, allow exploration credits to be applied against corporate tax liability.	$0	-$10	-$10	-$10	-$10	-$10	-$5	-$5	-$5	-$5
3. Companies utilizing per-taxable-barrel credits for non-GVR production may also use small producer credits or per-taxable-barrel credits for GVR production to reduce liability below minimum tax effective 1/1/18.	-$10	-$10	-$10	-$20	-$30	-$30	-$15	$0	$0	$0
4. Refinery and LNG storage facility credits may be purchased by appropriation, after repeal of Oil and Gas Tax Credit Fund.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
5. Tax credit certificates (including transferred certificates) may be used to offset a liability or assessment for prior-year taxes, effective immediately.	Indeterminate - Net neutral when combined with budget impact									
6. Interest on all delinquent taxes changed to 3 percent over Federal Reserve rate, effective 1/1/18.	Indeterminate									
Additional impact of implementing above provisions together vs standalone.	$0	$0	$0	$0	$5	$10	$5	$0	$0	$0
Total Revenue Impact	**-$10**	**-$20**	**-$20**	**-$30**	**-$45**	**-$35**	**-$20**	**-$5**	**-$5**	**-$5**
A. Budget impact of North Slope operating loss credit elimination and carry-forward lease expenditures provisions effective 1/1/18.	$0	$45	$135	$175	$150	$140	$140	$145	$145	$145
B. Budget impact of Middle Earth credit changes effective 1/1/18.	$0	$10	$10	$10	$10	$10	$10	$5	$5	$5
C. Budget impact of companies utilizing per-taxable-barrel credits for non-GVR production may also use certain other credits to reduce liability below minimum tax effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of refinery and LNG storage credits may be purchased by appropriation.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
E. Budget impact allowing tax credit certificates to offset liability or assessment for prior-year taxes.	Indeterminate - Net neutral when combined with revenue impact									
F. Budget impact of interest changes, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone	$0	$5	$5	$5	$5	$0	$0	$0	$0	$0
Total Budget Impact	**$0**	**$60**	**$150**	**$190**	**$165**	**$150**	**$150**	**$150**	**$150**	**$150**
Total Fiscal Impact - (does not include potential changes in investment)	**-$10**	**$40**	**$130**	**$160**	**$120**	**$115**	**$130**	**$145**	**$145**	**$145**
Tax impact of carry-forward lease expenditure balances or credits - current law	$63	$55	$55	$55	$55	$55	$55	$49	$26	$0
Tax impact of carry-forward lease expenditure balances - proposed - base value	*$155*	*$330*	*$500*	*$630*	*$740*	*$855*	*$980*	*$1,095*	*$1,215*	*$1,325*
Tax impact of carry-forward lease expenditure balances - proposed - earned uplift	*$0*	*$5*	*$20*	*$50*	*$85*	*$135*	*$195*	*$270*	*$360*	*$460*
Tax impact of carry-forward lease expenditure balances or credits - proposed - total	$155	$335	$520	$680	$825	$990	$1,175	$1,365	$1,575	$1,785
Change in year-end balance due to proposal	$92	$280	$465	$625	$770	$935	$1,120	$1,316	$1,549	$1,785

NOTE: This bill eliminates the Oil and Gas Tax Credit Fund under AS 43.55.028. This fiscal note, and the spring forecast, assume that all outstanding credits earned before 1/1/18 by companies with <50,000 barrels per day production are funded through appropriation and purchased by the state.

NOTE: The fiscal impact of this proposal is an estimate based on the Spring 2017 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- Impact at Range of Prices





Impact of Carried Forward Liability

It is hard to capture the future impact of carried forward losses that don’t have associated production during the fiscal note period

- The $1.785 billion represents about $3.8 billion in carried forward losses ($1.325 billion at 35%) plus uplift
- None of these totals include the not-yet-committed spending that would be required for any of the large announced discoveries

Fiscal Analysis

Preliminary Life Cycle Analysis

- DOR's model looks at total state and producer cash flow over 40 years for a large North Slope new field development
  - o 750 million barrels recovered, maximum production of 120,000 bbl/ day
- Senate Resources Bill reduces producer cash flow by $165 million and reduces IRR by 0.3%
  - o Production tax is zero for three years (GVR) and minimum tax for seven years after due to use of carry-forwards. Full production tax begins in year 11
  - o This assumes the interpretation that the use of carry-forwards allows for the loss of per-barrel credits.
    If this were rewritten, the minimum tax would be in place due to more years of carry-forward use

Thank You!

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