

**04/02/16**  
**OVERVIEW:**  
**ALASKA'S**  
**OIL AND**  
**GAS TAX**  
**CREDIT**  
**SYSTEM**

<TARGET><BILL></BILL><SUBJECT>04-02-16 OVERVIEW  
ALASKAS OIL AND GAS TAX CREDIT  
SYSTEM</SUBJECT><COMM>SRES29</COMM></TARGET>

# ALASKA OIL & GAS CREDITS

**Presentation to Senate Resources Committee**  
**Juneau, Alaska > Saturday, April 2, 2016**

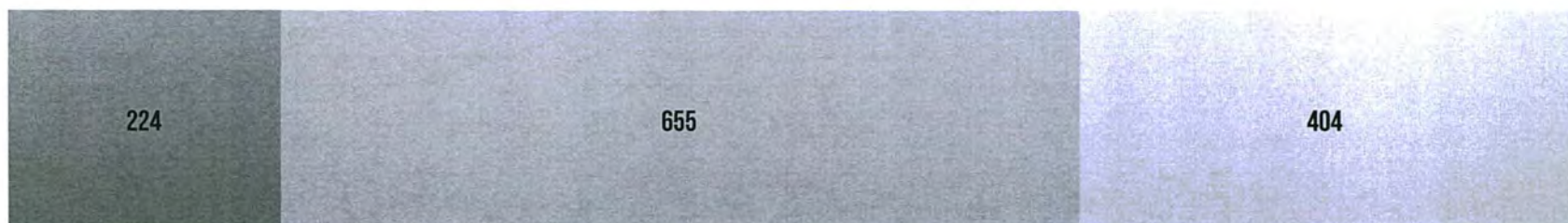
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# VISUALIZING ALASKA'S CREDIT SYSTEM (FY 2015)



■ NORTH SLOPE ■ NON-NS



■ NS REFUNDED ■ NS NON-REFUNDED ■ NON-NS REFUNDED ■ NON-NS NON-REFUNDED



■ NS \$ PER BARREL CREDIT ■ NS NET OPERATING LOSS ■ NS OTHER ■ NON-NS STATE SUPPORT

SOURCE: ALASKA DEPARTMENT OF REVENUE, TAX DIVISION

# NS CREDITS ARE INTEGRAL TO OVERALL TAX SYSTEM

Credit	Details	Status	Purpose
Net Operating Loss (NOL) or Carried Forward Annual Loss credit (.023b)	Credit of 35% of a carried forward annual loss Refundable for producers with <50,000 boe/d of production	Current From January 1 2014 to January 1 2016 was at elevated level of 45% (SB21 transition arrangements)	Make impact of tax system the same for new developer as incumbent producer
\$/bbl Credit (.024 i&j)	\$0-\$8/bbl produced ('old' oil) or \$5/bbl produced ('new' oil). Used against liability. Sliding credit may not reduce liability below 4% gross floor, fixed credit may not reduce below 0	Current	Provide a measure of 'progressivity' to tax system, reducing tax rates at lower oil prices; integral to component of tax system
Exploration Credits (.025)	30%-40% of qualifying exploration costs for exploration wells or seismic outside existing units	Expire on July 1 2016	Incentivize new exploration
Small Producer Credit (.024c)	\$12mm/yr for producers with <50,000 boe/d production, tapering to 0 for producers with 100,000 boe/d	Closes to new applicants that do not have commercial production by May 1 2016 9 year 'tail' from first production for companies already eligible	Ease burden of previous fiscal system changes on new small companies that had come to the North Slope prior to changes

# NON-NS CREDITS GEARED TO SUPPORT ACTIVITY

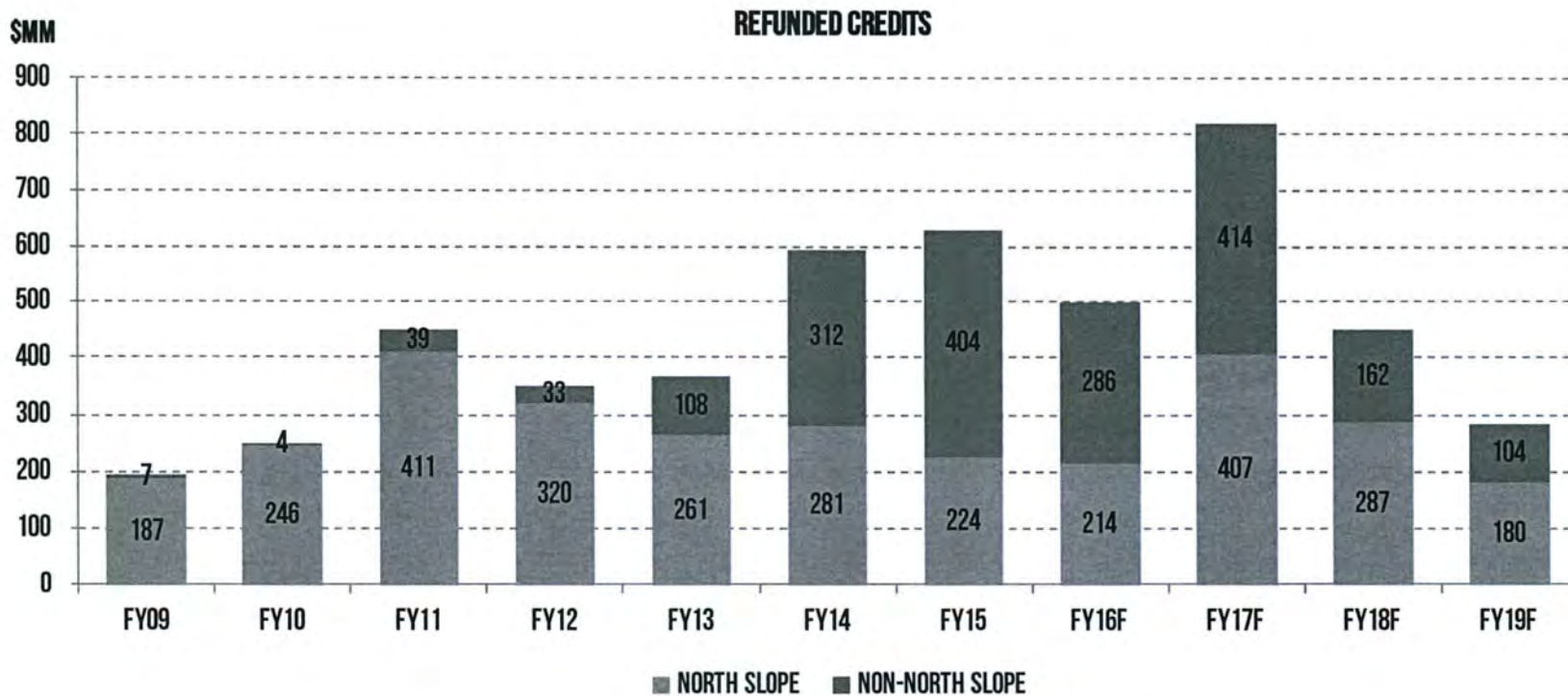
Credit	Details	Status	Purpose
Net Operating Loss (NOL) or Carried Forward Annual Loss credit (.023b)	Credit of 25% of a carried forward annual loss Refundable for producers with <50,000 boe/d of production	Current	Incentivize Cook Inlet Production
Capital & Well Expenditures (.023 a&l)	Credit of 20% for qualified capital expenditures (QCEs) Credit of 40% for QCEs that are intangible drilling costs	Current	Incentivize Cook Inlet Production
Exploration Credits (.025)	30%-40% of qualifying exploration costs for exploration wells or seismic based on distance from existing wells/units	Expire on July 1 2016	Incentivize new exploration
Small Producer Credit (.024c)	Up to \$12mm/yr for producers with <50,000 boe/d production, tapering to 0 for producers with 100,000 boe/d Non-refundable	Closes to new applicants that do not have commercial production by May 1 2016 9 year 'tail' from first production for companies already eligible	Limited applicability given low to zero tax liabilities and other credits
Frontier Basin Credit (.024a)	Up to \$6mm/yr	Closes to new applicants that do not have commercial production by May 1 2016 9 year 'tail' from first production for companies already eligible	Incentivize exploration & development outside North Slope and Cook Inlet

# REFUNDED CREDITS REACHED NEW HIGH IN FY 2015

Refundable credits in FY 2015 reached \$628 mm, the highest point ever

In both 2014 and 2015, the majority of these credits went to non-North Slope producers

Under DOR's current forecast, credits will exceed \$1.3 billion across FY 2016 and FY 2017



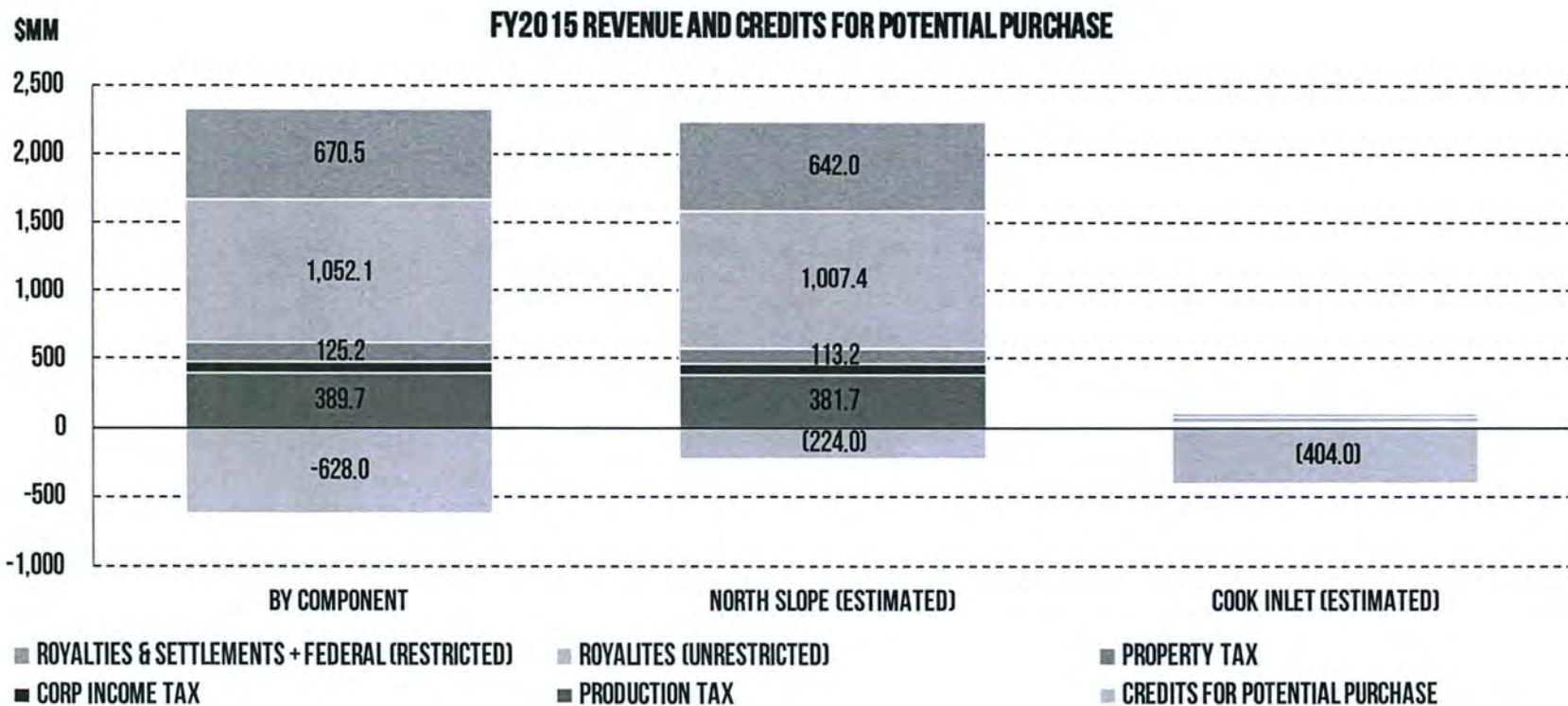
SOURCE: ALASKA DEPARTMENT OF REVENUE, TAX DIVISION

# BIG DIFFERENCE BETWEEN NORTH SLOPE AND COOK INLET

The majority of refundable credits go to Cook Inlet producers

Cook Inlet production, however, generates limited direct revenue for the state

Credits on the North Slope are more limited but also a far smaller fraction of total value generated



SOURCE: ALASKA DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK; TAX DIVISION; ANALYTICA ESTIMATES

# HARD TO BE BOTH NORWAY & N. DAKOTA AT SAME TIME

## Gross taxes

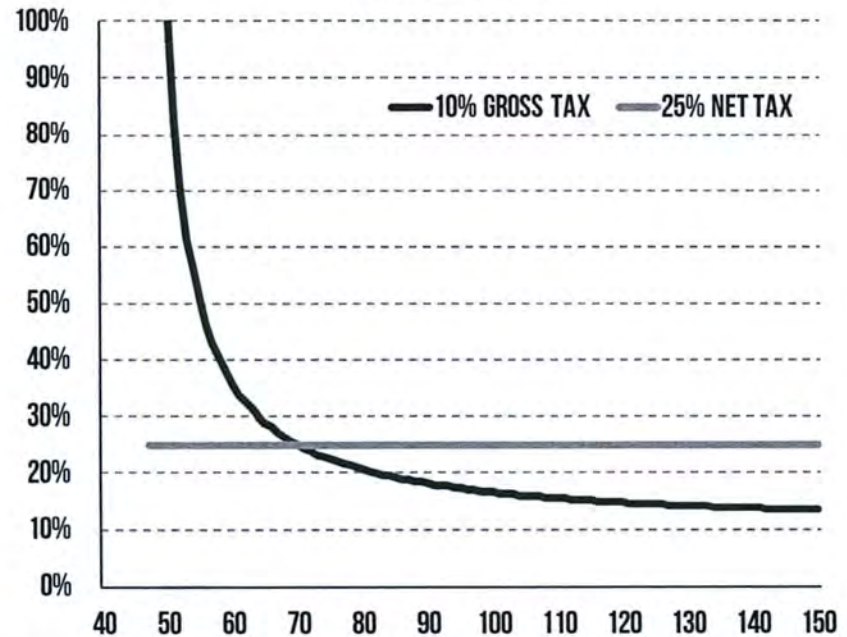
- Less volatile, shift risk to private sector
- Simple and easy to administer
- High/low government take at low/high prices
- Disadvantages marginal investment

## Net taxes

- More volatile revenues for government
- Harder to administer
- Efficient—do not distort decision-making
- Enable investment across commodity cycle

ANS WC	40	60	80	100	120	140
TRANSPORT	10	10	10	10	10	10
GVPP	30	50	70	90	110	130
OPEX	18	18	18	18	18	18
CAPEX	18	18	18	18	18	18
PTV/BBL	-6	14	34	54	74	94
<b>10% GROSS TAX</b>	<b>3</b>	<b>5</b>	<b>7</b>	<b>9</b>	<b>11</b>	<b>13</b>
% GROSS	10%	10%	10%	10%	10%	10%
% NET	#N/A	36%	21%	17%	15%	14%
<b>25% NET TAX</b>	<b>-1.5</b>	<b>3.5</b>	<b>8.5</b>	<b>13.5</b>	<b>18.5</b>	<b>23.5</b>
% GROSS	-5%	7%	12%	15%	17%	18%
% NET	25%	25%	25%	25%	25%	25%

EFFECTIVE TAX RATES



# CASHFLOW TAXES: MORE EFFICIENT, MORE VOLATILE

Purpose of net tax is to minimize distorting impact on investment

Best achieved by making the state's fiscal cost/benefit as close as possible to equity investor

Results in outflows during development, receipts during production

## HIGHLY SIMPLIFIED CASHFLOW AND INCOME EXAMPLE

YEAR	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
PRODUCTION (THOUSAND BBLs)	-	-	-	1,000	1,000	900	810	729	656	590
ANS WC	60	60	60	60	60	60	60	60	60	60
TRANSPORT	10	10	10	10	10	10	10	10	10	10
GVPP/BBL	50	50	50	50	50	50	50	50	50	50
GVPP (\$THOUSANDS)	-	-	-	50,000	50,000	45,000	40,500	36,450	32,805	29,525
OPEX	-	-	-	18,000	18,000	16,200	14,580	13,122	11,810	10,629
CAPEX	20,286	60,857	33,809	20,286	-	-	-	-	-	-
PRE-TAX CASHFLOW	(20,286)	(60,857)	(33,809)	11,714	32,000	28,800	25,920	23,328	20,995	18,896
ASSET VALUE	-	-	-	135,238	108,190	86,552	69,242	55,393	44,315	35,452
DEPRECIATION	-	-	-	27,048	21,638	17,310	13,848	11,079	8,863	7,090
NET INCOME	-	-	-	4,952	10,362	11,490	12,072	12,249	12,132	11,805
25% CASHFLOW TAX	(5,071)	(15,214)	(8,452)	2,929	8,000	7,200	6,480	5,832	5,249	4,724
25% INCOME TAX	-	-	-	1,238	2,590	2,872	3,018	3,062	3,033	2,951

# ALASKA'S PRODUCTION TAX: ORIGINS IN 2006 PROPOSAL

PPT as proposed by Dr Pedro van Meurs useful to understand core of system and evolution to date

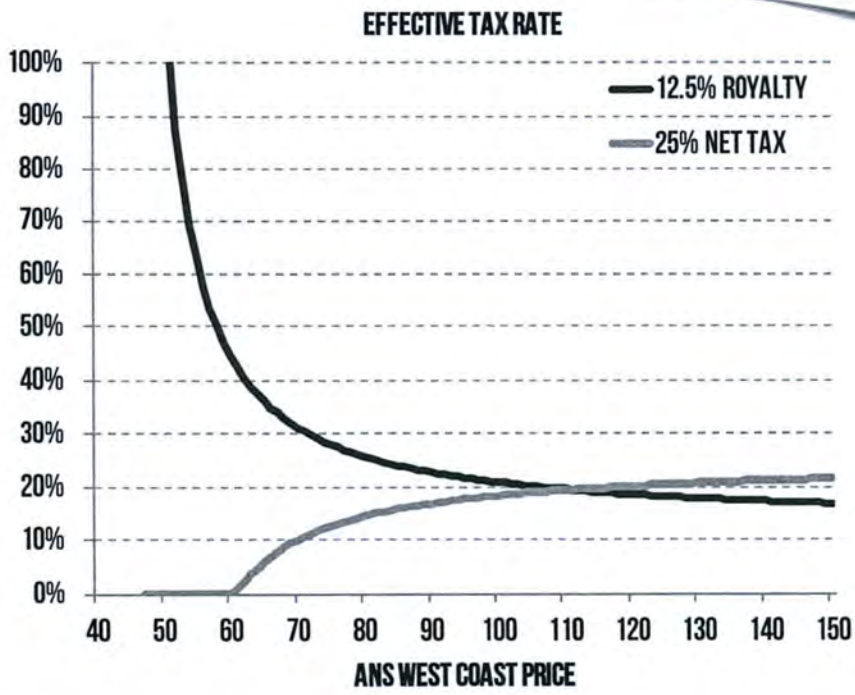
25% flat cashflow tax, 25% credit for net operating losses (NOLs), 20% capital credit

45% government support for spending for new and incumbent players alike

Statewide floor of zero (credits tradable rather than reimbursable)



ANS WC	40	60	80	100	120	140
TRANSPORT	10	10	10	10	10	10
GVPP	30	50	70	90	110	130
OPEX	18	18	18	18	18	18
CAPEX	18	18	18	18	18	18
PTV/BBL	(6.0)	14.0	34.0	54.0	74.0	94.0
25% NET TAX	(1.5)	3.5	8.5	13.5	18.5	23.5
CAPITAL CREDIT	3.6	3.6	3.6	3.6	3.6	3.6
TAX AFTER CREDITS	(5.1)	(0.1)	4.9	9.9	14.9	19.9
% GROSS	-17%	0%	7%	11%	14%	15%
% NET	#N/	-1%	14%	18%	20%	21%



# NOL CREDIT AIMS TO EQUALIZE TAX SYSTEM IMPACT

Incumbent can deduct spending against liability at marginal tax rate: 25% gov't spending support

Aim for NOL credit to ensure same impact for new developer with no liability

Alternative is to carry forward: same cash impact over time, but disadvantages new developer economics

In original proposal, credits not refundable but tradable

Aim was for new developers to sell to incumbent producers at close to face value

In reality credits sold for much less than face value - much value captured by incumbents

As a result, credits made refundable by the treasury, to direct full value to new developers

HIGHLY SIMPLIFIED CASHFLOW AND INCOME EXAMPLE

YEAR	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
PRODUCTION (THOUSAND BBLs)	-	-	-	1,000	1,000	900	810	729	656	590
ANS WC	60	60	60	60	60	60	60	60	60	60
TRANSPORT	10	10	10	10	10	10	10	10	10	10
GVPP/BBL	50	50	50	50	50	50	50	50	50	50
GVPP (\$THOUSANDS)	-	-	-	50,000	50,000	45,000	40,500	36,450	32,805	29,525
OPEX	-	-	-	18,000	18,000	16,200	14,580	13,122	11,810	10,629
CAPEX	20,286	60,857	33,809	20,286	-	-	-	-	-	-
PRE-TAX CASHFLOW	(20,286)	(60,857)	(33,809)	11,714	32,000	28,800	25,920	23,328	20,995	18,896
25% CASHFLOW TAX	(5,071)	(15,214)	(8,452)	2,929	8,000	7,200	6,480	5,832	5,249	4,724

# ACES: STEEP PROGRESSIVITY, HIGH SPENDING SUPPORT

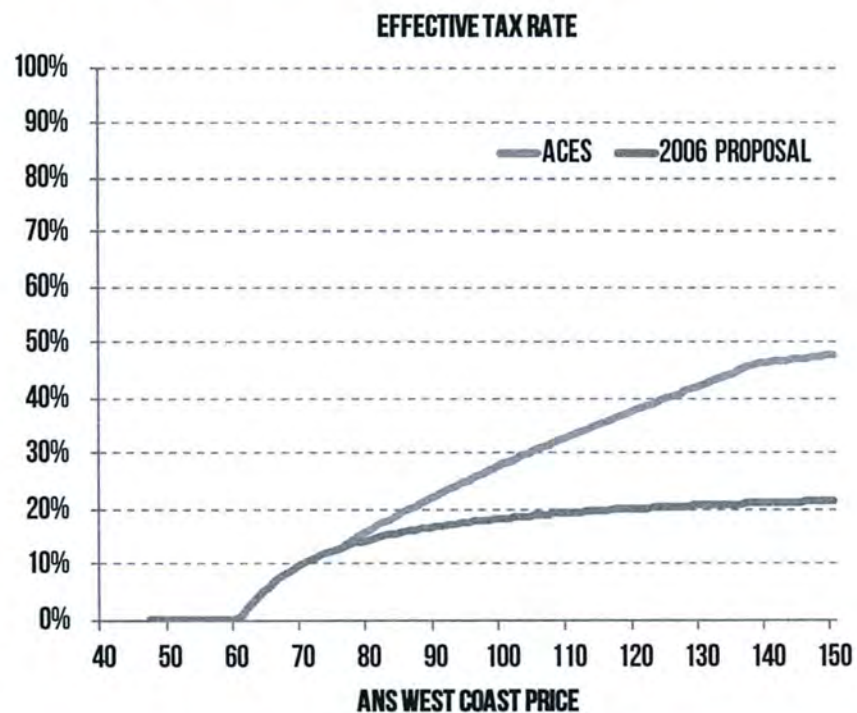
Tax rate 25% to 75% (variable with PTV/bbl), 20% capital credit, 40% exploration credit, 25% NOL credit

High progressivity: high marginal tax rates (up to 86%, higher at yet-unseen prices)

High marginal rates + credits = very high state support for spending (from 45% to over 100%)

With high prices and low spending, brought huge revenue; low prices and high spending major risks

ANS WC	40	60	80	100	120	140
TRANSPORT	10	10	10	10	10	10
GVPP	30	50	70	90	110	130
OPEX	18	18	18	18	18	18
CAPEX	18	18	18	18	18	18
PTV/BBL	(6.0)	14.0	34.0	54.0	74.0	94.0
NET TAX RATE	25%	25%	27%	35%	43%	50%
NET TAX CALC	-	3.5	9.0	18.7	31.5	47.1
4% GROSS FLOOR	1.2	2.0	2.8	3.6	4.4	5.2
TAX BEFORE CREDITS	1.2	3.5	9.0	18.7	31.5	47.1
NOL CREDIT	1.5	-	-	-	-	-
CAPITAL CREDIT	3.6	3.6	3.6	3.6	3.6	3.6
TAX AFTER CREDITS	(3.9)	(0.1)	5.4	15.1	27.9	43.5
% GROSS	-13%	0%	8%	17%	25%	33%
% NET	#N/A	-1%	16%	28%	38%	46%



# SB21: PROTECT ON THE LOW END, GIVE BACK AT THE HIGH

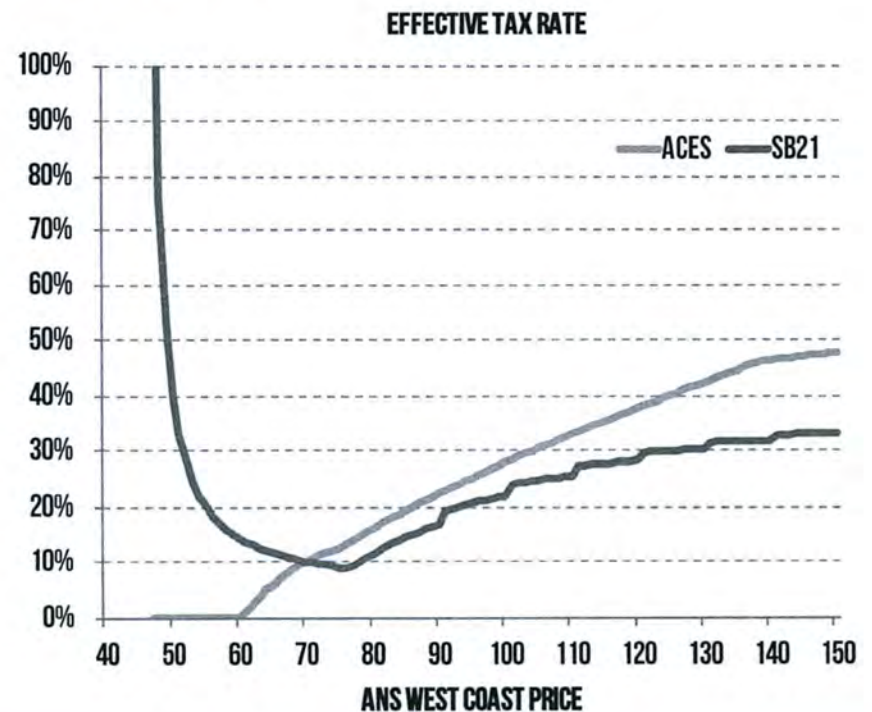
Tax rate 35%, \$0 to \$8 per-bbl credit, hardened gross floor, 35% NOL credit

Key aim was to reduce state support for spending and make predictable: 35% for everyone

Reduced rates at high prices for competitiveness, but 4% gross floor binding to protect at low end

Significantly reduced the risks brought by low prices and high spending

ANS WC	40	60	80	100	120	140
TRANSPORT	10	10	10	10	10	10
GVPP	30	50	70	90	110	130
OPEX	18	18	18	18	18	18
CAPEX	18	18	18	18	18	18
PTV/BBL	(6.0)	14.0	34.0	54.0	74.0	94.0
NET TAX RATE	35%	35%	35%	35%	35%	35%
NET TAX PRE \$/BBL	-	4.9	11.9	18.9	25.9	32.9
\$/BBL CREDIT	8.0	8.0	8.0	7.0	4.0	-
NET TAX CALC	(8.0)	(3.1)	3.9	11.9	21.9	32.9
4% GROSS FLOOR	1.2	2.0	2.8	3.6	4.4	5.2
TAX BEFORE NOL	1.2	2.0	3.9	11.9	21.9	32.9
NOL CREDIT	2.1	-	-	-	-	-
TAX AFTER CREDITS	(0.9)	2.0	3.9	11.9	21.9	32.9
% GROSS	-3%	4%	6%	13%	20%	25%
% NET	#N/A	14%	11%	22%	30%	35%



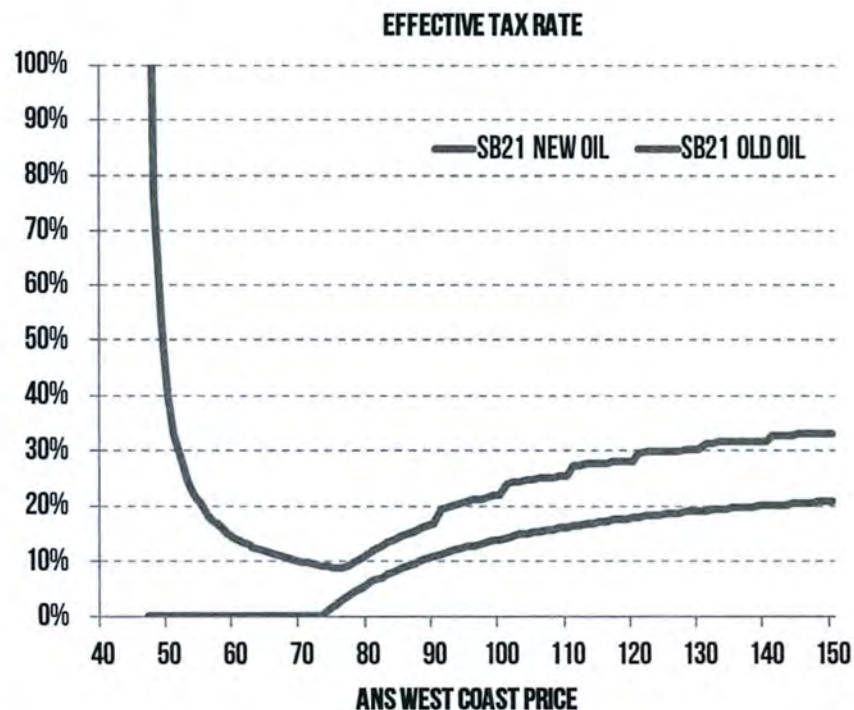
# SB21: SPECIAL INCENTIVES FOR “NEW OIL”

Gross Value Reduction (GVR) - reduce GVPP by 20% or 10% for certain units / participating areas

Purpose of GVR - reduce effective tax rates for particular fields without ring-fencing costs

GVR-eligible production receives fixed \$5/bbl credit, not variable \$0-\$8/bbl, no hard floor

ANS WC	40	60	80	100	120	140
TRANSPORT	10	10	10	10	10	10
GVPP BEFORE GVR	30	50	70	90	110	130
GVPP AFTER GVR	24	40	56	72	88	104
OPEX	18	18	18	18	18	18
CAPEX	18	18	18	18	18	18
PTV/BBL BEFORE GVR	(6.0)	14.0	34.0	54.0	74.0	94.0
PTV/BBL	(12.0)	4.0	20.0	36.0	52.0	68.0
NET TAX RATE	35%	35%	35%	35%	35%	35%
NET TAX	-	1.4	7.0	12.6	18.2	23.8
4% GROSS FLOOR	1.0	1.6	2.2	2.9	3.5	4.2
\$/BBL CREDIT	5.0	5.0	5.0	5.0	5.0	5.0
TAX BEFORE NOL	(4.0)	(3.4)	2.0	7.6	13.2	18.8
NOL CREDIT	4.2	-	-	-	-	-
TAX AFTER CREDITS	(8.2)	(3.4)	2.0	7.6	13.2	18.8
% GROSS	-27%	-7%	3%	8%	12%	14%
% NET	#N/A	-24%	6%	14%	18%	20%



# CI ACTIVITY HAS RESPONDED TO INCENTIVES

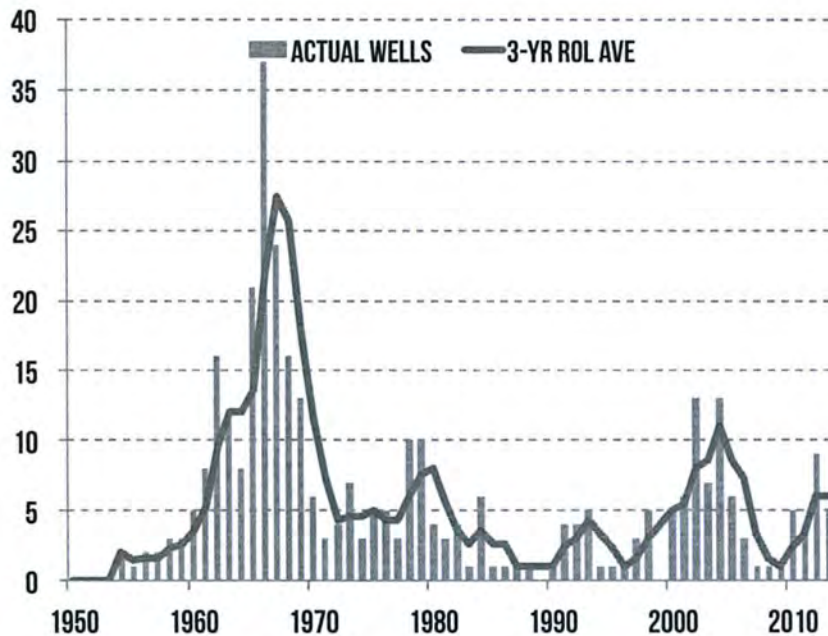
Exploration drilling in Cook Inlet has gone through several cycles since 1950s

Recent exploration activity (post 2010) on par with previous exploration peaks

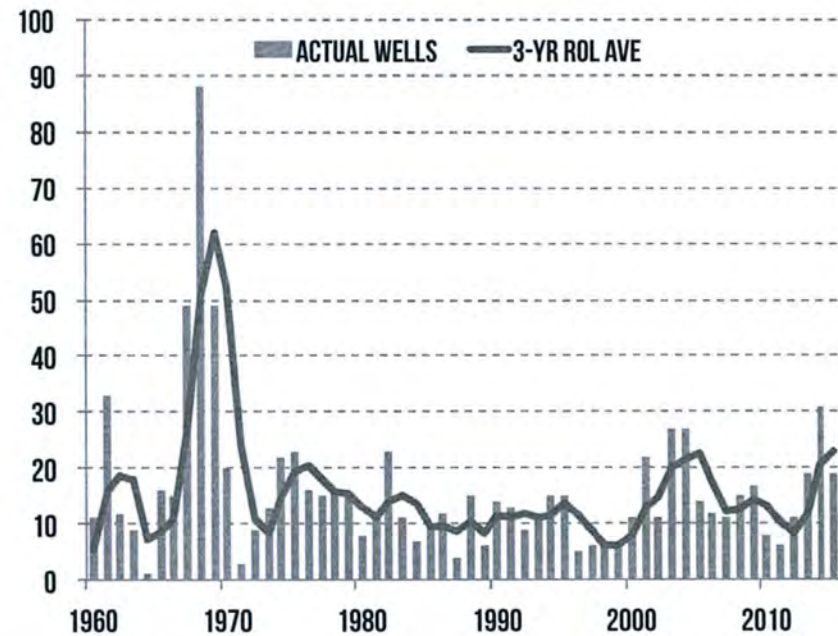
Development drilling has been more stable over the years

Recent growth placing three-year rolling average among highest in state's history

COOK INLET: EXPLORATORY WELLS SPURRED



COOK INLET: WELLS BY YEAR OF FIRST OIL/GAS



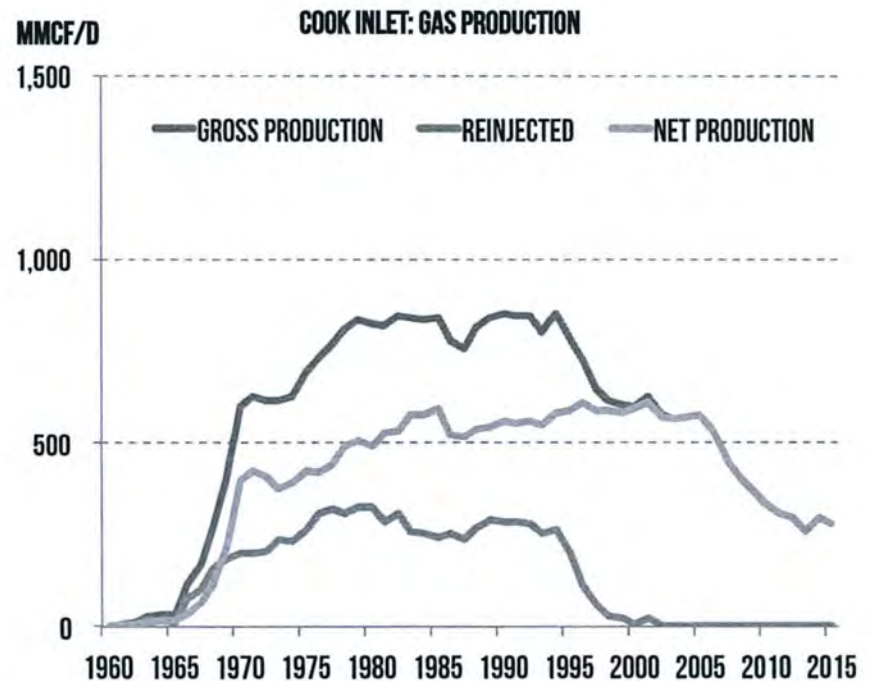
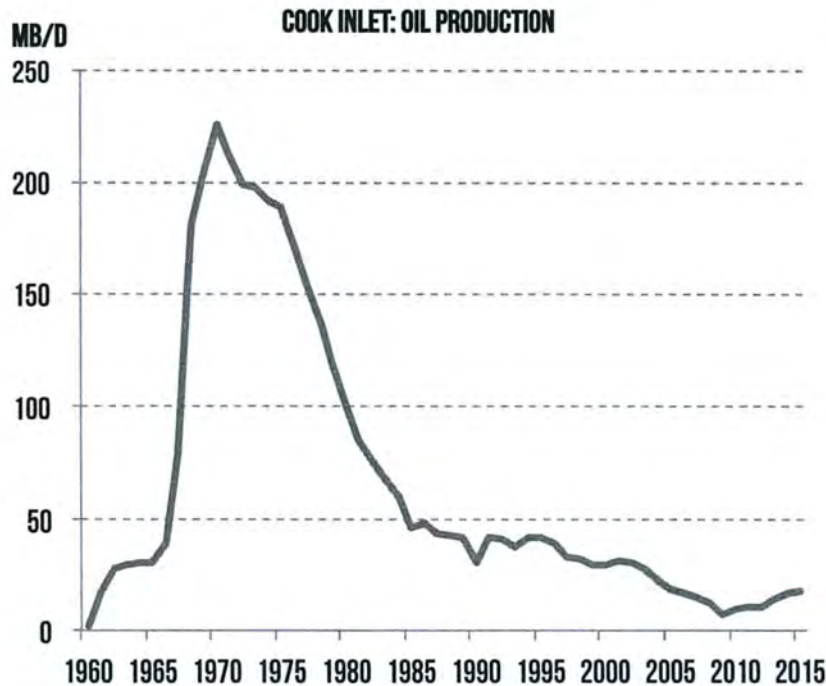
SOURCE: ALASKA OIL AND GAS CONSERVATION COMMISSION, OIL AND GAS DATA WEB APPLICATION (DATA THROUGH DECEMBER 2015)

# COOK INLET OIL AND GAS PRODUCTION: BASIC FACTS

**Oil** Peak in 1970 at 226 mb/d; trough in 2009 at 7.5 mb/d; upturn post 2010 (+10.5 mb/d)

**Gross Gas** Peak in 1990 at 853 mmcf/d; big drops in 1994–1998 and 2005–2013; stable in 2014–15

**Net Gas** Peak in 1996; 1990s plateau from blowdown at Swanson River; fall post 2005, then stable



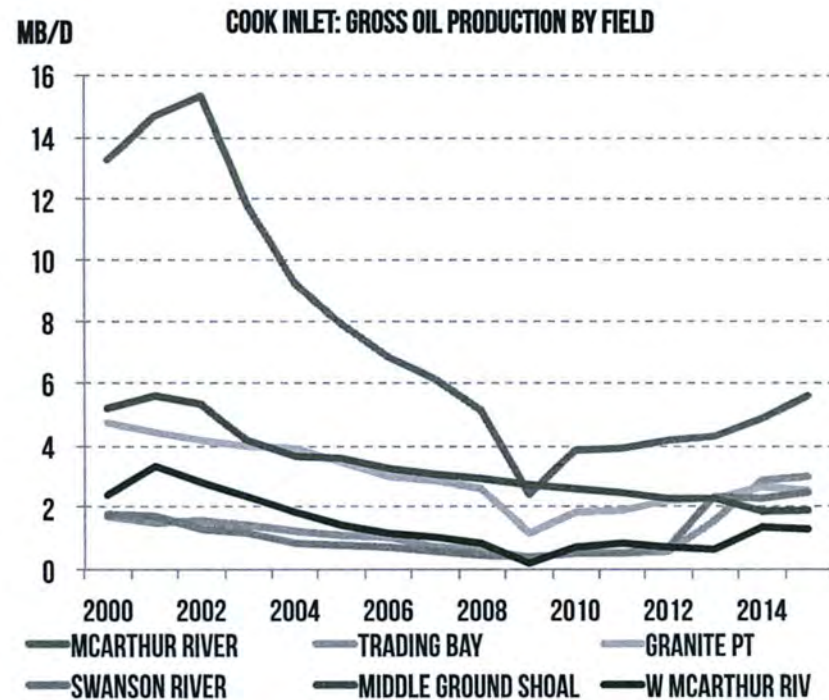
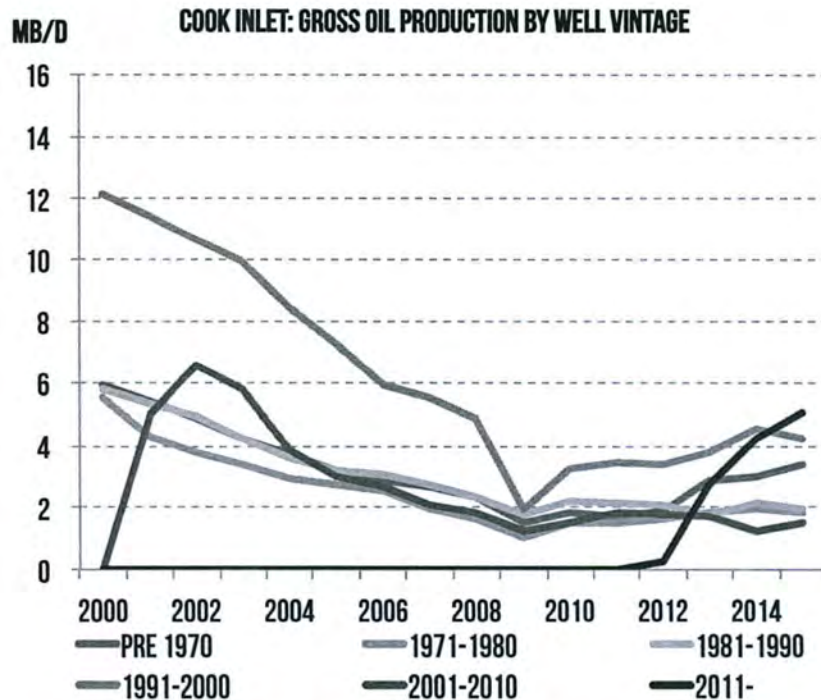
SOURCE: ALASKA OIL AND GAS CONSERVATION COMMISSION, OIL AND GAS DATA WEB APPLICATION (DATA THROUGH DECEMBER 2015)

# OIL UP FROM WORKOVERS, NEW WELLS IN EXISTING FIELDS

Production from old wells has risen, especially from wells drilled before 1970 and in 1990s

New wells drilled after 2011 have also added about 5 mb/d of production

Production is up in most fields; biggest gains from McArthur River field



SOURCE: ALASKA OIL AND GAS CONSERVATION COMMISSION, OIL AND GAS DATA WEB APPLICATION (DATA THROUGH DECEMBER 2015)

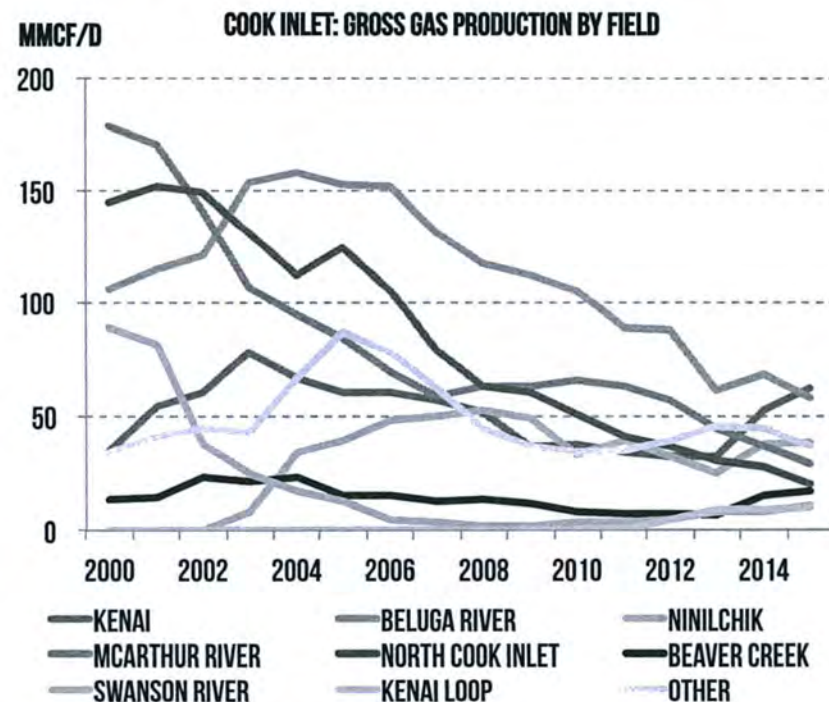
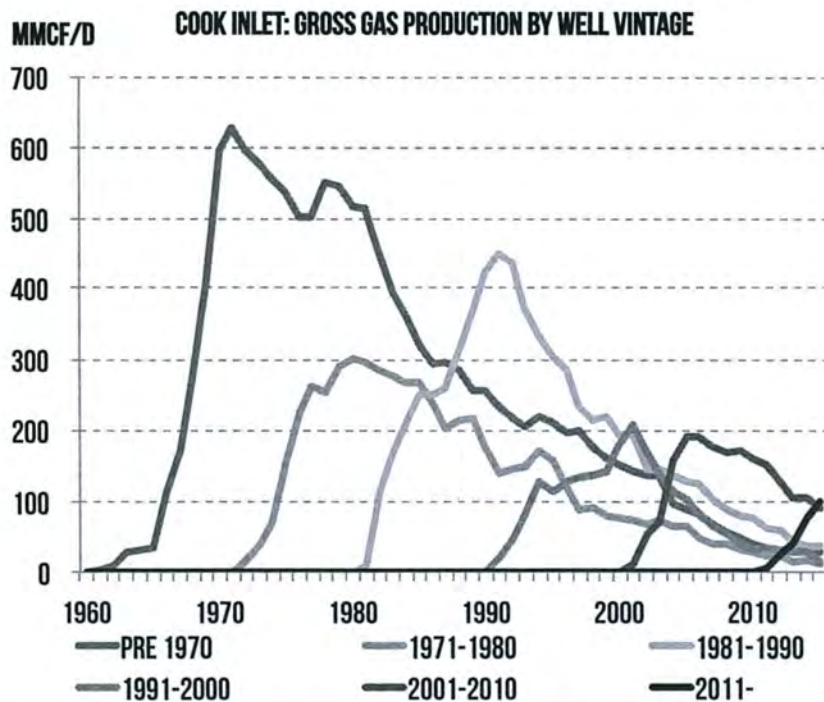
# GAS FLATTENING FROM NEW WELLS IN EXISTING FIELDS

Wells drilled after 2011 have added about 100 mmcf/d of new production

Production from Beluga River, Ninilchik, and North Cook Inlet declined by 85.7 mmcf/d in 2011–2015

Growth from Kenai (+28 mmcf/d), Beaver Creek (+10), Kenai Loop (+9.7), and Swanson River (+7.3)

Only Kenai Loop is (major) new field (first gas in 2012); other growth from workovers and new wells



SOURCE: ALASKA OIL AND GAS CONSERVATION COMMISSION, OIL AND GAS DATA WEB APPLICATION (DATA THROUGH DECEMBER 2015)

## THE COOK INLET OIL AND GAS MARKET: A SCORECARD

What has happened to oil and gas production and activity in the Cook Inlet in recent years?

**Oil production has risen from 7.5 mb/d in 2009 to almost 18 mb/d**

**Gas production has stabilized after years of steadier decline**

How has the gas market adjusted in recent years?

**Cook Inlet has undergone major transition in supply, demand, prices, competition and expectations**

**Some of these changes are typical in mature basins—others are unique to Cook Inlet**

What's the outlook and how sensitive is the outlook to changes in oil/gas fiscal system?

**DNR: 1,183 bcf in remaining 2P reserves; 1,600 bcf w/ Cosmopolitan and Kitchen Lights (ballpark)**

**Continued drilling at old fields plus Cosmopolitan and Kitchen Lights: current market well supplied**

**At current (gas) price levels, brownfield investment should be profitable under stricter fiscal regime**

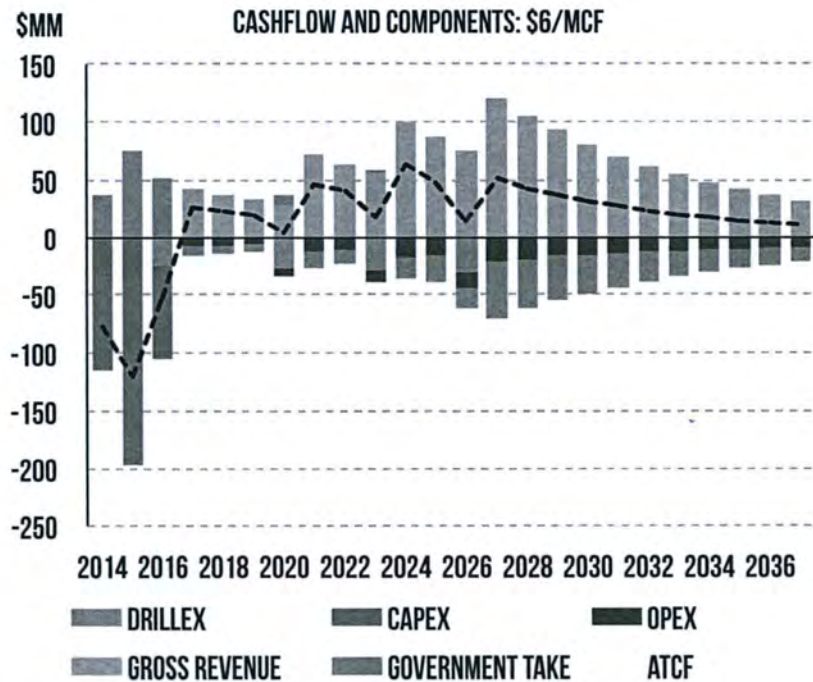
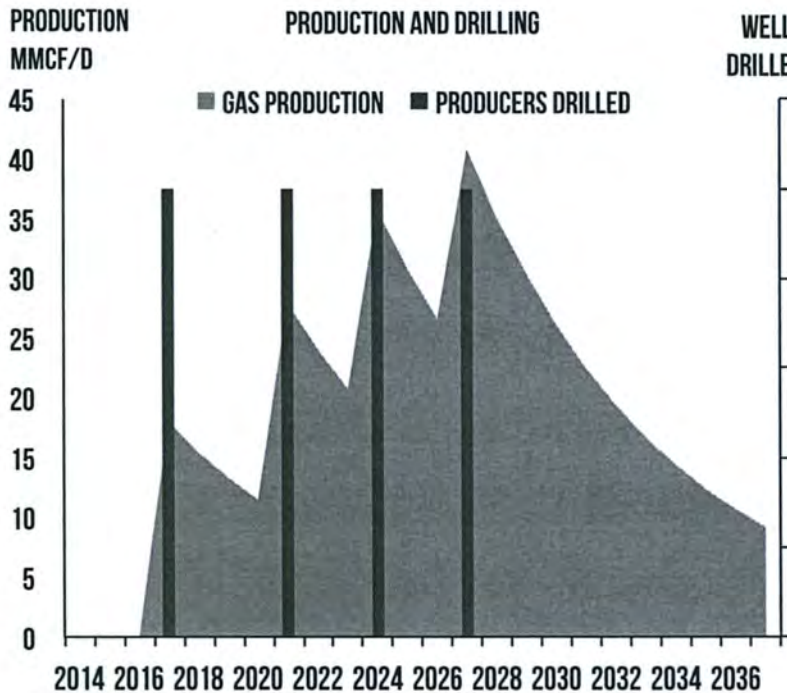
**Credits more important for developing new resources, especially with demand constraints**

**Currently much uncertainty over future regime - setting a stable, sustainable system is paramount**

# PROJECT #1: MARKET CONSTRAINED (ASSUMPTIONS)

Large upfront investment but constrained gas market

Limited ability to sell gas: can only drill a well every few years

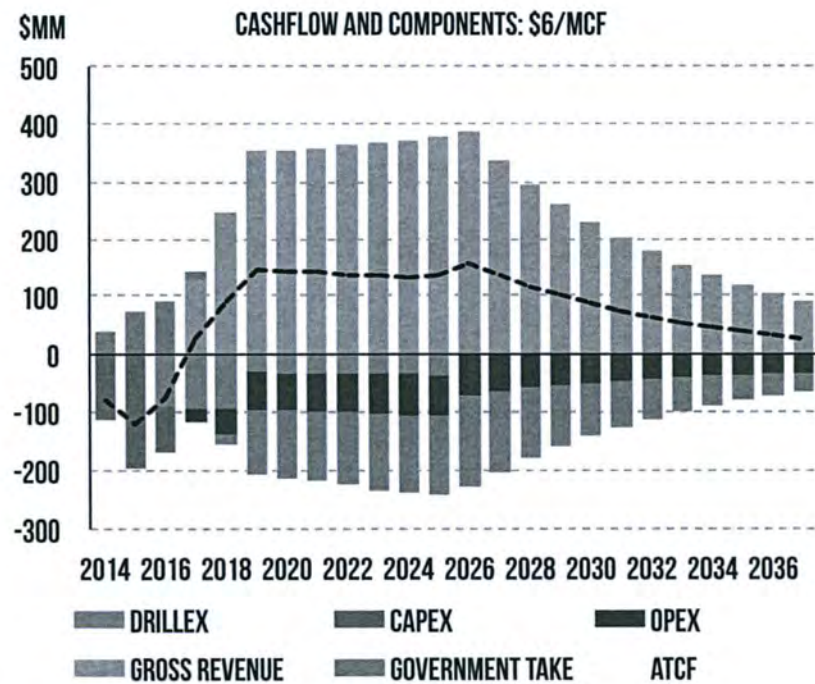
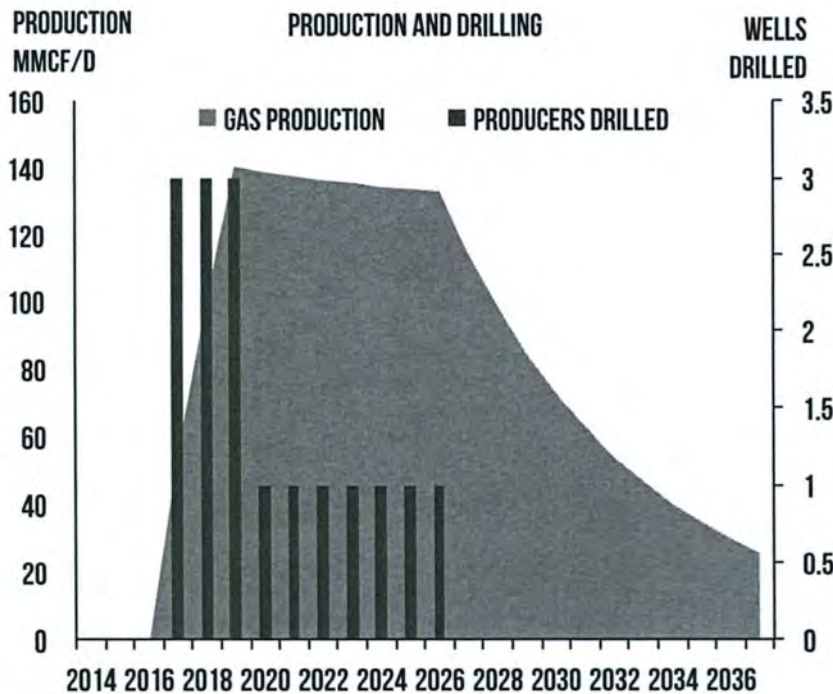


# PROJECT #2: MARKET UN-CONSTRAINED (ASSUMPTIONS)

Large upfront investment but un-constrained gas market

Continued drilling lead to a plateau of 130 mmcf/d

Scenario would require a step change in existing supply-demand dynamics in Cook Inlet

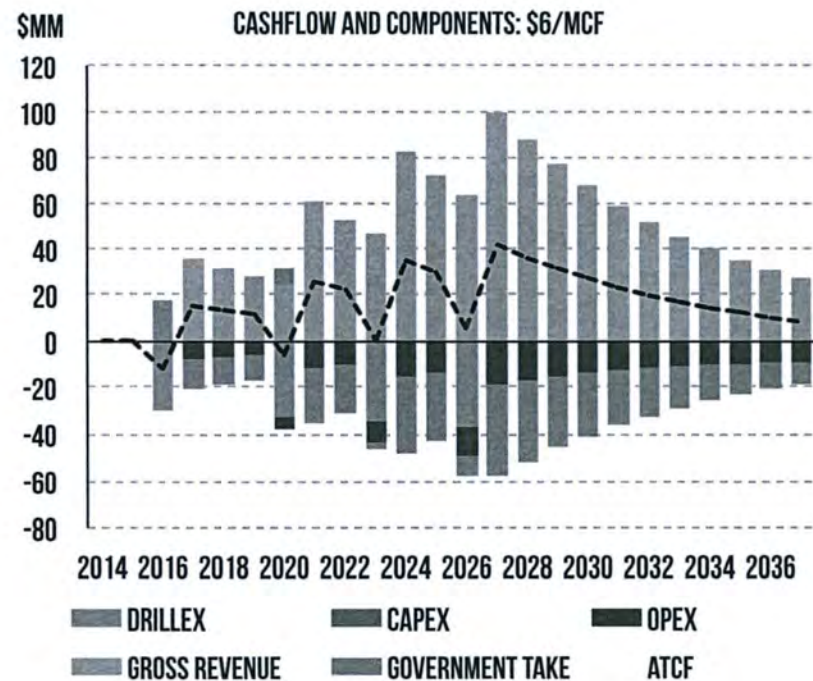
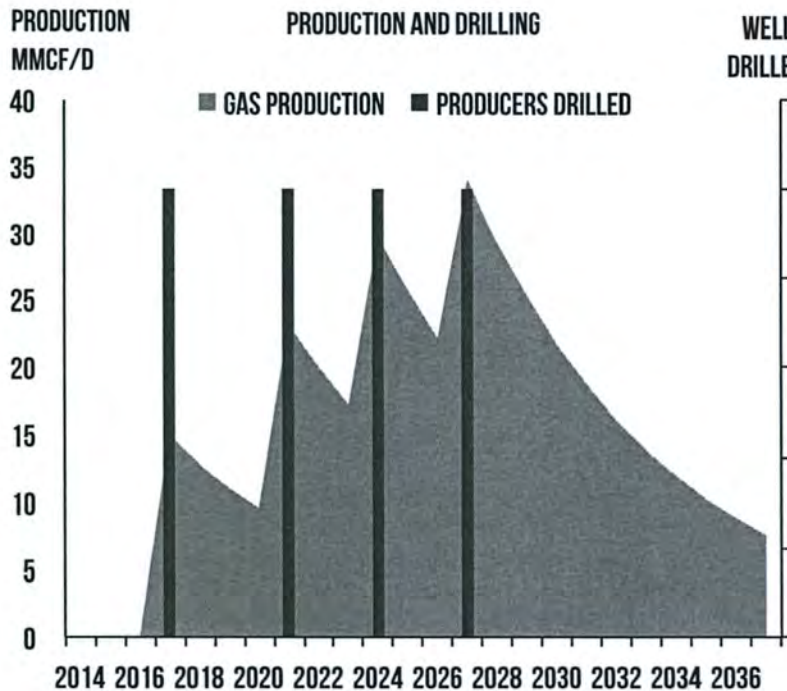


# PROJECT #3: DRILLING IN EXISTING FIELD (ASSUMPTIONS)

Drilling expenditures at existing production—smaller upfront investment

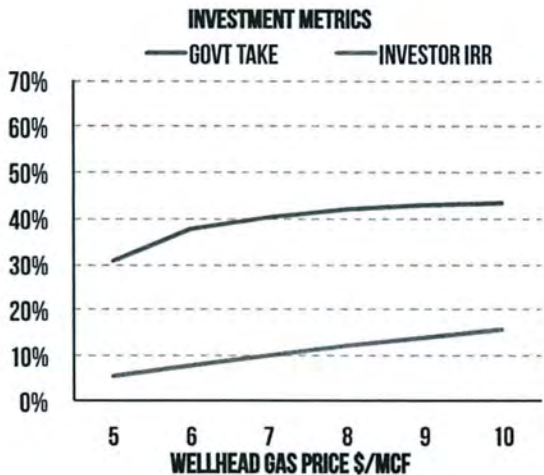
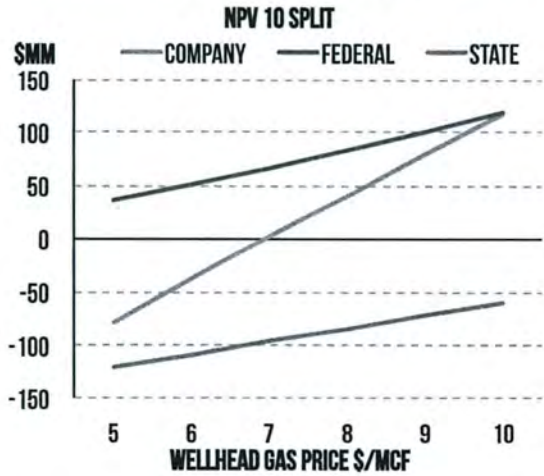
No market constrains assumed

This is a point-forward analysis—it ignores sunk, entry or acquisition costs

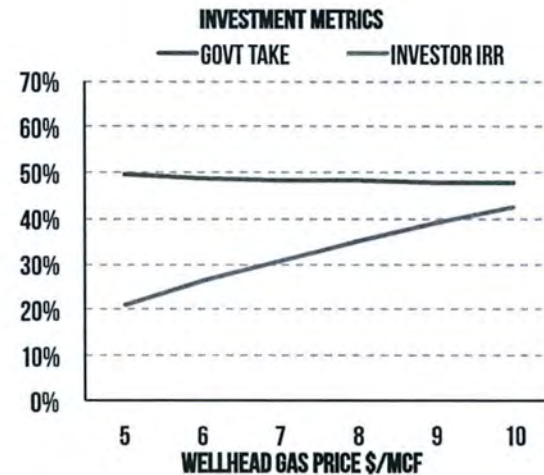
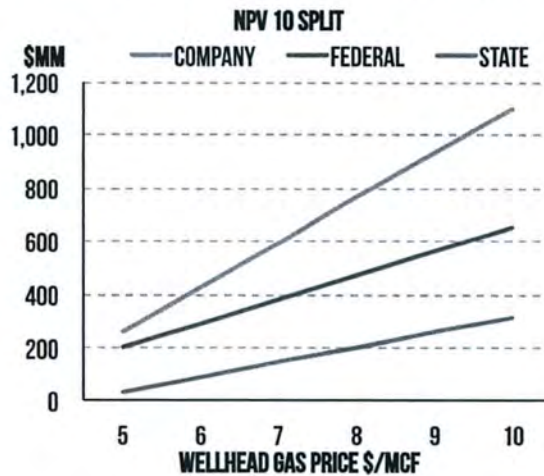


# PROJECT ECONOMICS FOR DIFFERENT PROJECT TYPES

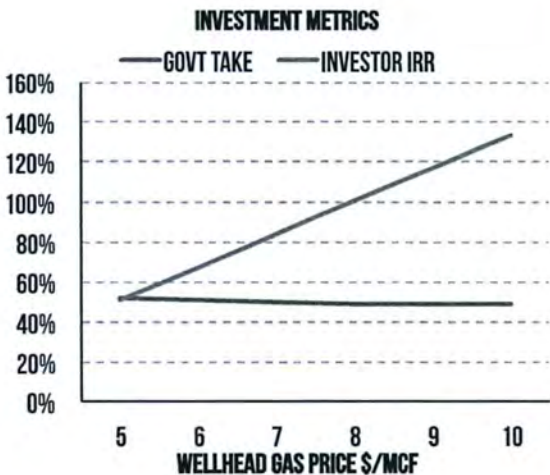
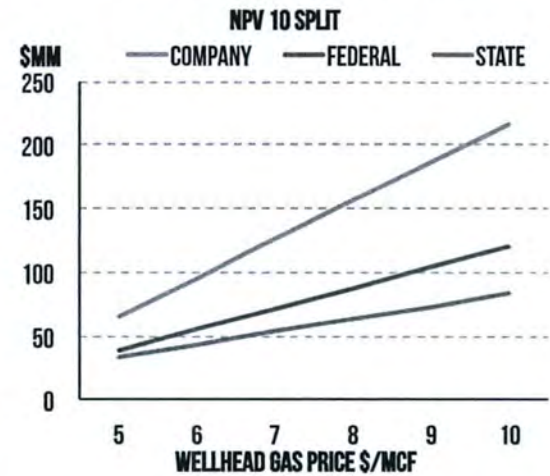
PROJECT 1 (CONSTRAINED)



PROJECT 2 (UN-CONSTRAINED)



PROJECT 3 (EXISTING)



NEW SUSTAINABLE

**ALASKA**

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*Pulling Together to Build Our Future*

## **Oil and Gas Tax Credit Reform**

**SB130**

Department of Revenue

**Presentation to Senate Resources Committee**

April 2, 2016

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## *Bill Title*

“An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments on estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition of “qualified capital expenditures”; adding a definition for “outstanding liability to the state”; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payment for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments, and providing for an effective date.” (273 words)

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*Suggested Informal Short Title*

An Act reforming oil and gas tax credits and strengthening the minimum oil and gas production tax.

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## *What We'll Be Discussing*

1. Lay of the Land- Why Credit Reform is Needed
2. Credit Cost in Perspective
3. Work over Last Interim
4. Provisions of SB130
5. Impact of SB130 on Specific Industry Sectors
6. Fiscal Impact
7. Implementation
8. Future Presentations

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**Lay of the Land:  
Why Tax Credit Reform  
is Needed**

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## *Why Credit Reform is Needed*

### **FY 2007 thru 2016, \$8.0 Billion in Credits**

#### **North Slope**

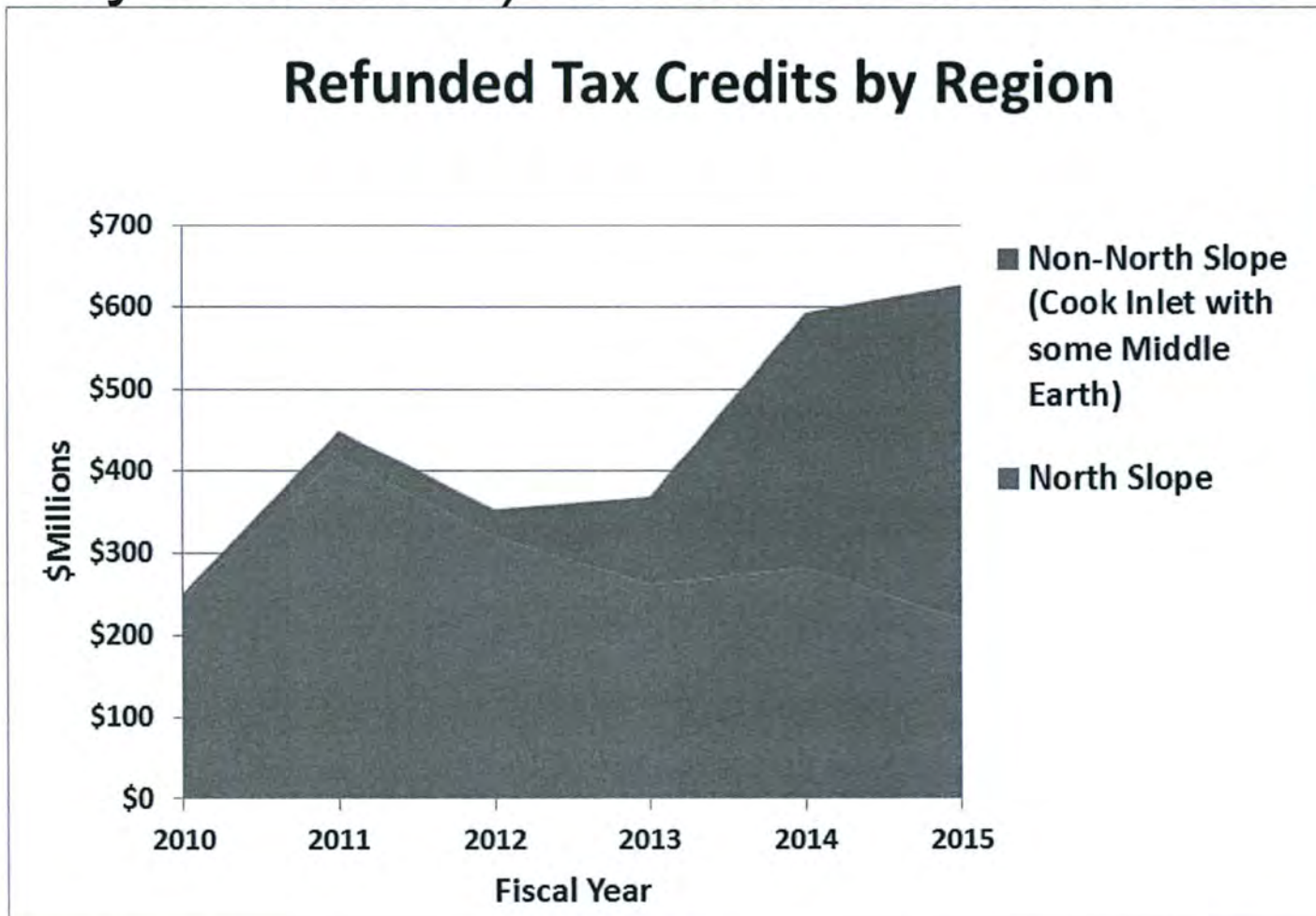
- \$4.4 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- \$2.3 billion refunded credits
  - New producers and explorers developing new fields

#### **Non-North Slope (Cook Inlet & Middle Earth)**

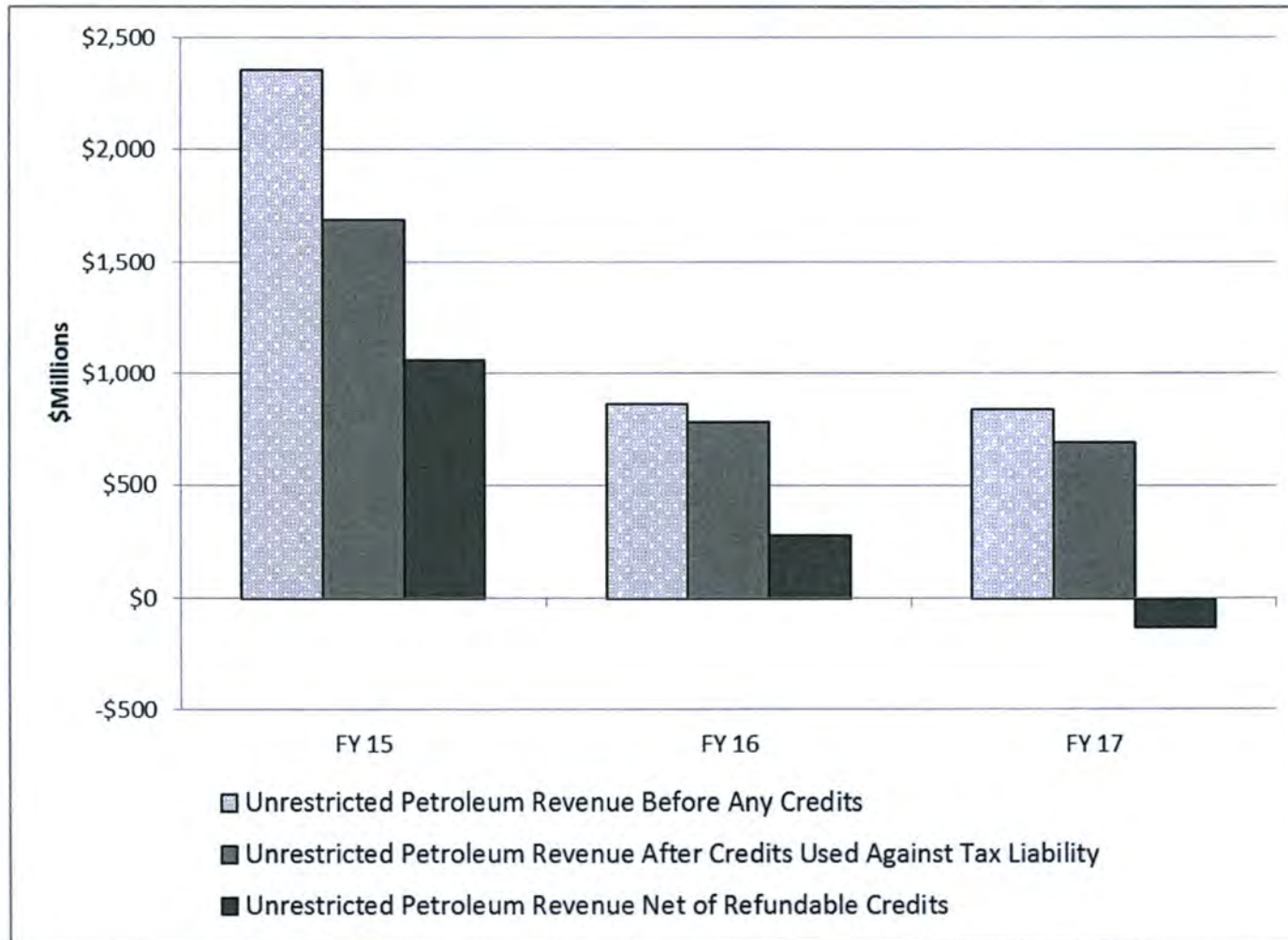
- \$0.1 billion credits against tax liability
  - Another \$500 to \$800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- \$1.2 billion refunded credits (most since 2013)

# *Why Credit Reform is Needed*

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



# Why Credit Reform is Needed



\*This graph shows net tax credits versus unrestricted petroleum revenue, which includes the petroleum property tax, petroleum CIT, production tax, oil and gas hazardous release surcharge, oil and gas conservation surcharge, rents, and petroleum royalties, bonuses, rents, and interest. Net tax credits include certain refinery credits under AS 43.20.

Source : Department of Revenue - PRELIMINARY Spring 2016 forecast

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# Credit Cost in Perspective

## *Credit Cost in Perspective*

### **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
- \$650 million went to 13 North Slope projects that do not have any production. Some of these are abandoned, and some are in process
- \$450 million went to six non-North Slope projects that have production
- \$450 million went to eight non-North Slope projects that do not have any production

## *Credit Cost in Perspective*

### **North Slope Refundable Credits**

Of the \$1.45 billion that was spent between FY07-FY15 supporting six producing projects:

- Total production through end of FY15 is 38.5 million barrels
- Total credits = **\$37.30** / barrel
  - This number will decrease over time due to additional production from these fields
- Lease expenditures for these projects, through FY15, were \$4.94 billion
  - Credit support was **29%** of lease expenditures

## *Credit Cost in Perspective*

### **Cook Inlet Refundable Credits**

Of the \$450 million that was spent between FY07-FY15 supporting six producing projects:

- Total production through end of FY15 is 55.9 million BOE (much of this was gas)
- Total credits = **\$7.80 / BOE** or about **\$1.30 / mcf**
  - This number will decrease over time due to additional production from these fields
- Lease expenditures for these projects, through FY15, were \$1.09 billion
  - Credit support was **40%** of lease expenditures

## *Credit Cost in Perspective*

### **Cook Inlet Tax Caps**

- Estimated value to industry \$550-\$850 over the years 2007-2013
- Total Production Estimate
  - Gas: ~ 250 million cubic feet / day for seven years = 640 BCF of gas or 106 million BOE
  - Oil: ~ 10,000 barrels / day for seven years = 26 million BOE
  - Total Production = 132 million BOE
- Using midpoint \$700 million estimate, value of caps = **\$5.30 / barrel** or **\$0.88 / mcf**
- **Sum of Credits + Tax Caps: \$2.18 / mcf**

## *Credit Cost in Perspective*

### **Status of Credit Fund / Demand for FY16-17**

- **FY16 Appropriation Capped at \$500 million**
  - \$473 million paid out to date
  - About \$200 million North Slope, \$273 million non-North Slope
  - \$27 million left in fund with \$4 million in-process claims
- **Current DOR Work Pool \$675 million**
  - \$10 million in older NOL credits
  - \$22 million in older exploration credits
  - \$552 million in 2015 NOL, QCE, WLE credits
  - \$60 million in 2015 exploration credits
  - \$31 million additional 2015 NOL, QCE, WLE expected via amended returns

## *Credit Cost in Perspective*

### **Status of Credit Fund / Demand for FY16-17**

- All the “in hand” applications, if eligible, result in a known demand for FY2017 of **\$652 million**
- This is very current information, based on the CY15 tax “true-up” which was due on Thursday 3/31
- Expected credit applications during CY2016, which could also be paid in FY17:
  - Another \$40 million in quarterly requests for QCE and WLE outside the North Slope
  - Another \$60 million in “last minute” exploration claims
  - About \$20 million in LNG storage and refinery claims
- Total, foreshadowing “final” Spring 2016 forecast, \$775 million- slight reduction from \$825 million

## *Credit Cost in Perspective*

- What impacts the change from \$825 to \$775?
  - Higher than expected NOL claims for CY 2015 (increases about \$100 million)
  - Decision to treat all CY 2016 claims for NOL credits as FY 2018 obligations, whereas in the past we had treated them as partly FY17 and party FY18 (decreases about \$150 million)
- So FY17 decreases by about \$50 million, but FY18 and FY19 will increase by at least that amount

## *Credit Cost in Perspective*

### **Growing Carried Forward NOL's: A New Problem**

- Since the beginning (2007) all companies except the three major producers have been able to receive cash for their tax credits. Majors must “carry them forward”
  - Companies producing less than 50,000 bbl /day
  - Hilcorp crossed over this threshold in 2015
- One or more of the majors had an operating loss in 2015. That becomes an NOL credit that can be used against taxes starting this January (to reduce payments below the minimum tax, as far as zero)
  - This only partly offsets minimum tax payments this calendar year. We still have some positive production tax income.
- With the Spring Revenue Forecast, we now see all three majors with much larger losses in 2016, and possibly for years beyond

## *Credit Cost in Perspective*

- By January 2017, production tax monthly payments will be effectively zero (mainly the private royalty tax)
- Loss credits from the majors, in excess of what it takes to reduce taxes to zero, are carried into a future year

### **Production Tax and Carried Forward Production Tax Credits, per the spring forecast**

<b>Fiscal Year</b>	<b>ANS Oil Price</b>	<b>Production Tax Revenue (\$millions)</b>	<b>Carried Forward Credits at Year End (\$millions)</b>
2016	\$39.52	\$133.4	\$385
2017	\$38.89	\$45.6	\$632
2018	\$43.79	\$15.7	\$766
2019	\$48.89	\$10.7	\$747
2020	\$54.48	\$12.5	\$600
2021	\$60.29	\$32.2	\$284
2022	\$61.64	\$105.2	\$151
2023	\$63.03	\$216.9	\$74
2024	\$65.45	\$198.0	\$1
2025	\$65.90	\$272.1	\$0

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# **Work Over Last Interim**

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## *Work Since Last Session*

- Governor's line-item veto capped FY16 spending at \$500 million
- Temporary liquidity crisis; many meetings with industry and others to help reassure lenders
- Multiple presentations with history, current practice, and possible changes
  - Joint Resources in Kenai, June 17
  - Three "regional" presentations to Senate Working Group September through November
  - All presentations on BASIS; we're prepared to go through similar information for the committee
- Development of reform legislation including plan for transition from current system

## *Recommendations of Senate Working Group*

1. Gradual implementation
2. Consider Timeline / Sector Impacts
3. Protect local vendors at bankruptcy
4. Protect Minimum Tax “Floor”
5. Protect Frontier Basin Tax Breaks
6. Enhance Reporting Requirements

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# **Provisions of SB 130**

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## *Provisions of SB 130*

### **Major Bill Themes**

1. Reduce the state's annual cash outlay;
2. Protect Net Operating Loss credits as a playing field leveler between legacy producers and newcomers;
3. Limit repurchases;
4. Strengthen the minimum tax;
5. Be more open and transparent;
6. Honor and pay credits earned to date and through any transition period.

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## *Provisions of SB 130*

### **Main Bill Components**

- 1. Exploration Credits-** *sunset and transition*
- 2. Cook Inlet Drilling Credits-** *phase out while retaining operating loss credits*
- 3. Repurchase Limits-** *limit cash outlay*
- 4. Remove Exceptions / Loopholes**
- 5. Strengthen Minimum Tax-** *prevent certain credits from going below the floor, plus increase to 5%*
- 6. Other Provisions-** *technical cleanup, transparency, interest rate reform*

## *Summary of Major Bill Provisions*

### **Exploration Credits**

- On 7/1/16, the “Jack up Rig” and “Frontier Basin” credits expire
- Also, regular .025(a) credits expire for North Slope and Cook Inlet
  - .025(a) credits remain for “Middle Earth” until 2022
- **Administration policy is to let them expire.**
- Preemptively repeal other exploration credit programs that are not currently being used, in AS 38.05.180(i) and AS 41.90.
- Add .025 DNR data requirements to .023(b)

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## *Summary of Major Bill Provisions*

### **Cook Inlet Drilling Credits**

- **Repeal AS 43.55.023(a) and .023(l)**
  - SB21 repealed the “spending based” credits for the North Slope
  - Prevent profitable companies who pay zero taxes from receiving state credit payments
  - Need for a broader Cook Inlet tax reform before 2022
- **Reduce general Cook Inlet cash support for development to the 25% .023(b) credit**

## *Summary of Major Bill Provisions*

### **Repurchase Limits**

- Expand current .028(e)(4) restriction saying companies who produce greater than 50,000 BOE / day can't have credit certificates repurchased, and must hold them to use against future production
  - **Any company with global annual revenue greater than \$10 billion / year**
  - Restore PPT-era cap of \$25 million / company / year
  - Percentage of repurchase tied to percentage of Alaska resident hire
  - **Carried-forward loss credits expire after 10 years**

## *Summary of Major Bill Provisions*

### **Remove Exceptions / Loopholes**

- Provisions that artificially inflate net operating losses
  - **Can't use GVR (new oil value reduction) to increase the size of a Net Operating Loss** (has led to credits greater than 100% of loss)
  - If a municipal entity owns production and sells only a portion of that production to an outside party, only the pro-rata share of expenses can be deducted against revenue

## *Summary of Major Bill Provisions*

### **Strengthen Minimum Tax**

- **Can't use an operating loss credit, small producer credit, or exploration credits to reduce payments below the 4% floor**
  - This is an actual fiscal impact in FY16; in calendar year 2015 one or more major producers had a net operating loss. In that case, NOL credits can reduce minimum tax to zero beginning this year.
  - This one provision is retroactive to 1/1/16
- **Extend 4% floor to GVR-eligible "new" oil**
- **Prevent per-taxable-barrel credits earned in one month from being used against another month's taxes at true-up**
- **Increase from 4% (at prices above \$25) to 5%**

# *Summary of Major Bill Provisions*

## **Other Provisions**

- Interest Rate Reform
  - Eliminate error in SB21 that prevents compound interest on underpayments and assessments
  - **Increase interest rate to state's "opportunity cost," seven percent above Fed Discount Rate**
- Confidentiality Waiver
  - Name of company and how much they received in state repurchased credits
- Transportation Costs can't reduce Gross Value below zero
- Credit certificates must first be used to satisfy any obligation to the state

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# **Impact of SB 130 on Specific Industry Sectors**

## *Bill Impact: Example Scenarios*

### **North Slope Major Producer**

- Higher oil prices: no change
- Prices below ~\$85: currently paying 4% minimum tax; must pay increase to 5%
- Extended period of very low prices: cannot use Net Operating Loss credit to reduce payments below the “floor”

## *Bill Impact: Example Scenarios*

### **North Slope New or Smaller Producer**

- Higher oil prices: no change
- Prices below ~\$85: must pay minimum tax. Currently per-barrel credit can reduce taxes to zero
- If company has an operating loss, the Gross Value Reduction cannot be used to increase the size of the loss to earn a larger NOL credit

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## *Bill Impact: Example Scenarios*

### **North Slope New Project Developer**

- Net Operating Loss Credits continue to be earned at the 35% level – no change
- Large Multinational Companies: must hold their credit certificates to be used against future tax liability
- Smaller Companies: limited by \$25 million / company / year cap. Must carry forward all credits in excess of this

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## *Bill Impact: Example Scenarios*

### **Cook Inlet Existing Producer**

- Currently pays low to zero taxes due to Cook Inlet tax caps, yet is eligible for 20%-40% credit repurchase for Capital and Well Lease Expenditure credits
- Repeal of these credits means producers without an operating loss do not earn refundable credits. Tax caps remain through the end of 2021

## *Bill Impact: Example Scenarios*

### **Cook Inlet New Field Developer**

- Currently receives a 25% Net Operating Loss credit stacked with either the 20% Capital or 40% Well credit. State typically refunds 50-60% of costs
- With repeal of Capital and Well credits, will continue to receive 25% Net Operating Loss credit
- Large Multinational Companies: must hold their credit certificates to be used against future tax liability
- Smaller Companies: limited by \$25 million / company / year cap. Must carry forward all credits in excess of this

## *Bill Impact: Example Scenarios*

### **Interior / Frontier Area Explorer**

- Currently receiving 65% state credits for exploration; 50-60% for development
- With repeal of Capital and Well credits, development projects will only receive the 25% Net Operating Loss credit
- However, exploration credits have been extended through 2022, meaning qualified expenditures continue to receive 65%

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# **Fiscal Impact of SB 130 on State of Alaska Budget**

## *Fiscal Impact*

**At the time the bill was introduced,  
FY17 Impact Est. \$500 Million / year**

- Elimination of about \$200 million / year in certificates
  - Mostly from repeal of .023(a) and (l) as well as elimination of so-called loopholes
- Deferral of payment on another \$200 million / year in certificates that would have to be held for use against future tax liability
  - Based on various new repurchase limits
- Additional revenue of about \$100 million
  - Strengthening minimum tax plus increase to 5%
  - Interest rate reform

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## *Fiscal Impact*

**Based on the Spring 2016 Revenue Forecast,  
plus more granular modeling,  
FY17 Impact Est. \$785 Million / year**

- Elimination of about \$50 million / year in certificates
- Deferral of payment on another \$550 million / year in certificates that would have to be held for use against future tax liability
  - Larger NOL's due to lower prices
  - Larger exploration spending before program sunset
- Additional revenue of about \$185 million
  - Added hardening; most producers will have 2016 NOL's, further reducing revenue below floor

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## *Fiscal Impact*

**In future years, our “status quo” credit forecast appears to decrease.**

**This can’t really be built into future 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



# Implementation

# *Implementation*

## **Transition**

- Bill is being written with an effective date of 7/1/16 for nearly all changes
- “Honoring Existing Credits” means:
  - Roughly \$200 million FY2016 “overhang”
  - Estimated \$625 million credits expected to be earned and payable in FY2017 (likely revised to \$575)
  - Plus all credits earned in first half of CY2016 prior to the effective date
  - Total equals about \$1 billion which will be paid via an appropriation to the .028 Tax Credit Fund
  - \$926.6 million fund cap in fiscal note, in addition to \$73.4 million in the operating budget

## **Connection to Fiscal Plan**

- SB130 was introduced as one of 10 bills that comprised the governor's fiscal plan.
- All the bills taken together, with anticipated budget cuts, proposed a balanced budget by FY19
- The broader fiscal package, and the specific tax credit bill, are intended to add certainty to industry regarding what support the state can provide and how we're going to continue to pay for government
- Original bill also assumed companion "AIDEA Loan" bill to help with projects that lost funding with credit changes
  - HB129 would create a new "fourth fund" at AIDEA to concentrate on oil and gas development loans, for proven reserves
  - Envisioned \$200 million initial fund capitalization

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# *Implementation*

## **Administration**

- The changes anticipated in this bill still require somewhat substantial reprogramming of the Tax Revenue Management System (TRMS) and Revenue Online (ROL) which allows a taxpayer to file a return online and update the current tax return forms
- We have received a preliminary estimate from the software developer, and currently assume a one-time cost of about \$1.2 million to accomplish this
- We do not anticipate any additional costs to administer the tax program
- There will also be a need for substantial amendments to existing regulations to fully implement the changes



# **Future Presentations**

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## *Content of Future Presentations*

### **We've provided seven different presentations to other committees; all are on BASIS**

- History and development of tax credits, and history of the minimum production tax
- Various credits and how they have been used, which ones haven't been, and what is sunseting
- Detailed forecasts and scenario analysis
- Details and modeling of specific provisions
- Life cycle modeling of typical new projects, with impact of legislation
- Explanation and modeling of changes made in other committees

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Thank You!

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