

01/22/13

SB 21 -

Oil and

Gas

Production

Tax

<TARGET><BILL>SB 21</BILL><SUBJECT>01-22-13 SB 21 - Oil  
and Gas Production Tax</SUBJECT><COMM>STTP28</COMM></TARGET>



THE STATE  
*of* **ALASKA**  
GOVERNOR SEAN PARNELL

**Department of Revenue**

COMMISSIONER'S OFFICE  
Bryan Butcher, Commissioner

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January 17, 2013

The Honorable Peter Micciche, Co-Chair  
Senate Special Committee on TAPS Throughput  
State Capitol Room 125  
Juneau, Alaska 99801

The Honorable Mike Dunleavy, Co-Chair  
Senate Special Committee on TAPS Throughput  
State Capitol Room 510  
Juneau, Alaska 99801

Dear Co-Chairs Micciche and Dunleavy:

Senate Bill 21 was read across the floor on January 16, 2013 and referred to the Senate Special Committee on TAPS Throughput for consideration. I respectfully request a hearing to be scheduled at your earliest convenience for the proposed changes to Alaska's oil and gas production tax to be discussed.

Governor Parnell is committed to getting more oil into the pipeline and increasing job opportunities for Alaskans. The current oil and gas production tax system is one of the obstacles the Governor has identified to stemming the decline in TAPS throughput and increasing oil production in Alaska.

Senate Bill 21:

- Eliminates the progressive function in the current production tax and maintains the current 25% tax rate.
- Eliminates qualified capital expenditure credits for expenditures made after December 31, 2014 for expenditures made, north of 68 degrees north latitude (the North Slope) to explore for, and develop oil and gas.
- Establishes a 20% gross revenue exclusion for production from units formed after January 1, 2003 and new participating areas in units that were in existence prior to January 1, 2003.
- Reforms the current net loss carry forward to require that it be carried forward to offset a tax liability and limits the instances in which the credit may be transferred.
- Extends the current small producer tax credit.
- Changes the fund source for the Community Revenue Sharing Fund from the progressive function in the current production tax system to the Alaska Net Income tax.

Co-Chairs Micciche and Dunleavy  
January 17, 2013  
Page 2

These changes are aimed at ensuring that the state continues to receive fair compensation for the sale of its resources while establishing a more competitive investment climate for job creation.

If the Committee requires any additional information, please contact me.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bryan Butcher". The signature is written in dark ink and is positioned above the printed name.

Bryan Butcher  
Commissioner

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Governor Sean Parnell  
STATE OF ALASKA

January 15, 2013

The Honorable Charlie Huggins  
President of the Senate  
Alaska State Legislature  
State Capitol, Room 111  
Juneau, AK 99801-1182

Dear President Huggins,

To create more economic opportunity for Alaskans, we must proactively choose a future of more oil production. Therefore, under the authority of Article III, Section 18 of the Alaska Constitution, I am transmitting a bill relating to oil production taxation.

Alaska's oil belongs to Alaskans, and increased oil production will mean increased private sector opportunity for Alaskans. Alaska engineers, contractors, and maintenance personnel earn their livelihoods from oil production; indirectly so do business owners, retailers, and working men and women of all trades. Oil production also provides revenue and drives public sector opportunities for schools, public safety, roads and ferries, energy infrastructure, and many other services for Alaskans.

**Need for Legislation**

Alaskans are well aware that oil production from legacy fields is declining. Not because we are running out of oil, but because we are running behind the competition. Alaska's North Slope has billions of proven barrels of oil, but we do not have a tax system designed to attract new investment for more production. At high oil prices, the current progressive tax rate structure creates highly variable tax rates and takes far more profit from investors than other competing jurisdictions. Investors take their money where they get a greater return, and they are investing new capital elsewhere. Legislation is necessary to drive new investment to create new Alaska production and new opportunities for Alaskans.

Under current law, the generous tax credits for capital expenditures support company spending now, but on spending not necessarily targeted for new production. Consequently, the State experiences the short-term risk of writing large checks from the treasury for those credits with no corresponding increase in production. Legislation is necessary to mitigate this risk, and focus company investment on long-term, new Alaska production.

**Guiding Principles**

Tax policy must be fair to Alaskans. Any changes to oil taxes should, when taken together, be geared to foster new production. Changes should result in a more simple tax system and restore balance to our fiscal system. And, tax policy must make Alaska competitive for the long-term. If these guiding principles are met, I believe we will more fully maximize the benefit of Alaskans' oil resources for Alaskans.

### **Legislation Summary**

The bill maintains a 25 percent base tax rate with a 20 percent gross revenue exclusion for new oil. It eliminates the progressivity calculation, and eliminates the qualified capital expenditure credits for North Slope expenditures. The bill reforms the remaining credits so that they are taken when there is production.

### **Fair to Alaskans and Fosters New Production**

The legislation provides more downside price protection for Alaskans in exchange for more upside price revenue to the companies. Under the current tax system, State revenues depend primarily on the price of oil, but the current qualified capital expenditure credits depend on the level of company spending. If prices fall, State revenues are reduced but the State retains the obligation to pay credits. Further, if additional development occurs, under the current system, the credit obligation could grow substantially. Given the State's other obligations like public safety and schools, this imbalance exposes the State to substantial financial risks. By reforming the credit system, this bill rebalances the current tax structure to ensure revenues to the State in low price environments.

The legislation targets new Alaska production rather than just company spending, thus unlocking more of Alaskans' oil for more Alaskan private sector and public sector opportunities. This goal is accomplished by eliminating the current 20 percent tax credit under AS 43.55.023(a) for qualified capital expenditures incurred after December 31, 2013, to explore for, develop, or produce oil and gas deposits located on the North Slope. The bill would amend the 25 percent tax credit issued under AS 43.55.023(b) for a carried-forward annual loss based on expenditures incurred after December 31, 2013, to explore for, develop, or produce oil and gas deposits located on the North Slope by limiting the transferability and monetization of the tax credit. The amendment to AS 43.55.023(b) will encourage investment aimed at production by requiring a producer or explorer to carry the credit forward to offset future tax liabilities. Additionally, the bill extends the small producer tax credit available under AS 43.55.024(c). The small producer tax credit is nontransferable.

The bill creates additional incentives for new production on the North Slope by providing for a 20 percent revenue exclusion based on the gross value at the point of production of oil and gas produced from a lease or property that was not, as of January 1, 2003, within a unit. It also proposes the same 20 percent revenue exclusion for oil and gas production from new participating areas in units that were formed before January 1, 2003. Similar to the new North Slope carried-forward annual loss tax credit and the extended tax credit for small producers, these incentives only would apply to a company when it has production.

### **More Simple, Restores Balance**

The bill simplifies the oil and gas production tax by repealing the progressive tax rate structure in Alaska's current tax system by levying a flat rate tax of 25 percent on oil and gas production statewide, subject to current tax ceilings on certain oil and gas, for production beginning January 1, 2014. The repeal of the progressive tax rate structure in this bill encourages the type of long-term planning and investment needed to promote new investment in new production in Alaska.

### **Long-Term Competitiveness**

By shifting the incentives away from spending and towards new production we assure these tax changes are for the long run. Producers get the benefit of tax changes later – after they produce new oil when they can offset earlier liabilities against new production. Additionally, by giving back more

The Honorable Charlie Huggins  
January 15, 2013  
Page 3

of the high side at high oil prices (while better protecting Alaskans against the downside of lower oil prices), we assure companies will make their investments for the long haul because they are more likely to take short-term risk with capital if they are assured greater return over time at higher prices.

In summary, this bill provides a path to more Alaskan opportunity through more Alaskan oil production. I urge your prompt and favorable action on this measure.

Sincerely,

A handwritten signature in black ink that reads "Sean Parnell". The signature is written in a cursive, flowing style with a large initial "S".

Sean Parnell  
Governor

Enclosure

**Senate Bill 21**  
**Oil and Gas Production Tax**  
**SECTION ANALYSIS**

**Section 1:** AS 29.60.850, relating to certain appropriations to the general fund is amended to allow the legislature to make appropriations based on taxes paid during the previous calendar year under the Alaska Net Income Tax Act, AS 43.20, to conform to the repeal of AS 43.55.011(g) in section 26 of the bill.

**Section 2:** AS 43.55.011(e), relating to the levy of the oil and gas production tax, is amended to eliminate the reference to AS 43.55.011(g), the monthly progressivity tax, which is repealed in section 26 of the bill. Beginning January 1, 2014, AS 43.55.011(e) would levy on producers of oil and gas produced each calendar year a flat rate tax of 25 percent of the production tax value of taxable oil and gas produced from each lease or property in the state. No change is made to current tax ceilings that apply to Cook Inlet oil and gas, gas produced outside the Cook Inlet basin and used in the state, and oil and gas produced from new fields outside the Cook Inlet basin and south of the North Slope.

**Section 3:** Amends AS 43.55.011(o), relating to gas used in the state, to clarify that the tax ceiling applicable to gas used in the state does not apply to gas subject to AS 43.55.011(p)(the seven year tax limitation of four percent of gross value at the point of production for oil and gas first produced commercially outside of the Cook Inlet basin and south of 68 degrees North latitude after December 31, 2012, and before January 1, 2022).

**Section 4:** Amends AS 43.55.020(a), monthly installment payments of estimated tax, to clarify payment provisions relating to the determination of tax due for oil and gas subject to AS 43.55.011(p) and makes other minor clarifying amendments.

**Section 5:** Amends AS 43.55.020(a), monthly installment payments of estimated tax, for oil and gas produced after January 1, 2014, to conform to the repeal of AS 43.55.011(g), and to amend the calculation of monthly payments based on North Slope oil and gas to conform with the gross revenue exclusion in new subsection (f), AS 43.55.160, in section 24 of the bill.

**Section 6:** AS 43.55.020(d), related to payment by a producer to a private royalty owner, is amended to refer to the tax levied by AS 43.55.011(e) instead of AS 43.55.011(e)-(g). This amendment does not change the substance or effect of AS 43.55.020(d) although to avoid confusion, the amendment is made effective the same date as the repeal of AS 43.55.011(g).

**Section 7:** Amends AS 43.55.023(a) to eliminate the current restrictions on use of a tax credit for qualified capital expenditures and allow the full amount of a tax credit to be applied in a single calendar year beginning January 1, 2013 for expenditures after December 31, 2012.

**Section 8:** Amends AS 43.55.023(a), effective immediately, to limit the 20 percent tax credit for qualified capital expenditures incurred north of 68 degrees North latitude (North Slope) to expenditures incurred before January 1, 2014. Tax credits under AS 43.55.023(a) based on expenditures to explore for, develop, or produce oil and gas deposits south of the North Slope are not affected.

**Section 9:** Amends AS 43.55.023(b) to provide that the 25 percent tax credit for a carried-forward annual loss based on expenditures incurred after December 31, 2013, to explore for, develop, or produce oil and gas deposits located on the North Slope are no longer redeemable for cash, nor are they transferable except as provided in new AS 43.55.023(t) in section 15 of the bill. Carried-forward annual loss tax credits based on expenditures incurred after December 31, 2013, to explore for, develop, or produce oil or gas deposits located south of the North Slope are not affected.

**Section 10:** Amends AS 43.55.023(c) to conform with new amendments to AS 43.55.023 in section 15 of the bill, related to the new rules that will apply to the tax credit for carried-forward losses incurred for expenditures related to North Slope activities.

**Section 11:** Amends AS 43.55.023(d), issuance of transferable and redeemable tax credit certificates for qualified capital expenditures, to conform to the amendments to AS 43.55.023(a) in section 7 of the bill authorizing the Department of Revenue to issue one tax credit certificate for the full amount of a transferable tax credit.

**Section 12:** Amends AS 43.55.023(d), issuance of transferable and redeemable tax credit certificates for qualified capital expenditures, so that tax credits certificates based on lease expenditures incurred after December 31, 2013 to explore for, develop, or produce oil and gas deposits on the North Slope are no longer redeemable for cash; nor are the tax credits transferable except in limited circumstances. The reference to AS 43.55.023(i), the transitional expenditure credit, is deleted to conform to the repeal of AS 43.55.023(i) in section 26 of the bill. Tax credits based on lease expenditures to explore for, develop, or produce oil and gas deposits south of the North Slope are still transferable and redeemable for cash from the oil and gas tax credit fund.

**Section 13:** Amends AS 43.55.023(g), issuance of tax credit certificates, to conform to the repeal of AS 43.55.023(m) in section 25 of the bill.

**Section 14:** Amends AS 43.55.023(n), issuance of tax credit certificates, to conform to the repeal of AS 43.55.023(m) in section 25 of the bill.

**Section 15:** Amends AS 43.55.023 by adding new subsections (p)–(u), effective January 1, 2014 relating to tax credits for carried-forward annual losses based on adjusted lease expenditures incurred to explore for, develop, or produce oil or gas deposits located on the North Slope.

Subsection (p) limits application of a North Slope carried-forward loss credit to tax liability two or more calendar years after the expenditures on which the credit is based were incurred, but the credit may not be applied later than 10 years after the expenditures were incurred.

Subsection (q) establishes a “first earned, first used” rule by requiring that available North Slope carried-forward loss tax credits must be applied in order of the year the expenditures were incurred, with the earliest year first, against tax liability under AS 43.55.011(e).

Subsection (r) provides an annual 15 percent increase in the amount of a North Slope carried-forward loss tax credit subject to compliance with subsections (p), (q) and (s). An amount of a tax credit subject to this subsection begins to increase on January 1 of the second calendar year immediately following the year the expenditures on which the credit is based were incurred, unless that second calendar year is the year for which the credit is applied. The credit stops increasing on December 31 of the year preceding the year against which the credit is applied against the person’s tax liability. The increase under this subsection has no value except as applied against a person’s tax liability, and the credit expires if not used within the 10 year period in AS 43.55.023(p) of this section.

Subsection (s) provides that a tax credit will not increase under section (r) if the credit could have been applied to a producer’s tax liability and provides the order in which credits must be applied and calculations for the determination of when a tax credit could be applied against a person’s tax liability.

Subsection (t) provides that a North Slope carried-forward loss tax credit is not transferable except to another person that acquires an interest in the lease or property owned by the transferee at the time the lease expenditures on which the credit is based were incurred. A transferee’s use of the credit is subject to the provisions of (u) of this section, and includes filing information on the transfer with the Department of Revenue. The transferee’s use of the credit against its tax liability is subject to audit by the Department of Revenue to the same extent as a tax credit that has not been transferred.

Subsection (u) sets out limitations for use of a North Slope carried-forward loss tax credit where a tax credit is used by a producer to whom a tax credit has been

transferred through acquisition of leases or properties, or by a producer that has acquired the person that holds the tax credit. The transferee or successor may use the amount of the tax credit specified in this subsection, but the amount of the credit that may be applied against the transferee's or successor's tax liability under AS 43.55.011(e) for a calendar year may not exceed 20 percent of the sum obtained by an equation based on the taxable gross value at the point of production from the lease or property in a calendar year multiplied by the percentage interest in the lease or property owned by the person that incurred the expenditures on which the tax credit is based.

**Section 16:** Amends AS 43.55.024(d) to extend for 6 years the time that a producer may take a tax credit under AS 43.55.024(c), the small producer credit. Qualifying producers would have until 2022 (instead of 2016) to take the nontransferable small producer tax credit. The extension also applies to producers that did not have commercial production in the state before April 1, 2006, but that first have commercial production before May 1, 2022. Those producers may take the tax credit for nine calendar years (the same period as in current law) after the start of commercial production.

**Section 17:** Amends AS 43.55.028(e) to conform to the repeal of AS 43.55.023(m) in section 25 of the bill.

**Section 18:** Amends AS 43.55.028(g) to conform to the repeal of AS 43.55.023(m) in section 25 of the bill.

**Section 19:** Amends AS 43.55.030(e) (1), annual statements of qualified capital expenditures, to clarify current practice that both explorers and producers must file statements reporting qualified capital expenditures and other information required under AS 43.55.030(e).

**Section 20:** Amends AS 43.55.030 by adding new subsection (g) which requires an explorer or producer claiming a tax credit subject to AS 43.55.023(p)–(u) (section 15 of the bill) to file an annual statement with the Department of Revenue reporting the nature and amount of the expenditures on which the North Slope carried-forward loss credit is based, the amount the person intends to carry forward, any increase in the amount of the credit, and other information required by the Department of Revenue.

**Section 21:** Amends AS 43.55.160(a), calculation of annual production tax values, to clarify and conform to the provisions of AS 43.55.011(p).

**Section 22:** AS 43.55.160(a), calculation of annual production tax values, is repealed and reenacted to conform to the repeal of the monthly progressivity tax in section 26 of the bill. For oil and gas produced after January 1, 2014, a producer of oil and gas will no longer need to calculate monthly production tax values for oil and for purposes of AS 43.55.011(g), the progressivity tax. Other clarifying amendments are made setting out

the categories for which a separate annual production tax value must be calculated, but the method of calculating annual production tax value is not affected.

**Section 23:** Amends AS 43.55.160(e) to conform to the amendments in section 22 of the bill.

**Section 24:** Amends AS 43.55.160 by adding new subsection (f) which provides that in calculating the annual production tax value for oil and gas produced north of 68 degrees North latitude the gross value at the point of production of the oil or gas meeting either or both of the following criteria is reduced by 20 percent if (1) produced from a lease or property that does not contain land that was within a unit on January 1, 2003; (2) produced from a participating area established after December 31, 2011, that is within a unit formed under AS 38.05.180(p) before January 1, 2003, if the participating area does not contain a reservoir that had previously been in a participating area established before January 1, 2012. The gross value at the point of production is not reduced if it is zero or less before any reduction.

**Section 25:** Repeals AS 43.55.023(m) relating to tax credit certificates.

**Section 26:** Repeals AS 43.55.011(g), 43.55.023(i) and 43.55.160(c).

**Section 27:** Applicability sections.

**Section 28:** Retroactivity provisions for sections 3, 7, 11, 13, 14, 17, 21 and 25.

**Section 29:** Transition provision providing the Department of Revenue authority to adopt regulations, to be effective not before the date of the effective date of the provisions of this bill.

**Section 30:** Sections 1, 2, 5, 6, 9, 10, 12, 15, 20, 22-24, and 26 take effect January 1, 2014.

**Section 31:** Except as provided in section 30, the remaining sections of the bill will take effect immediately under AS 01.10.070(c).

# FISCAL NOTE

STATE OF ALASKA  
2013 LEGISLATIVE SESSION

Bill Version SB 21  
Fiscal Note Number 1  
(S) Publish Date 1/16/13

Identifier (file name) 0647-DOR-TAX-01-15-13 Dept. Affected Revenue  
Title Production Tax on Oil and Gas Appropriation Treasury and Taxation  
Allocation Tax Division  
Sponsor Rules by Request of the Governor  
Requester Governor OMB Component Number 2476

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	FY14 Appropriation Requested	Included in Governor's FY14 Request	Out-Year Cost Estimates					
			FY14	FY15	FY16	FY17	FY18	FY19
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants, Benefits								
Miscellaneous								
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**FUND SOURCE** (Thousands of Dollars)

1002	Federal Receipts							
1003	GF Match							
1004	GF							
1005	GF/Prgm (DGF)							
1037	GF/MH (UGF)							
1178	temp code (UGF)							
<b>TOTAL</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**POSITIONS**

Full-time							
Part-time							
Temporary							

**CHANGE IN REVENUES**

	***	***	***	***	***	***	***
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Estimated **SUPPLEMENTAL (FY13) operating costs** \_\_\_\_\_ (separate supplemental appropriation required)  
(discuss reasons and fund source(s) in analysis section)

Estimated **CAPITAL (FY14) costs** \_\_\_\_\_ (separate capital appropriation required)  
(discuss reasons and fund source(s) in analysis section)

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? yes  
If yes, by what date are the regulations to be adopted, amended, or repealed? 1/1/2014 Discuss details in analysis section.

**Why this fiscal note differs from previous version (if initial version, please note as such)**

Initial version.

Prepared by Cherie Nienhuis, Ed King and Michael Pawlowski  
Division Tax Division  
Approved by Bryan Butcher, Commissioner  
Department of Revenue

Phone 907-269-1019  
Date/Time 1/15/2013, 11:39 pm  
Date 1/15/2013

## FISCAL NOTE ANALYSIS #1

STATE OF ALASKA  
2013 LEGISLATIVE SESSION

BILL NO. SB 21

### Analysis

This bill limits the provision that the State of Alaska purchase transferable tax credit certificates for credits earned from leases or properties that contain land that is north of 68 degrees North latitude to credits based on expenditures incurred before January 1, 2014. The operating portion of the long-term fiscal plan anticipates an average of \$400 million in refundable credits through 2023. It is anticipated that the limitation of this provision would reduce those future appropriations, beginning in FY 2015.

**Regulations:** The bill does not direct DOR to adopt new regulations to implement its provisions, but existing regulations may need to be amended to conform to changes in eligibility for redeemable tax credits, and to account for repeal of some sections. There may be additional regulations required, but not before January 1, 2014.

**\*\*\*The revenue impact of this bill is an estimate based on Fall 2012 Forecast.**

This bill makes several changes to the oil and gas production tax system. Each of the major changes, along with its potential revenue impact, is discussed separately below. The effective date of each of the bill's provisions listed below is January 1, 2014, with the exception of provision 6 (bill section 7), which is effective for expenditures beginning January 1, 2013.

- 1. The progressive portion of the production tax at AS 43.55.011(g) is repealed, and the production tax at AS 43.55.011(e) is retained at a tax rate of 25% of production tax value.** Based on our Fall 2012 forecast, this change decreases production tax revenue over the forecast period analyzed. Please see detailed summary table on page 3 of this fiscal note.
- 2. Production tax credits under AS 43.55.023(a) for qualified capital expenditures are limited to expenditures incurred before January 1, 2014 on leases or properties that contain land north of 68 degrees North latitude.** Based on our Fall 2012 forecast, this change increases production tax revenue annually over the forecast period analyzed. Please see detailed summary table on page 3 of this fiscal note.
- 3. Companies that incur net losses from leases or properties that contain land north of 68 degrees North latitude will earn a credit of 25% of those losses to be carried forward for a maximum period of ten years. These net loss carry-forwards will increase at an annual rate of 15 percent beginning on January 1 of the second calendar year following the year of the loss.** The revenue impact of this provision is confidential under our forecast, however, the impact is expected to be minimal.
- 4. A gross revenue exclusion (GRE) is applicable to production from leases or properties containing land that is north of 68 degrees North latitude and meets one or both of two criteria: (1) is produced from a lease or property that does not contain land that was within a unit on January 1, 2003; or (2) is produced from a participating area established after December 31, 2011 for lease or properties in a unit formed before January 1, 2003.** This provision is intended to incentivize future production and the revenue impact of this provision based on the current production forecast is minimal.
- 5. The small producer credit at AS 43.55.024 is extended to the later of 2022 or the ninth calendar year after the calendar year that the producer first has commercial production.** This provision extends the small producer credit six years from the original sunset date of 2016. The revenue impact based on the current revenue forecast is minimal.
- 6. The provision requiring that credits be taken over two years is eliminated.** This provision would result in companies using credits earlier than they would without this change, and except for the time value of money impact, it is revenue neutral. This provision applies to expenditures after December 31, 2012.
- 7. The community revenue sharing fund is amended to allow the legislature to make appropriations from the tax revenue collected under AS 43.20, as opposed to revenue collected under AS 43.55.011(g).** The impact of this provision is indeterminate.

Analysis Continued

Provisions in the Bill and their Estimated Fiscal Impact as compared to Fall 2012 Forecast (\$millions)

Brief Description of Provision	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
1. Elimination of progressive portion of tax	-\$800	-\$1,500	-\$1,700	-\$1,800	-\$1,750	-\$1,650
2. Limitation of credits for qualified capital expenditures for North Slope	\$300	\$700	\$650	\$550	\$475	\$400
3. Net operating losses carried forward and increased at 15% per year	Less than -\$50 million per year under Fall 2012 forecast					
4. Gross revenue exclusion for certain areas						
5. Small producer credit extended to 2022	\$0	\$0	\$0	-\$25	-\$25	-\$50
6. Provision requiring credits be taken over 2 year eliminated*	-\$250					
7. Amendment to the community revenue sharing fund	Indeterminate					
<b>Total Revenue Impact</b>	<b>-\$750</b>	<b>-\$800</b>	<b>-\$1,050</b>	<b>-\$1,275</b>	<b>-\$1,300</b>	<b>-\$1,300</b>
Impact on Operating Budget	-\$150	\$250	\$250	\$250	\$250	\$250
<b>Total Fiscal Impact</b>	<b>-\$900</b>	<b>-\$550</b>	<b>-\$800</b>	<b>-\$1,025</b>	<b>-\$1,050</b>	<b>-\$1,050</b>

\*Provision 6 above, which eliminates the requirement that credits be taken over 2 years is revenue neutral, and simply shifts the tax liability from future years to FY 2014. The total impact of that provision is \$400 million, with \$250 million taken against tax liability as a revenue impact and \$150 million impacting the operating budget. The total fiscal impact consists of both revenue impacts and operating budget impacts of the bill.

The impacts listed above are based on production and prices as forecasted in our Fall 2012 revenue forecast. The forecasted oil prices are between \$109.61 and \$118.29. All data here are estimates; all figures have been rounded to reflect the uncertainty in the estimates.

Analysis Continued

**Differences in General Fund Unrestricted Revenue under  
Proposed Bill from Current Tax System in \$Millions\***

\*Note: These hypothetical examples of additional production assess the impacts from the change in tax rates and credits only and do not attempt to quantify impacts of other parts of the bill, such as the removal of the credit split or the impact on the long-range budget.

**At Forecasted Production**

Oil Price in \$/barrel	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$90	\$25	\$275	\$225	\$75	\$50	\$0
\$100	-\$200	-\$100	-\$175	-\$300	-\$350	-\$300
\$120	-\$900	-\$1,350	-\$1,425	-\$1,525	-\$1,475	-\$1,350

All additional production scenarios below compare additional production under the proposed bill to ACES without the additional production.

**Additional Production Scenario A**

Forecasted production plus 50 million barrel field developed by a New Entrant

Oil Price in \$/barrel	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$90	\$50	\$375	\$300	\$175	\$75	\$75
\$100	-\$200	-\$75	-\$150	-\$275	-\$350	-\$300
\$120	-\$900	-\$1,375	-\$1,400	-\$1,500	-\$1,475	-\$1,375

Assumes field outside of a current unit and subject to gross revenue exclusion, first oil in 2017 and peak production of 10,000 barrels per day in 2019. Total development cost of \$500 million.

**Additional Production Scenario B**

With addition of 4 oil rigs to legacy fields drilling from 2014-2019

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$90	\$100	\$550	\$575	\$525	\$550	\$475
\$100	-\$125	\$125	\$175	\$150	\$225	\$150
\$120	-\$825	-\$1,100	-\$1,000	-\$975	-\$800	-\$800

Assumes each oil rig drills 4 new production wells per year, with each well producing 1,000 barrels of oil per day beginning in FY 2014, with a maximum production rate of 60,000 barrels per day for a total of 140 million barrels. Development costs for each well assumed to be \$20 million.

**Additional Production Scenario C**

With new well pad and 4 additional rigs in legacy fields, plus new 10,000 bopd field starting in 2017

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$90	\$50	\$525	\$675	\$800	\$1,275	\$1,200
\$100	-\$175	\$150	\$325	\$500	\$1,025	\$975
\$120	-\$825	-\$1,000	-\$725	-\$475	\$225	\$225

Assumes new well pad within major North Slope unit producing a total of 125 million barrels of new production over an 8-year period starting in 2015 at total development costs of \$5 billion. Also includes scenario B above with 4 oil rigs in legacy fields and scenario A above with the addition of a new 50-million barrel field.

# FISCAL NOTE

**STATE OF ALASKA**  
**2013 LEGISLATIVE SESSION**

Bill Version SB 21  
Fiscal Note Number 2  
(S) Publish Date 1/16/13

Identifier (file name) LL0647-DNR-DOG-1-14-13 Dept. Affected Natural Resources  
Title Production Tax on Oil and Gas Appropriation Oil & Gas  
Allocation Oil & Gas  
Sponsor Rules by Request of the Governor  
Requester Governor OMB Component Number 439

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	FY14 Appropriation Requested	Included in Governor's FY14 Request	Out-Year Cost Estimates				
			FY15	FY16	FY17	FY18	FY19
<b>OPERATING EXPENDITURES</b>	<b>FY14</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants, Benefits							
Miscellaneous							
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>FUND SOURCE</b>		(Thousands of Dollars)					
1002	Federal Receipts						
1003	GF Match						
1004	GF						
1005	GF/Prgm (DGF)						
1037	GF/MH (UGF)						
1178	temp code (UGF)						
<b>TOTAL</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>POSITIONS</b>							
Full-time							
Part-time							
Temporary							

<b>CHANGE IN REVENUES</b>	***		***	***	***	***	***
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Estimated **SUPPLEMENTAL (FY13) operating costs** \_\_\_\_\_ (separate supplemental appropriation required)  
(discuss reasons and fund source(s) in analysis section)

Estimated **CAPITAL (FY14) costs** \_\_\_\_\_ (separate capital appropriation required)  
(discuss reasons and fund source(s) in analysis section)

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
If yes, by what date are the regulations to be adopted, amended, or repealed? N/A Discuss details in analysis section.

**Why this fiscal note differs from previous version (if initial version, please note as such)**

Initial Version.

Prepared by Bill Barron, Director  
Division Division of Oil and Gas  
Approved by Daniel S. Sullivan, Commissioner  
Department of Natural Resources

Phone 269-8800  
Date/Time 1/14/13 5:00 PM  
Date 1/14/2013

FISCAL NOTE ANALYSIS #2

STATE OF ALASKA  
2013 LEGISLATIVE SESSION

BILL NO. SB 21

**Analysis**

LL0647 reforms the oil and gas production tax system in Alaska. This bill will not result in any procedural changes in how the Division of Oil and Gas operates and therefore the Department of Natural Resources (DNR) does not anticipate any fiscal impact to the Department's operating budget.

This bill proposes to improve Alaska's competitiveness and encourage producers to invest more by simplifying the oil and gas production tax system. First, this bill repeals the progressive tax structure, which will help encourage the type of long-term planning and investment needed to promote new investment in new production in Alaska. Further, this bill shifts incentives away from spending and provides new incentives to reward new production. At forecasted price ranges, overall government take and marginal tax rates are reduced materially. To the extent that investments are made as a consequence of these changes to the tax regime, royalty revenue may rise.

The fiscal impact on royalty revenue is an indeterminate positive.

FISCAL NOTE ANALYSIS #2

STATE OF ALASKA  
2013 LEGISLATIVE SESSION

BILL NO. SB 21

Analysis Continued

**Differences in Royalty Revenues from  
New Production Scenarios in \$Millions\***

\*Note: These scenarios are based on Department of Revenue modeling.

**At Forecasted Production**

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$ 120	\$0	\$0	\$0	\$0	\$0	\$0
\$ 100	\$0	\$0	\$0	\$0	\$0	\$0
\$ 90	\$0	\$0	\$0	\$0	\$0	\$0

**Additional Production Scenario A**

Forecasted production plus 50 million barrel field developed by a New Entrant

Oil Price in \$/barrel	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$120	\$0	\$0	\$0	\$12	\$24	\$35
\$100	\$0	\$0	\$0	\$10	\$20	\$29
\$90	\$0	\$0	\$0	\$9	\$17	\$26

Assumes field outside of a current unit and subject to gross revenue exclusion, first oil in 2017 and peak production of 10,000 barrels per day in 2019. Total development cost of \$500 million.

**Additional Production Scenario B**

With addition of 4 oil rigs to legacy fields drilling from 2014-2019

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$120	\$57	\$106	\$147	\$181	\$212	\$179
\$100	\$47	\$87	\$120	\$148	\$173	\$146
\$90	\$42	\$77	\$107	\$132	\$154	\$130

Assumes each oil rig drills 4 new production wells per year, with each well producing 1,000 barrels of oil per day and declining at a rate of 15% per year. Development costs for each well assumed to be \$20 million.

**Additional Production Scenario C**

With new well pad and 4 additional rigs in legacy fields, plus new 10,000 bopd field starting in 2017

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
\$120	\$111	\$213	\$307	\$433	\$557	\$533
\$100	\$91	\$174	\$251	\$354	\$455	\$435
\$90	\$81	\$155	\$223	\$314	\$404	\$386

Assumes new well pad within major North Slope unit producing a total of 125 million barrels of new production over an 8-year period starting in 2015 at total development costs of \$5 billion. Also includes scenario B above with 4 oil rigs in legacy fields and scenario A above with the addition of a new 50-million barrel field.



# Overview of SB 21 Oil & Gas Production Tax

*January 22, 2013*  
*Alaska Department of Revenue*



# The Proposal (Highlights)



1. Eliminate Progressivity and Credits Based on Capital Expenditures.
2. Reform remaining credits to be carried forward to when there is production.
3. Establish a "Gross Revenue Exclusion" for newer units and new participating areas in existing units (NEW OIL).
4. Hold Cook Inlet and Middle Earth Harmless.



# Eliminate Progressivity & Credits Based on Capital Expenditures



## Progressivity

Main Sections: 1,2,26

Conforming Sections: 5,6,22,23

## North Slope QCE Credits

Main Sections: 8

Conforming Sections: 7, 11, 12





Establish a “Gross Revenue Exclusion” for newer units and new participating areas in existing units.



## Gross Revenue Exclusion (The GRE)

Main Sections: 24

Conforming Sections: 5



# Hold Cook Inlet and Middle Earth Harmless



## Hold Cook Inlet & Middle Earth Harmless

Main Sections: 3

Conforming Sections: 4, 13, 14, 17, 18, 21, 25

# ARRESTING TAPS THROUGHPUT DECLINE & OIL TAX REFORM

## **TAPS Throughput Committee**

Tuesday, January 22, 2013

Juneau, Alaska

**Dan Sullivan, Commissioner**

Alaska Department of Natural Resources

**Bryan Butcher, Commissioner**

Alaska Department of Revenue



# TAPS

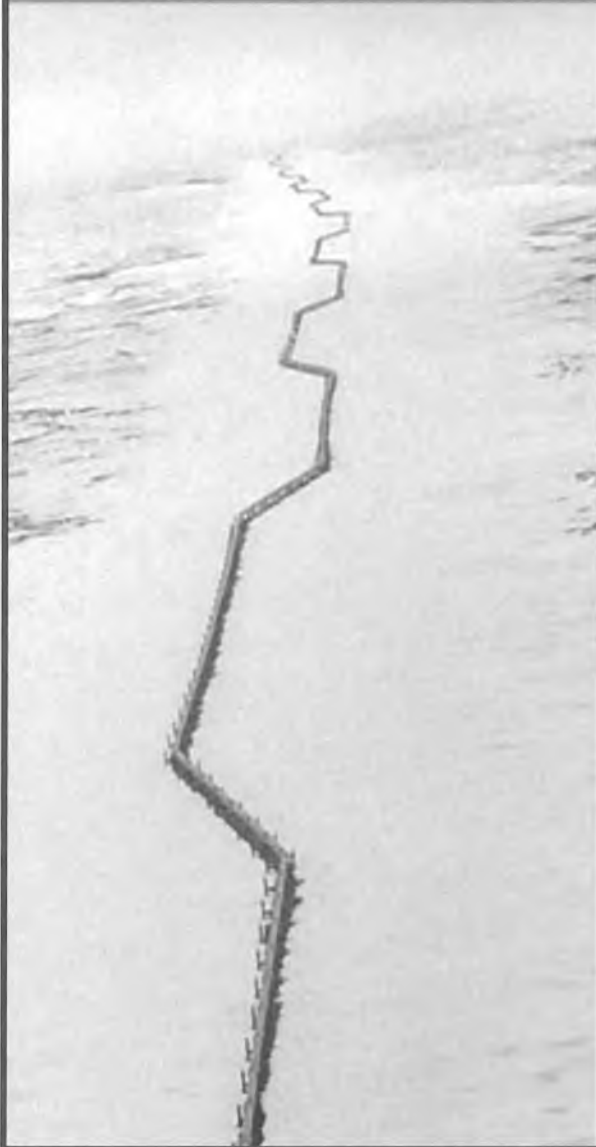
## - A CRITICAL STATE & NATIONAL ENERGY ASSET -

- The Trans Alaska Pipeline, 11 pump stations, several hundred miles of feeder pipelines, and the Valdez Marine Terminal constitute the Trans-Alaska Pipeline System (TAPS).
- At 800 miles long, the Trans Alaska Pipeline is one of the longest pipelines in the world; it crosses more than 500 rivers and streams and three mountain ranges as it carries Alaska's oil from Prudhoe Bay to Valdez.
- The U.S. Congress was instrumental in the approval and rapid development of TAPS. Congress approved construction of the pipeline with the Trans Alaska Pipeline Authorization Act of 1973.
- The principle focus of this Act is as relevant today as it was in 1973: *"the early development and delivery of oil and gas from Alaska's North Slope to domestic markets is in the national interest because of growing domestic shortages and increasing dependence upon insecure foreign sources."*



# TAPS

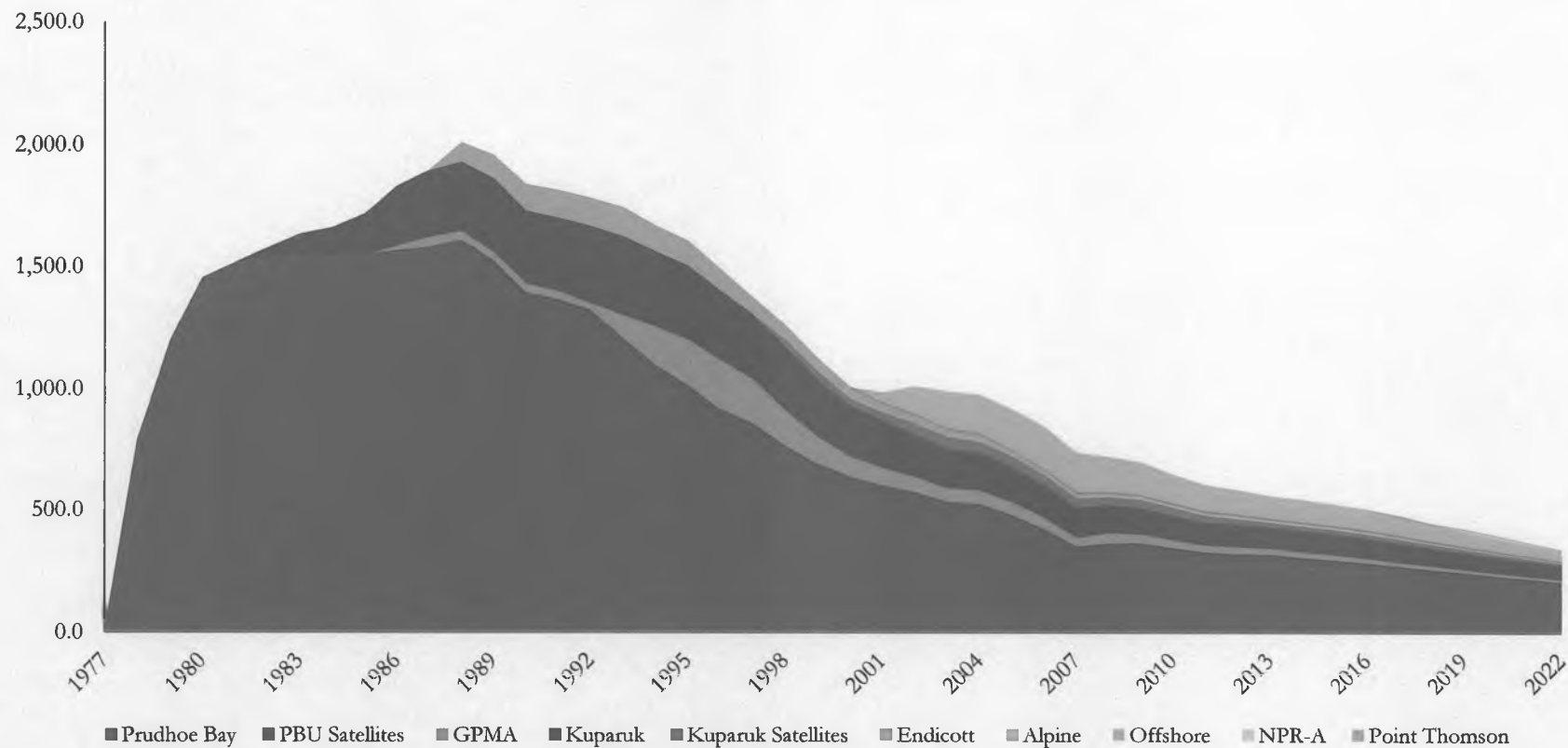
## - A CRITICAL STATE & NATIONAL ENERGY ASSET -



- TAPS has transported over 16.3 billion barrels of oil and natural gas liquids since June of 1977. Production peaked at 2.2 million barrels per day in the late 1980s, representing 25% of U.S. domestic production
- Since its peak, however, throughput has steadily declined; today, TAPS is 2/3 empty and declining at an average of 6% per year
- TAPS throughput decline threatens economic disruption and the very existence of our pipeline
- We must encourage industry to invest in exploration and development of conventional and unconventional resources on state and federal land, onshore and offshore
- TAPS has plenty of capacity for increased throughput
- Most near-term critical economic issue facing the state
- Less oil in the pipeline year after year takes away revenue from future generations—the ultimate giveaway
- Reconfiguration, 1.2 million barrels/day

# OIL TAX REFORM - PRODUCTION HISTORY -

## ANS Production



Source: Alaska Department of Revenue Fall 2012 Revenue Sources Book: <http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?2682f>

# TAPS

## - THROUGHPUT DECLINE IS AN URGENT PROBLEM -

- TAPS throughput decline is the MOST URGENT issue facing the State's economic future
- January 2011 TAPS shutdown



**Petroleum News, February 27, 2011:  
“Jan. shutdown puts TAPS close to brink:**

Alyeska executives describe efforts to prevent freezing in pipeline after pump station oil leak in era of low oil throughput”

**WSJ, May 11, 2011:**

**“Shrinking Oil Supplies Put Alaskan Pipeline at Risk”**

“Now, dwindling oil production along Alaska's northern edge means the pipeline carries less than one-third the volume it once did—and the crude takes five times as long to get to its destination.

That leisurely flow means the oil is above ground longer and more exposed to Alaska's frigid weather; the crude sometimes arrives chilled to 40 degrees. As the flow and temperature continue to drop, experts say the risks of a clog or corrosion increase, as do the odds of ruptures and spills.”

# ALASKA'S NORTH SLOPE OIL & GAS POTENTIAL

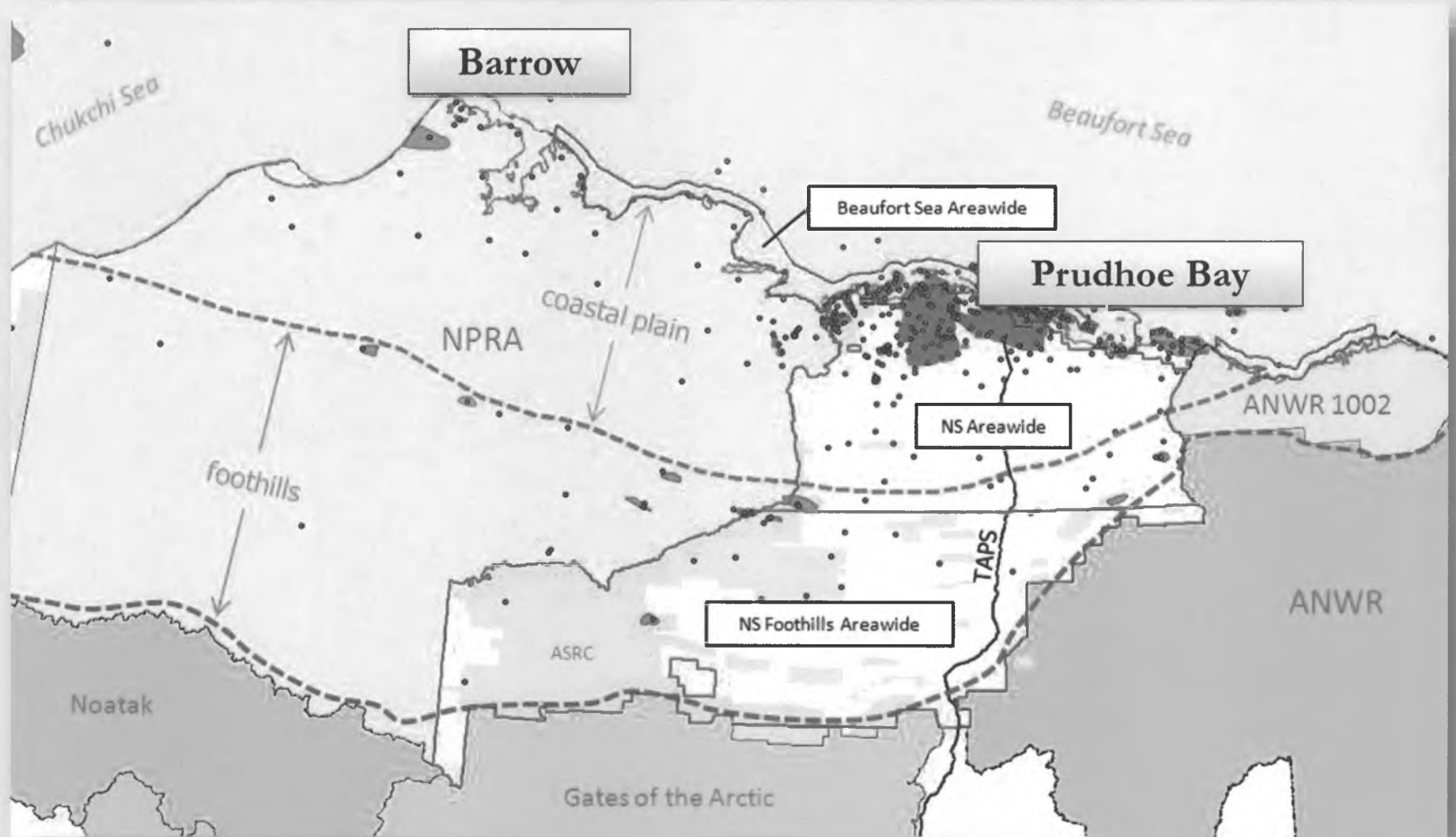
- USGS estimates that Alaska's North Slope has more oil than any other Arctic nation
  - **OIL:** Est. 40 billion barrels of conventional oil (*USGS & BOEMRE*)
  - **GAS:** Est. over 200 trillion cubic feet of conventional natural gas (*USGS*)
- Alaska has world-class unconventional resources, including tens of billions of barrels of heavy oil, shale oil, and viscous oil, and hundreds of trillions of cubic feet of shale gas, tight gas, and gas hydrates
  - Positive methane hydrate test production



*Compared to most hydrocarbon basins, Alaska is relatively underexplored, with 500 exploration wells on the North Slope, compared to Wyoming's 19,000.*

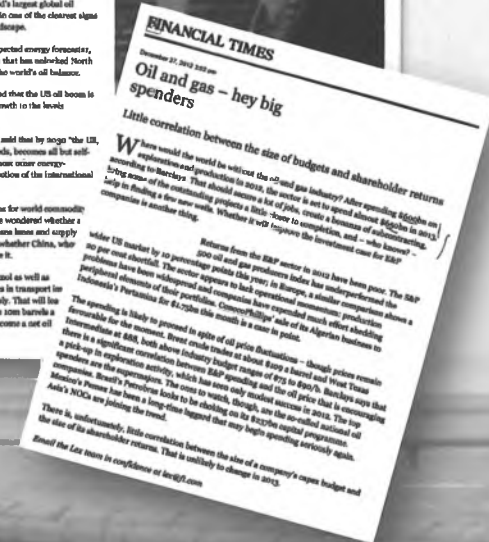
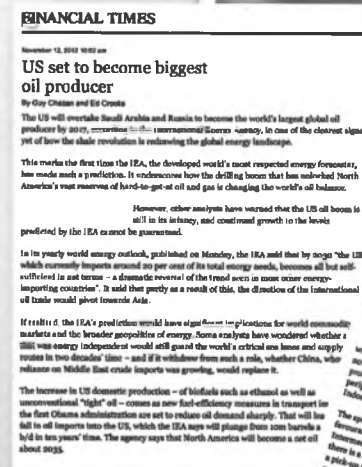
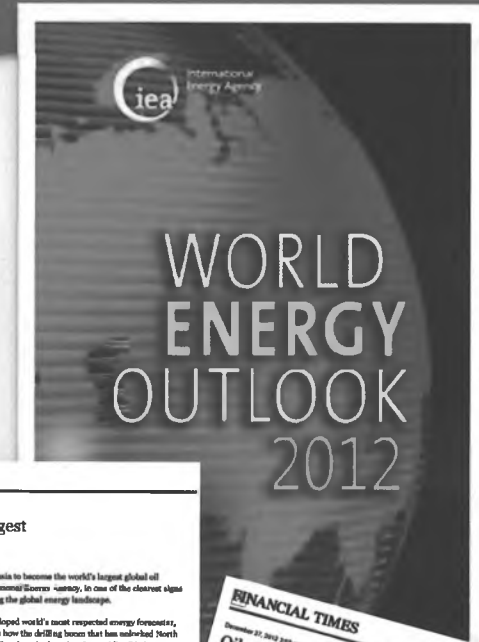


# ALASKA'S NORTH SLOPE OIL & GAS POTENTIAL



# U.S. ENERGY RENAISSANCE

- Global and U.S. hydrocarbon boom
- IEA World Energy Outlook 2012 – U.S. to overtake Saudi Arabia and Russia to become the world's largest global oil producer by the second half of this decade.
- Financial Times, November 12, 2012 – *“U.S. set to become biggest oil producer”*
- Financial Times, December 27, 2012 – *“Oil and gas – hey big spenders”*
  - 2012 - \$600 billion on exploration and production in oil and gas industry
  - 2013 projected - \$650 billion on exploration and production in oil and gas industry



# OTHER BASINS HAVE TURNED DECLINE AROUND

THE  INDEPENDENT

## North Sea set to create 50,000 new jobs as investment soars

Tom Bawden

Monday, 14 January 2013

North Sea employment is set to boom this year. Up to 50,000 new jobs are expected in Britain's oil and gas industry.

The jobs bonanza will support-services staff North Sea to nearly half a million.

"There's been a lot of at the moment," said behind the research. "their life. At the same have made it economic he added.

Further down the line, 35,000 jobs in the new Institute of Directors.

The expansion has been set to be ploughed into be the biggest creator the North Sea for a decade Shetland Isles, that will

The surge in investment Sea development, pro Energy and Climate Change

Although North Sea production output was 4.5m barrels 2m barrels. On the day to compete for employment more than twice the number

**"The expansion has been spurred by record-breaking levels of investment, with about £40bn set to be ploughed into North Sea production in the next three years..."**

**"The surge in investment comes after the government relaxed the tax regime around North Sea development, prompting a record-breaking licensing round when the Department of Energy and Climate Change awarded 167 new licenses on 330 blocks last October."**

**"Budget 2012: North Sea oil tax reforms 'to lead to £50bn investment': An extra £50bn could be pumped into the North Sea oil and gas industry thanks to a new package of tax reforms."**

Budget 2012: North Sea oil tax reforms 'to lead to £50bn investment'

An extra £50bn could be pumped into the North Sea oil and gas industry thanks to a new package of tax reforms.

The Budget was a 'turning point' for industry relations with the Treasury. Photo: Rex Features

By Emily Gosden

10:11PM GMT 21 Mar 2012

Industry body Oil & Gas UK said the Chancellor's promise of certainty on decommissioning tax relief and new tax breaks on small and deepwater fields would stimulate tens of billions of pounds of additional investment.

The Budget was a "turning point" for industry relations with the Treasury after outrage at the surprise tax rise in last year's Budget, Oil & Gas UK said. The measure means more than 2bn barrels of the UK's oil and gas reserves that would otherwise have been left in the ground will now eventually be recovered at no net cost to the Exchequer.

The Treasury estimates that the reforms could actually boost its coffers by £1bn over the next five years, due to tax on projects that would not otherwise have gone ahead.

The Chancellor confirmed that he would draw up a contract with the industry to permanently guarantee levels of tax relief on the £30bn bill for decommissioning old infrastructure, a move that Oil & Gas UK said could stimulate up to £40bn investment during the lifetime of the North Sea basin. Anxiety over whether rates might be cut has blocked some deals.

The Chancellor unveiled new 'field allowances', doubling tax breaks for developing smaller fields and introducing a £3bn allowance for some deepwater fields with significant reserves in the new exploration frontier West of Shetland. The allowances should see £10bn extra investment, the industry body said.

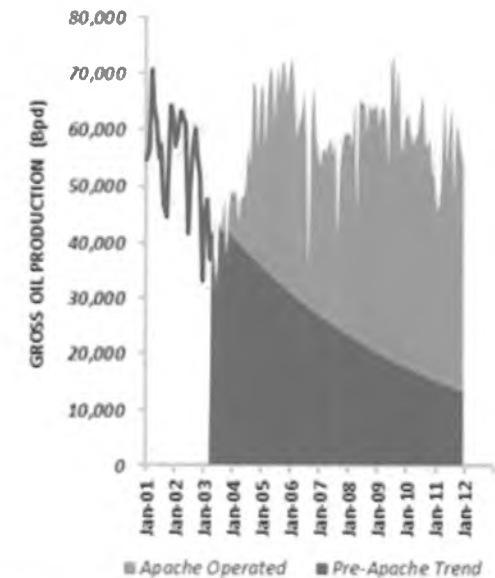
Malcolm Webb, Oil & Gas UK's chief executive, said the Budget was a "turning point for the UK's oil and gas industry" toward "a more stable future fostered by constructive collaboration between government and industry".

# OTHER BASINS HAVE TURNED DECLINE AROUND

## Apache Corporation: Forties Field Acquisition

- Field discovered in early 1970s by BP; purchased by Apache in 2003
- Contains estimated 4.2 to 5.0 billion barrels of oil in place
- Production peaked at over 500,000 Bpd, but by 2003, had declined to 40,000-45,000 Bpd
- Apache has “beaten the curve” by adding reserves, production, and value
- Have returned over 400% of their original 2003 investment

### BEATING THE PRODUCTION CURVE



# SECURE ALASKA'S FUTURE—OIL

- *Secure Alaska's Future—Oil* is the State's comprehensive strategy to increase TAPS throughput to one million barrels a day
  - I. Enhance Alaska's global competitiveness and investment climate
  - II. Ensure the permitting process is structured and efficient
  - III. Facilitate and incentivize the next phases of North Slope development
  - IV. Promote Alaska's resources and positive investment climate to world markets
- **Governor Parnell's 2013 State of the State:** *"Our problem is not below the ground. Our problem is above the ground."*
  - The missing piece is meaningful tax reform
  - "Our state's prosperity has always rested on natural resources. Tonight, that foundation is at risk, not because we are running out of oil, but because we are running behind the competition."





# OIL TAX REFORM

## - PRINCIPLES -

- Governor reiterated his principles:
  - Tax reform must be fair to Alaskans
  - Encourage new production
  - Simple so that it restores balance to the system
  - Durable for the long-term
- Integrated team – DOR and DNR
- Consultants - EconOne



# OIL TAX REFORM

## - THE PROCESS -

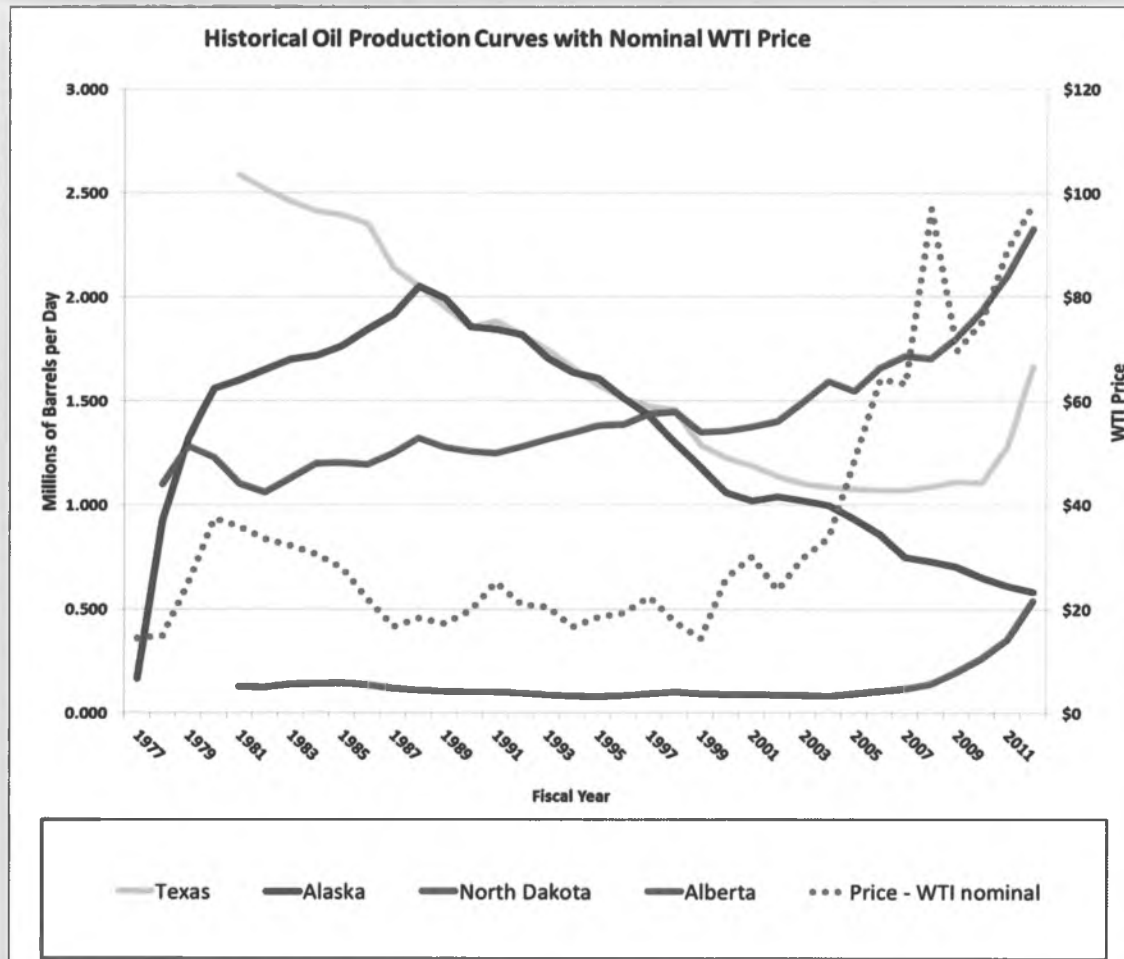
- The team reviewed previous work by both the Legislature and the Administration
- Identified problems with the current tax system
  - Declining Production
  - Competitive Environment
  - Progressivity
  - Tax Credits
- Coordinated effort to understand impacts of production decline on TAPS/Revenues



# OTHER BASINS HAVE TURNED DECLINE AROUND

- HISTORICAL OIL PRODUCTION -

How Did Our Competition Fare When Prices Spiked?



# COMPARING ALASKA

- Consultants have compared Alaska to other opportunities using detailed models and analyzing a variety of financial metrics.
- The following example is for a 50 million barrel development in Alaska and comparable developments in the Lower-48, Canada and United Kingdom North Sea.
  - Developed by a new entrant to the State.
  - Compares net present value (NPV) per barrel of oil equivalent discounted 12%

West Coast ANS Prices	NPV-12% ACES (Current)	NPV-12% Average L48 Unconventional	NPV-12% Norway	NPV-12% UK Post-1993 with Brownfield
\$70	\$1.78	\$.11	-\$0.81	\$2.74
\$90	\$3.47	\$3.66	\$1.29	\$6.43
\$100	\$4.07	\$5.53	\$2.34	\$8.25
\$110	\$4.86	\$7.84	\$3.39	\$10.06

*Example: at \$100 a barrel, a company would earn \$4.07 in Alaska but \$5.53 in the Lower 48 and \$8.25 in the U.K. North Sea.*

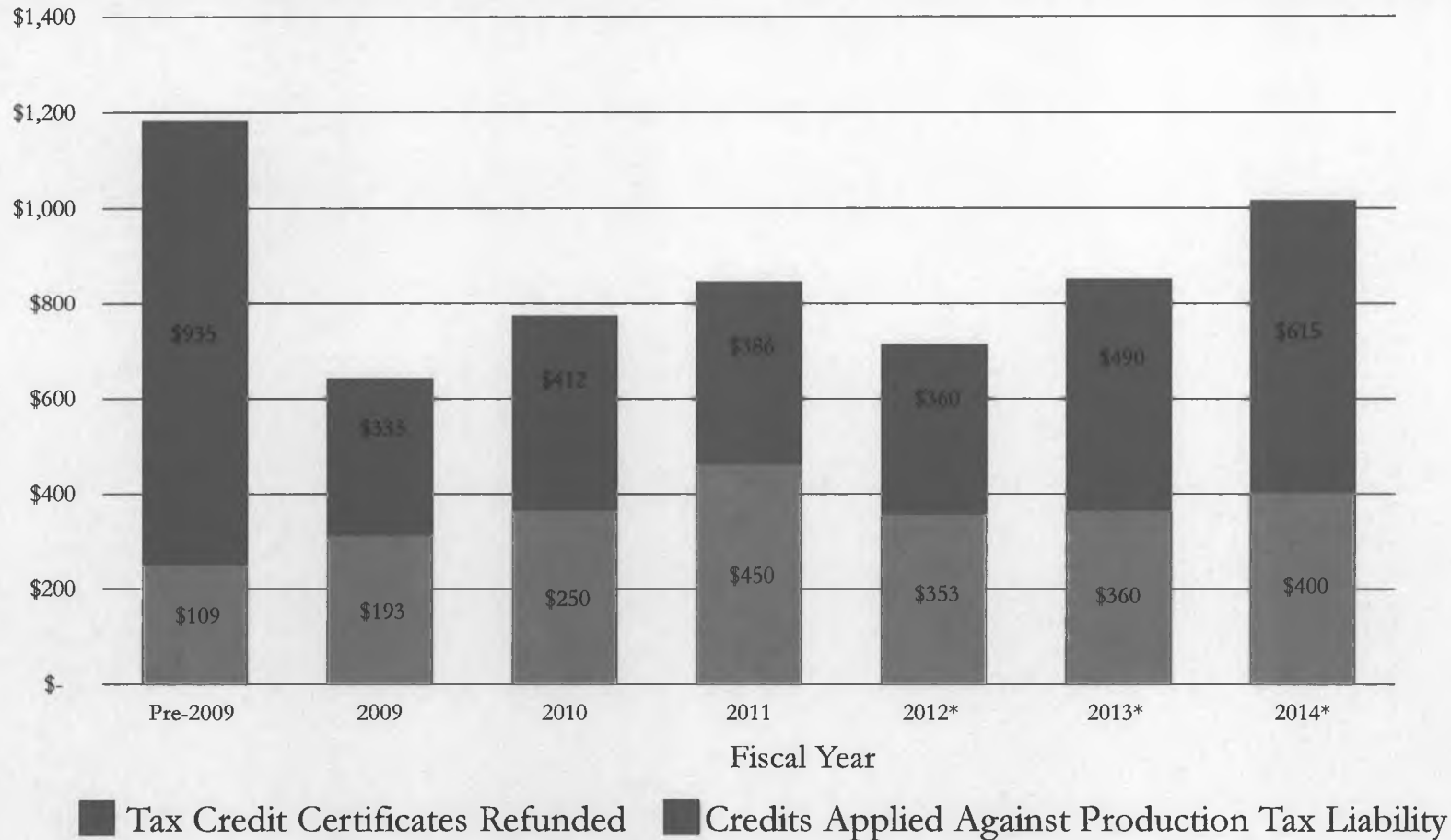
# OIL TAX REFORM

## - PROGRESSIVITY -

- Progressivity is complicated and unpredictable, both for the state and investors
  - Tax rate increases by .4% for every \$1 per barrel that the production tax value (price minus transportation costs minus lease expenditures) exceeds \$30/barrel up to \$92.50 per barrel, then .1% until the total tax rate equals 75%
  - Calculated Monthly
- High marginal tax rates



# OIL TAX REFORM - PRODUCTION TAX CREDITS -



\*Estimated pending final true-ups

\*\* Fall 2012 Revenue Sources Forecast

Source: Alaska Department of Revenue

# OIL TAX REFORM

## - TAPS TARIFFS—WORK TO DATE-

- Identified growing concern in DOR and DNR that TAPS tariffs in our revenue modeling did not dynamically link throughput with tariff rates or capture any added capex or opex spending for low-throughput mitigation measures
- Current work **NOT** designed to find the optimal low-flow mitigation option or forecast specific operational outcomes and exact tariffs
- Preliminary Observations:
  - Low flow mitigation capital and operating expenditures could increase tariffs by as much as \$1 (18%) per barrel by 2019 and as much as \$2.50 (33%) per barrel in 2022
  - Assuming price, production and tariff provided in the Fall 2012 Revenue Sources Book, a \$1 increase in the TAPS tariff will decrease state oil and gas revenue by an average of \$110 million

# OIL TAX REFORM

## - THE PROPOSAL: HIGHLIGHTS -

1. Eliminate Progressivity and Credits Based on Capital Expenditures
2. Reform remaining credits to be carried forward to when there is production
3. Establish a “Gross Revenue Exclusion” for newer units and new participating areas in existing units (NEW OIL)
4. Hold Cook Inlet and Middle Earth Harmless