Alaska Department of Revenue

Oil and Gas Tax Credits

Presentation in Kenai to Joint Resources Committee

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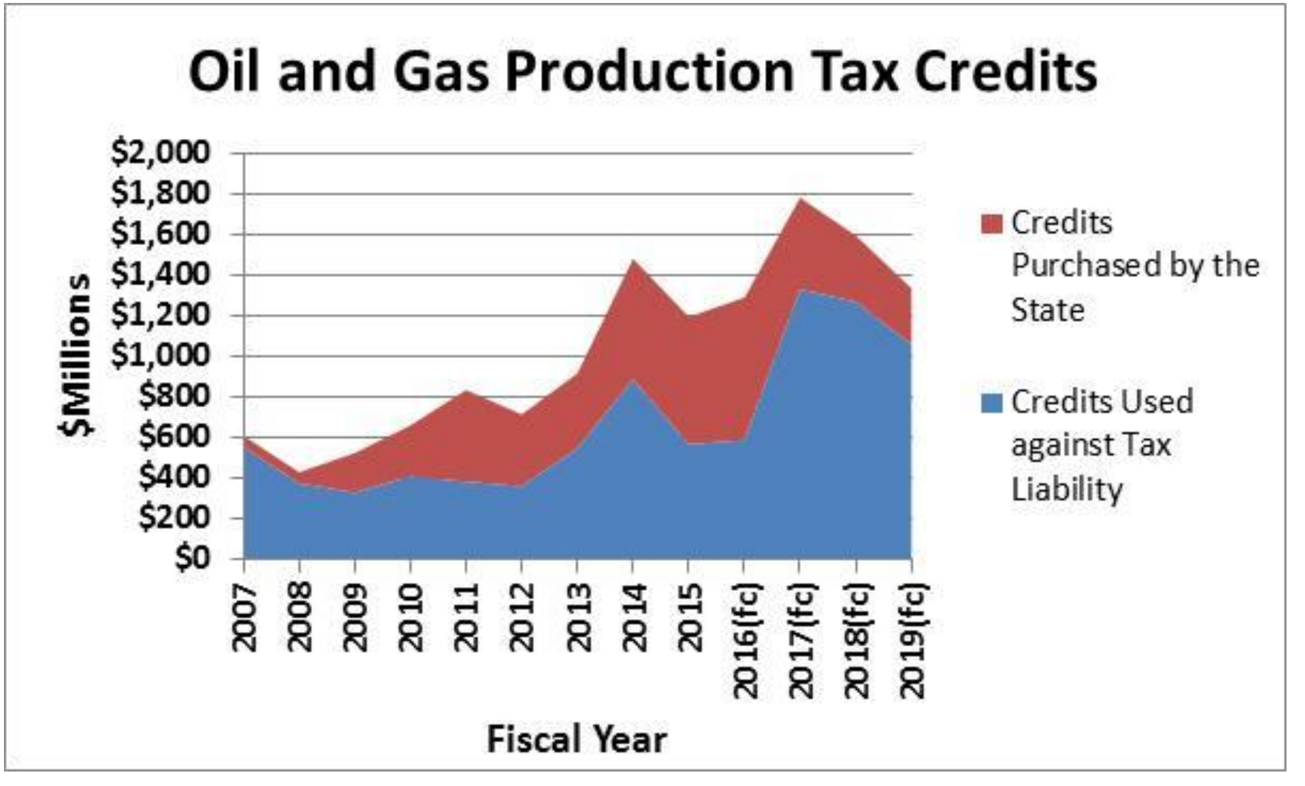
Randall Hoffbeck, Commissioner
Ken Alper, Tax Division Director
Alaska Department of Revenue

What We'll be Discussing

- Summary and Overview
- History
- Some Deeper Explanation
- Myths and Clarifications
- Projections & Going Forward

Summary and Overview

Over the last 10 years the size and the applicability of the oil and gas tax credit program has increased



From FY 2007 – 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
- $2.2 billion refunded credits
  - New producers and explorers developing new fields

Non North Slope (Cook Inlet & Middle Earth)

- $0.1 billion credits against tax liability
  - Limited liability due to Cook Inlet tax cap
- $0.8 billion refunded credits
  - Rapid growth beginning in FY13

Plus another $0.5 to $0.8 billion Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF

History

History of Oil and Gas Tax Credits

- The first “modern era” credit was the Alternative Credit for Exploration, AS 43.55.025 (SB 185, 2003)
  - 20%-40% credit depending on type and location of work
  - Could be taken against liability, sold to a producer with tax liability, or carried forward
  - Initially no state reimbursement option

History of Oil and Gas Tax Credits

- Several Credits added with passage of PPT and switch to a net-profits tax (HB3001, 2006)
  - 20% Carry-Forward Annual Loss (NOL) Credit
  - 20% Qualified Capital Expenditure (QCE) Credit
  - Small Producer & New Areas Credit
  - Transitional Investment Expenditure (Clawback) Credit
- Added a mechanism for state buyback of credits from smaller producers and explorers (less than 50,000 bbl / day), for up to $25 million / year (with a reinvestment requirement)

History of Oil and Gas Tax Credits

- Credits Modified with ACES (HB2001, 2007)
  - Carry Forward Annual Loss Credit increased to 25%
  - Eliminated Transitional Expenditure Credit
  - Eliminated $25 million cap and created the Tax Credit Fund (AS 43.55.028)
- Several Cook Inlet Specific Credits added in 2010
  - Gas Storage Facility Credit (HB280)
  - 40% Well Lease Expenditure Credit for all areas south of 68 degrees (HB280)
  - Jack-up Rig Credit (SB309)

History of Oil and Gas Tax Credits

- Several original restrictions on credit repurchase were also loosened in 2010 (HB280)
  - “Ringfence” (applying Cook Inlet credits against North Slope production)
  - “Reinvestment” (require commitment to new spending in the amount of reimbursed credits)
  - “Recapture” (first apply credits to the difference between the calculated tax and the actual liability under the Cook Inlet tax cap)
  - “Timing” (allow one-year payback instead of two-year payback of Cook Inlet credits)

Repurchase totals for Cook Inlet have increased dramatically since 2012, in part due to these changes

History of Oil and Gas Tax Credits

- Frontier Areas Credit (modeled on Jack-up Rig Credit) and LNG Storage Facility Credit (modeled on Gas Storage Facility Credit) added in 2012 (SB23)
- Credits Modified with SB21 (2013)
  These changes were for the North Slope only
  - Eliminate the 20% Capital Credit
  - Create the Per-Taxable-Barrel Credit ($0 to $8 / bbl for legacy oil, $5 / bbl or GVR or “new” oil)
  - Increase the Loss Carry Forward (NOL) credit to 35%. (45% for 2014 and 2015)
  - Oil and Gas Service Industry Credit
- In-state Refinery Infrastructure Credit (AS 43.20.053) added by HB287 (2014)

Deeper Explanations

Credit Reimbursement is a Two-Step Process

1. Dept. of Revenue Auditors Review and Approve Credit “Certificates”
    - These are earned based on the statute, and on the work done by the producer or explorer
    - There is no discretion- if the expenses qualify, we issue the certificate
2. “Certificates” are Presented for Repurchase
    - These are subject to available funds
      Budget section for reimbursement can be written either capped or open-ended
    - Regulations in place in event funds are limited

Other things to know about reimbursements

- Estimates in operating budgets are often missed

Fiscal Year	Estimate in Operating Budget	Actual Amount Reimbursed
	($millions)	
FY11	$180	$450
FY12	$400	$353
FY13	$400	$369
FY14	$400	$593
FY15	$450	$625
FY16	$700	?
Total 11-15	**$1,830**	**$2,390**

- Reimbursement is front-loaded in the fiscal year
  - Many credits have a statutory requirement to issue certificates 120 days after the (March) tax filing deadline
  - That means we issue many certificates in July, and reimburse them in August

Limit on State Reimbursement

- Credit reimbursement is only available to small producers and new companies
  - Per AS 43.55.028(e)(4), a company producing over 50,000 bbl / day can not have their credits repurchased by the state
  - Alternatives remain in place:
    - Hold until they have a tax liability
    - Sell (transfer) to a company with a tax liability

Credit Information

- In 2015, the Tax Division made efforts to compile historic summary information and make it widely available
  - Three reports provided today to the committee
    - Table of which credits were used in which years
    - Historic and forecasted credits by category and region
    - Impact of Cook Inlet tax cap
  - Aggregated data only per AS 43.55.890. We do not provide company-specific credit information

Notes on the Credit Summary Report

- "Non-North Slope" includes Middle Earth (due to the small number of credits there)
- For each region of the state, it combines all the '.023' credits, meaning the "spending" credits (capital, well) are combined with the "loss" credits
- Per-taxable-barrel credits in North Slope
  - Lower in 2014 due to higher oil prices
  - Lower in 2015 and '16 due to the limit of the 4% Gross Minimum Tax
  - Higher in 2017 because prices are forecasted to increase somewhat, but will be still low enough to qualify for the full $8 / bbl

Not All Credits Should be Viewed as a "Cost"

- The largest credits, the 20% capital credit in ACES and the per-barrel credit in SB21, are integral parts of the tax system. They are built-in offsets to the tax rate
  - Most of the "credits used against tax liability" fall into this category
- Other credits were created to encourage a desired behavior by industry.
  - Most of the "refunded credits" fall into this category

Myths and Clarifications

Myth #1: Many credits are remnants from ACES, and will soon expire

Three credits potentially fall into this category, but make up a small percentage of the totals

1. 20% Qualified Capital Expenditure Credit (AS 43.55.023(a); North Slope only)
   - With the passage of SB21 in 2013, this credit changed from a 2-year to a 1-year reimbursement
   - The change meant that credits earned in 2013 were claimed faster
   - The credit sunset in the middle of FY14
   - There are no North Slope capital credits still being claimed. This credit is still available elsewhere

Myth #1: Many credits are remnants from ACES, and will soon expire

2. 30%-40% Alternative Credit for Exploration (AS 43.55.025)
   - Several subcategories of this credit expire on 7/1/16
     - Regular 30% and 40% credits for North Slope and Cook Inlet
     - 80%-100% “Jack-up Rig” credit for Cook Inlet
     - 75%-80% “Frontier Areas” credit
     - Extended in Middle Earth through 2021
   - We can expect certificate applications into 2017, with the last reimbursements in FY18
   - Only about $25 million of these is typically repurchased per year. And once they sunset much of the Cook Inlet spending will still be able to qualify for other, non-sunsetting credits

Myth #1: Many credits are remnants from ACES, and will soon expire

3. Small producer credit (AS 43.55.024(c))
   - Up to $12 million / year depending on volume
   - Cannot be reimbursed, transferred, or carried-forward. To be used, a company must have a tax liability
   - Will stop taking new applicants on 5/1/16; a company can only qualify for nine years so it’s a slow sunset
   - In 2014, 10 companies were able to claim this credit for a total of $60.2 million

4. Also the Middle Earth Credit (AS 43.55.024(a)) sunsets after 2016 but has never been used

Myth #2: DOR's projections for FY17-19 show a decline in credit reimbursements, which can be built into budgets

- Our credit forecast only includes "known" projects
- Most "new" projects would add to the amount of projected credits
- Credit projections use the same conservative methodology as DOR's production forecast

Potential New Projects

- As an example, Repsol recently announced a major find on the North Slope
  - Good for Alaska
  - Jobs, Oil in the Pipeline, Future Revenue
- What happens when they start spending?
  - A theoretical $1 billion in field development costs in 2016 likely would add $350 million in state credit reimbursements (NOL) in 2017
  - This is not in currently in our forecasts
  - Several years before any actual oil revenue
- Same phenomenon, in scale, for many smaller projects

Impact of AKLNG Construction

- If gas project goes forward, will require several billion dollars in upstream spending
  - Largely building out Pt. Thomson
  - Costs not built into tariffs
- Enalytica in 2014 estimated nearly $2 billion in oil tax impacts (via both deductions and credits) prior to first gas
  - Based on 35% of about $5 billion in costs

Projections and Going Forward

How We Forecast Credits

- The credit forecast is in most cases tied to our forecast of company spending (lease expenditures)
  - Carry-forward annual loss credit is usually based on total spending by companies without production (explorers)
  - Cook Inlet capital and well lease expenditure credits are based on actual allowable spending on these activities (explorers & producers)

How We Estimate Lease Expenditures

- Department of Revenue reviews and analyzes lease expenditure data from companies' annual returns and monthly information filings
- We get semi-annual projections of lease expenditures for the next five years, by property, from most unit operators
- Direct consultation with some companies
- Publicly available information and news releases on planned exploration, development, or production activity

How We Estimate Lease Expenditures

- Lease expenditures are included in the forecast if the corresponding production meets DOR’s criteria for inclusion in the production forecast.
- For explorers, lease expenditures are included for known and announced near-term projects, and an assumption is made for ongoing longer-term exploration spending
- Since 2012, the production forecast is ‘risked.’ In other words, new projects are assigned probabilities to reduce over-estimation
- Risk factors are applied to the lease expenditure forecast consistent with the risking of the production forecast

How We Forecast Credits

- Bottom line, the credits are only in the forecast if:
  - The production that the credits would generate is in the forecast, and
  - The spending that will result in the production is in the forecast

  or

  - The credit results from exploration spending from a planned or announced project

THANK YOU

Please find our contact information below:

Randall Hoffbeck
Commissioner
Department of Revenue
Randall.Hoffbeck@Alaska.gov
(907) 465-2300

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

dor.alaska.gov