

BP Testimony to Senate Resources Committee

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Madame Chair, Members of the Committee: For the record my name is Joe Reese and I am Senior Managing Tax Counsel for BP Alaska. I am very pleased to be here to provide BP's views on tax policy and, in particular, SB 130. BP is a member of AOGA and supports the testimony provided by AOGA earlier today.

The success of Alaska's oil and gas tax policy is critical to BP, to the AK LNG Project, and to the many Alaskans who benefit, both directly and indirectly, from the successful exploration, development, and production of Alaska's oil & gas. A durable, predictable, and administrable oil and gas tax policy must be in place to unlock those benefits.

BP is committed to maintaining a safe and compliant business in Alaska that is sustainable. Over the past two years, there has been a 70% drop in oil price. In 2015, BP paid ~\$263m in royalties and taxes that resulted in a financial loss of ~\$194 million. Under the current market conditions, BP's business in Alaska is spending more cash than it brings in, and this is not sustainable. As a result, BP has undertaken an ~17% reduction in force and the PBU working interest owners have reduced activity levels. PBU economics are at a point where tax increases in the cost structure would result in even lower activity levels and would be detrimental to our business in Alaska – a 1% increase to the minimum tax is equal to 6 months of rig work at PBU. If, for example, production decline were to return to 10% annually over the next five years, the State would lose ~\$793m in royalty revenue alone not to mention the lost production tax and income tax

revenue. Operating under a predictable, durable and administrable oil and gas tax policy is essential to maintaining the activity level at Prudhoe Bay and the long-term viability of an AK LNG Project.

BP is committed to complying with tax laws in a responsible manner and to having open and constructive relationships with tax policy makers. One of the major costs to BP's business in Alaska is oil production tax. While we are currently cash flow negative, we still pay oil production tax because certain of our cash costs, like our investment in the AK LNG Project and other specifically excluded costs, are not deductible for production tax purposes.

At current prices, PBU production does not attract oil production tax credits. While PBU doesn't currently receive production tax credits, we don't support limiting the production tax credits provided in SB 21 because it would negatively impact the oil & gas industry as a whole, including the many other companies that have made investments, created jobs, and added production in Alaska.

Just as the industry is struggling to make ends meet, the State also faces severe budget shortfalls. While reasonable people may disagree about how to improve the current oil and gas tax policy, now is not the right time to make changes that would increase taxes and further inhibit our ability to maintain the activity level at Prudhoe Bay. Near-term changes to the State's oil and gas tax policies will have long-term consequences for all of us.

Now, I'd like to provide a few comments specifically about why SB 130 is bad tax policy:

1. The Administration has proposed an Increase to minimum tax -The Administration's proposal to increase the minimum tax from 4% to 5%

would have a chilling effect on additional investment. This would represent a 25% tax increase to BP at a time when BP needs that cash to maintain our activity level. This proposal does not provide durability and therefore is not good tax policy.

2. The Administration has proposed an artificial limitation on the use of credits within a tax year – The production tax is an annual tax paid in monthly installments reflecting budgeted costs and forecasted prices that evolve during the year, with a final “true-up” to the actual figures on March 31st of the following year. This structure of monthly installments and a final true-up reflects the fact that the producers keep their financial books and records on an annual basis and do not close and balance them on a monthly or quarterly basis. The Administration proposes to limit the amount of a tax credit to the specific amount reflected for it in each monthly installment. This means any increase between that initial credit amount and any greater amount determined for it at true-up would be disallowed, but any reductions at true-up in monthly reported credits would be reflected in the total allowable amount for that credit for the year. This inconsistency is not based on good tax policy, but is simply a significant tax increase. It pretends that annual tax credits can be accurately quantified and reported on a monthly basis, even though it is not possible to have perfect full-year information when the monthly installments are filed. This provision is neither predictable nor administrable and therefore is not good tax policy.
3. The Administration has proposed a material increase to the interest rate for tax overpayments and underpayments: Currently, the interest is

calculated at a rate 3% points above the federal funds discount rate, using simple interest. The proposal would more than double the differential from the fed funds rate, to 7% points above the federal funds discount rate, and have interest compound at the end of each calendar quarter. Such a compound rate would reward the Department of Revenue for being slow in its audits, because 7.4% interest compounded quarterly would represent, by itself, more than 55¢ for each \$1 of additional tax claimed by the audit. This provision does not allow for predictability and therefore is not good tax policy.

4. The Administration has proposed limitations on the use of the net operating loss tax credit: The Administration's proposal would prevent the use of net operating loss tax credits to reduce the minimum tax. In other words, companies that made important investments in the prior year, even when they may have been spending more cash than they were bringing in, would be prevented from recovering part of that investment. NOL tax credits are utilized by a broad range of companies both on the North Slope and in Cook Inlet, and changing their value would be a disincentive for future investment decisions. This provision does not allow for durability or predictability and therefore is not good tax policy.
5. The Administration has proposed an erosion of taxpayer confidentiality: Confidentiality is the cornerstone for any self-reporting tax like the production tax. Unlike a property tax — where the government determines the value of your house on the basis of objective market parameters instead of relying on you to provide information about the value of the house — a self-reported tax relies on taxpayers to provide

details about the factors that determine the amount of the tax. For production tax these details include, for instance, specific terms of contracts for production-related services, the arrangements and costs incurred to get the oil or gas to market, and specific terms and conditions for each sale or disposition of that oil or gas. Such information can often be commercially sensitive for competitive reasons, and in some cases it would be a crime to disclose such information to competitors or the public either directly or through a third party. Confidentiality ensures that the Department of Revenue won't disclose such information. SB 130 attacks the principle of confidentiality and therefore SB 130 would be bad tax policy.

Again:

- BP is committed to maintaining a safe and compliant business in Alaska that is sustainable;
- BP is committed to complying with tax laws in a responsible manner and to having open and constructive relationships with tax policy makers; and
- BP supports durable, predictable and administrable oil and gas tax policy and that is why we do not support SB 130.

Thank you.