

Evaluation of ACES with HB 110 Proposal

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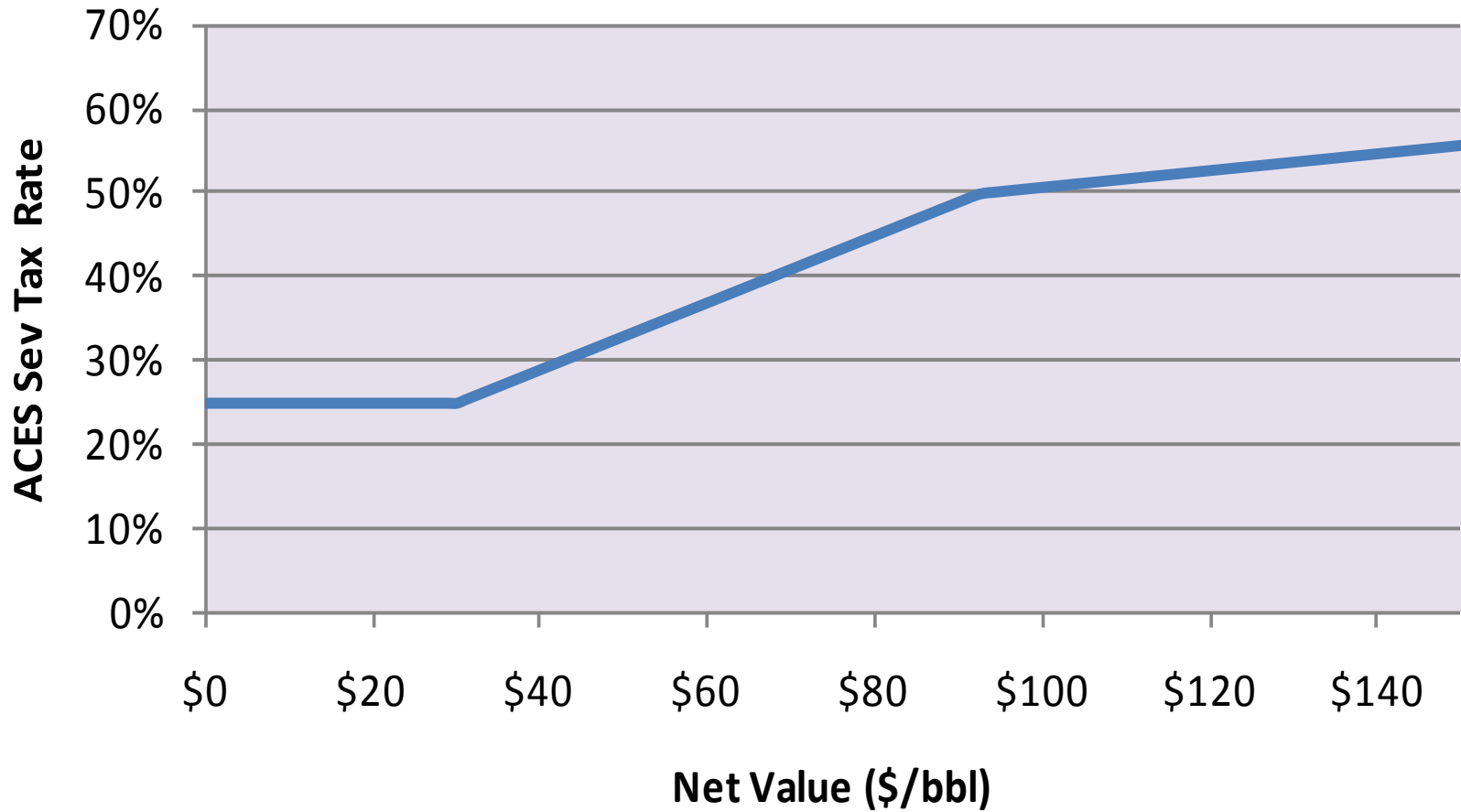
Overview

- I. How ACES Operates / Problems it Creates
- II. International Competitiveness
- III. Current Evidence of Problems from ACES
- IV. Proposal to Fix ACES

Tax Rate under ACES

- Base rate of 25% of net value (after deducting all costs)
- Progressivity element when net value per barrel exceeds \$30/bbl:
 - $(\text{Net value per barrel value} - \$30) \times .004$
- If oil market price is \$90/bbl:
 - Net value per barrel is \$58/bbl
 - $\text{Progressivity} = (\$58 - \$30) \times .004 = 11.2\%$
 - $\text{Total tax rate} = 25\% + 11.2 = 36.2\%$
 - $36.2\% \times \$58 \times 0.875 \text{ (non-royalty)} = \$18.37/\text{bbl}$
 - **APPLIES TO ENTIRE NET VALUE**

ACES Severance Tax Rate

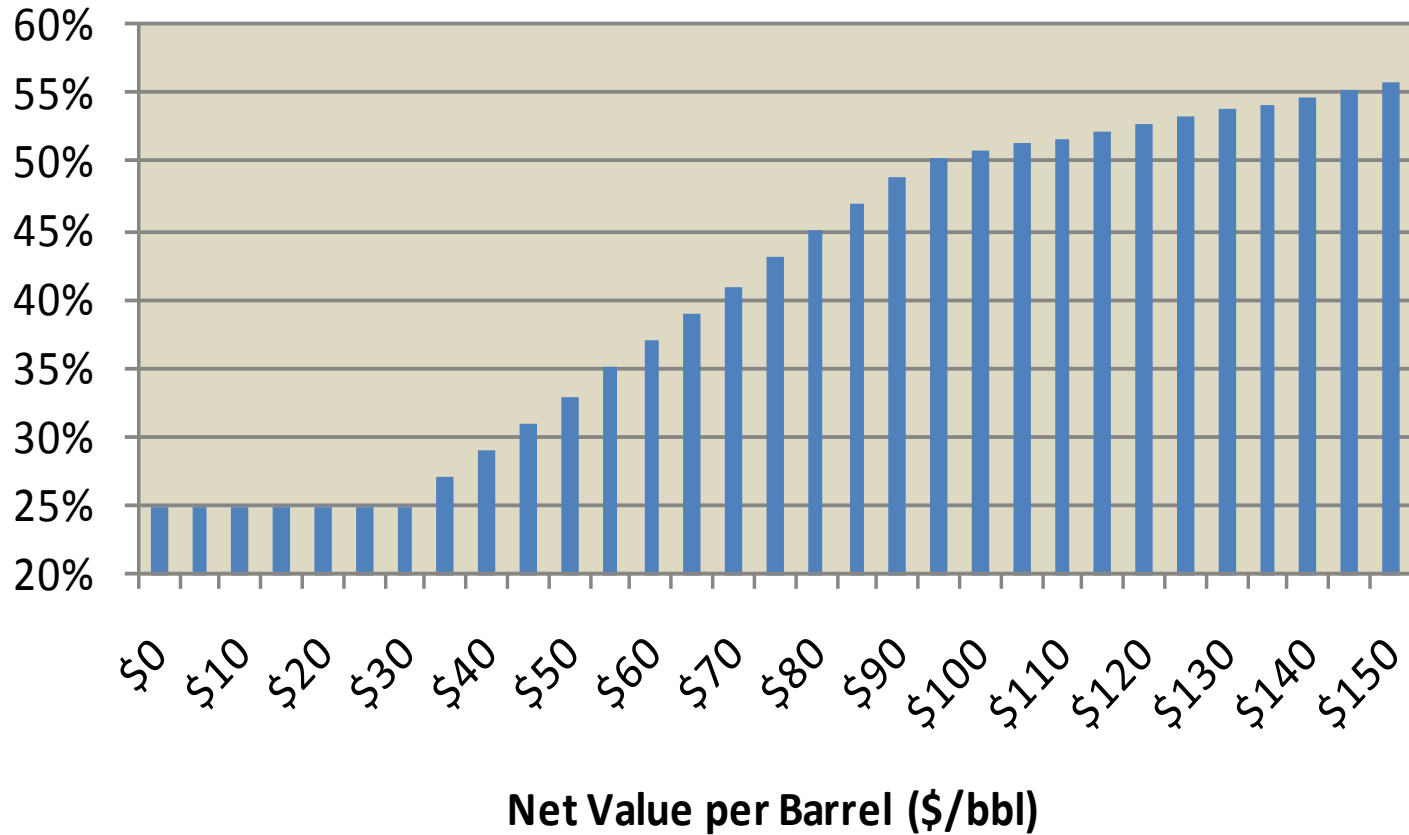


2010 U.S. Tax Rate for Single Taxpayer

- First \$8,375 10%
- Next \$25,625 15%
- Next \$48,400 25%
- Next \$89,450 28%
- Next \$201,800 33%
- Anything over \$373,650 35%

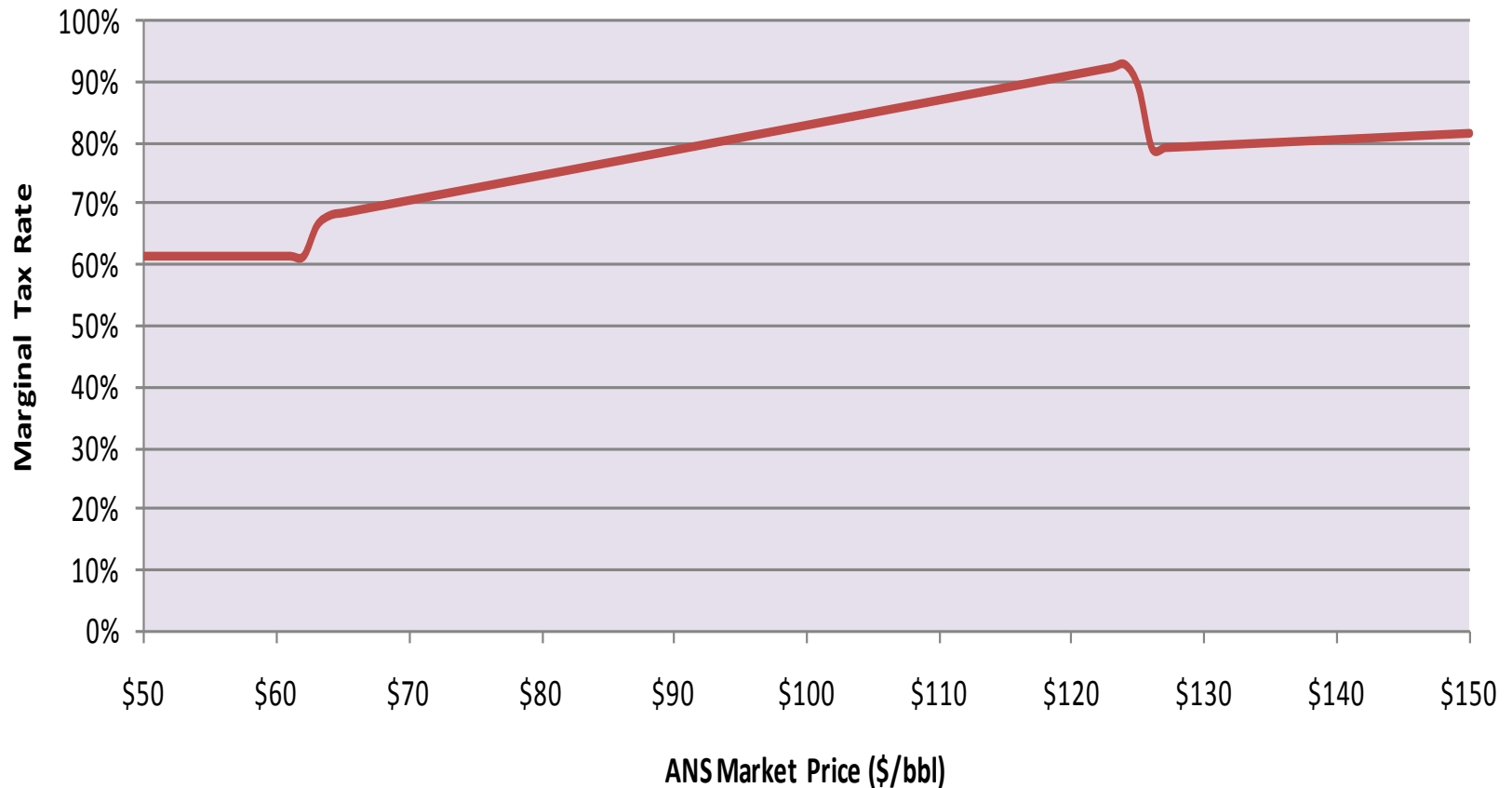
What Happens to the First Dollar of Value under ACES

Tax Rate on the First Dollar of Value

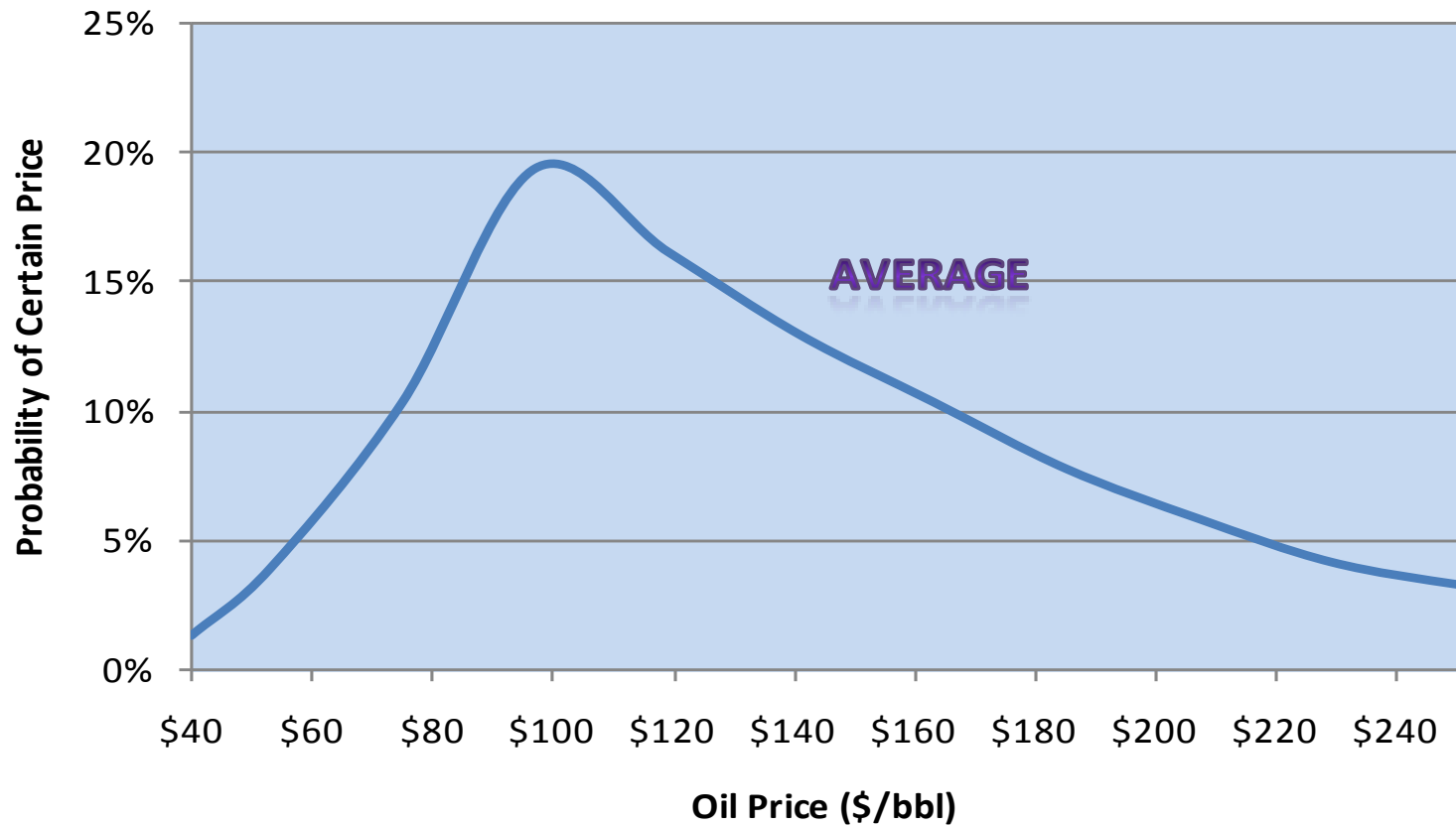


Marginal Tax Rate under ACES (All State & Federal Taxes & Royalties)

How Much Gov't Gets When Price Goes Up \$1

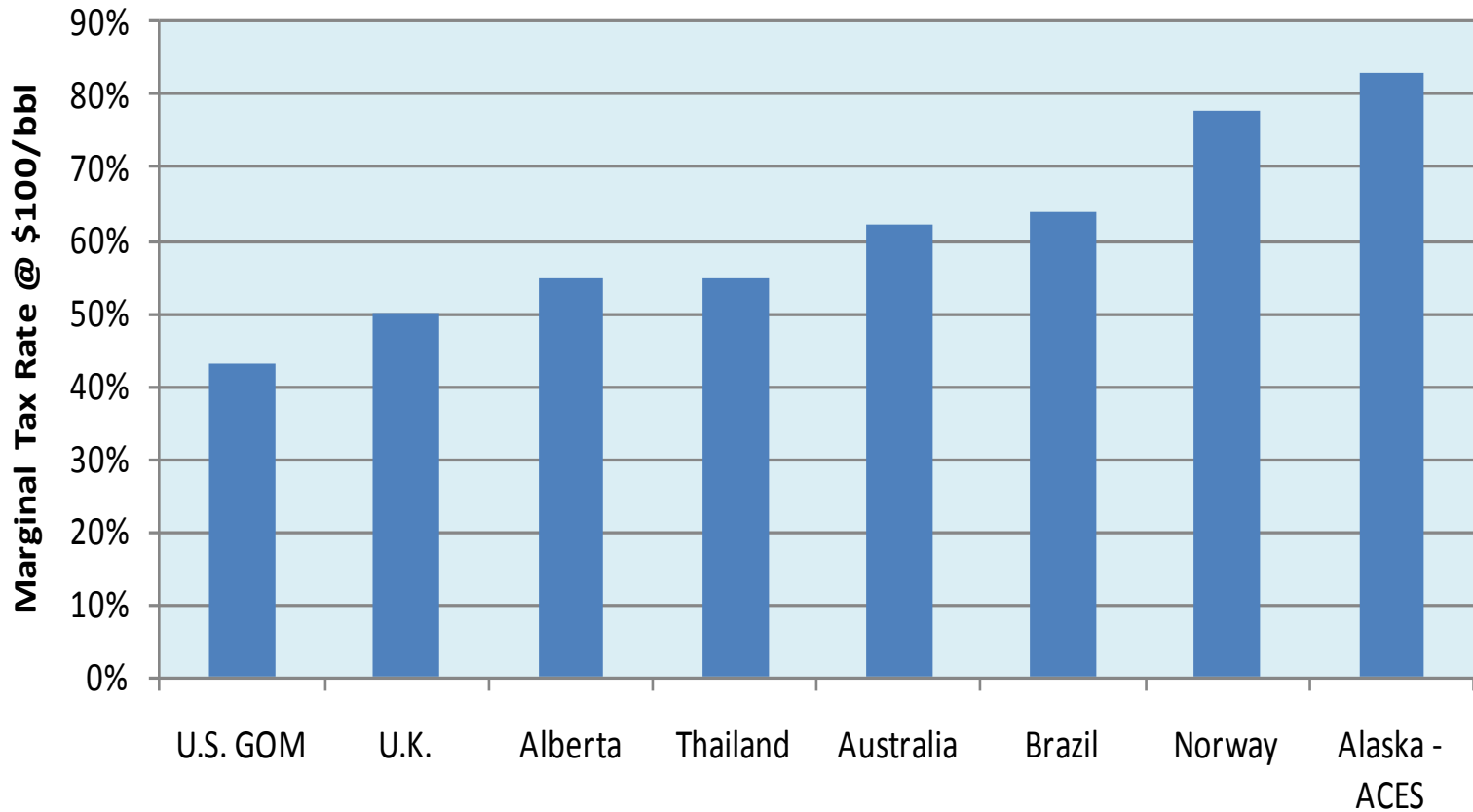


Hypothetical Expected Price Outlook

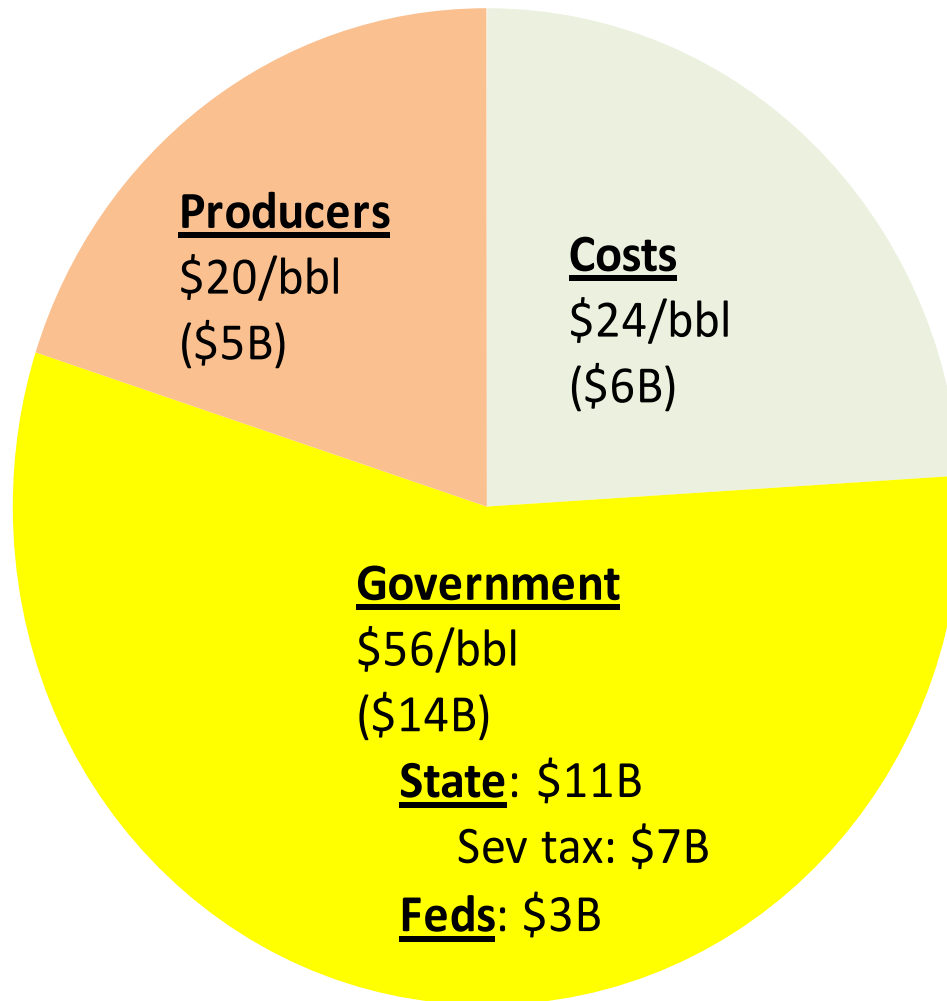


International Competitiveness

International Marginal Tax Rates @ \$100/bbl Market Price Tax & Royalty Regimes



Where \$100/bbl (\$25B) Went in 2008



After-Tax Income that Would Have Been Earned in Alaska in 2008
With Rates from Other Tax & Royalty Regimes
(\$billions)

Gulf of Mexico	\$10.3
U.K.	\$9.0
Alberta	\$8.2
Thailand	\$8.2
Australia	\$6.9
Brazil	\$6.6
Alaska	\$5.0
Norway	\$4.1

ConocoPhillips Financial Performance: Alaska vs. Rest of World (\$millions)
2008 (\$100/bbl) vs. 2009 (\$60/bbl)

	<u>Alaska</u>	<u>Rest of World</u>
Additional pre-tax income 2009 over 2008	\$3,673	\$14,707
Additional taxes 2009 over 2008*	<u>\$2,898</u>	<u>\$7,163</u>
Additional after-tax income 2009 over 2008	\$775	\$7,544
Percentage of additional pre-tax income retained after-tax	21%	51%

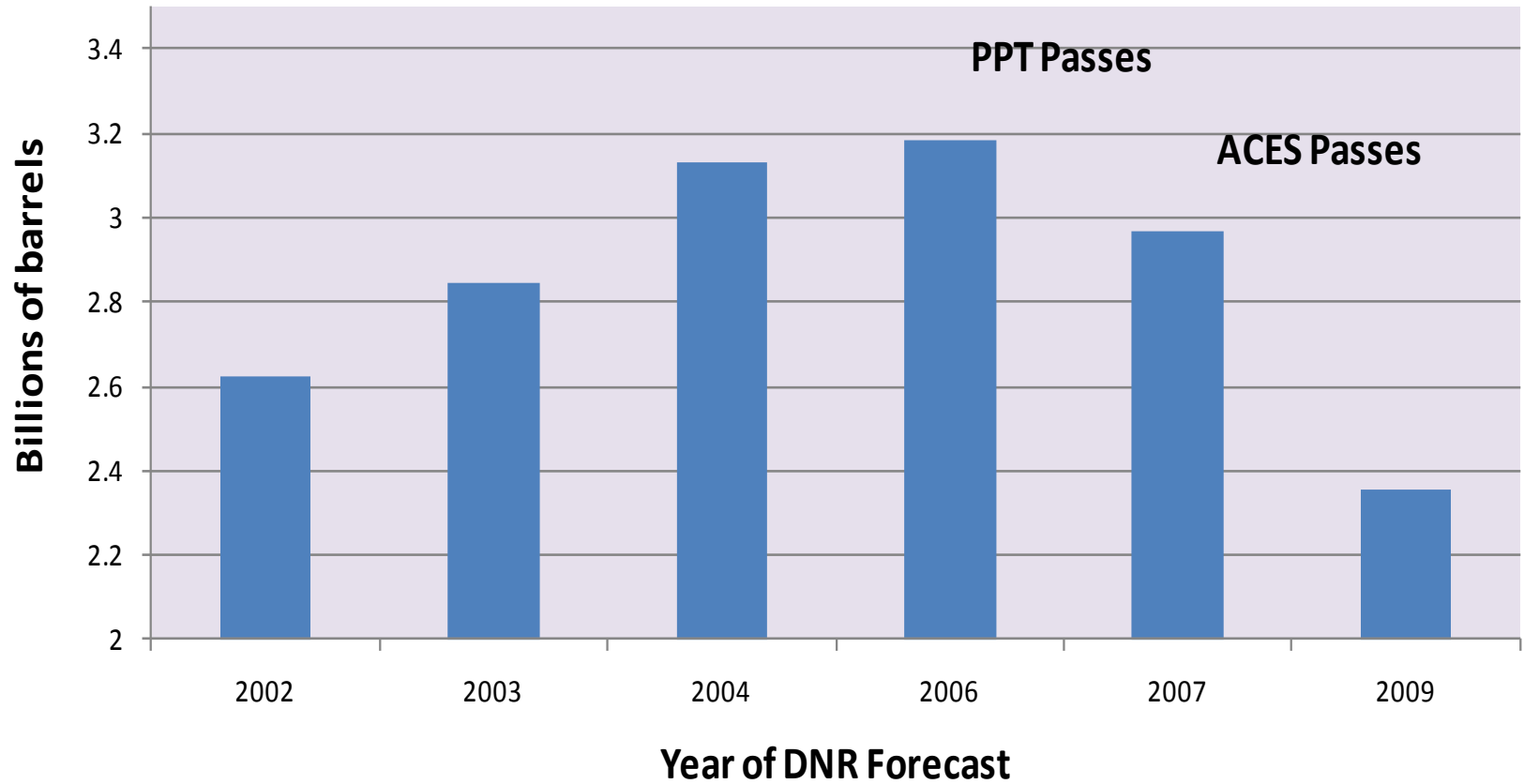
* Alaska: 80% severance tax / 20% income tax; Rest of World: 10% severance tax / 90% income tax

OIL SEVERANCE TAX RATES BY STATE

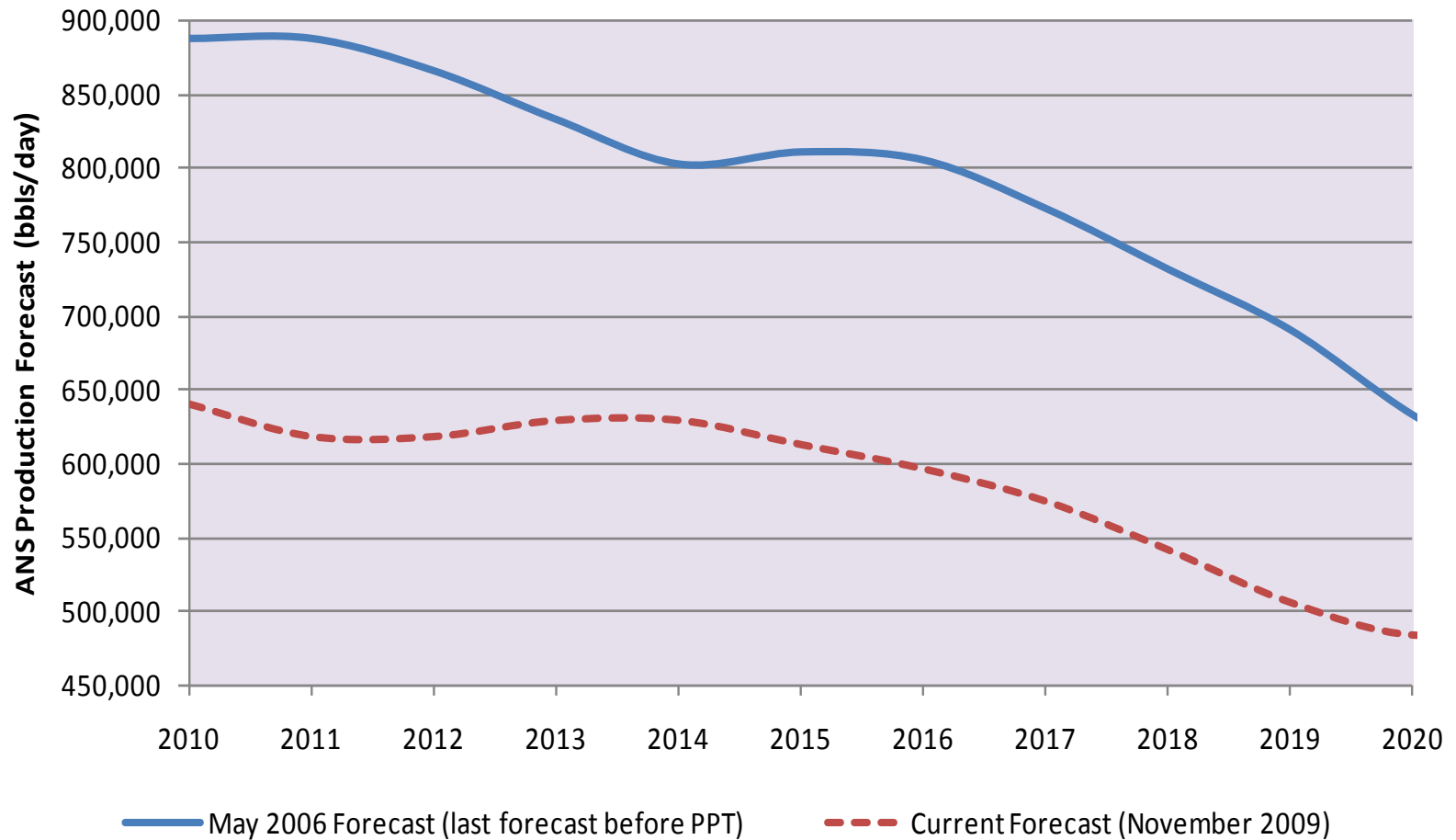
<u>State</u>	<u>Rate (% of gross)</u>	:	<u>State</u>	<u>Rate (% of gross)</u>
		:		
Iowa	NONE	:	Illinois	5.00%
New York	NONE	:	Colorado	5.00%
Pennsylvania	NONE	:	West Virginia	5.00%
Ohio	10 cents/bbl	:	Utah	5.00%
California	0.10%	:	Mississippi	6.00%
Indiana	1.00%	:	Wyoming	6.00%
Nebraska	3.00%	:	Michigan	6.60%
New Mexico	3.75%	:	Oklahoma	7.00%
Alabama	4.00%	:	Florida	8.00%
Kansas	4.30%	:	North Dakota	11.50%
Kentucky	4.50%	:	Louisiana	12.50%
South Dakota	4.50%	:	Montana	12.50%
Texas	4.60%	:	<u>ALASKA @ \$90 market</u> (25 % of gross equivalent)	
Arkansas	5.00%			

The State is Making
Lots of Money Now:
What is the Problem?

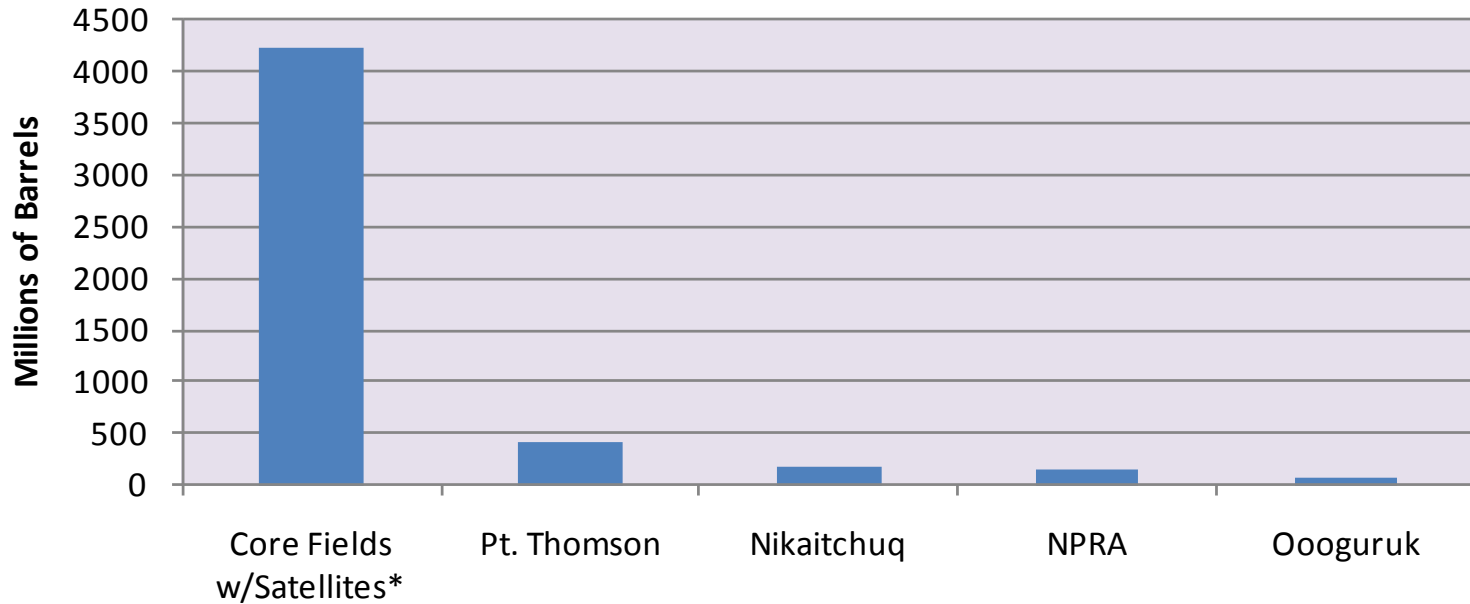
A History of DNR Forecasts of Total Production between 2010 and 2020 (billions of barrels)



Dept of Natural Resources ANS Production Forecast Before & After PPT (bbls/day)



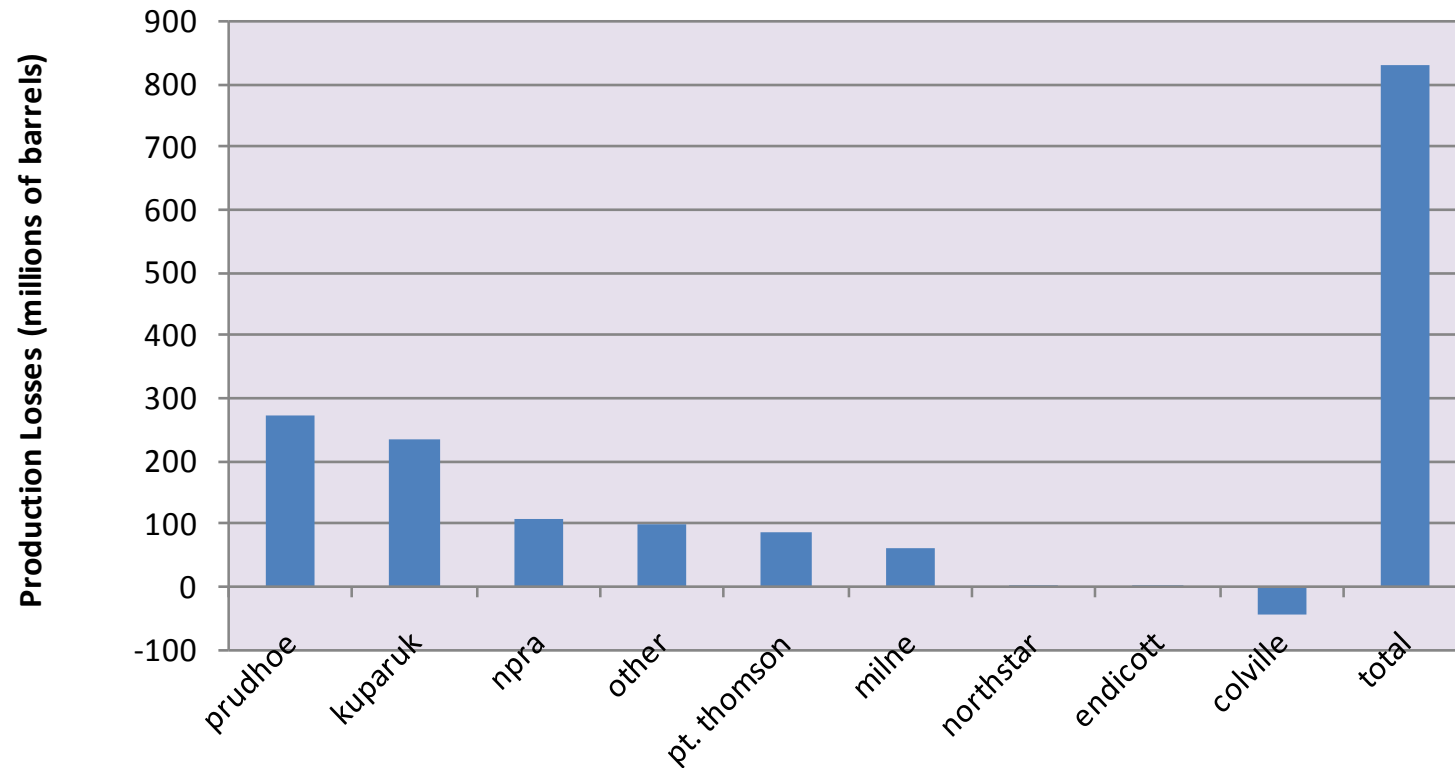
Oil Production Forecast 2010-2050 (Millions of Barrels)



*Core fields are Prudhoe, Kuparuk, Alpine, Endicott, Milne Pt., Northstar

Source: DNR Division of Oil & Gas 2009 Annual Report: p. 29

Total Forecasted Production Losses 2010-2020 between 2006 and 2009 Forecasts (millions of barrels)



Investment: The Big Picture

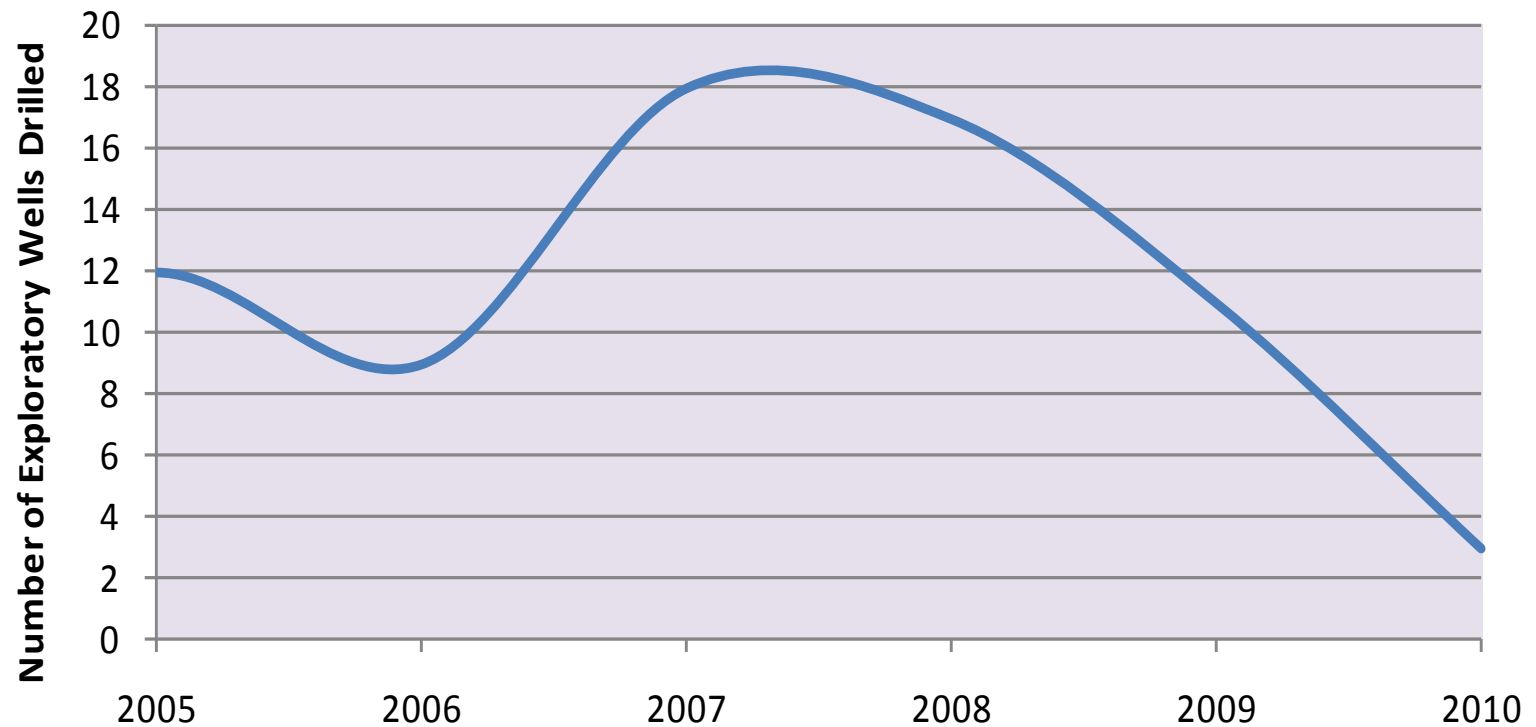
- Production requires capital investment
- At the corporate level Alaska competes for capital with other jurisdictions
 - Capital is finite
 - Capital is fluid
 - Capital will go to where it gets the best deal

Resource Potential

- 2007 Department of Energy report: 10 billion barrels of additional economically recoverable oil on the North Slope **in current core producing area.***
- DNR's current production forecast is for 5 billion barrels between now and 2050.

* Department of Energy, National Energy Technology Laboratory, "Alaska North Slope Oil & Gas: A Promising Future or an Area of Decline?," August 2007, pp. 2 - 152-153.

North Slope Exploratory Wells Drilled: 2005-2010



Context of Spending

- Core fields down*
- Non-core fields up* (Nikaitchuq and Pt. Thomson)
 - A small share of potential reserves
- No other new fields on the horizon
- Gold-plating

* Department of Revenue “Oil and Gas Production Tax Status Report to the Legislature,” January 18, 2011, p. 8.

GOLD-PLATING

Spending more because someone else is picking up the tab

	<u>Before</u>	<u>Spend \$1 in Capital</u>
ANS Market Price	\$90.00	\$90.00
Less:		
Transportation Cost	\$6.00	\$6.00
Capital Cost	\$13.00	\$14.00
Operating Cost	<u>\$13.00</u>	<u>\$13.00</u>
Net value	\$58.00	\$57.00
Severance Tax		
Severance Tax Rate	36.20%	35.80%
Credit	\$2.60	\$2.80
Severance Tax	\$15.77	\$15.06
Pre-income tax income	\$42.23	\$41.94
Combined state/federal income tax (41%)	\$17.31	\$17.20
After-income tax income	\$24.91	\$24.75
Reduction in income		\$0.17

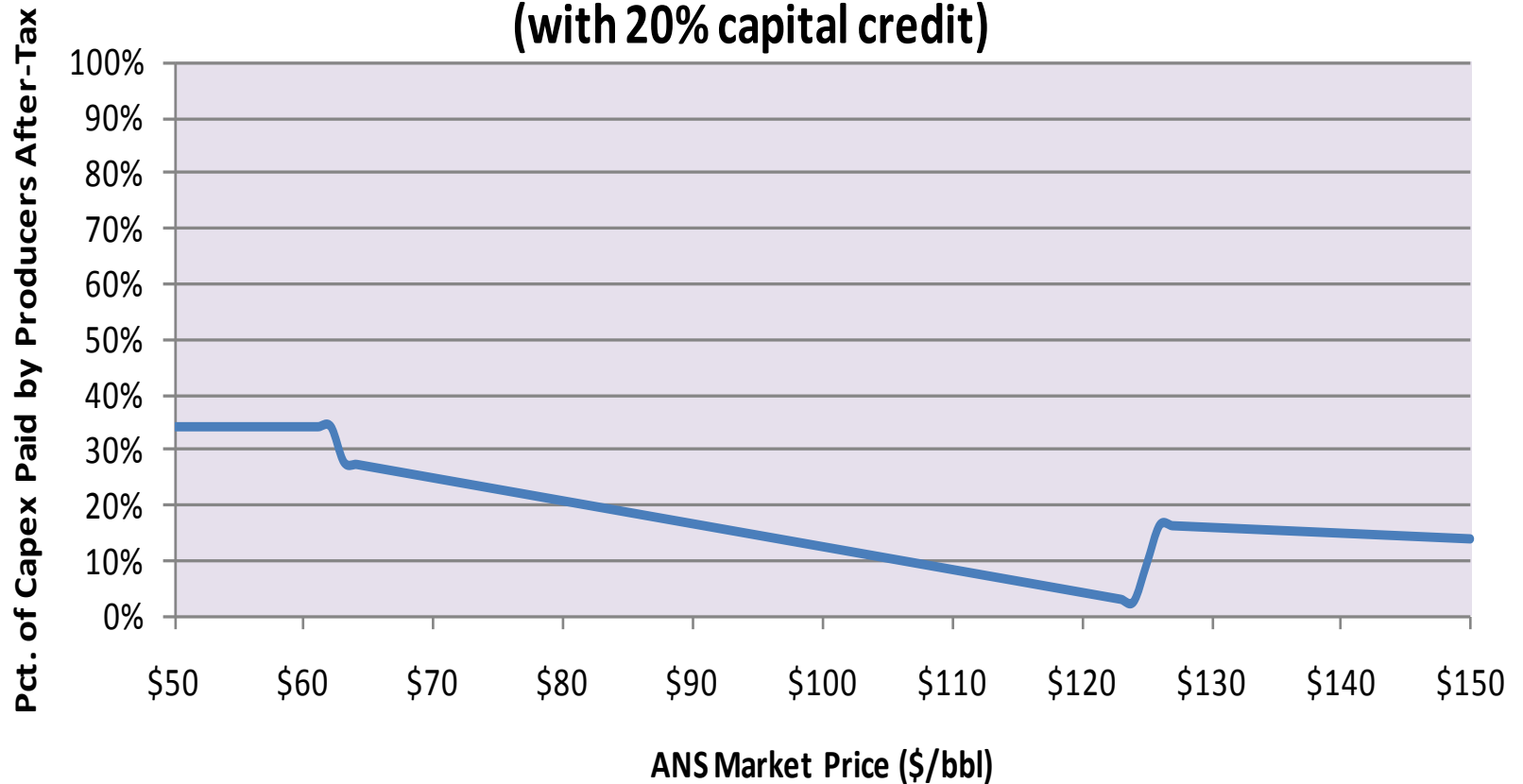
Bottom Line:

Spent \$1 but reduced income by only 17 cents

The purchase only cost 17 cents after-tax

The other 83 cents picked up by the state/feds in reduced taxes

Gold-Plating: Percentage of Capital Cost Paid by Producers After-Tax under ACES (with 20% capital credit)



Implications of Gold-Plating

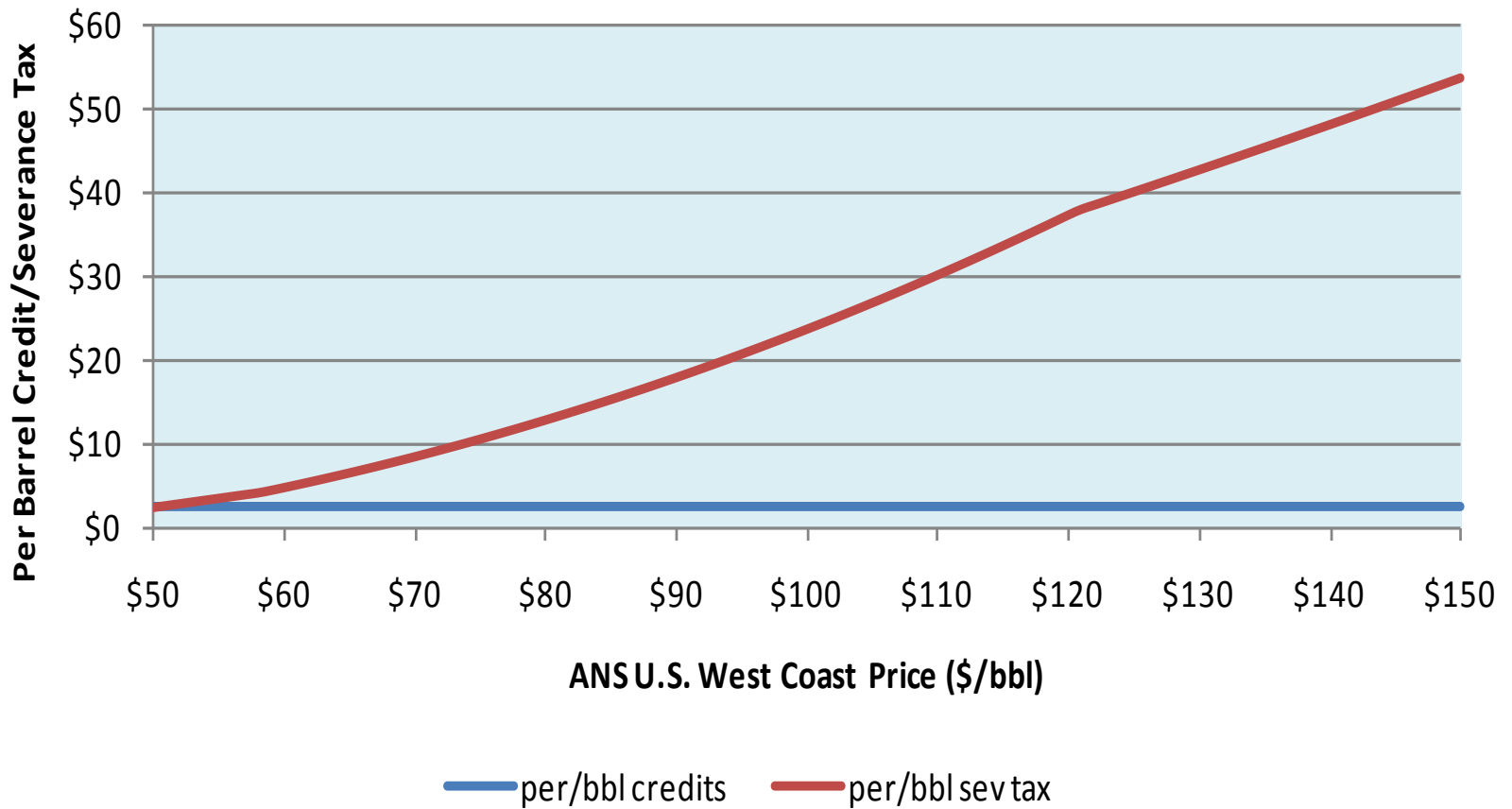
- Gold-plating is not efficient spending (spending to produce barrels)
- Gold-plating happens because of high marginal tax rates at high prices under ACES
- Gold-plating may explain a lot of spending without the commensurate increase in production

Fixing ACES

Fair Share: Economic Aspect

- Maximizing benefit to people
 - Long-term benefit
 - Linked to maximizing long-term production
 - Production maximized by continual investment
- In designing a tax need to be mindful of how Alaska stacks up internationally
- What is “fair” is what you can get in a competitive environment

Cash Flow Impact: Credits vs. ACES Severance Tax



Proposal for Fix: Bracketed Tax Structure

- The problem is not progressivity – but the progressivity structure
- Changing the progressivity structure
 - HB 110:
 - Bracketed progressivity structure
- Values within structure

Proposed Bracket Structure: HB 110 (Existing Units)*

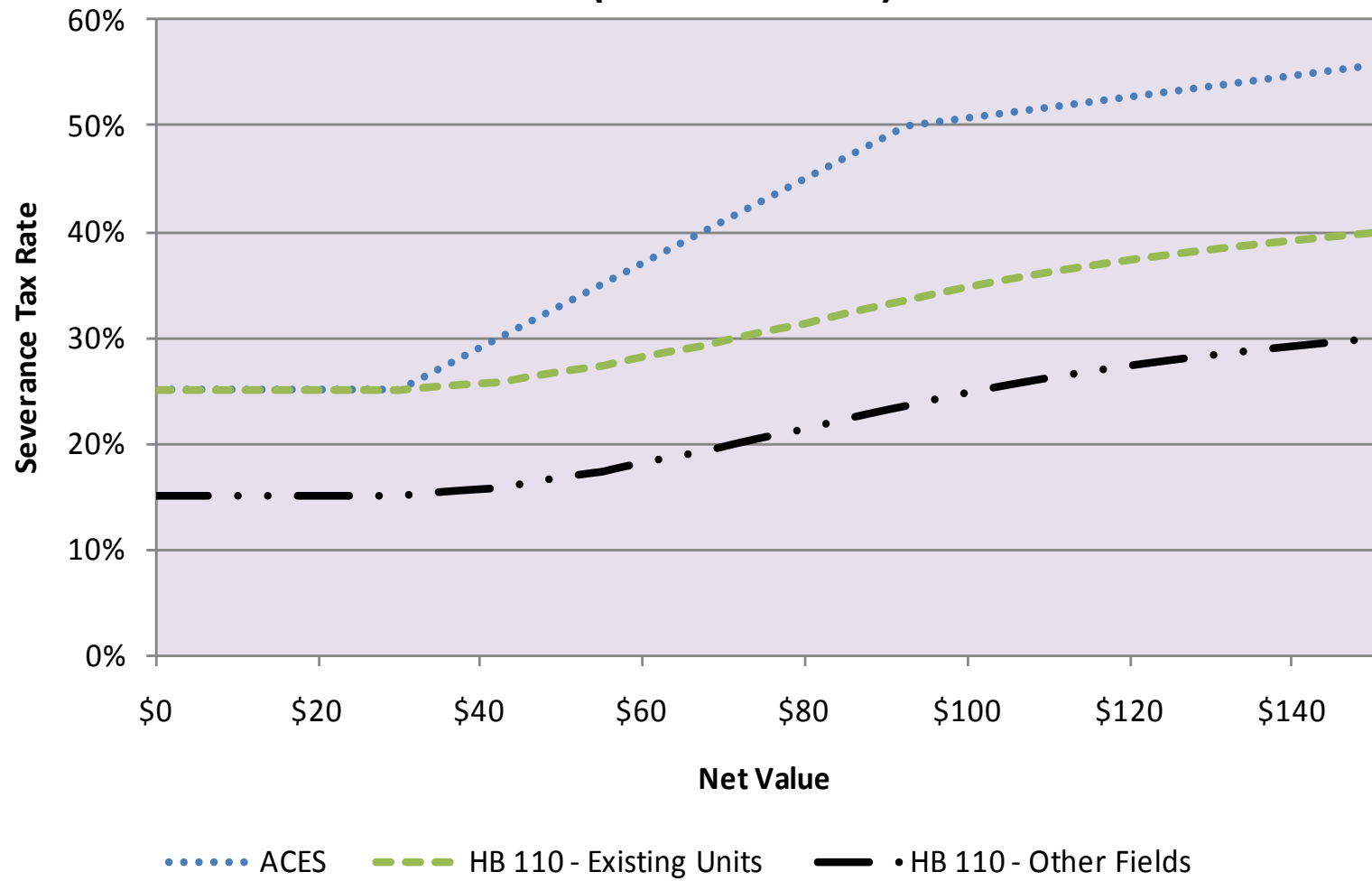
Based on Net Value p/bbl**

• \$0/bbl - \$30.00/bbl	25.0%
• Next \$12.50/bbl (\$30.00 - \$42.50/bbl)	27.5%
• Next \$12.50/bbl (\$42.50 - \$55.00/bbl)	32.5%
• Next \$12.50/bbl (\$55.00 - \$67.50/bbl)	37.5%
• Next \$12.50/bbl (\$67.50 - \$80.00/bbl)	42.5%
• Next \$12.50/bbl (\$80.00 - \$92.50/bbl)	47.5%
• Anything over \$92.50/bbl	50.0%

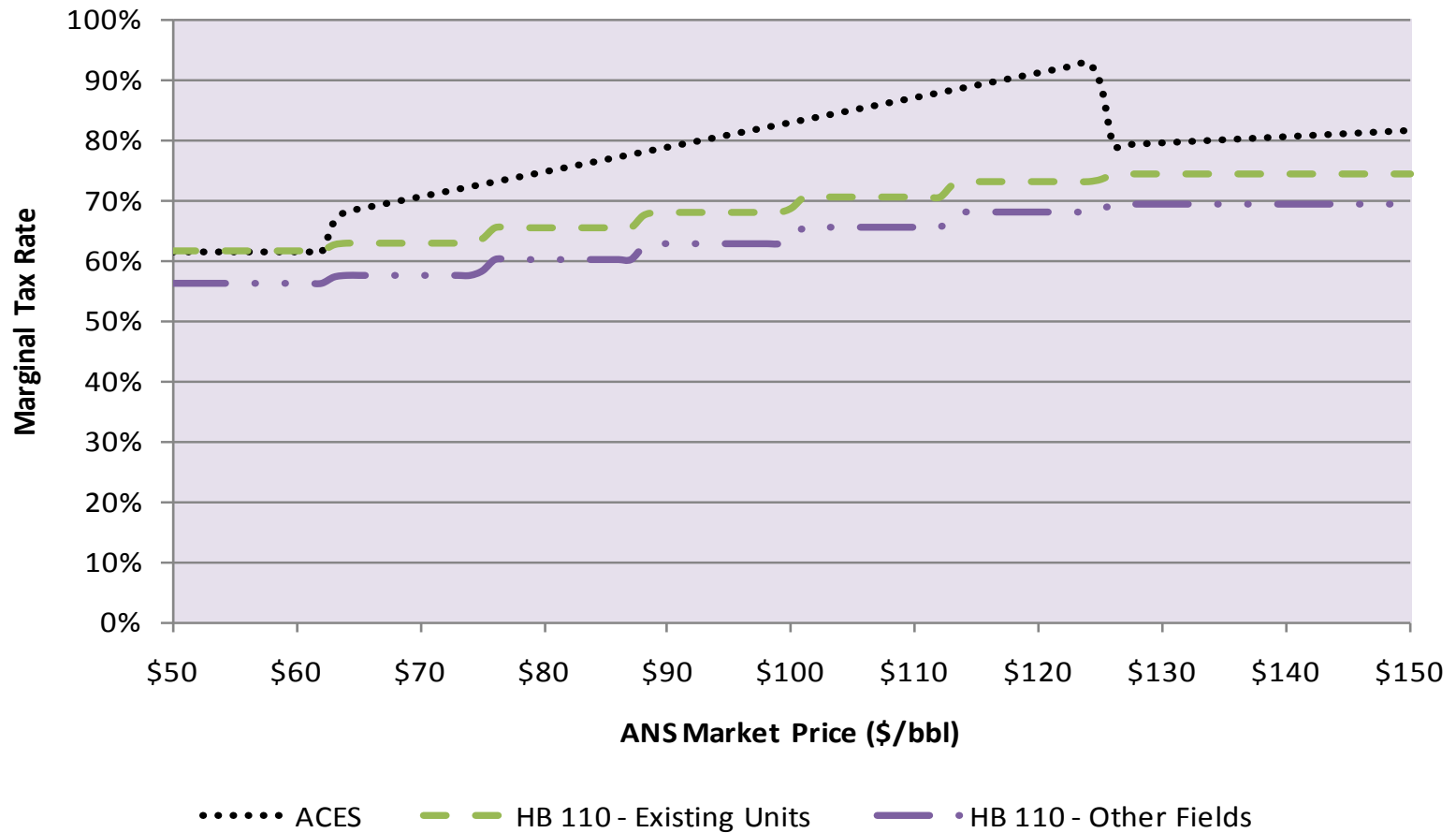
* For other fields outside existing units the tax rates are 10 percentage points less

** These net values are approximately \$30 less than market values (the ANS West Coast price).

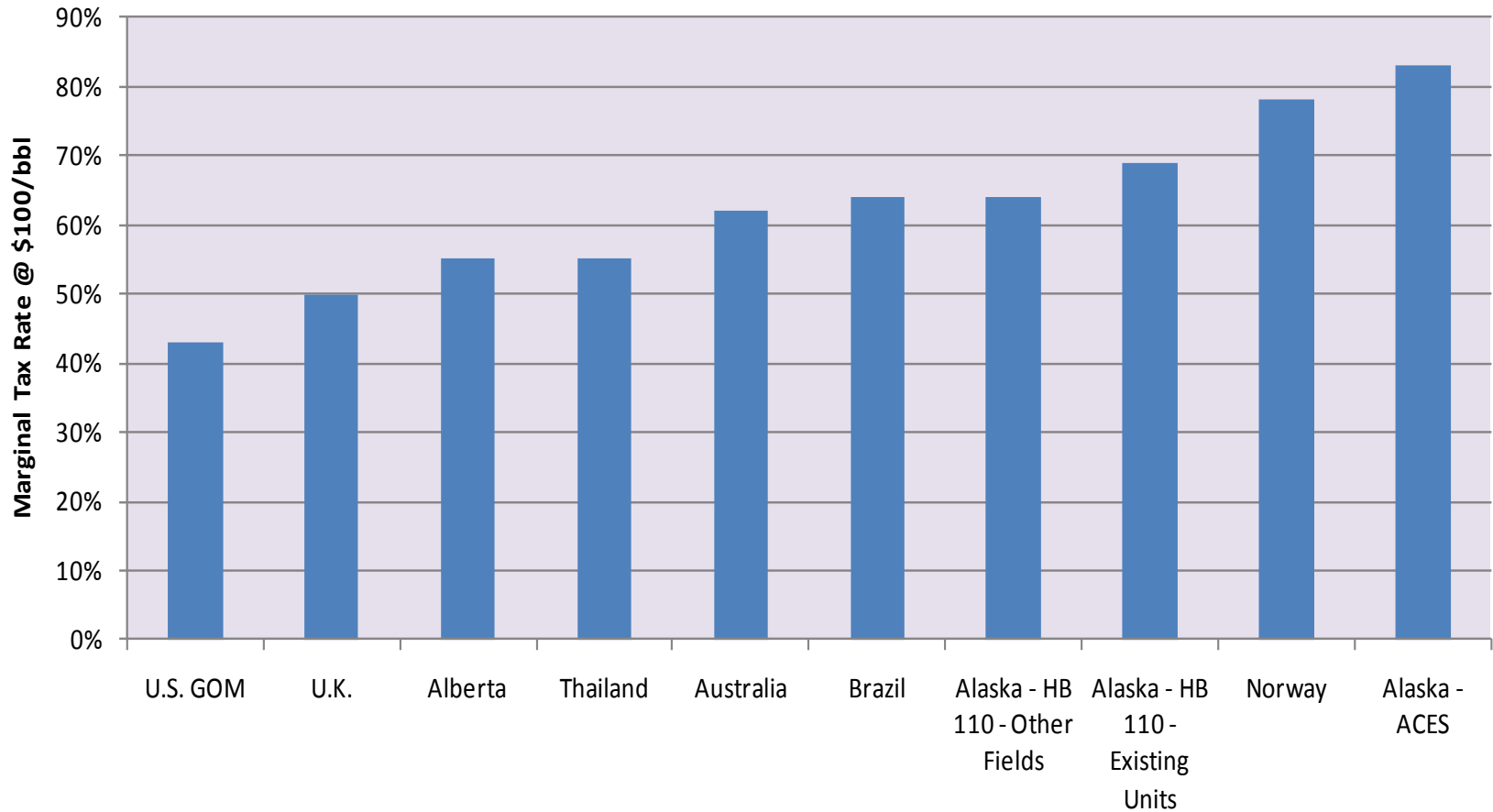
Comparison of Effective Severance Tax Rates (Before Credits)



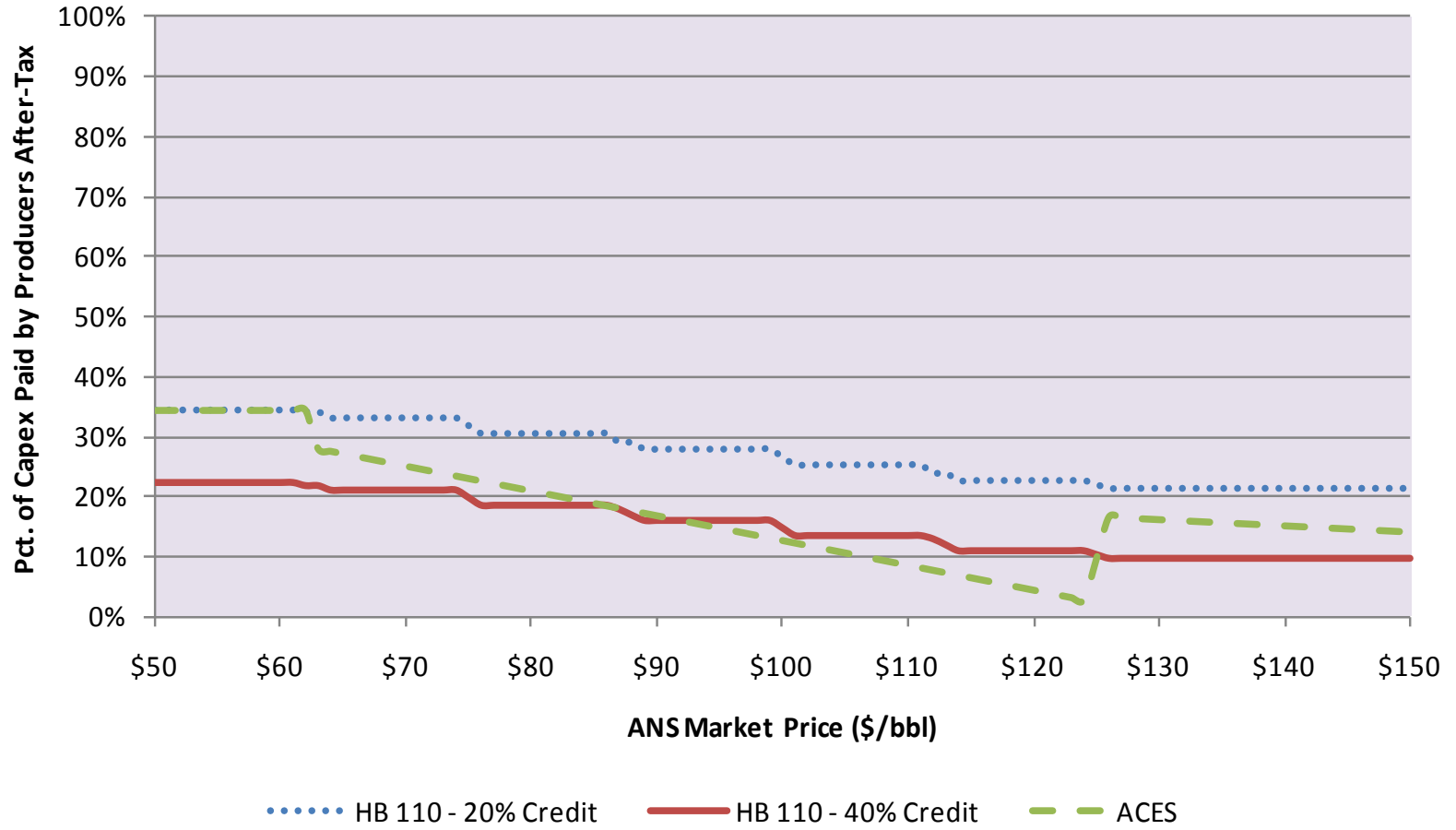
Marginal Tax Rates (All state & federal taxes and royalties)



International Marginal Tax Rates @ \$100/bbl Market Price Tax & Royalty Regimes



Gold-Plating: HB 110 (Existing Units) vs. ACES (Pct. of Capex Paid by Producers After-Tax)



Revenue Losses from Proposal?

- Initial revenue losses likely
- DOR's production forecast does not consider availability of capital
 - Very plausible that status quo production forecast is **too high**
- Very plausible that with lower taxes there will be greater investment and production
 - Very plausible that production forecast under HB 110 is **too low**
- Cannot compare revenues between taxes using the same number of barrels