Alaska Department of Revenue

Oil and Gas Tax Credits- "Middle Earth" Focus

Presentation to Senate Tax Credit Working Group

Anchorage, November 19, 2015

Ken Alper, Tax Division Director
Alaska Department of Revenue

What We'll be Discussing

1. General Information and Terms
2. Categories, Trends, and Latest Data
3. Middle Earth Tax Regime
4. Middle Earth Credits
5. Impending Sunsets / What Will Remain?
6. Potential Legislative Changes

General Information and Terms

General Information and Terms

- Essentially all commercial oil and gas production in Alaska has been from either Cook Inlet or the North Slope
- Other areas have seen sporadic exploration since the early 1900's
  - Jack Roderick book great resource on early history
- In addition to general purpose credits and incentives, various programs created specifically for these areas
  - Geologically promising areas all around the state
  - Diversify supply & expand economy
  - Supply gas for local utilities & economic development

General Information and Terms

"Middle Earth"

- General term for all areas of Alaska outside the North Slope (defined as "north of 68 degrees latitude") and Cook Inlet (defined as a "geological basin")
- Informal term does not appear in statute. First used during legislative debates on PPT bill in 2006

"Frontier Basins"

- Specific term for six promising regions targeted for certain activities in SB23 (2012)

General Information and Terms

- Very little "numbers" reporting is possible
  - Very few actual credits / projects
  - Confidentiality statutes require there to be multiple users of a benefit before we can release an aggregate number
  - Our previous historic credit reports have divided the state into "North Slope" and "Non-North Slope." The great majority of "Non-North Slope" is Cook Inlet, and we can't really say exactly how much

Categories, Trends and Latest Data

Categories, Trends, and Latest Data

FY 2007 thru 2015, $7.4 Billion in Credits

North Slope

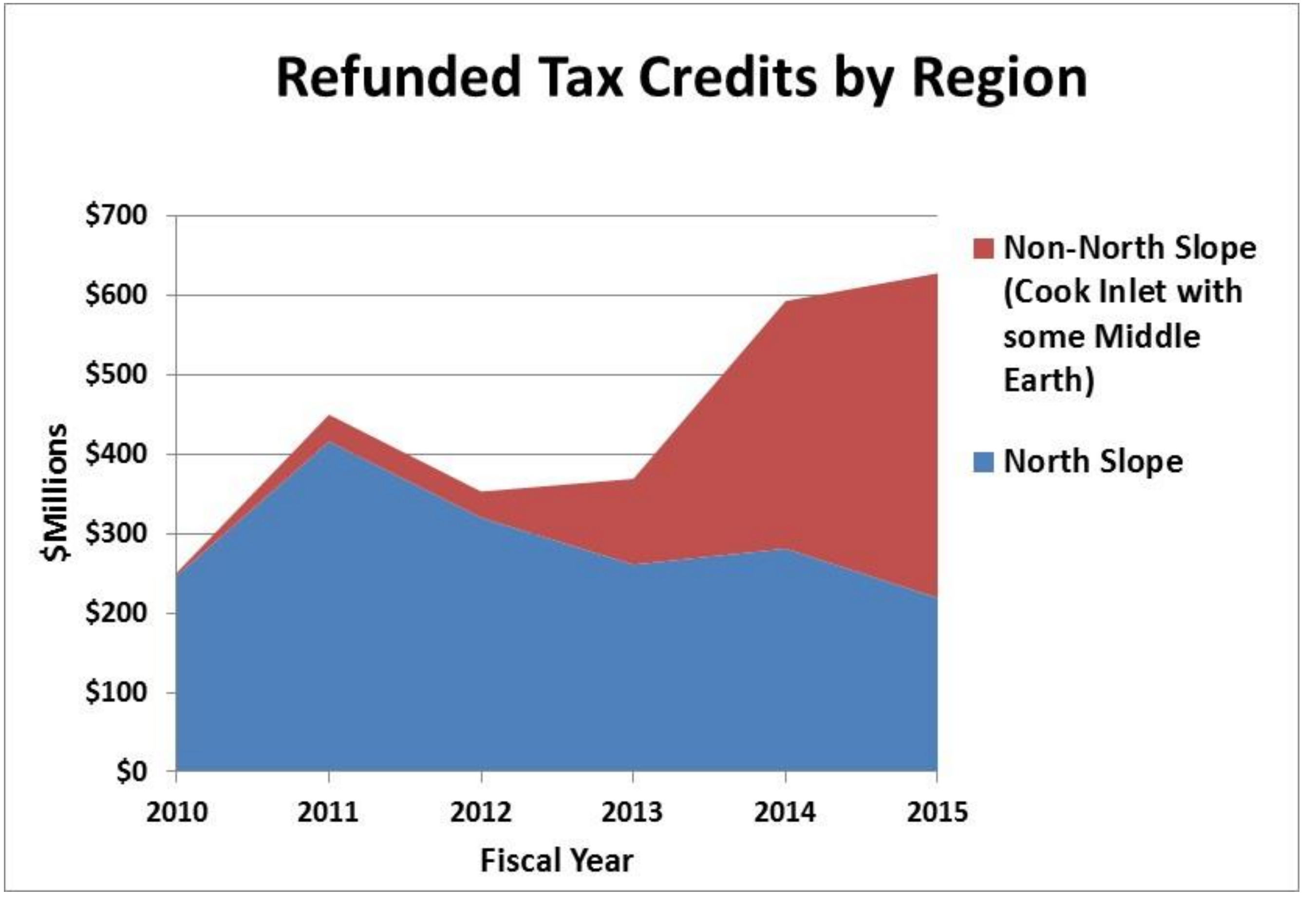
- $4.3 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- $2.1 billion refunded credits
  - New producers and explorers developing new fields

Non North Slope (Cook Inlet & Middle Earth)

- $0.1 billion credits against tax liability
  - Another $0.5 to $0.8 billion Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- $0.9 billion refunded credits (most since 2013)

Categories, Trends, and Latest Data

- Tremendous growth in non-North Slope (almost entirely Cook Inlet) refunded credits since FY10



- Preliminary FY15 Totals on Repurchased Credits ($millions)

	Est. Spring RSB	Prelim.
North Slope "023"	$340	$203
North Slope "025"	$0	$21
Non-NS "023"	$255	$383
Non-NS "025"	$26	$21
Total	**$625**	**$628**

Non-North Slope was 64% of Credits Repurchased by the State in FY15

New Information (Aggregated Data)

Of the $3 billion in state-refunded credits through the end of FY15:

- $1.45 billion went to six North Slope projects that now have production
- $0.65 billion went to 13 North Slope projects that do not have any production. Some of these are abandoned, and some are in process
- $0.45 billion went to six non-North Slope projects that have production
- $0.45 billion went to eight non-North Slope projects that do not have any production

New Information (Aggregated Data)

Of the $500 million in authorized credit repurchases for FY16:

- About <u>$455 million</u> has already been repurchased
  - About $200 million from North Slope and $255 million from Cook Inlet / Interior
  - 56% non-North Slope, similar to FY15 data
- Nearly all are 2014 NOL's and Cook Inlet Drilling
- Most of the applications we have in-hand don't need to be issued until next July

Middle Earth
Tax Regime

Middle Earth Tax Regime

- No historic commercial production
- Before 2006, the whole state was on the same "ELF" tax system as the North Slope
- ELF was a 12.25%-15% gross tax with a multiplier (0 to 1) to help challenged fields
  - Calculation for each field was based on production per well-day
  - Multiplier dropped to zero at the "economic limit" which was set at 300 barrels/ day

Middle Earth Tax Regime

- Initial 2006 PPT bill, as introduced applied statewide
  - Concern with Cook Inlet gas supply and a tax increase harming exploration and development
  - With the intent of "holding Cook Inlet harmless," <u>Legislature added ELF-based Tax Cap in PPT, which remained with passage of ACES</u>
- The 2007 ACES bill extended the "Cook Inlet tax cap" to "all gas used in the state"

Middle Earth Tax Regime

- AS 43.55.011(o): Before January 1, 2022, tax on gas produced outside of Cook Inlet and consumed in state is taxed at the average tax rate (and average price of gas) for Cook Inlet taxable gas in the year preceding April 1, 2006.
- Production tax on gas in Cook Inlet varies from field to field, averages about 17 cents/ mcf
- **So production from "middle earth" before 2022, per ACES, would be pegged to that average tax figure of about 17 cents / mcf**

Middle Earth Tax Regime

- SB23 from 2012 added AS 43.55.011(p) (this was the "Frontier Area Credits" bill, originally HB276, that became an omnibus end-of-session bill along with the Film Tax Credit renewal and the Small Business Corporate Income Tax Exemption)
- For <u>any oil or gas</u> produced outside Cook Inlet and North Slope that begins <u>production before 2022</u>, the tax may not exceed <u>4% of gross</u> value for the <u>first seven years</u> of production
- More on the "credits" parts of this bill in a few slides

Middle Earth Tax Regime

- The major oil and gas tax change that passed in 2013, SB21 did not apply outside the North Slope
- In 2022, the tax caps for gas in-state sunset.
  No later than 2029 (7 years after first production in 2022), the 4% gross tax cap sunsets
- Tax regime will revert to the “underlying” statute, which is a hybrid of ACES and SB21:
  - 35% flat tax rate (SB21)
  - 20% capital credit (ACES)
  - 25% carry-forward annual loss credit (ACES)
  - 40% well credit (Cook Inlet Recovery Act)
  - No per-taxable barrel credit, GVR, or minimum tax

Middle Earth
Tax Credits

Middle Earth Tax Credits

- 20% Qualified Capital Expenditure Credit (AS 43.55.023(a))
  - Incentive to develop new projects and reinvest in existing fields
  - ACES-era credit that was repealed for the North Slope in 2014
  - Can be for either exploration or development expenditures
  - Can be cashed out regardless of whether a company is profitable, so long as they have no tax liability

Middle Earth Tax Credits

- 40% Well Lease Expenditure Credit (AS 43.55.023(l))
  - Alternative to Capital credit, added in 2010 by HB280 (Cook Inlet Recovery Act).
    Extended to all areas of state south of 68 degrees
  - Gives greater tax advantage to specific well drilling expenditures, “intangible drilling costs”
  - Can be for either exploration or development wells
  - Can be cashed out regardless of whether a company is profitable, so long as they have no tax liability
  - An expense cannot qualify for both 023(a) and 023(l)

Middle Earth Tax Credits

- 25% Carry-forward annual loss (sometimes called “Net operating loss” or “NOL”) credit (AS 43.55.023(b))
  - Reimburses companies for a percentage of their net operating losses
  - <u>Stackable</u> with Capital, Well, or Exploration credits

Middle Earth Tax Credits

- Alternative Credit for Exploration (AS 43.55.025(a)-(f))
  - 30-40% refundable credit for certain exploration activities
  - DNR pre-approval and data submission requirements
  - Originally added to statute in 2003, before switch to net profits system
  - Can be stacked with 023(b) (NOL) credits
  - Sunsets 7/1/16 for North Slope and Cook Inlet
  - **Extended to 1/1/22 for Middle Earth**

Middle Earth Tax Credits

- Frontier Areas Credit (AS 43.55.025(a)(6-7); AS 43.55.025(m-o))
  - Added in 2012 by SB23
    Modeled on "jack-up rig" credit for Cook Inlet
  - 75% up to $7.5 million for first four seismic shoots
  - 80% up to $25 million for first four exploration wells
  - Six target areas defined by latitude and longitude near **Fairbanks, Glennallen, Kotzebue, Emmonak, Egegik, and Port Moller**
  - Not combinable with other credits including Net Operating Loss
  - Sunsets 7/1/16

Middle Earth Tax Credits

- $15 million Liquefied Natural Gas Storage Facility Credit (AS 43.20.047)
  - Added in 2012 by SB23.
    Modeled on “gas storage facility” credit for Cook Inlet
  - $15 million or up to 50% of cost
  - Minimum 25 million gallon capacity for a new facility
  - Must be regulated as a utility
  - In service by January 1, 2020

Applied against corporate income tax.

Can be received by companies other than oil producers

Middle Earth Tax Credits

For any producers with tax liability, two specific credits were added by PPT in 2006:

- Small Producer Credit (AS 43.55.024(c))
  - Credit of up to $12 million / year for producers with less than 100,000 bbl / day of production
- Middle Earth Credit (AS 43.55.024(a))
  - Credit of $6 million / year for any producers
- Both of these are not refundable. Cannot reduce taxes below zero. Cannot be carried forward
  - Closed to new applicants in May 2016. A company can receive both of these credit for up to nine years
  - None have been used in “Middle Earth”

Impending Sunsets / What Will Remain?

Sunsetting in Middle Earth:

- Small Producer Credit
- Middle Earth Credit (the old $6 million PPT-era credit)
  - For both of these, no longer able to apply if no production by 5/1/16
- Frontier Basin Credits (from 2012 bill)
  - 75% Seismic / 80% Exploration Well
  - Work must be done before 7/1/16

Remaining in Middle Earth:
Explorers

- Exploration Credits remain until 1/1/22
  - Most expenditures will qualify for the highest level (40%) of the “exploration” credit
- Most expenditures will also qualify for the “carry forward annual loss” or “NOL” credit (25%)
- These are “stackable,” meaning state reimburses about **65%** of total expenses

Remaining in Middle Earth:

Developers (pre-Production)

- Most expenditures qualify for either the “capital” (20%) or “well lease expenditure” (40%) credit
  - One or the other
- Most expenditures will also qualify for the “carry forward annual loss” or “NOL” credit (25%)
- These are “stackable,” meaning state reimburses between **45% and 65%** of expenses

Remaining in Middle Earth: Producers

- Choice of two tax caps
  - 17 cent "gas used in state" (before 1/1/22)
  - 4% of gross value for all oil and gas (first 7 years if production begins by 2022)
- Most expenditures qualify for either the "capital" (20%) or "well lease expenditure" (40%) credit
  - State reimburses between **20% and 40%** of non-operating expenses
- As in Cook Inlet, credits greatly outnumber taxes

Potential Legislative Changes

Potential Legislative Changes

- The administration’s tax credit package will likely recommend no specific Middle Earth changes
  - Exploration credits provide substantial benefit for six years longer than the rest of the state
  - Existing tax caps ensure that any discovery that comes into production that will pay little or any production tax
- Other statewide changes may impact, for example, how some refundable credits are repurchased or may introduce new programs
- We look forward to discussing specific legislation

THANK YOU

Please find our contact information below:

Ken Alper
Director, Tax Division
Department of Revenue
Ken.Alper@Alaska.gov
(907) 465-8221

dor.alaska.gov