Tax Testimony to House Resource Committee

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Co-Chairs, 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 along with my colleague Diane Colley, who is BP's Manager of Production Tax and Royalty. BP is a member of AOGA and supports the testimony provided by AOGA earlier today. Diane and I are here to provide BP's views on tax policy and, in particular, HB 247.

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. Under the current market conditions, BP's business in Alaska is spending more cash than it is bringing in, and this is not sustainable. As a result, BP is instituting a reduction in force of ~13% and is evaluating our activity level at PBU in order to adjust expenditures in response to the lower price environment. Improving our cost base is essential to maintaining our 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. It is worth noting

that Alaska's production tax is not a tax on "profits"; it is more accurately described as a tax on cash flow because of the way capital expenditures are treated. Currently we are cash flow negative, yet we still pay 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.

Further, at current prices, BP receives no oil production tax credits from the State of Alaska, nor does Prudhoe Bay production attract oil production tax credits under the minimum tax. While BP doesn't currently receive production tax credits, we also 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, we'd like to provide a few comments specifically about HB 247:

1. <u>The Administration has proposed several changes to the Minimum Tax:</u>
    a. <u>Increase</u> -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.

b. Artificial limitation on 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.

2. 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 would seriously increase the unpredictability of Alaska's tax policy.

3. Net Operating Loss Tax Credit Loss: 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.
4. Confidentiality: Current law allows the Department of Revenue to publicly disclose information about tax credits on an "aggregated" basis for a group of three or more taxpayers, and the Administration proposes to change this to allow disclosure of an individual taxpayer's credit information. Because of taxpayers' privileges and immunities under the U.S. and Alaska constitutions, confidentiality is the cornerstone for the Department of Revenue's legal authority to require taxpayers to report and pay their own taxes without violating those privileges and immunities. But waiving the confidentiality of taxpayer information is basically an all-or-nothing proposition for taxpayers because neither constitution specifically authorizes partial waivers, while not specifically disallowing them either. In other words, a taxpayer can't be statutorily required to waive unconditionally that

confidentiality without the risk that such a statute would itself violate the taxpayer's constitutional privileges and immunities.

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 HB 247.

Given the current economic environment, 2016 looks to be a challenging year for all of us. We at BP, and we as Alaskans, know what it means to face challenges. The best way we have found is to do so together.

Thank you.