



# State of Alaska Department of Revenue

**Analysis of HB 288**

**Increase to Gross Minimum Tax**

Presentation to House Resources Committee

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# *Four Major Oil and Gas Revenue Sources*

## **Property Tax**

Pipeline, Equipment, Facilities. About 80% of property tax collections are credited back to local governments

## **Royalty**

Landowner's share, usually 12.5%. Most North Slope production is on State land. At least  $\frac{1}{4}$  of royalties go to the Permanent Fund

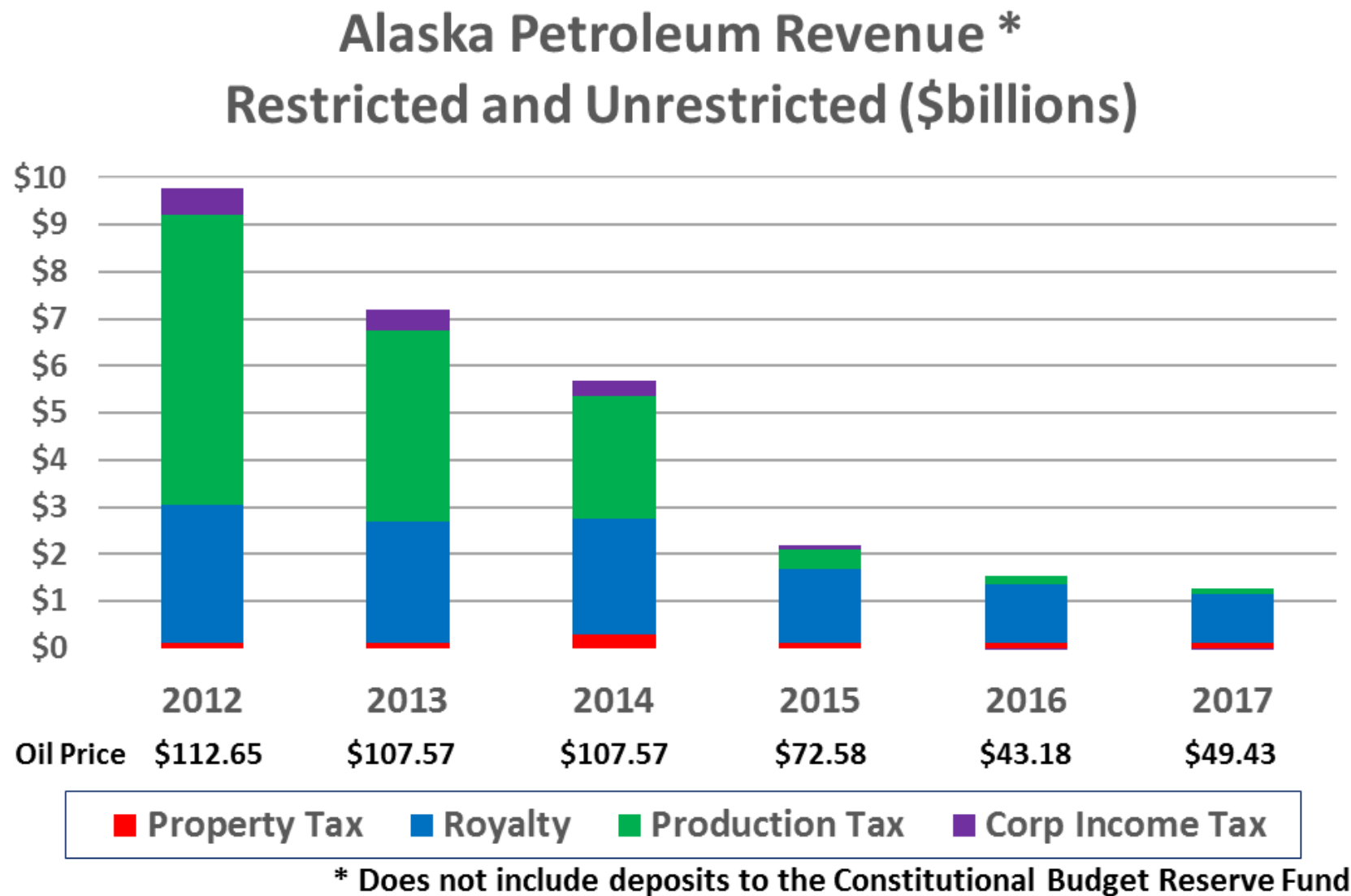
## **Production Tax**

Based on net profits; most of the conflict in recent years is over this tax. North Slope tax is 35% less a variable “per-taxable-barrel” credit, with a gross minimum tax “floor”

## **Corp. Income Tax**

Taxes the remaining profit after production tax, based on global asset apportionment. Rate is 9.4%, but effectively closer to 7%

# *Oil and Gas Revenue, Fiscal Years 2012-2017*



# *Recent Oil and Gas Tax Credit Reform- Recap*

## **HB 247 Passed June, 2016**

- Phased out Cook Inlet and reduced Middle Earth credits
- Extended Cook Inlet gas tax cap, added \$1 / bbl oil tax cap
- Added sunset / “graduation” provisions to Gross Value Reduction for new North Slope oil production
- Annual cap on per-company, per-year cash credit payments
- Resident hire priority for cash credit payments
- Limited transparency with annual report of who receives cash for credits
- Increase interest rate on delinquent production taxes for first three years, then reduced to zero
- Technical cleanup and repeal of obsolete language
- Regulation package proposed and adopted, effective 1/1/17

# *Recent Oil and Gas Tax Credit Reform- Recap*

## **HB 111 Passed July, 2017**

- Most credits no longer eligible for state repurchase after 7/1/17, other than refinery / LNG storage
- NOL credit under former AS 43.55.023(b) repealed 1/1/18
- New system of carried-forward lease expenditures beginning 1/1/18
- Process for how carried-forward expenditures are used in a future year once the producer has taxable value
  - “Ringfence,” preventing use until the property for which losses were incurred commences regular production
  - Taxpayer flexibility on use, limited by minimum tax
  - If unused, lease expenditures begin to lose value after 10 years in most cases

# *Oil and Gas Tax Credit Reform- Recap*

## **HB 111 Passed July, 2017 (continued)**

- Align interest rate changes among all tax types and eliminate three-year interest limitation
- Credits can be carried-back and used against a prior year tax liability including interest and penalties for which an audit assessment has not been issued
- Conditional exploration credits granted at time of application, to ensure place in queue
- Seismic work in Middle Earth no longer eligible for exploration credits after 2017
- Exploration credits in Middle Earth can be used to offset the explorer's corporate income tax
- Delayed repeal of tax credit fund after all are purchased
- Established Legislative working group

## *What Does HB 288 Do?*

**Recent oil tax bills were multi-part and complex.  
HB 288 makes only one change:**

- Increases the Gross Minimum Tax, or “Floor,” from 4% of gross value to 7% of gross value, when the average price of oil for the year is greater than \$25 per barrel

## *How does the minimum tax work?*

**The production tax is based on a calculation of net profits that is called “Production Tax Value”**

**For each taxable (non-royalty barrel):**

$$\begin{array}{rcl} & \text{Market Price} & \\ - & \text{Transport Cost (tariff and marine)} & \\ \hline = & \text{Gross Value “GVPP”} & \\ - & \text{Lease Expenditures (operating and capital)} & \\ \hline = & \text{Production Tax Value “PTV”} & \end{array}$$

**The production tax calculation (legacy oil) is a “higher of”**  
PTV x 35% - “per barrel credit” (\$8 at current prices), or  
GVPP x 4% (the minimum tax rate)

**This bill would raise the minimum tax rate to 7%**



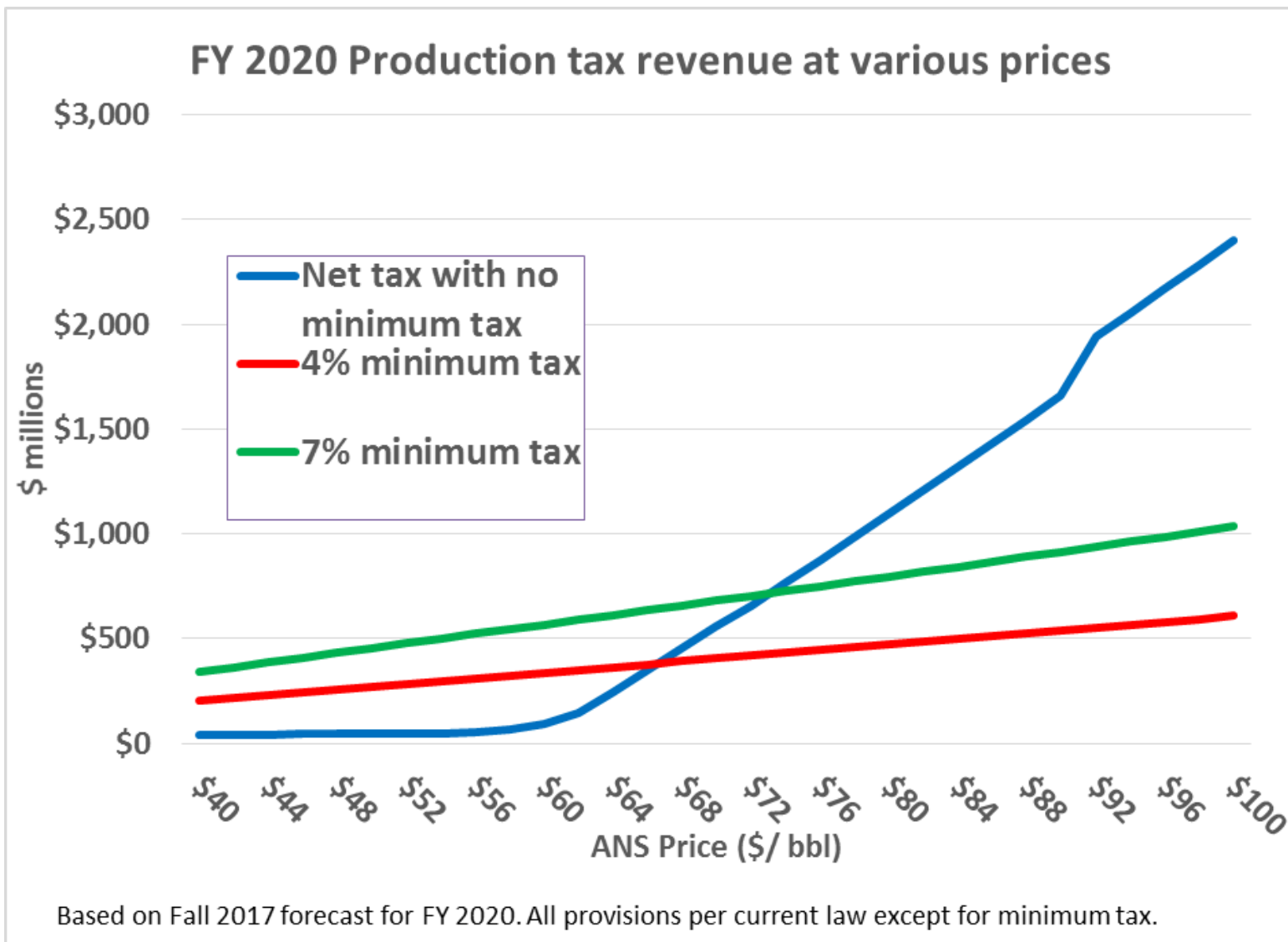
# *Revenue Impact is a Function of Price*

## Production Tax Calculation At Different Prices

per one barrel of taxable oil; FY19 costs per Fall 17 RSB

Price		\$40	\$50	\$60	\$70	\$80	\$90	\$100
Transport		\$9.86	\$9.86	\$9.86	\$9.86	\$9.86	\$9.86	\$9.86
GVPP		\$30.14	\$40.14	\$50.14	\$60.14	\$70.14	\$80.14	\$90.14
Lease Expend		\$26.79	\$26.79	\$26.79	\$26.79	\$26.79	\$26.79	\$26.79
PTV (net)		\$3.35	\$13.35	\$23.35	\$33.35	\$43.35	\$53.35	\$63.35
Tax at 35%		\$1.17	\$4.67	\$8.17	\$11.67	\$15.17	\$18.67	\$22.17
Per-BBL Credit		\$8	\$8	\$8	\$8	\$8	\$7	\$6
Existing	Tax per Net	-\$6.83	-\$3.33	\$0.17	\$3.67	\$7.17	\$11.67	\$16.17
	4% Minimum Tax	\$1.21	\$1.61	\$2.01	\$2.41	\$2.81	\$3.21	\$3.61
	<b>Higher Of</b>	<b>\$1.21</b>	<b>\$1.61</b>	<b>\$2.01</b>	<b>\$3.67</b>	<b>\$7.17</b>	<b>\$11.67</b>	<b>\$16.17</b>
Proposed								
	Tax per Net	-\$6.83	-\$3.33	\$0.17	\$3.67	\$7.17	\$11.67	\$16.17
	7% Minimum Tax	\$2.11	\$2.81	\$3.51	\$4.21	\$4.91	\$5.61	\$6.31
	<b>Higher Of</b>	<b>\$2.11</b>	<b>\$2.81</b>	<b>\$3.51</b>	<b>\$4.21</b>	<b>\$7.17</b>	<b>\$11.67</b>	<b>\$16.17</b>
<b>Tax Increase with 170 million taxable barrels (\$millions)</b>		<b>\$154</b>	<b>\$205</b>	<b>\$256</b>	<b>\$91</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

# Revenue Graph



# *Issues for Consideration- Tax Complexity*

**Alaska's production tax is among the most complex in the world**

- Multiple tax “segments”
- Apportioning of lease expenditures
- Tax caps and alternate minimums
- Carry forwards, ringfence, downlift
- Historic and remaining credits

**Increasing the minimum tax maintains all the administrative complexity**

- However, most of it would not be used, because at a wide range of prices the production tax would be:
  - *0% for “new oil” eligible for the Gross Value Reduction*
  - *7% for “legacy oil” not eligible for the GVR*

## *Issues for Consideration- Impact at Different Prices*

### **Oil profitability is very different at \$30 vs. \$50 vs. \$70**

- Current 4% minimum tax kicks in at \$25 oil; this is maintained for the 7% rate in HB 288
- Estimated average “break even” oil price on current legacy production is about \$37 for FY2019
- This is down substantially, about \$15 per barrel, since FY2015
- Companies have reacted to lower prices by cutting costs. Natural limits to how much this can be cut
- A producer who may be able to absorb a tax increase at \$70 oil could face substantial fiscal impact at \$30
- Raising the minimum tax will increase the break even price of the typical field by about \$1 per barrel

## *Issues for Consideration- Industry Profitability*

**Oil profitability estimates are up dramatically since last spring. These are FY19 figures from the Spring and Fall 2017 forecasts:**

- Increased production added \$1.0 billion in value
- Reduced spending added \$1.1 billion
- Total \$2.1 billion in additional divisible profits
- (this is after paying royalty and property tax, but before production tax, and state and federal income tax)
- Of this, at the forecast price:
  - Production tax forecast increased \$40 million
  - Statutory tax credit appropriation increased \$150 million

## *Issues for Consideration- Historic Gross Tax*

**Before the switch to a net profits tax in 2006, Alaska's oil production tax, the "ELF" (economic limit factor), was a gross tax that varied from field to field.**

**The average tax rate was:**

- 1995: 11.8%
- 1998: 10.5%
- 2001: 8.3%
- 2004: 6.4%
- 2006: 6.7%

**Although taxes were much higher in the era of high prices, since 2015 the production tax has been almost entirely based on the 4% gross tax**

## *Issues for Consideration- Tax Stability*

### **Alaska has developed a reputation for an unstable tax regime, with seven changes in the past 13 years:**

1. 2005: Gov. Murkowski aggregates Prudhoe Bay satellite fields for ELF calculation
2. 2006: Petroleum Production Tax “PPT” changed from taxing gross revenue to net profits
3. 2007: Alaska’s Clear and Equitable Share “ACES” corrects revenue shortfalls due to bad cost estimates in PPT
4. 2010: Cook Inlet Recovery Act “CIRA” provided additional credits outside the North Slope targeted at southcentral gas supply issues
5. 2013: SB21 was a tax cut primarily impacting higher prices and providing “new oil” benefits via the “gross value reduction”
6. 2016: HB247 began tax credit reform, phasing out Cook Inlet credits and limiting “new oil” benefits
7. 2017: HB111 completed tax credit reform, eliminating cashable credits and providing for carried-forward losses

## *Issues for Consideration- New Fields*

### **A minimum tax increase could reduce the viability of future projects**

- HB111 eliminated cashable credits for operating losses, and replaced them with carry-forward lease expenditures
- These can be used to reduce future taxable profits, once the underlying leases are in production
- Carry-forwards can only be used to reduce taxes to the minimum tax
- During the 3 to 7 years a field earns the GVR, the per-taxable barrel credit can further reduce taxes to zero
- Once the GVR is sunset, the per-barrel credit cannot be used below the minimum tax



## *Issues for Consideration- New Fields*

### **A minimum tax increase could reduce the viability of future projects (continued)**

- The current system assumes that the minimum tax will be the actual tax paid, even at higher prices, until a company is able to “use up” (recover) all of their development costs
- Increasing the effective tax rate by 75% during what could be the peak production years could impact the present value, and thus break even price, for a project
- Also, reducing the amount of carry-forwards that can be used in a given year extends the number of years the minimum tax will be paid, and increases the likelihood that they could be lost outright, due to the “downlift” or sunset provisions of HB111

## *Issues for Consideration- New Fields*

### **Life Cycle Analysis for hypothetical new field (Large field model; 750 million barrels, 120,000 bbl / day peak production)**

Oil Price	Total Production Tax (\$millions)		Producer IRR		Break Even Price (NPV10)	
	Status Quo	HB288	Status Quo	HB288	Status Quo	HB288
	Quo	HB288	Quo	HB288	Quo	HB288
\$60	\$5,913	\$6,288	7.5%	7.4%	\$72	\$73
\$80	\$13,484	\$13,652	11.4%	11.2%		
Fall 17 FC	\$6,685	\$6,988	8.0%	7.8%		

# THANK YOU

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