

PRODUCTION TAX CREDITS

Senate Finance Committee

2/18/2010

Alaska State Department of Revenue

Overview

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☐ **Types of Tax Credits**

- ☐ Credits Applied Against Tax Liability
- ☐ Transferable Tax Credit Certificates
- ☐ Cash Refunds History
- ☐ Tax Credit Analysis

Types of Credits

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Credits which may be taken against oil and gas production taxes include:

- ▣ Capital Expenditure Credits
- ▣ Exploration Credits
- ▣ Net Operating Loss (“NOL”) Carry Forward Credits
- ▣ Transitional Investment Expenditure (“TIE”) Credit
- ▣ Small Producer Credits

Types of Credits

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Capital Expenditure Credits (AS 43.55.023(a)(1))

- ▣ 20% of qualified capital expenditures (QCE)
- ▣ QCE include drilling, construction of facilities, new equipment, etc.
- ▣ Same expenditures may also qualify for NOL Carry Forward Credit
- ▣ Same expenditures do **not** qualify for additional EIC credit
- ▣ Must be spread over 2 years
- ▣ Credits may be cashed or transferred

Types of Credits

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Exploration Credits

□ Two Main Types

▣ 43.55.023(a)(2) Capital Credit for Exploration Activity (20%)

▣ 43.55.025 Exploration Incentive Credits (“EIC”) (30%-40%)

Types of Credits

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43.55.023(a)(2) **Capital Credit for Exploration Activity**

- ▣ **20%** of qualifying expenditures
- ▣ Qualifying expenditures related to geologic and geophysical exploration, or in connection with an exploration well
- ▣ Must be spread across 2 years
- ▣ Same expenditures may also qualify for NOL Carry Forward Credits
- ▣ Credits may be cashed or transferred

Types of Credits

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Exploration Credits

- Two Main Types
 - ▣ 43.55.023(a)(2) Capital Credit for Exploration Activity (20%)
 - ▣ 43.55.025 Exploration Incentive Credits (“EIC”) (30%-40%)

Types of Credits

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43.55.025 Exploration Incentive Credits

- ▣ **30% - 40%** of qualified expenditures depending on well location and proximity to existing wells and unit boundaries
- ▣ Qualified expenditures include certain expenses associated with seismic and geophysical exploration work, and exploration well drilling
- ▣ Same expenditures may also qualify for NOL Carry Forward Credit
- ▣ Same expenditures do **not** qualify for Capital Expenditure Credit
- ▣ To receive credit, taxpayer must provide certain well data to DNR
- ▣ Expires 2016
- ▣ Credits may be cashed or transferred

Types of Credits

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NOL Carry Forward Credit - 43.55.023(b)

- ▣ **25%** of net operating loss
 - Applied against tax liability in following year
- ▣ Credit based on adjusted lease expenditures which include both operating and capital expenses
- ▣ Same capital expenditures may also qualify for exploration credit under 43.55.023(a)(2)
- ▣ Credits may be cashed or transferred

Types of Credits

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Transitional Investment Expenditure (TIE) Credits - 43.55.023(i)

- Credit equals 20% of qualifying capital expenditures:
 - incurred between March 31, 2001 and April 1, 2006, and
 - not exceeding 10% of the capital expenditures incurred between March 31, 2006 and January 1, 2008.
- Revised under Aces to cover only producer or explorer not having production prior to January 1, 2008
- Credits are **not** transferable and may **not** be carried forward beyond 2013
- Same capital expenditures may **not** qualify for exploration credit under 43.55.025

Types of Credits

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Small Producer Credit - 43.55.024(a)

- ▣ Available for companies producing less than 50,000 bbl/day of oil BTU-equivalent
- ▣ Credit is up to \$6 million against tax liability
- ▣ Production must be from wells outside of Cook Inlet and North Slope
- ▣ Expires 2016 or 9 years after first commercial oil or gas production if before May 1, 2016
- ▣ Credits may **not** be cashed or transferred or carried forward

Types of Credits

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Small Producer Credit - 43.55.024(c)

- Available for companies producing not more than 100,000 bbl/day of oil BTU-equivalent
- Credit ranges between \$12 million and \$0 depending upon level of production.
- Credit can only be applied against tax liability
- Production not restricted by region
- Expires 2016 or 9 years after first commercial oil or gas production if before May 1, 2016
- Credits may **not** be cashed or transferred or carried forward

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Credits Applied Against Tax Liability

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Credits may be claimed in up to two ways:

(1) All Credits may be applied against tax liability

- .023(a) credits split over two years
- NOL , TIE, Small Producer and .025 credits all in current year

(2) Some Credits may be converted into a transferable
Tax Credit Certificate

- .023(a), NOL, and .025 Credits are convertible
- .023(a) and NOL Tax Credit Certificates must be applied over two years
- .025 Tax Credit Certificates can be used in single year

Credits Applied Against Tax Liability

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Tax Credits Earned by Producers, by Tax Year*

| Credit Type | 2006 | 2007 | 2008 | Total |
|-------------------------------|------------|------------|------------|--------------|
| Capital Expenditure Credit | 204 | 282 | 342 | 828 |
| TIE Credit | 98 | 145 | 0 | 243 |
| Small Producer Credit | 27 | 38 | 21 | 86 |
| Exploration Incentive Credits | 2 | 105 | 12 | 119 |
| TOTAL | 331 | 569 | 376 | 1,276 |

* Does not include explorers without current production

Credits Applied Against Tax Liability

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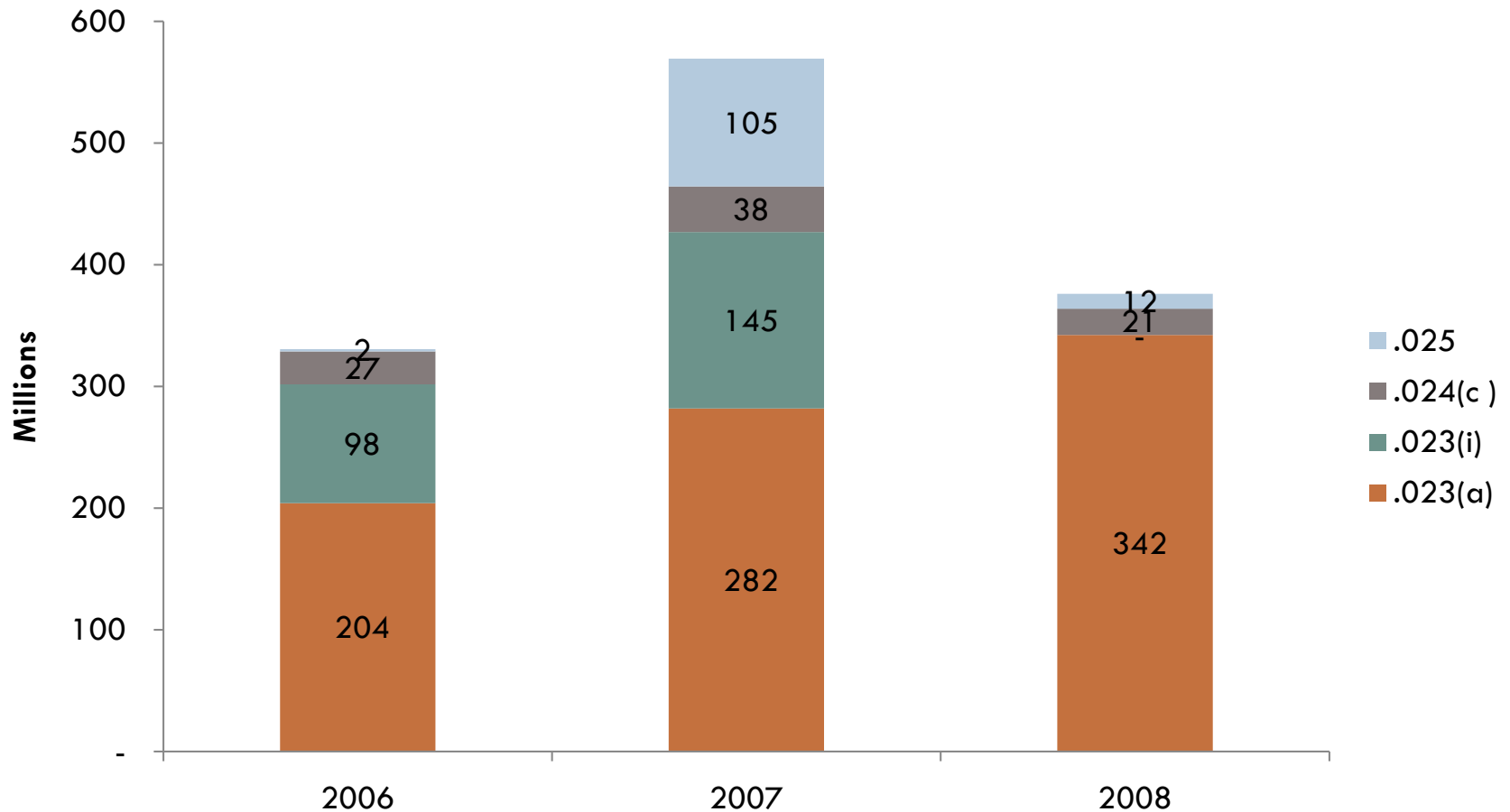
Tax Credits Applied by Producers Against Tax Liability, by Tax Year

| Credit Type | 2006 | 2007 | 2008 | Total |
|-------------------------------|------------|------------|------------|--------------|
| Capital Expenditure Credit | 195 | 194 | 243 | 632 |
| TIE Credits | 98 | 145 | 0 | 243 |
| Small Producer Credits | 27 | 38 | 21 | 86 |
| Exploration Incentive Credits | 2 | 92 | 17 | 112 |
| TOTAL | 322 | 469 | 282 | 1,073 |

Credits Applied Against Tax Liability

Credit Claimed On Tax Filings 2006 - 2008

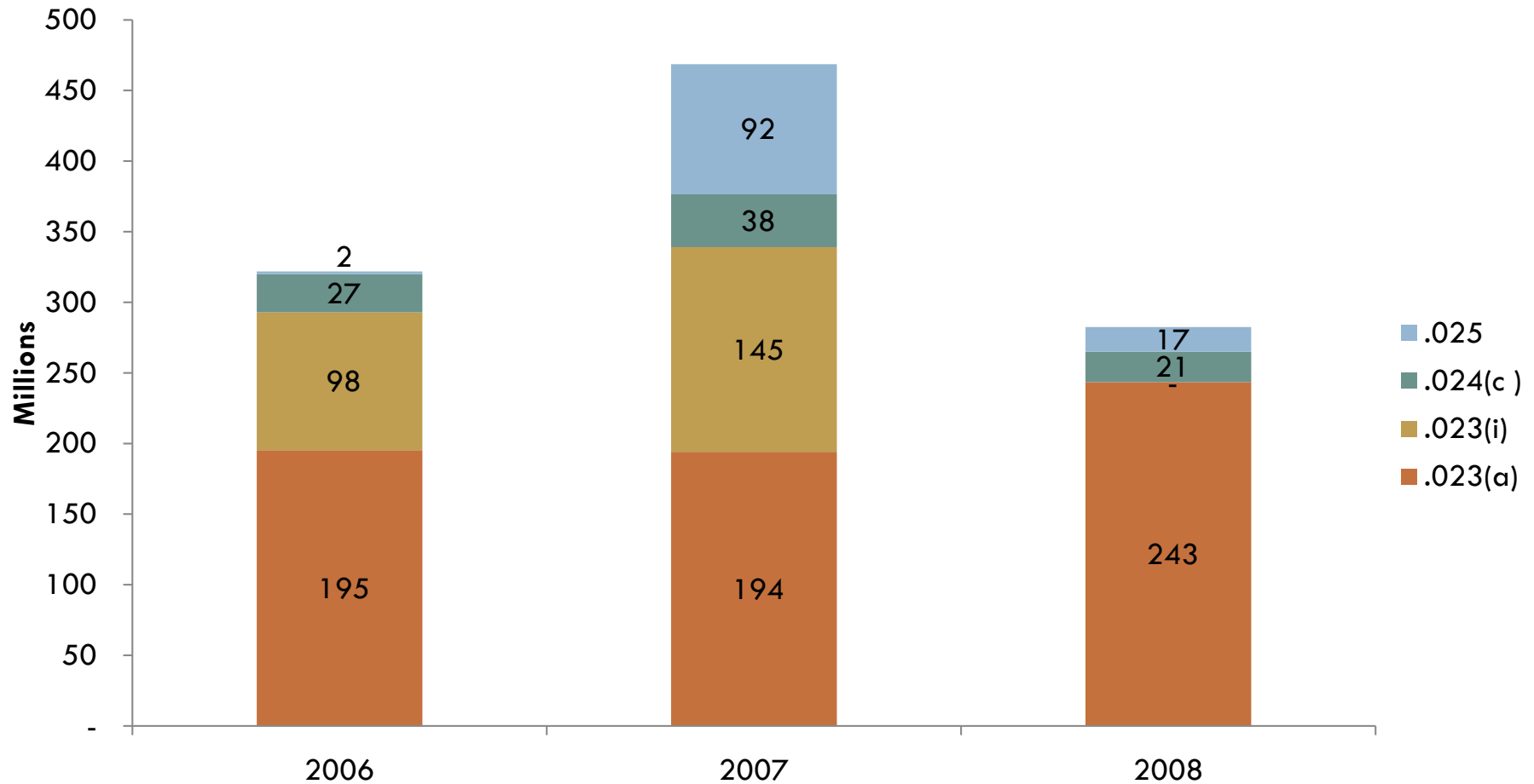
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Credits Applied Against Tax Liability

Credits Applied Against Taxes 2006 - 2008

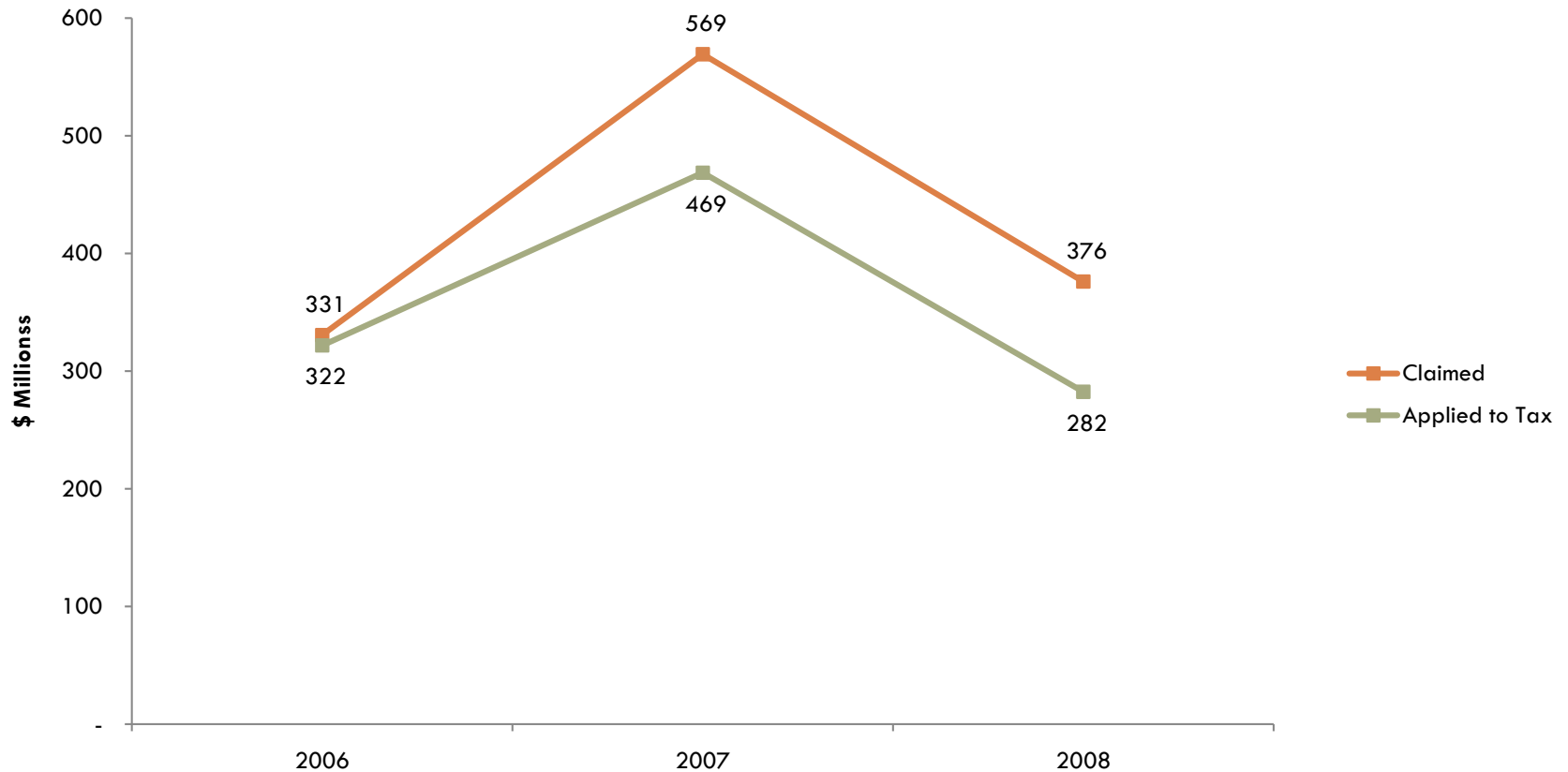
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Credits Applied Against Tax Liability

Tax Credits Earned and Applied to Tax

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Overview

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- Types of Tax Credits
- Credits Applied Against Tax Liability
- **Transferable Tax Credit Certificates**
- Cash Refunds History
- Tax Credit Analysis

Transferable Tax Credit Certificates

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Capital Credit Tax Certificates

- Number issued since 2006- 211 transferable credit certificates
- Capital Credits issued by type:
 - ▣ .023 (a)(1) Qualified Capital Exp- \$228.9 M
 - ▣ .023 (a)(2) Exploration/G&G- \$64.9M
 - ▣ .023 (b) NOL- \$340.1M

Transferable Tax Credit Certificates

Exploration Tax Credits .025

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Exploration Tax Credit Certificates

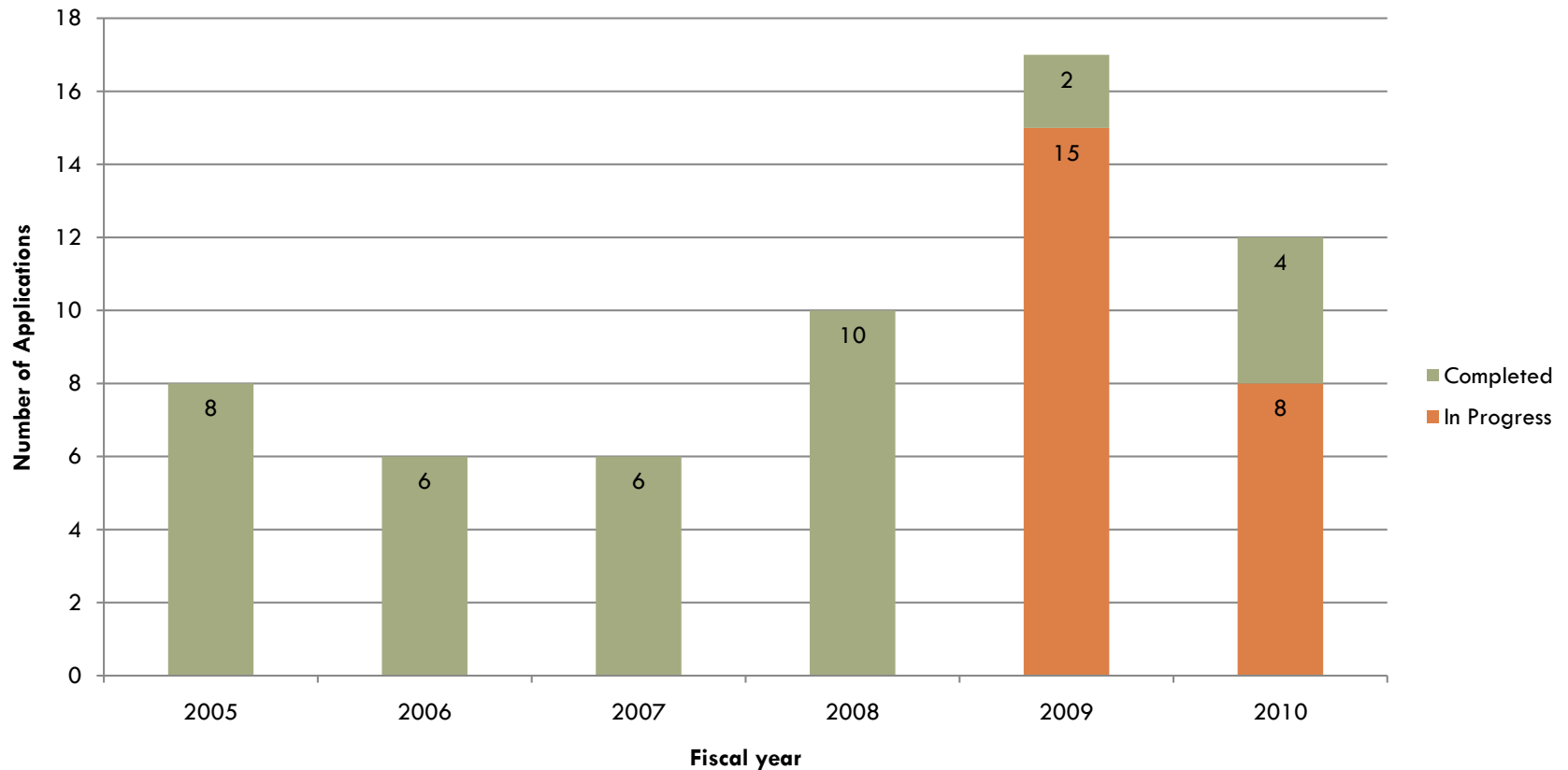
- Number of Applications- 59
- Gross Expenditures claimed- \$945.2 M
- Number Issued- 36 for \$185.2 M
- Applications in progress- 23 representing Gross Expenditures of \$439.9 M requesting \$148.3 M in credits

Transferable Tax Credit Certificates

Exploration Tax Credits AS 43.55.025

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Exploration Tax Credit Applications



Overview

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- Transferable Tax Credit Certificates (TTCC)
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Cash Refunds History

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Cash Refunds Governed by AS 43.55.028:

- To cash must be usable against tax liability
- Must show subsequent (24 months) QCEs or lease bids equal to cash sought
- Have a zero tax owed in current and past years
- Have no more than 50,000 BOE/d

Cash Refunds History

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Tax Credits Purchased

By fiscal year (\$M)

| | |
|--------------------|-------------|
| □ 2007 | 54.6 |
| □ 2008 | 54.1 |
| □ 2009 | 193.1 |
| □ 2010 (thru 2/12) | <u>98.4</u> |
| TOTAL | 400.2 |

Cash Refunds History

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Oil & Gas Tax Credit Fund

| | | |
|--------------------------------|--------------|---|
| Appropriations - | \$ 469 | M |
| Tax Credit Purchases (TC Fund) | (321) | M |
| Tax Credit Purchases (GF) | (79) | M |
| Interest Earned | <u>21</u> | M |
| Balance | <u>\$ 90</u> | |

Overview

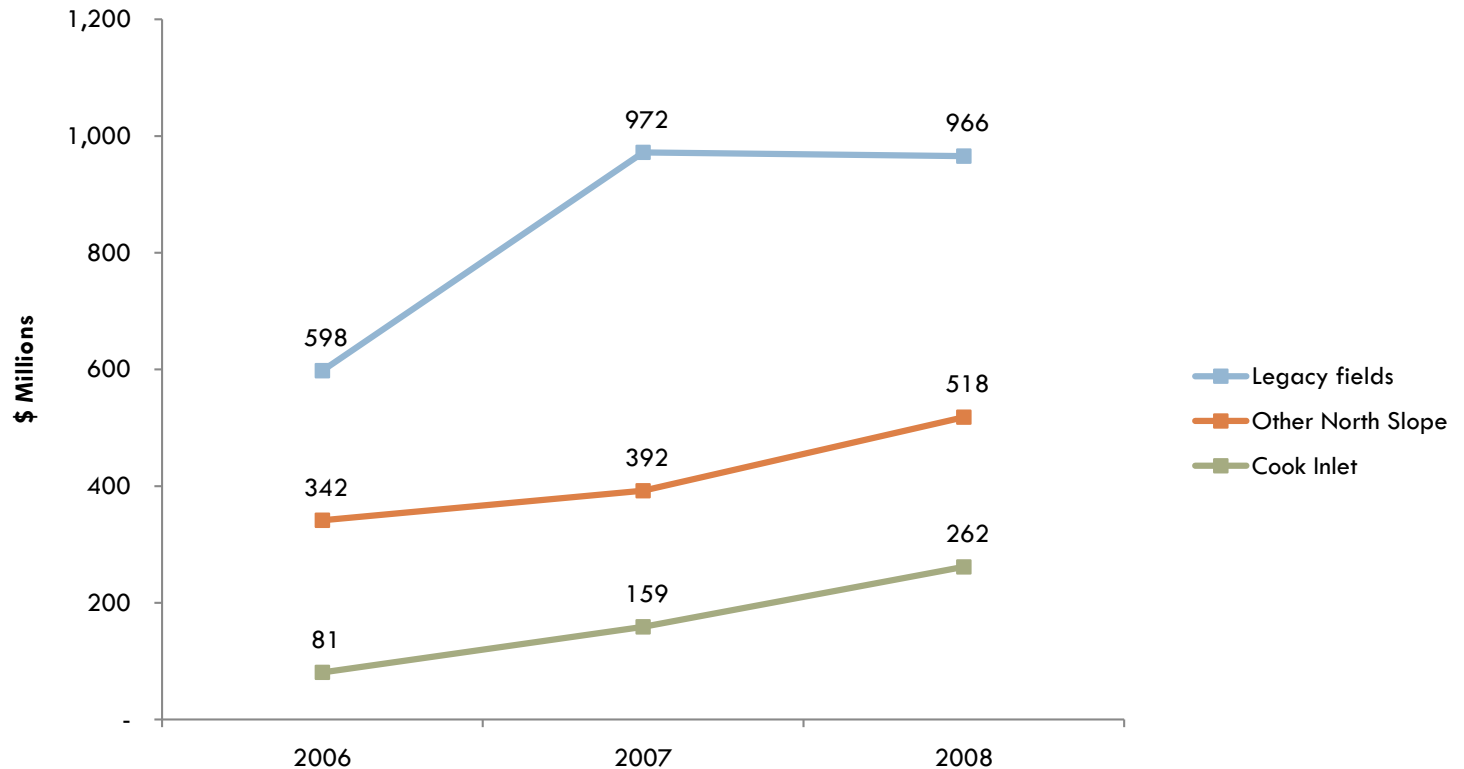
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- **Tax Credit Analysis**

Tax Credit Analysis

Qualified Capital Expenditure Deductions

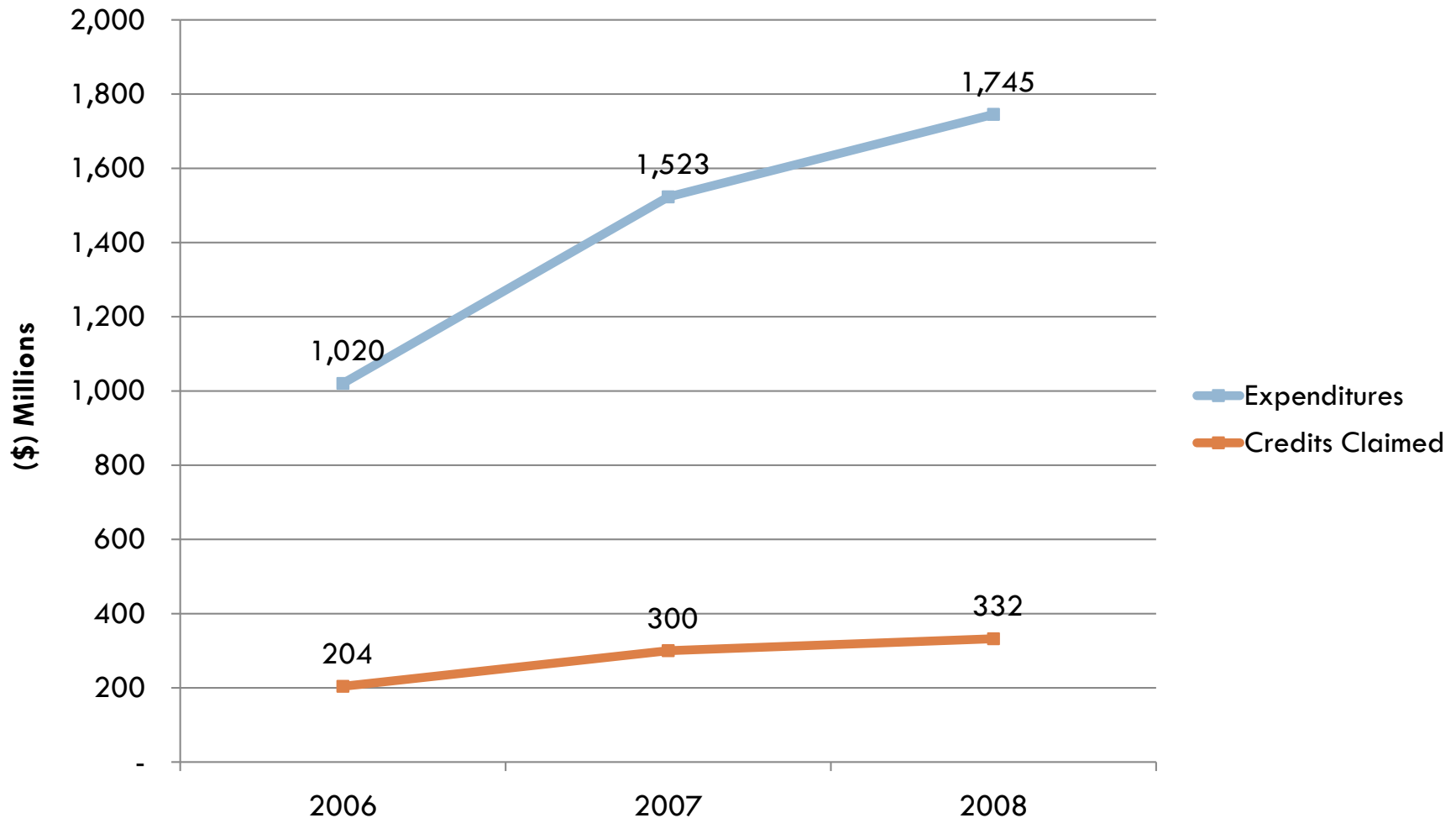
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Tax Credit Analysis

Credits Claimed under .023 Against Tax Liability

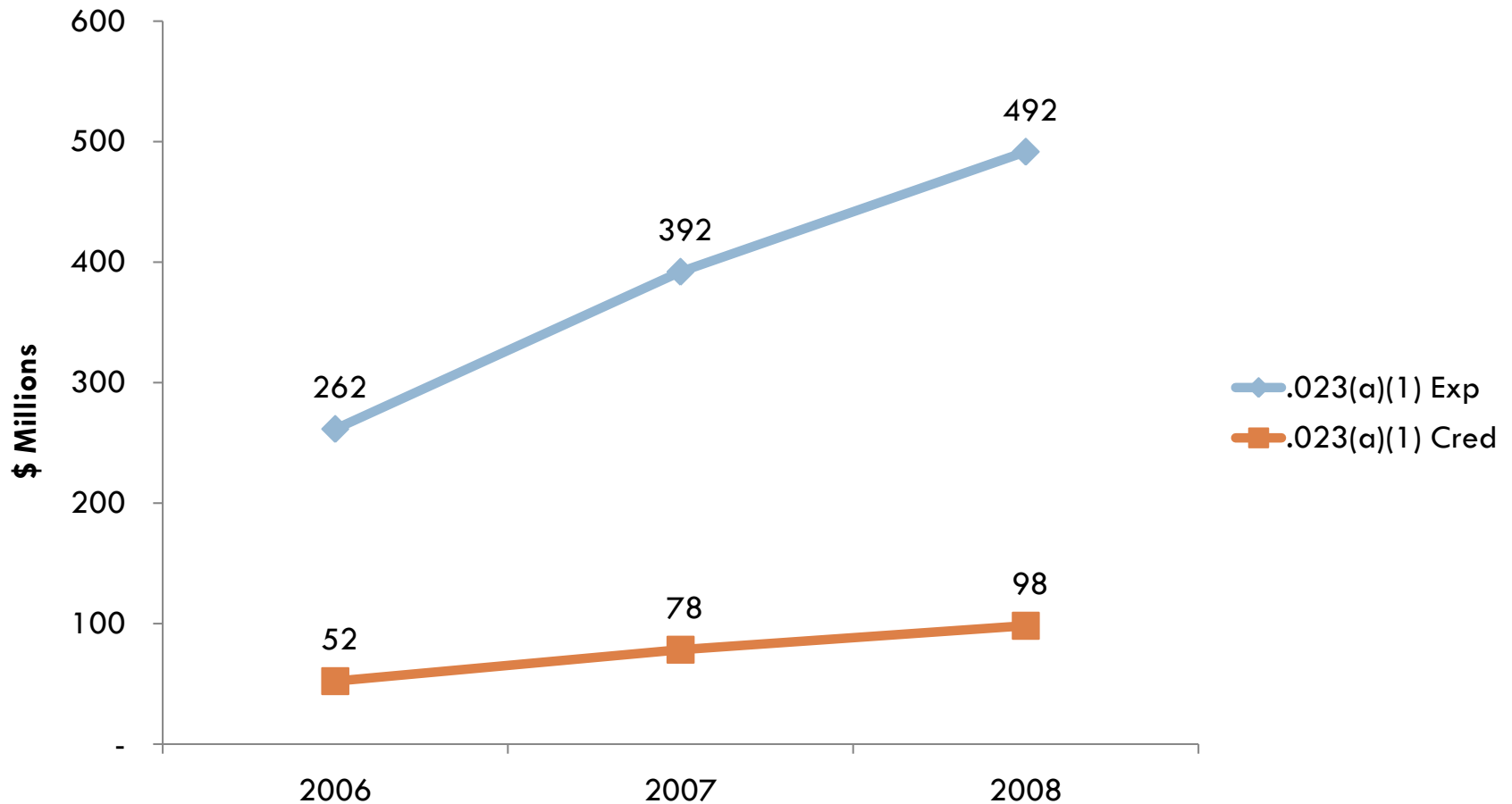
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Tax Credit Analysis

Capital Credit Certificates under .023(a)(1)

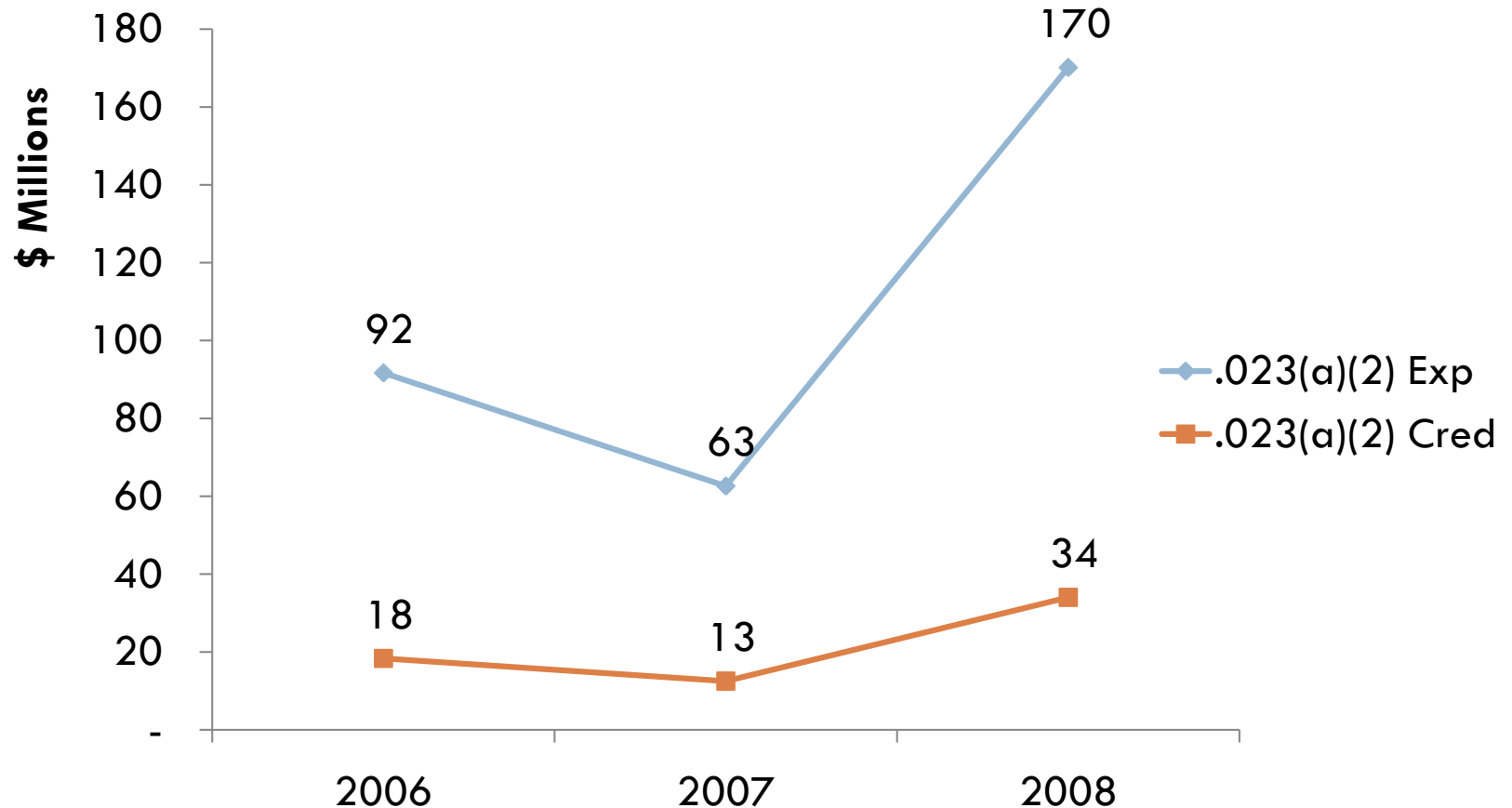
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Tax Credit Analysis

Capital Credit Certificates Under .023(a)(2)

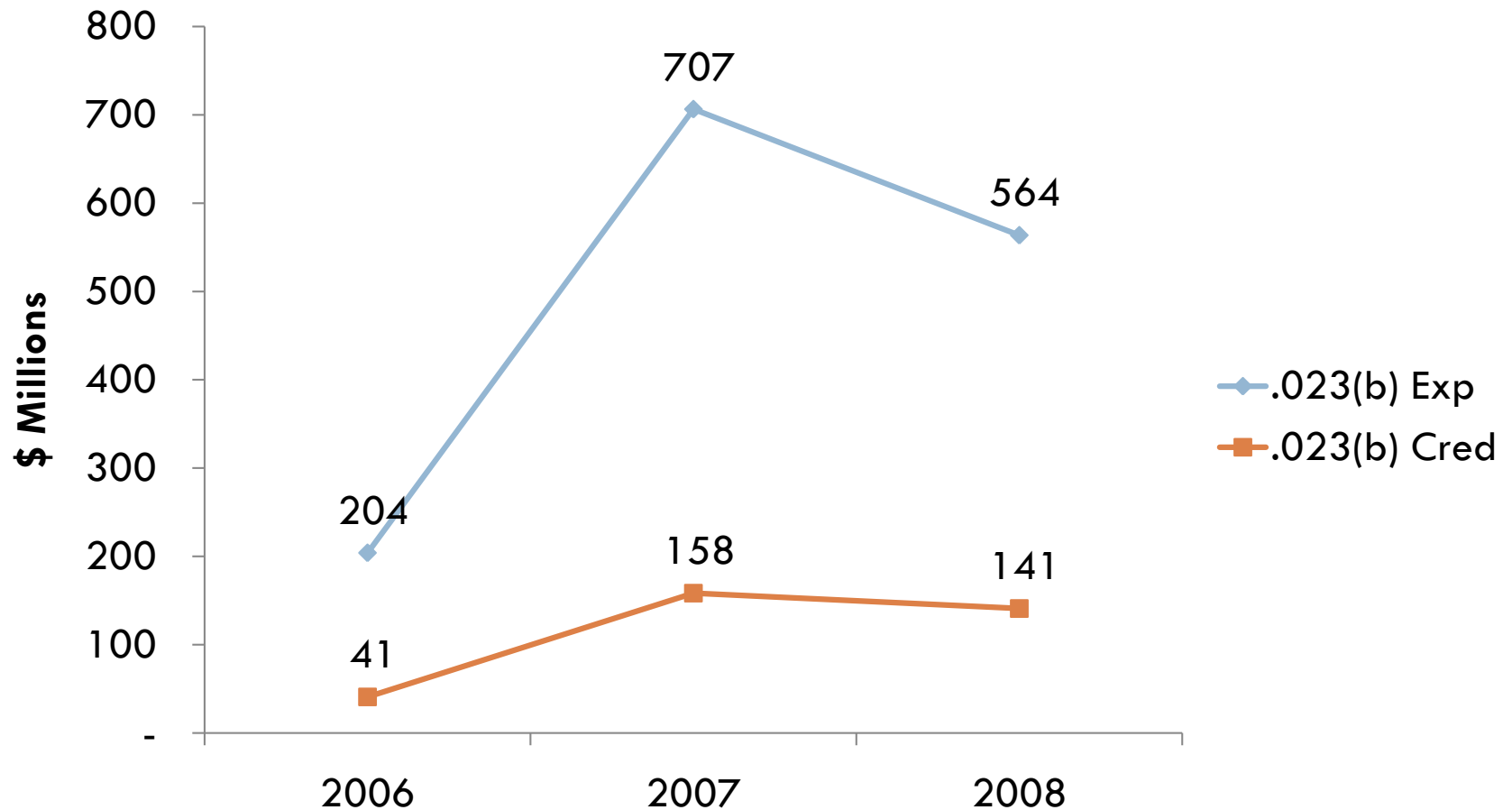
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Tax Credit Analysis

Expenditures vs. NOL Credit Certificates

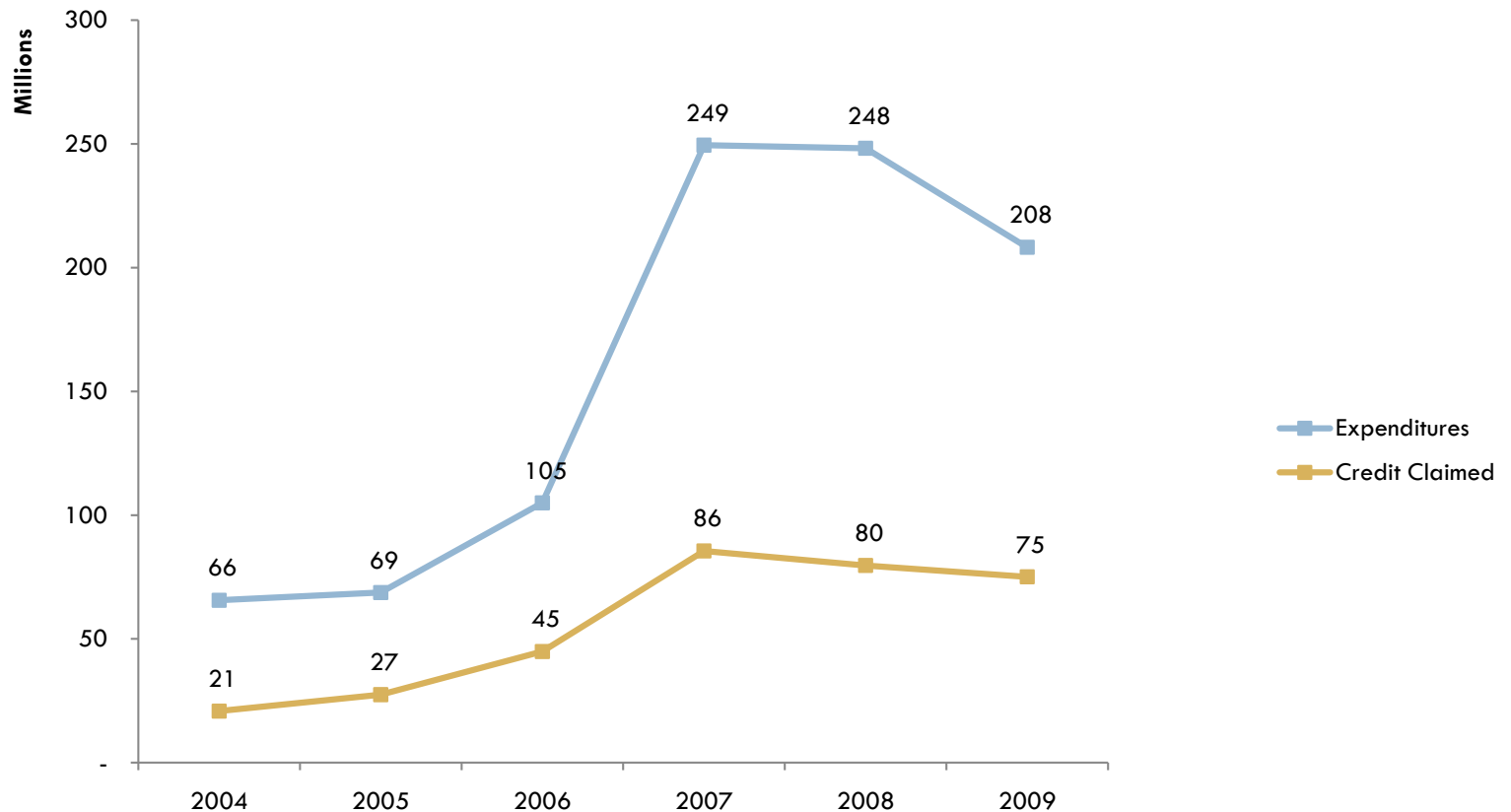
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Tax Credit Analysis

Expenditures vs. .025 Exploration Credit Applications

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Conclusions

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- ❑ Legacy NS Fields- Increase in Producers' Capital expenditures from 2006-2008 but plateau in Capital deductions from 2007-2008
- ❑ Non-Legacy NS fields and Cook Inlet- Steady Increase in Capital expenditures
- ❑ Since 2007- Exploration Credit Applications have more than doubled
- ❑ Increased .023(a)(2) and NOL credits in 2007 and 2008 also suggest increased Exploration activity