ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SRES 12700

State Purchase of Tax Credits Certificates (continued)

- Retains existing criteria for refunds except eliminates $25 million maximum

Payment of the Tax
Bill secs. 22-25, 51

- Current system of monthly installment payments and final payment on March 31 is retained
- Installment payments now take account of the tax floor for units subject to the tax floor and also take account of Cook Inlet tax ceilings
- Installment payments do not take account of progressivity rate

— Interest rate
• a market rate • during year of filing - after filing date = "statrate" B approx 11% compounded

—— s'c mechanism DID take into account progressivity
—— new (proposed) protects cc's who might fall out of compliance over progressivity (which is annual calculation) that's hard to anticipate monthly

Payment of the Tax (continued)

- **AS 43.55.110(f), Bill sec. 51 – Gives express authority to Department to require tax payments to be made electronically**

most tax payers do pay electronically
this mandates it – removes any question

CH – what forms of pyt do get now
Marsha – (1) electronic wire
(2) cashiers cks
but not Mandated – which leads to "cks in the mail" syndrome

Reporting Requirements AS 43.55.030, 43.55.040

- Bill sec. 46 – Makes clear that every oil or gas producer must file an annual return, whether or not tax is due
- Bill sec. 46 - Expands the list of specific information requirements for returns (note: Department retains general authority to require more information)

Reporting Requirements (continued)

- **Bill secs. 47 & 49 – Additional penalty of up to $1,000 per day for late filing or nonfiling of required returns or reports**
- **Bill sec. 48 – Requires explorers or producers to file an annual statement on expenditures (or adjustments) even if no oil or gas is produced during the year**

- Filed electronically – Requirement in the bill
- not an onerous reporting [illegible]

Reporting Requirements (continued)

- **Bill sec. 48 – Makes clear that the Department may also require monthly reports from producers, explorers, and operators**
- **Bill sec. 49 – Adds express authority for the Department to require reporting of forward-looking information for revenue forecasting purposes**

Reporting Requirements (continued): Bill sec. 51

- **AS 43.55.110(e) – Gives express authority to Department to require returns and reports to be filed electronically**

CH asked the question - re reporting -
- the new creates allow the Dept to specify the form of elec filing

Confidential and Public Information

- **AS 38.05.035, Bill sec. 2 – broad authority for DNR to share oil and gas lease related information with DOR for purposes of administering the production tax**
- **AS 43.05.230, Bill sec. 13 – broad authority for DOR to share production tax related information with DNR**

Confidential and Public Information (continued)

- Under both provisions, confidential information is still confidential
- AS 43.55.890, Bill sec. 61 – Makes clear that Department of Revenue may publish extensive production tax information aggregated among at least three producers or three explorers

- clarifying provision

why 3 & not 2? Sen Stevens -

MP Dept of law in looking at fisheries side standard was 3 - If is a standard that has worked well

Additional Administrative Improvements

- AS 39.25.110, Bill sec. 10 – oil and gas auditors placed in exempt service
- Transition provision, Bill sec. 67 – current employees may opt to stay in classified service
- AS 43.05.260, 43.55.075, Bill secs. 14, 50 – statute of limitations for production tax is six years, not three years

· addt'l info. the dept needs addt'l time to audit & enforce tax laws.
· A considerable time needed - by both parties - extensions allowed now.

Additional Administrative Improvements (continued)

- **AS 43.55.075(b), Bill secs. 1, 50 - Legislative confirmation of Department of Revenue's interpretation of statute of limitations as applied to events that retroactively change amount of production tax or credit: period of limitations begins to run when a return is filed reflecting the change**

.examples RCA or FERC refunds.
asking legis to confirm existing interpretation of law

Additional Administrative Improvements (continued)

- **AS 43.55.110(g), Bill sec. 51 – Gives express authority to the Department of Revenue to issue advisory bulletins interpreting production tax statute and regulations for guidance of taxpayers and others; non-binding unless Department provides otherwise**

. Dept not doing because of Broad interpretation because courts would want regulations -

Transition, Applicability, and Effective Dates

- Bill secs. 66, 72 – Most substantive changes in the production tax are prospective beginning Jan. 1, 2008
- Bill secs. 66, 71 – Changes to lease expenditure exclusions and use of unit operating agreements for lease expenditures are retroactive to April 1, 2006

*exclusions
+Repair Replacement - DNRR
*Replacement etc..

CHJ. comment. why didn't we do in regular session w/ Retro effective dates.
(he requested no answer) Just the question

Transition, Applicability, and Effective Dates (continued)

- **Bill secs. 66, 71 – Statute of limitations extension applies to still-open periods and retroactive to April 1, 2006**
- **Bill sec. 71 – Clarification that tax-exempt entities may not transfer tax credits applies back to beginning of the respective tax credit provisions**

need to specify the retroactivity

023: (66)
025: 4/1/03

Most other provisions of the bill take effect immediately.

Provisions 4/06. the RFP can be retroactive to that date.

Auth to immediately begin RFP but not in effect until Jan 2008.

Transition, Applicability, and Effective Dates (continued)

- Bill sec. 73 – Most other provisions of the bill take effect immediately
- Bill secs. 68, 70 – DOR and DNR may start developing regulations immediately, and regulations may be retroactive to applicability date of the statutory provisions they implement

Senate Resources

Comments on Governor's ACES Proposal

Steven B Porter

10/22/2007

-Stability

-Alaska's Prospectivity

- ACES Incentives

-Summary

Senate Resources

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Stability

Application of the law not a change in law

1) Decision on Prudhoe Bay Satellites - Borealis, Midnight Sun, Orion, Polaris, Point McIntyre, and Aurora are integrated and collectively managed. Merely implemented the intent of the statute. When you consolidate wells with PBU facilities the regulations contemplate consolidation for tax purposes.

1st change in stability world.

2) PPT tax. The producers have generally opposed any changes to the ELF prior to the SGDA negotiations. They liked the economics of ELF but knew they were going to have to agree to some change in order to get
    a. Fiscal certainty under their contract
    b. They were also hoping for contract approval if they agreed to the change
    c. They lost on all counts.
        i. They did not get the tax they "agreed to"
        ii. They did not get any type of certainty on the tax
        iii. They did not get the contract
3) The governor has called you back to review the tax because of the "cloud" on the tax. I don't think this review will cause the world to see you as unstable. The industry will certainly say it is true, but anyone who really looks underneath their rhetoric will know the truth. They also know the truth. This is merely an evaluation of what was done – with a possible early mid-course correction.
4) If you change the tax now and change it again during the regular session, there may be a problem.

Alaska's Prospectivity

1) Oil
   a. State lands- less than 20% of the future potential are on state lands where we receive both royalty and tax.
      i. Puddles
      ii. Heavy Oil – will come back to this
   b. NPRA – around 30% of future potential is in NPRA
      i. No royalty but ½ the royalty comes back to the state first as impact aid, then to fund PCE then another fund before it has a possibility to get to the general fund. Of the millions of dollars that the state has received from NPRA I don't think any of it has reached the general fund.
      ii. Taxes – you still get taxes. But high costs will result in high opex and capex.
   c. Offshore OCS – over 50% of future potential is in the OCS
      i. No royalty
      ii. No taxes
   d. What is the future vision for oil
      i. Gov should go to congress and get us the same as the Gulf States have. They get a share of the OCS revenues because the feds recognize that the local state jurisdictions are impacted by OCS development – and they can oppose it and prevent it from proceeding forward
         1. This should be before shell drills any exploration wells

2. Should work with the NSB to make sure that the operations in the OCS minimize the impact to the environment and local communities and subsistence culture

ii. Heavy oil should be encouraged because it has the greatest chance on state lands of contributing to the future revenue stream of the state

1. One of the slides yesterday showed the industry doing stress case economics at $40. Commissioner Galvin stated that heavy oil will be impacted around $41 dollars from the implementation of the 10% gross tax which means that we may actually create a situation where we have prevented or slowed one of the most prospective oil reservoirs on state lands by passing the gross minimum tax. The minimum tax looks like it was designed to penalize heavy oil not help it.

e. Alaska competitiveness –

i. We are a mature (between Colville and canning) province as far as oil is concerned. Geology is king. Heavy oil and puddles

ii. NPRA has larger potential in the Alpine type range

iii. OCS still has the elephants but at great cost and high environmental/legal risk.

2) Gas

a. Pedro said the gas pipeline was uneconomic

b. I would call it indeterminate

i. Four things needed to say economic or uneconomic

1. Costs of the pipeline
2. Future price of gas
3. Stability of the taxes and what they are
4. Internal Rate of Return/Project evaluation criteria

c. The submittal of the proposals will not change the above substantially unless the applicants accepts, transfers, or provides a way to handle some of the above risks to the state's and the shipper's satisfaction.

d. When the proposals come out at the end of November the state should review the proposals then evaluate how they can help the state move the project forward. The project is not a gasline through Canada or an LNG line to Valdez. It is monetizing the North Slope gas resource to the greatest benefit of the people of the State of Alaska. It may mean making adjustments to the law in January. It may mean taking a new course, it also may mean AGIA is working and all that needs to be done is to implement it.

3) Timing of development in general and gas pipeline development specifically.

a. A reasonable timeline for gas pipeline development is at least 10 years. Anything less than that you need to examine the proposal closely to make sure they are not shortcutting process that may impact them and the state in the future.

b. A reasonable timeline for oil development depends on proximity to existing facilities. E.g.,

i. Tarn took around 2 years and was probably one of the fastest because it was near Kuparuk.

ii 6 to 8 years is a better estimate for prospects that are within 25 miles of existing facilities.

iii. Around 10 years for projects that is more remote.

iv. These are rough rules of thumb that don't take in to consideration specific environmental, logistics, cultural and subsistence issues of a particular project - each of which could delay development for several years.

ACES incentives

1) Legacy fields and all other existing fields.
   a. Places a higher tax burden on them
   b. Takes away the TIE credits
   c. Ring fences certain credits.
2) Explorers
   a. Places a higher tax burden on them
   b. Gives them a guarantee of getting their tax credit giving them 2% to 3% extra on their transferrable credits
   c. Moves net operating losses to 25% carryover.
   d. The costs of the higher tax exceed the credit benefit.

Summary

Someone asked yesterday what the governor's economic policy should be regarding oil and gas.

I recommend a few things

1) Encourage heavy oil development; don't place penalties in front of it.
2) Work with Congress to get our fair share of OCS revenue before shell or any other oil company drills in the OCS.
3) Works with local communities to make sure their concerns are addressed before development proceeds and so that responsible development can proceed.

Senate Resources Committee SB 2001 Details

Presentation by Dan E. Dickinson, CPA
For Legislative Budget & Audit Committee
October 22, 2007

1. Rate etc.

- Caveats on government take statistics
  - Apples to apples comparisons very useful – but be very wary about plucking numbers from different studies
  - Need to look at rest of the fiscal system. For example, some governments encourage developing high paying jobs (low industry taxes), and pick it up in personal income and consumption taxes.

2. Progressivity

- Switch in factors
- Switch from monthly to annual typically means lower dollars
  - Spikes don't average out
  - Higher base – but won't capture as much upside
    - Less progressive
- Modeling Issue – requirements

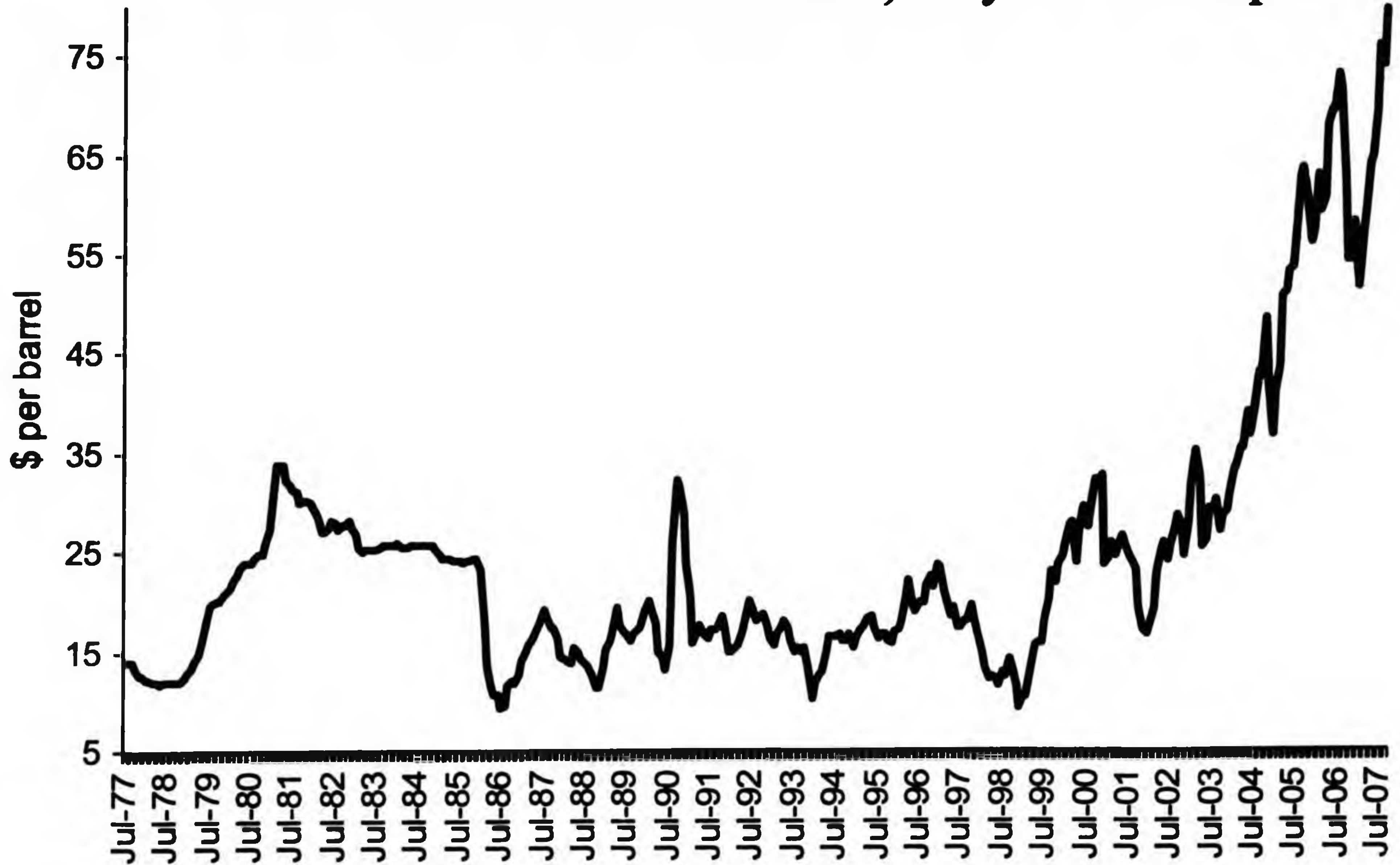
2. Progressivity

Comparing Annual and Monthly analysis of FY 2008 with hypothetical spike

	US West Coast Price/ bbl	Per Barrel Total Costs	Per Barrel Production Tax Value	Adjustment Converting Production Tax Value to Price Index	Price Index	Rate per Dollar of Price Factor	Incre-mental Progres-sivity %	Volumes (millions of bbls)	Progres-sivity Tax (millions of dollars)
	$/bbl	$/bbl	$/bbl	$/bbl	$/bbl	%	%	MM bbls	MM $
A	B	C	D= (B+C)	E	F= (D+E)	G	H= (F*G)	I	J= (D*H*I)
Monthly Analysis, $40 Adjustment and .0025% Parameter under Current Law									
Jul	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.7	-
Aug	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.7	-
Sep	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.1	-
Oct	51.43	(23.85)	27.58	(40.00)	-	0 25%	0.00%	20.7	-
Nov	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.1	-
Dec	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.7	-
Jan	77.15	(23.85)	53.29	(40.00)	13.29	0.25%	3.32%	20.7	36.7
Feb	102.86	(23.85)	79.01	(40.00)	39.01	0.25%	9.75%	18.7	144.2
Mar	77.15	(23.85)	53.29	(40.00)	13.29	0.25%	3.32%	20.7	36.7
Apr	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.1	-
May	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.7	-
Jun	51.43	(23.85)	27.58	(40.00)	-	0.25%	0.00%	20.1	-
								244.0	217.6
Yearly Analysis, $30 Adjustment and .002% Parameter, as Proposed									
Yr	60.00	(23.85)	36.15	(30.00)	6.15	0.20%	1.23%	244.0	108.5

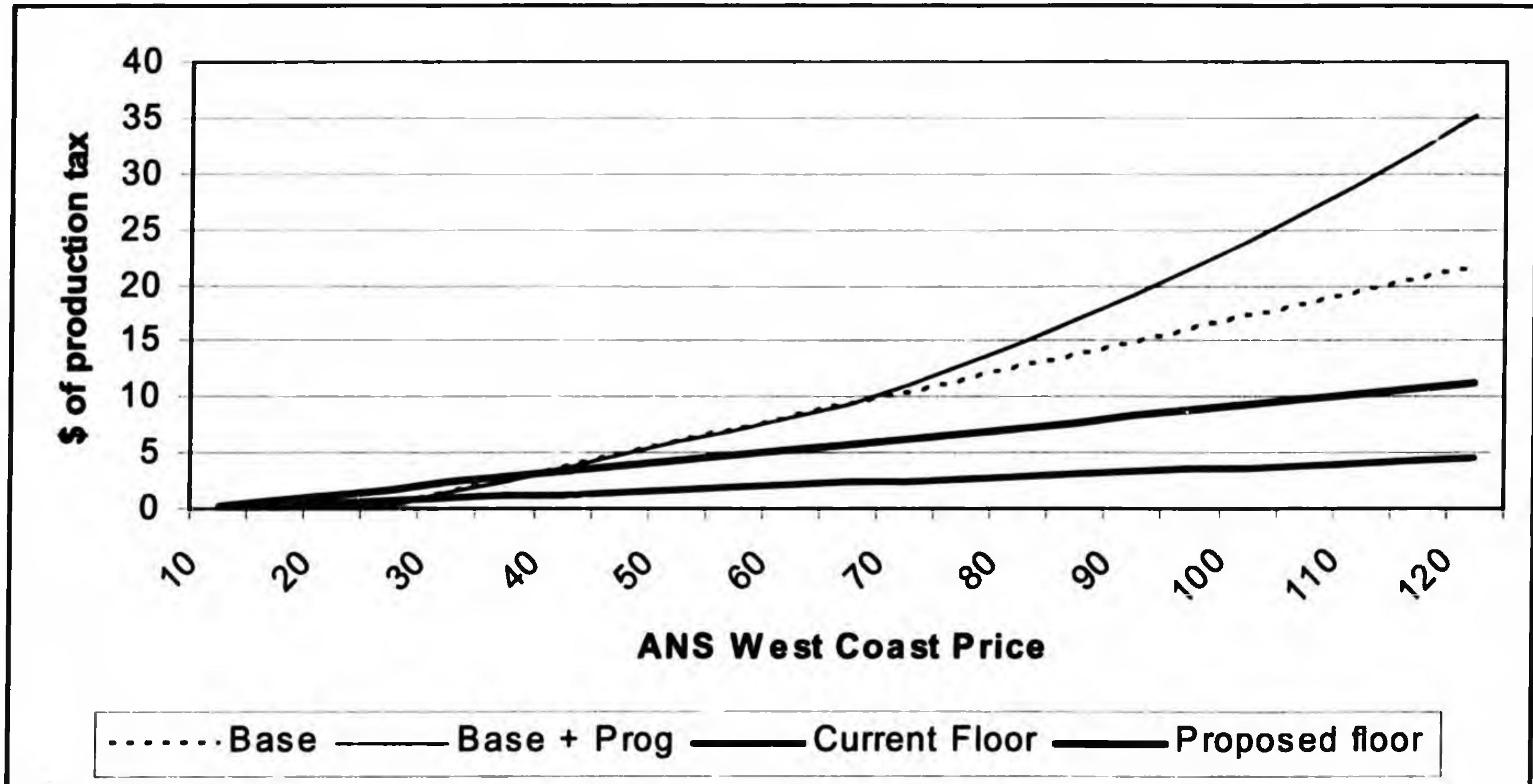
Source: Dickinson October 3 2007 report: NOT A PREDICTION

ANS West Coast Price, July 1977 – Sept 2007



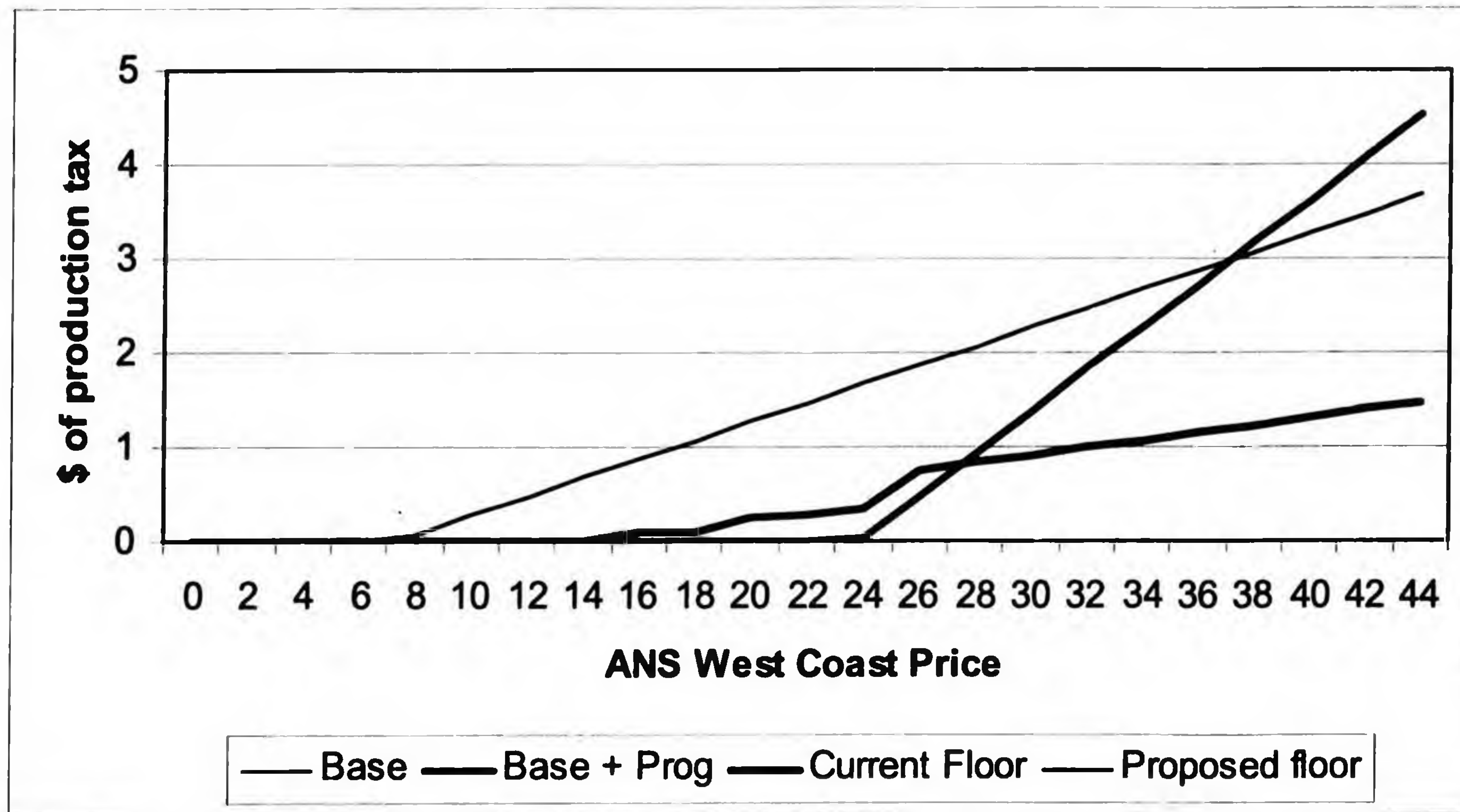
Source: Alaska Department of Revenue, Tax Division

3. Effect of Gross Floors – Low End



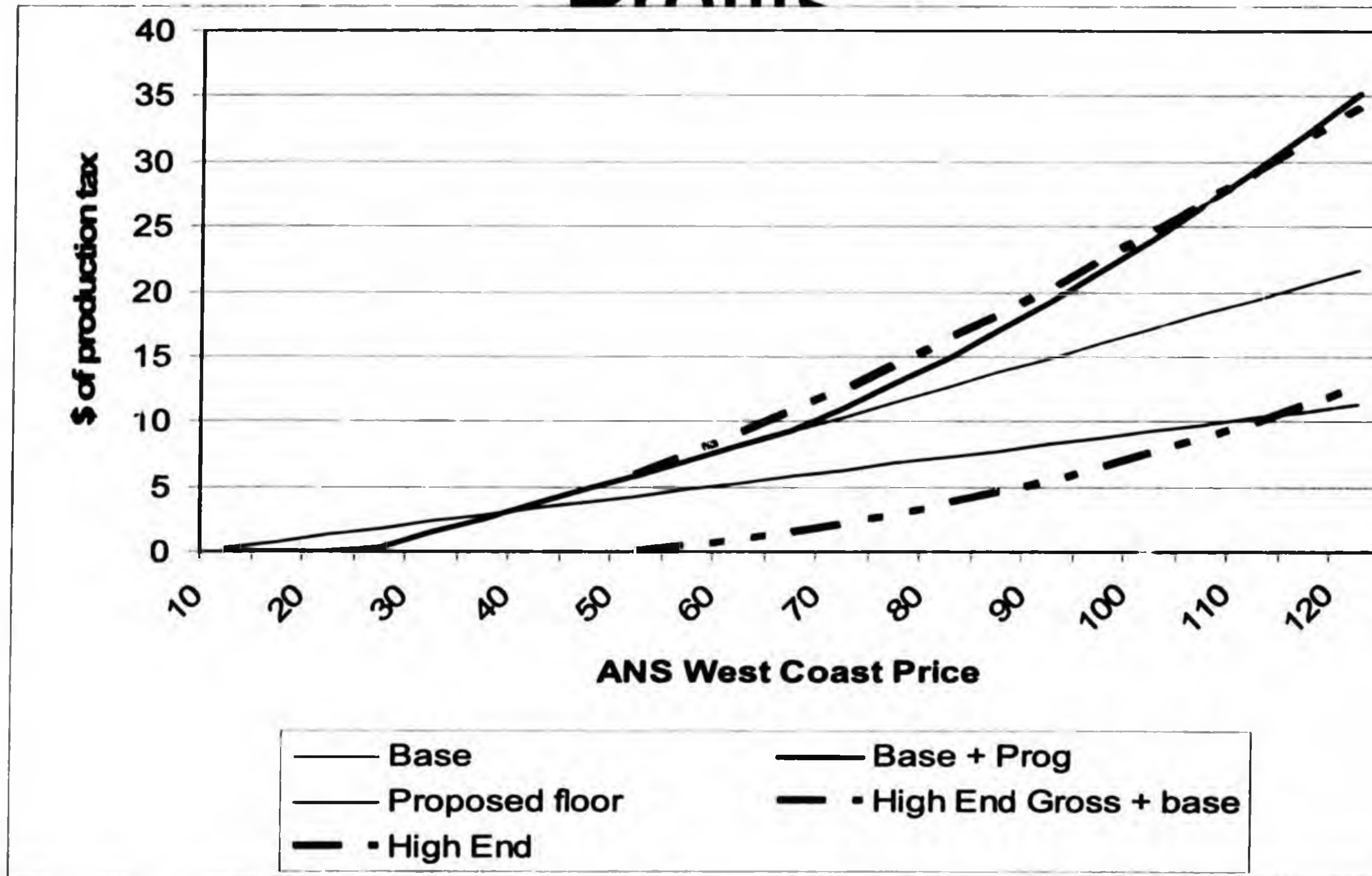
Cost assumption = $7.22 downstream cost, 16.63 upstream cost, barrels assumed to be legacy production

3. Effect of Gross Floors – Low End



Cost assumption = $7.22 downstream cost, 16.63 upstream cost, barrels assumed to be legacy production

3. Effect of Gross Floor- Windfall Profits



Cost assumption = $7.22 downstream cost, 16.63 upstream cost, barrels assumed to be legacy production

3. Legacy Ring Fencing – One Way

- Proposal is to ring fence Prudhoe Bay and Kuparuk into a “legacy field”
- Profits generated in Legacy Fields could be offset by investment credits and losses elsewhere (except when floor in place)
- Investment credits and losses generated in Legacy Fields could be offset by profits generated elsewhere

.023 Investment Credits

- .023 (b) Proposes to have loss carry forward credits calculated at the tax rate instead of 20%
  - makes sense to treat explorers and producers same
- .023 (d) proposal spreads credits out over two years-
  - because of difference between fiscal year and calendar year may not improve predictability that much
  - little actual fiscal effect after first year
- .023 (i) Proposed elimination of TIE credits
  - Compare rules to DNR Commissioner's proposed ability to grant credits for pre 2003 work in .025 (i)

.024 Non Transferable Credits

- Only proposed change would not allow these to be applied against the floor.

.025 Exploration Credits

- Proposal adds specific disallowances in .025(b) (3) for "costs arising from gross negligence or violations of health safety, or environmental statutes or regulations"
- Compare to lease expenditure disallowance in .165 (e) (6) for "costs arising from fraud, willful misconduct, gross negligence, violation of law, or failure to comply with an obligation under a lease, permit of license issued by the state or federal government"

.025 Exploration Credits

- Current AS 43.55.025 (c) says bottom whole must be three mile from previously drilled bottom hole, except in CI, if DNR determines "distinct exploration target"
- Proposal has three requirements – DNR approval before hand, must meet 3 mile requirement if not in CI, DNR approval afterwards.
- Change from rules to seeking agency approval.

.025 Exploration Credits

- Proposal would make data on non state lands more available to DNR and public as condition of credit.

- Using tax code for other (worthwhile) goals

.025 Exploration Credits

- Under current law, only additional wells spudded in a drilling season (150 days) can qualify for exploration credits
- Under proposal that figure is expanded to two drilling seasons (540 days)
- Shifting credits to explorers

.025 Exploration Credits

- Proposal will create mini-TIE allowing DNR to authorize tax credits for pre 2003 seismic work.

- Shift from rules to agency approval.

7. Allowable Lease Expenditures AS 43.55.160

- Proposal greatly simplified section because monthly calculations no longer needed for progressivity.
  - However, a monthly gross (destination value) based windfall profits tax would not require division of costs between months.

7. Allowable Lease Expenditures AS 43.55.165

- Under proposal allowable lease expenditures must be a defined in regulation
  - Switch from what is not forbidden is permitted to what is not permitted is forbidden.
- Can Joint interest billings be used? – although specific language is gone, appears DOR may still go down this road under its regulations

7. Allowable Lease Expenditures AS 43.55.165 (e) (6)

Current prohibition – "costs arising from

- fraud,
- willful misconduct or
- gross negligence"

Proposal adds

- violation of law; or
- failure to comply with an obligation under a lease, permit, or license issued by the state of federal government.
- Compare to proposed AS 43.55.025(b) (3)

7.Allowable Lease Expenditures AS 43.55.165 (e) (15)

- Dismantling, Removal and Restoration cash payments (DR&R) upstream
  - does not include common carrier pipelines
  - 'matching' accruals during operations not allowed
- Current law – allowed multiplied by a fraction of production before 2006 over total production
- Proposal totally disallows DR&R
- Even under current law much DR&R likely to never be deducted as no offsetting revenues.

7. Allowable Lease Expenditures AS 43.55.165 (e) (19)

- Proposal disallows costs arising in response to a problem which required an unscheduled reduction in production or resulted in an release of gas.
  - Regulations will probably define “unscheduled” -24 hour notice? Weekly? Annual? What if reduction amount is different from “scheduled” amount. What if one week of scheduled maintenance takes two weeks?
  - Encouraging capital investments to create Redundancy?
- Still allowed if “acts of God”

7. Allowable Lease Expenditures AS 43.55.165 (e) (18)

- Current law disallows 30 cents a barrel from what would otherwise be allowable capital costs
- This was described as dealing with the known corrosion issue.