And Fairness to All

Fair Production Tax to Alaskans and Industry

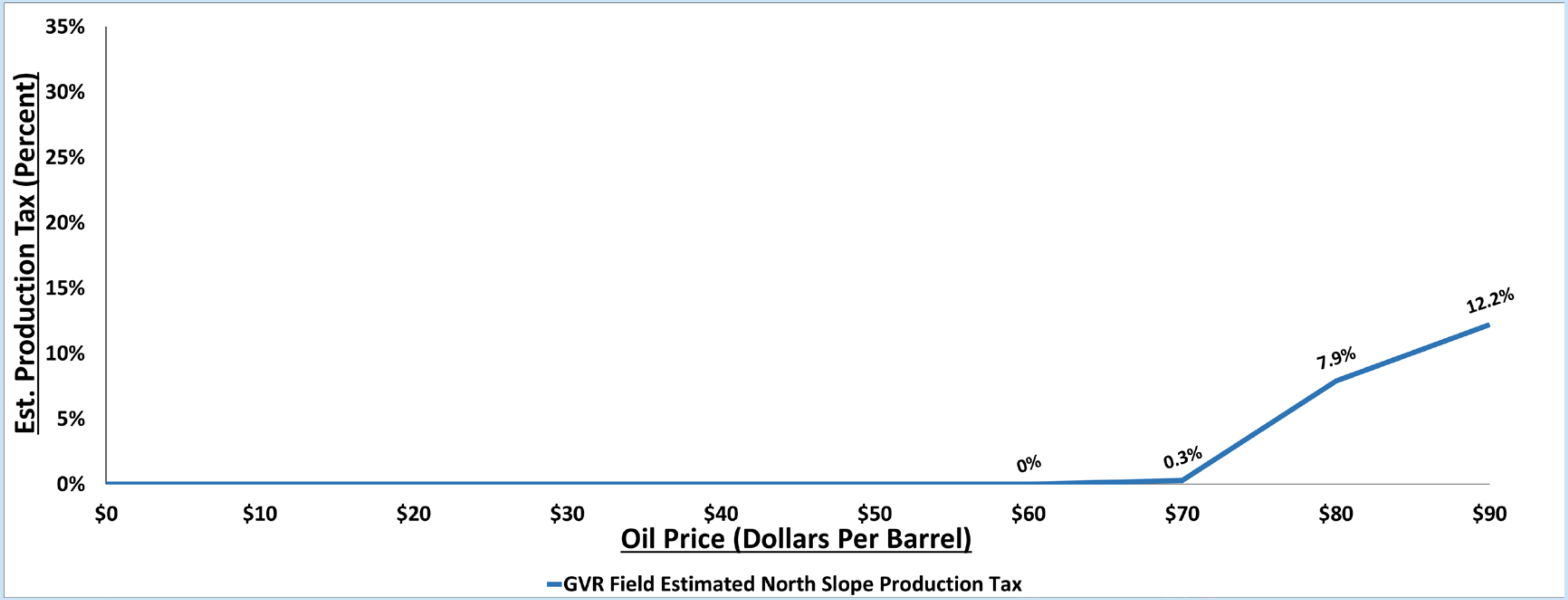
HB 133

Oil and The Alaska Constitution

"The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the state, including land and water, for the maximum benefit of its people."

-- Article 8, Section 2 of the Alaska Constitution

The 0% Oil Production Tax Problem: GVR Fields



Source: Office of Rep. Gara

Three Ways to Obtain GVR Tax Reduction for Post-2002 Fields

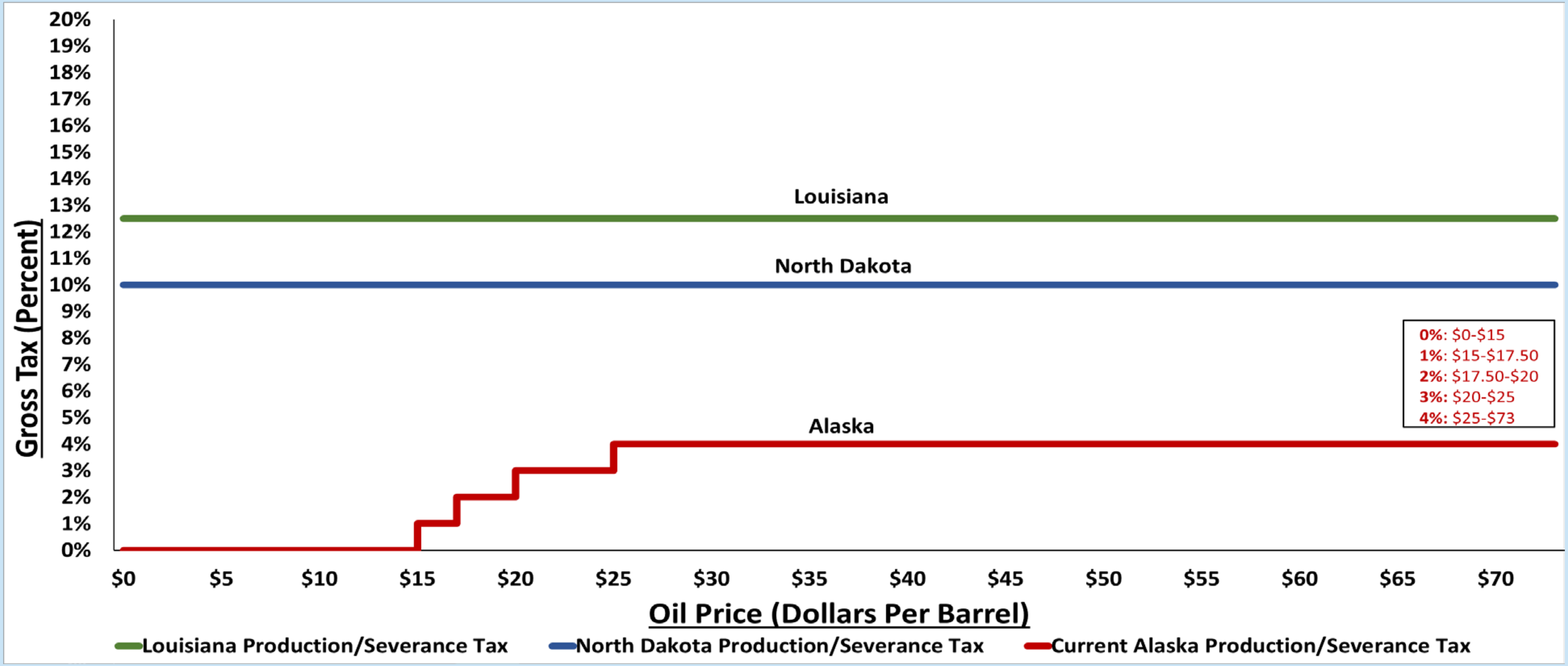
(1) the oil or gas is produced from a lease or property that does not contain a lease that was within a unit on January 1, 2003;

(2) the oil or gas is produced from a participating area established after December 31, 2011, that is within a unit formed under AS 38.05.180(p) before January 1, 2003, if the participating area does not contain a reservoir that had previously been in a participating area established before December 31, 2011;

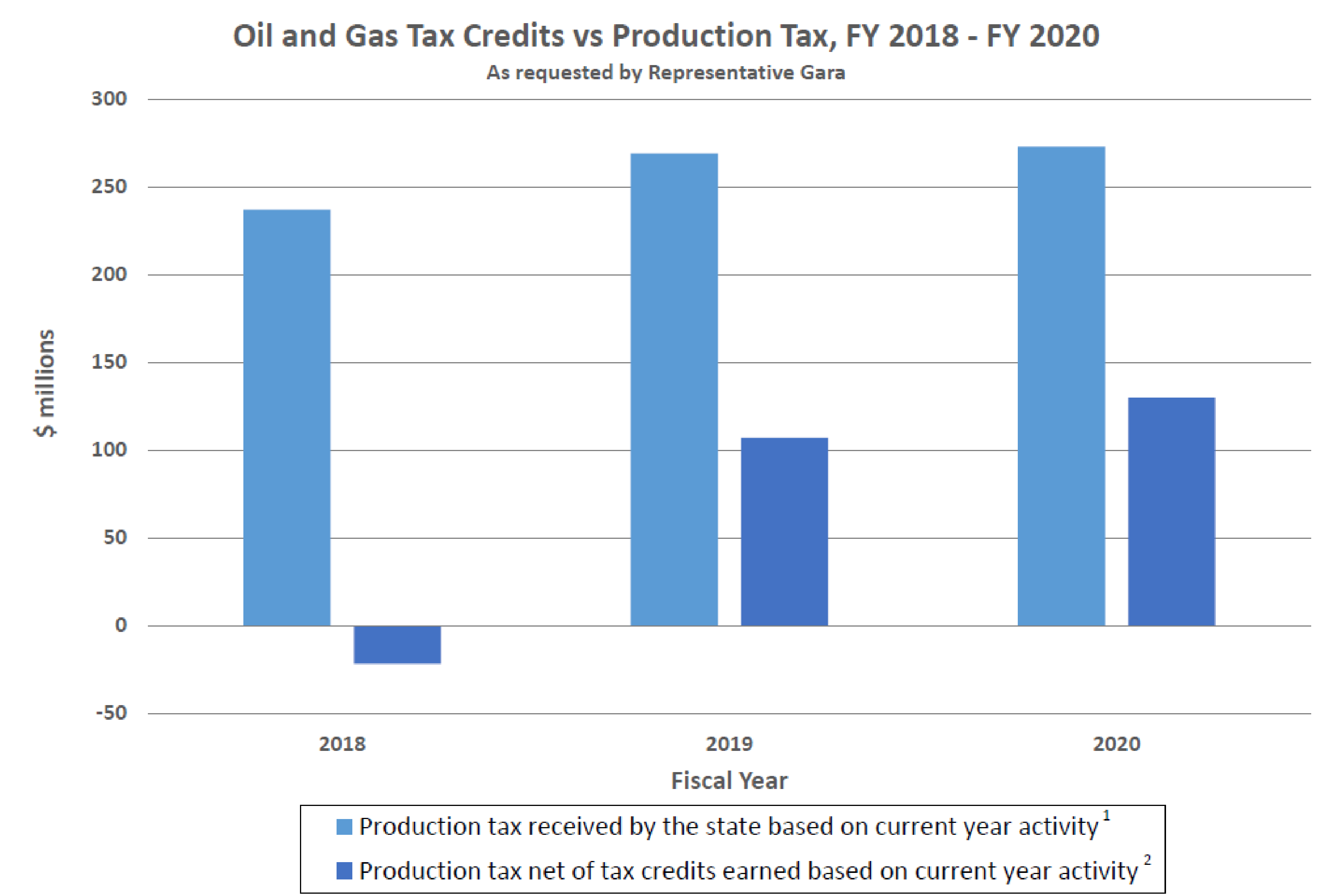
(3) the oil or gas is produced from acreage that was added to an existing participating area by the Department of Natural Resources on and after January 1, 2014, and the producer demonstrates to the department that the volume of oil or gas produced is from acreage added to an existing participating area.

Source: AS 43.55.160(f)

The 4% Oil Production Tax Problem: Non-GVR Fields



Source: Office of Rep. Gara



[1] Actual production tax revenue received, but not including tax credits applied against liability that were based on activity in a previous fiscal year

[2] Production tax credits earned during the fiscal year that will be eligible for refund or application against a liability in a future year

Oil and Gas Tax Credits vs Production Tax, FY 2018 - FY 2020

		$ Millions Fiscal Year		
		2018	2019	2020
Production tax received by the state based on current year activity	1	$ 237	$ 269	$ 273
Credits Earned - North Slope		$ 178	$ 125	$ 109
Credits Earned - Non-North Slope		$ 81	$ 37	$ 34
Credits Earned - Total		$ 259	$ 162	$ 143
Production tax net of tax credits earned based on current year activity	2	$ (22)	$ 107	$ 130

[1] Actual production tax revenue received, but not including tax credits applied against liability that were based on activity in a previous fiscal year

[2] Production tax credits earned during the fiscal year that will be eligible for refund or application against a liability in a future year

Effective Tax Rates on Net Value

using Current Assumptions*

Oil Price	Non-GVR	20% GVR Eligible
$60	12.1%	0.0%
$70	9.1%	0.3%
$80	13.1%	7.9%
$90	20.0%	12.2%
$100	24.4%	15.0%
$110	27.5%	17.0%
$120	29.8%	18.4%
$130	31.5%	19.5%
$140	32.9%	20.4%
$150	34.1%	21.1%

*Current assumptions include transport costs of $9.77 per barrel and deductible lease expenditures of $33.64 per taxable barrel, based on the North Slope average for FY 2018 as estimated in the Fall 2016 forecast. For this table, net value is the same as "production tax value," defined in AS 43.55.160. The effective tax rates in this table are calculated by dividing the production tax after credits by the production tax value.

Using assumptions of $9.77 in transport costs and $33.64 per taxable barrel in deductible lease expenditures, applied to a typical field, we estimate that the minimum tax of 4% of gross value at the point of production exceeds 35% of production tax value minus sliding scale per-taxable-barrel credits at between $73 and $74 per barrel, for a typical field. This is illustrated in the calculation below.

Source: Dept. of Revenue

Average Break- Even Point for Active North Slope Producers: $40.21

Source: Fall 2016 Revenue Source Book p. 118

Appendix E 2

Production Tax Estimate for FY 2017

Using income statement format

Note: This table presents an approximation of the production tax calculation, and does not match production tax estimates throughout this publication.

	Price	Barrels (Thousands)	Value (Millions of Dollars)
Avg ANS Oil Price ($/bbl) and Daily Production	$46.81	490.3	$23.0
Annual Production			
Total		178,961	$8,377.6
Royalty, Federal and other barrels [1]		-21,314	($997.8)
Taxable barrels		157,647	$7,379.8
Downstream (Transportation) Costs ($/bbl)			
ANS Marine Transportation	-$3.13		
TAPS Tariff	-$5.81		
Other	-$0.39		
Total Transportation Costs	-$9.33	157,647	($1,470.6)
Gross Value at Point of Production (GVPP)			$5,909.2
Deductible Lease Expenditures [2]			
Deductible Operating Expenditures	-$17.68		($2,786.9)
Deductible Capital Expenditures	-$13.20		($2,080.6)
Total Lease Expenditures	-$30.88	157,647	($4,867.6)
Production Tax			
Gross minimum tax (4%*GVPP)			$236.4
Production Tax Value (PTV)			$1,041.6
Gross Value Reduction (GVR)			($68.7)
Production Tax Value (PTV) after GVR			$973.0
Base Tax (35%*PTV after GVR)			$340.5
Total Tax before credits (base tax or minimum tax)			**$340.5**
North Slope Credits applied against tax liability [3]			**($225.0)**
Estimated Total Tax after credits [4]			**$115.5**

The 4% Oil Tax Problem

Current Law

Price	Percent
< or equal to $15	0
$15-17.50	1%
$17.50-20	2%
$20-25	3%
>$25-approximately $73	4%

Other States

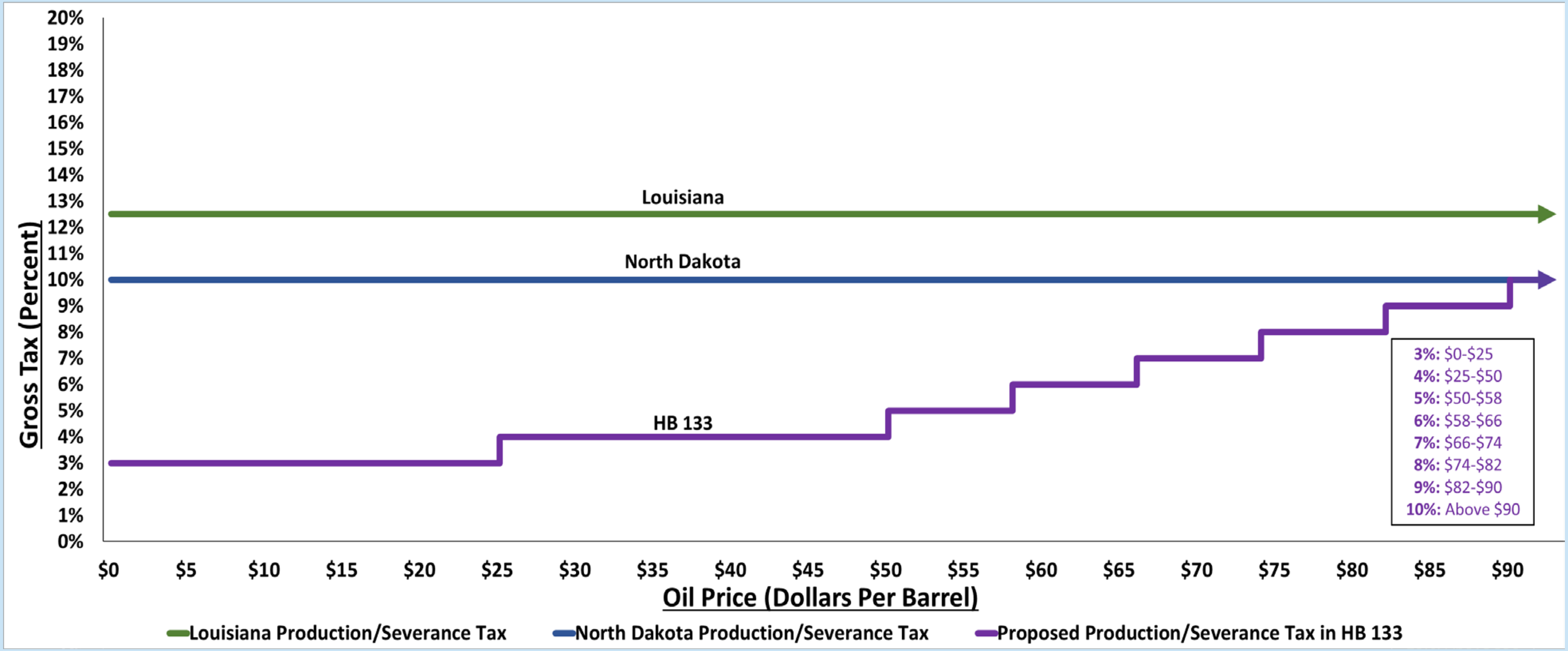
North Dakota 10-11%
Louisiana 12.5 %

HB 133

Price	HB 133*
< $25	3%
$25-50	4%
$50-58	5%
$58-66	6%
$66- 74	7%
$74-82	8%
$82-90	9%
>$90	10%

* Except for heavy oil

HB 133 Tax Rate Compared to North Dakota and Louisiana



Source: Office of Rep. Gara

Much Criticized ELF Tax
Higher Tax Rate for Major Fields

Alaska’s largest field, Prudhoe Bay, paid a 13% Gross Tax under the old ELF oil tax structure in 2005. Alpine and North Star were also higher-tax fields under the ELF.

Source: January 2005 Department of Revenue Information

Lower 48 States:
Higher Royalties- Private Landowners

Private Royalties prevail in the lower 48, where companies generally make royalty payments to private lease owners, and not to the state.

<u>Prevailing</u> Alaska Royalty Rate on Gross Revenue: 12.5% (very few smaller fields at approximately 16%)

Private Royalty Rates in Lower 48:

Texas	12.5-30%
California	16-25%
North Dakota	12.5-25%
Oklahoma	12.5-20%

Source: Alaska Oil + Gas Competitiveness Report

Alaska's Law:
What if ELF, PPT, ACES, SB21, HB 133 got it wrong?

- Royalty Relief!

- The repair mechanism if any tax requirement is too high to make a field economical

Royalty Reduction to Encourage Higher Cost Oil

- Royalty of 12.5%-16.5% can be reduced by over 50%
- Down to 5% for new fields
- Down to 3% to keep an existing field economic

Relief Valve:
Royalty Relief When the Tax Rate Is Too High

AS 38.05.180

(j) The commissioner

(1) may provide for modification of royalty on individual leases, leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05

(A) to allow for production from an oil or gas field or pool if

(i) the oil or gas field or pool has been sufficiently delineated to the satisfaction of the commissioner;

(ii) the field or pool has not previously produced oil or gas for sale; and

(iii) oil or gas production from the field or pool would not otherwise be economically feasible;

(B) to prolong the economic life of an oil or gas field or pool as per barrel or barrel equivalent costs increase or as the price of oil or gas decreases, and the increase or decrease is sufficient to make future production no longer economically feasible; or…

(4) may not grant a royalty reduction for a field or pool

(A) under (1)(A) of this subsection if the royalty modification for the field or pool would establish a royalty rate of less than five percent in amount or value of the production removed or sold from a lease or leases covering the field or pool;

(B) under (1)(B) or (1)(C) of this subsection if the royalty modification for the field or pool would establish a royalty rate of less than three percent in amount or value of the production removed or sold from a lease or leases covering the field or pool;

Petroleum news
A weekly newspaper based in Anchorage, Alaska

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Providing coverage of Alaska and northern Canada's oil and

Royalty relief for Nuna

DNR makes final finding on 5% royalty rate for new Oooguruk development

Alan Bailey

Petroleum News

Alaska tweaks royalty relief rules for oil companies

By Christopher Eshleman /ceshleman@newsminer.com Fairbanks Daily News-Miner Apr 27, 2011 (0)

But only five companies have applied for that help since the Legislature expanded eligibility in 1995, said Kevin Banks, who directs the state Division of Oil and Gas. Resource commissioners have approved two applications — for the Oooguruk and Nikiachuk fields — and in the latter case the break only arrives if the price of oil falls close to $42 per barrel.

4Q16 Adjusted Earnings ($MM)

Lower 48	($219)
Canada	($101)
Alaska	$116
Europe & North Africa	$82
Asia Pacific & Middle East	$182
Other International	($54)
Corporate & Other	($324)
Total	($318)

Source: ConocoPhilips 4th Quarter 2016 Conference Call

Net Income (Loss) Attributable to ConocoPhillips	Millions of Dollars		
	2015	2014	2013
Alaska	$ 4	2,041	2,274
Lower 48	(1,932)	(22)	754
Canada	(1,044)	940	718
Europe and North Africa	409	814	1,297
Asia Pacific and Middle East	(463)	2,939	3,532
Other International	(593)	(100)	223
Corporate and Other	(809)	(874)	(820)
Discontinued operations	-	1,131	1,178
Consolidated net income (loss) attributable to ConocoPhillips	$ (4,428)	6,869	9,156

Source: ConocoPhillips 2015 Annual Report

Net Income Attributable to ConocoPhillips		Millions of Dollars 2012	2011	2010
Alaska	$	2,276	1,984	1,727
Lower 48 and Latin America		1,029	1,288	1,029
Canada		(684)	91	2,902
Europe		1,498	1,830	1,703
Asia Pacific and Middle East		3,928	3,032	2,099
Other International		359	(377)	(418)
LUKOIL Investment		-	239	2,513
Corporate and Other		(993)	(960)	(1,304)
Discontinued operations		1,015	5,309	1,107
Consolidated net income attributable to ConocoPhillips	$	8,428	12,436	11,358

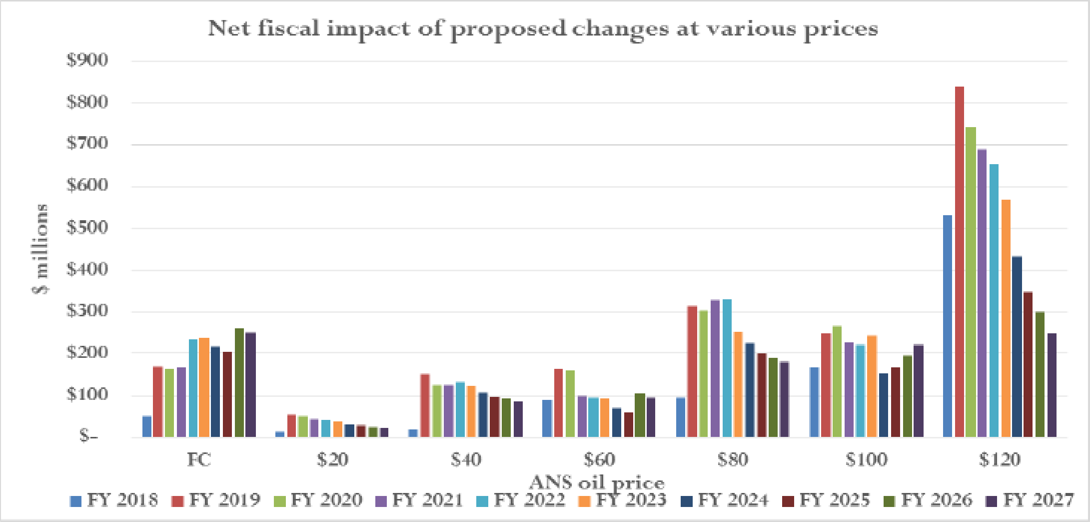
Source: ConocoPhillips 2012 Annual Report

Proposal: Rep Gara draft proposal Revised 1-27-17 by Department of Revenue

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.

Provisions in HB XXX and their Estimated Fiscal Impact based on Fall 2016 Forecast ($millions) - Fall 2016 FORECAST PRICE

Description of Provision	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
1. No credits or deductions can reduce tax below the minimum tax effective 1/1/18.	$20	$15	$0	$0	$0	$0	$0	-$10	-$25	-$5
2. Effective 1/1/18, replace current gross minimum tax brackets with new brackets starting at 4% of gross at prices below $50, and increasing by 1% for each $8 increase in price up to 10% of gross at prices above $90. Price triggers for brackets are adjusted for inflation bienially.	$20	$125	$120	$125	$195	$200	$200	$200	$255	$245
3. Effective 1/1/18, establish an additional minimum tax calculation based on production tax value. The production tax may not fall below 22.5% of PTV.	$20	$95	$80	$90	$145	$180	$220	$270	$270	$265
4. Effective 1/1/18, establish a progressive surcharge based on production tax value for North Slope production. The surcharge is 10% of the portion of PTV per barrel between $40 and $50, 15% of the portion of PTV per barrel between $50 and $60, 20% of the portion of PTV per barrel between $60 and $70, and 25% of PTV per barrel above $70. The progressive surcharge is calculated before applying the minimum taxes and the brackets are not indexed for inflation.	$0	$0	$0	$0	$0	$0	$0	$5	$5	$10
5. Repeal the Gross Value Reduction (GVR) effective 1/1/18.	$0	$25	$30	$40	$35	$40	$15	$0	$0	$0
Additional impact of implementing above provisions together vs standalone	-$10	-$90	-$65	-$85	-$140	-$180	-$215	-$260	-$245	-$265
Total Revenue Impact	**$50**	**$170**	**$165**	**$170**	**$235**	**$240**	**$220**	**$205**	**$260**	**$250**
A. Budget impact of No credits or deductions can reduce tax below the minimum tax effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
B. Budget impact of new gross minimum tax brackets effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
C. Budget impact of new net minimum tax calculation effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of new progressive surcharge effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
E. Budget impact of GVR repeal 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**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
Total Fiscal Impact - (does not include potential changes in investment)	**$50**	**$170**	**$165**	**$170**	**$235**	**$240**	**$220**	**$205**	**$260**	**$250**
Non-refundable carry-forward credits balance at fiscal year end - current law	$14	$0	$0	$0	$0	$0	$0	$0	$0	$0
Non-refundable carry-forward credits balance at fiscal year end - proposed	$31	$31	$31	$31	$31	$31	$31	$31	$31	$31
Change in year-end balance due to proposal	$17	$31	$31	$31	$31	$31	$31	$31	$31	$31



Chapter 4

5

Oil Price and Transportation Costs

Forecast Assumptions

	Nominal Dollars per Barrel										
	History	Forecast									
Fiscal Year	2016	2017[1]	2018	2019	2020	2021	2022	2023	2024	2025	2026
Alaska North Slope West Coast Price	43.18	46.81	54.00	60.00	63.00	67.00	71.00	75.00	78.00	84.00	88.00
ANS Marine Transportation	3.15	3.13	3.19	3.25	3.30	3.35	3.40	3.45	3.50	3.56	3.62
TAPS Tariff	6.25	5.81	6.18	6.54	6.96	7.39	7.83	8.30	8.81	9.32	9.85
Other Deductions and Adjustments[2]	0.48	0.39	0.39	0.39	0.39	0.41	0.43	0.46	0.48	0.52	0.56
ANS Wellhead Price	**33.30**	**37.48**	**44.23**	**49.81**	**52.36**	**55.85**	**59.33**	**62.79**	**65.21**	**70.59**	**73.97**

[1] FY 2017 values include four months of actual data.

[2] Includes other adjustments such as quality bank charges, feeder pipeline tariffs, location differentials, and company-amended information.

Source: Department of Revenue Fall 2016 Revenue Source Book

ACES vs. HB 133

- ACES maximum tax rate was 75% of profits
- HB 133 not likely to reach 40%

Minimum Profits Tax

- New minimum profits tax is 22.5%

- That was the modest rate in the pre-ACES "PPT" law.

- <u>Current Law</u> allows a <u>minimal 9.1%</u> profits tax

- <u>$700/bbl</u>; and a <u>13.1% profits tax at $80/bbl.</u>

Modest Share in Windfall Profits

When producer makes:

- $40 +/ barrel of profit
  - 10% surcharge on High profits only on that portion of net income above $40 in profit.
- $50 - $60 / barrel of profit
  - 5% additional surcharge on that portion of net income above $50/bbl in profit
- $60-$70/ barrel of profit
  - 5% additional surcharge on that portion of net income above $60/bbl in profi
- $70+/ barrel of profit
  - 5% additional surcharge on that portion of net income above $70/bbl in profit

Fair, Modest Compromise

- Higher minimum gross tax at lower prices
- Modest profits tax at high prices
- Recognizes oil companies reap larger profits at higher prices

Modest Tax At All Prices

- Minimum Gross Tax much lower than North Dakota, Louisiana
- Profits tax at high prices, modest compared to other jurisdictions

Alternatives

Minimum Gross Tax

- Should it rise by 1% at every $8 price increase as under current version?
- Should it rise by 1% at every $5 price increase? Every $6 increase?
- Should it cap at 8% instead of 10%

An Alternative Minimum Gross Tax

- 5% at $50/bbl
- 6% at $56/bbl
- 7% at $62/bbl
- 8% at $70/bbl

- No 9% and 10% tax rate
- Brings in potentially $190 million of revenue in FY2018
  - Royalty relief as always if a company needs it

A Fair Gross Value Reduction

- Currently 0% Production Tax up $70/bbl for seven years
- Bill softens revenue loss where needed
- No GVR for large fields producing 50,000 bbl/day or more
- Reduce GVR from maximum seven years to maximum five years
- First seven years are most productive in a field's life

Cook Inlet: All 0’s

- Current production tax on oil approximately 0% at all prices.

- HB 133: 22.5% of profits

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- Bracketed windfall profits surcharge above $40/bbl in profits

Questions?