# ALASKA'S OIL AND GAS PRODUCTION TAX "FROM ELF TO NOW"

Alaska Oil & Gas Association
Educational Supplement
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# INTRODUCTION

- **What is a production (severance) tax?**
  - **Tax is on the act of producing oil and gas**
  - **Tax is based on value of the resource as produced**
  - **Imposed under the State's sovereign power to tax production not otherwise exempt**
    - **Generally in Alaska this means the tax applies to production after State and federal royalties (7/8 of production for most pre-1979 leases; less for post-1978 leases having higher exempt royalty rates)**

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# RECENT PAST

- **Alaska's production tax methodology has been substantially changed in recent years**
  - **Pre-February 2005: Economic Limit Factor (ELF)**
  - **February 2005 – March 31, 2006: Aggregated ELF**
  - **April 1, 2006 – July 2007: Petroleum Production Tax (PPT)**
  - **July 2007 – 2013: Alaska's Clear and Equitable Share (ACES) ***
  - **2014 – present: MAPA (SB 21) & SB 138**
  - **Tax regulations**

*** Some provisions of ACES made retroactive to enactment of PPT, others to 1/1/2007**

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# WHY THE ELF AND WHAT WAS IT?

- **State wanted the production tax to be Alaska’s primary tax on production**
  - **As fields’ reserves are depleted, their economics deteriorate and tax relief becomes appropriate to prevent premature shut-in**
  - **Incentive to develop and produce smaller fields while keeping tax higher on larger, more prolific fields**

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# WHY THE ELF AND WHAT WAS IT?

- **Economic Limit Factor (ELF)**
- **Formulaic multiplier designed to reduce the effective production tax rate for a field as the field matures and becomes marginal**
  - **ELF tried to approximate the percentage of production value being consumed as the costs of producing that production**
  - **Production tax rate reduced to zero when the field was just breaking even**
  - **In essence, designed to allow the complete development of the field**

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# WHY THE ELF AND WHAT WAS IT?

- **Tax rate for a given field = ELF x its Base Rate**
  - **Oil: Base rate 12.25% for 1st 5 years, then 15%**
  - **Gas: Base rate 10%**
- **ELF basically a surrogate for deductions: tax rate reflected net operating margin after pipeline/tanker transportation costs and other limited costs**
- **Field-size added to oil ELF formula in 1989; in 2005 many North Slope fields were lumped together as one for ELF purposes**

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# WHY THE PPT AND WHAT WAS IT?

- **In 1995-2005 concerns arose over appropriateness of key statutory assumptions in the oil ELF formula**
  - **Kuparuk declined toward statutory 300 b/d per well break-even rate**
  - **“Field-size” made “small” fields too small**
- **Revenue decline, budget deficits and gas pipeline fiscal discussions**

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# WHY THE PPT AND WHAT WAS IT?

- **PPT was designed to deal with two major shortcomings many saw in the ELF**
  - **Create significant incentives to encourage exploration and development of oil and gas**
  - **Increase State tax take when oil and gas prices were high, regardless of the size or productivity of the field**

# WHY THE PPT AND WHAT WAS IT?

- **PPT was dependent on the value of the oil and gas produced**
  - **Basically a tax on the value of oil and gas when severed from the reservoir**
  - **Allowed recovery of certain costs back to the bottom of the well**
- **State's goal to raise industry taxes and PPT seen by some as necessary to help promote major gas development**
- **More than doubled industry's taxes**

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# PETROLEUM PRODUCTION TAX (PPT)

- **Geographically based production tax versus a field-by-field determination**
  - **Production/expenses treated separately for each of four "segments" within the state**
    - **North Slope**
    - **Cook Inlet Oil**
    - **Cook Inlet Gas**
    - **"Middle Earth"**

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# PETROLEUM PRODUCTION TAX (PPT)

- Taxed a producer's "production tax value" (PTV); i.e., value downhole at the point of severance from the reservoir
  - Allowed deduction of most capital costs back to the well bottom versus operating costs only under ELF
  - Certain tax credits allowed
  - Small producer relief

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# PETROLEUM PRODUCTION TAX (PPT)

- **Deductions and credits intended to encourage exploration/development**
- **Same tax rate for oil and gas from a given "segment"**
- **Created "progressivity"**

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# WHY ACES AND WHAT IS IT?

- Alaska's Clear and Equitable Share (ACES)
- Influenced by many factors:
  - Continued rising oil prices
  - Political scandals
  - Prudhoe Bay issues
  - Campaign rhetoric

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# WHY ACES AND WHAT IS IT?

- **Administration and legislature's desire to increase taxes on industry**
  - **Modified significant provisions of the PPT, including "progressivity"**
  - **Added numerous confusing, complicated regulations**
  - **Diluted many of the intended economic incentives envisioned under the PPT**
- **More than doubled industry's taxes . . . again**

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# HOW DOES THE PPT/ACES WORK?

- Gross Value of the oil and gas at the destination/market where it is delivered, sold or refined
  - SUBTRACT
    - Pipeline and marine transportation costs
    - Certain current year lease expenditures
      - Certain current year operating expenses
      - Certain current year capital expenses
- EQUALS the Production Tax Value (PTV)
  - TIMES base tax rate
  - ADD progessivity tax, if applicable
  - EQUALS gross tax (or minimum tax (on gross value) if higher)
  - SUBTRACT allowable tax credits
- EQUALS the Production Tax due

NOTE: different rules apply to Cook Inlet production

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

**Gross value of the oil and gas at the destination/market SUBTRACT**

**PPT (Key Provisions)**

**Pipeline and marine transportation costs**

- **Pipeline tariffs and marine tanker costs**

**ACES (Key Provisions)**

**Pipeline and marine transportation costs**

- **Pipeline tariffs and marine tanker costs**
- **Complicated by Department of Revenue (DOR) regulations**

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# HOW DOES THE PPT/ACES WORK?

## Gross value of the oil and gas at the point of production (Pump Station One) SUBTRACT:

### PPT (Key Provisions)

Certain current year operating expenses (opex)

- Upstream of point of production
- Activity need not be physically on lease or property
- 18 listed exclusions
- Costs related to ULSD
- Excess of FMV of internal/non-arm's length transactions
- DOR allowed to use JIB's as starting point
- DOR could issue regulations to clarify

### ACES (Key Provisions)

Certain current year operating expenses (opex)

- Upstream of point of production
- Activity need not be physically on lease or property
- 21 listed exclusions
- ULSD disallowed except for limited amounts
- Entire internal/non-arm's length transaction if in excess of FMV
- DOR not required/allowed to use JIB's
- Costs related to interruption of production disallowed
- 2006-2009 legacy field “standard deduction”
- Deductions limited to those allowed by DOR



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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

**Gross value of the oil and gas at the point of production (Pump Station One) SUBTRACT**

**PPT (Key Provisions)**

Certain current capital expenses (capex)

- Must be capital expense
- Same limitations as opex
- Deductible even if tax credit allowed
- 30¢ per BOE exclusion

**ACES (Key Provisions)**

Certain current capital expenses (capex)

- Must be capital expense
- Same limitations as opex
- Deductible even if tax credit allowed
- 30¢ per BOE exclusion

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

## EQUALS the Production Tax Value

**PPT (Key Provisions)**

- Cannot be reduced below zero
- Any excess deductions creates NOL tax credit
- NOL Tax credit determined at 20% rate

**ACES (Key Provisions)**

- Cannot be reduced below zero
- Any excess deductions create NOL tax credit
- **NOL Tax credit determined at base tax rate (25%)**

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

## TIMES the Base Tax Rate

**PPT (Key Provisions)**

- 22.5%

**ACES (Key Provisions)**

- 25%
- Special tax rate for non-Cook Inlet gas used in state

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# HOW DOES THE PPT/ACES WORK? -NORTH SLOPE

## ADD Progressivity

**PPT (Key Provisions)**

- 0.25% per $1/BOE over $40 PTV determined monthly
- Total cannot exceed 25%
- No brackets - all production taxed at highest rate
- Maximum base & progressivity - 47.5%

**ACES (Key Provisions)**

- 0.4% per $1/BOE when PTV between $30-92.50 (25%)

PLUS

- 0.1% per $1/BOE when PTV greater than $92.50
- Total cannot exceed 50%
- No brackets - all production taxed at highest rate
- Maximum base & progressivity - 75%

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

**EQUALS Gross Tax / OR Minimum Tax if greater**

## Minimum Tax Provisions

**PPT (Key Provisions)**

- 0-4% of gross value at point of production
- Depending on price of ANS
- Only on North Slope production

**ACES (Key Provisions)**

- 0-4% of gross value at point of production
- Depending on price of ANS
- Only on North Slope production

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

## SUBTRACT allowable tax credits

**PPT (Key Provisions)**

- 20% of current year qualified capex spend
- NOL tax credits from prior years
- Small producer tax credits
- Purchased tax credits
- Exploration tax credits (20%, 30% or 40%)
- Transition investment tax credits

**ACES (Key Provisions)**

- 20% of current year qualified capex spend - over 2 years
- NOL tax credits from prior years
- Small producer tax credits
- Purchased tax credits
- Exploration tax credits (20%, 30% or 40%)
- TIE credits eliminated after 2007 except for first time explorers

## EQUALS the Production Tax Due

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# HOW DOES THE PPT/ACES WORK? - NORTH SLOPE

## Statute of Limitations for audits

**PPT (Key Provisions)**

- 3 years

**ACES (Key Provisions)**

- 6 years

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# HOW DOES THE PPT/ACES WORK? -NORTH SLOPE

## Interest on Retroactive Application of Tax Regulations

**PPT (Key Provisions)**

- **Applicable**

**ACES (Key Provisions)**

- **Not applicable if good faith compliance (2010)**

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# WAS ACES WORKING?

- ACES highest state tax – no other state tax even close
- Production decline continued at alarming rate
  - Annual reinvestments at risk
  - TAPS issues
- Exploration activity continued to fall
  - Key explorers looking elsewhere
    - OCS focus
  - Drill rig counts
  - Industry spend on current infrastructure and current resource base – not resource additions
- Regulatory uncertainties complicate administration/ potential incentives
- Alaska investment climate/ fiscal regime rated near bottom

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# WHY MAPA AND WHAT IS IT?

- More Alaska Production ACT (MAPA)
- Influenced by many factors:
  - Continued liquids production decline
  - Alaska falling in state rankings for production while investment and production in other states booming
  - Investment tax credits incentive not tied to increased production and hurting state revenues

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# WHY MAPA AND WHAT IS IT?

- Influenced by many factors:
  - Focus on increasing production to yield increased future revenues and jobs
  - Maintain competitive tax structure at both high and low oil prices
  - Insure Alaska remains competitive into the future

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# KEY CHANGES UNDER MAPA

## ACES

- Unbracketed Progressivity
- 25% Base Tax Rate
- 75% Maximum Combined Tax Rate
- 20% Investment (Capex) Tax Credits
- Exploration tax credits (20%, 30% or 40%)

## MAPA

- No tax rate progressivity
- 35% Base Tax Rate
- 35% Maximum Tax Rate
- No Investment (Capex) Tax Credits
- 20-30% Gross Revenue Exclusion Incentive for New Production
- Sliding Scale Per Barrel Tax Credit for Post 2013 Production
- Production Tax Credits Not Available Against Minimum Tax
- In-State Manufacturing Income Tax Credit
- Competitiveness Review Board

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# WHY SB 138?

- **Designed to progress Alaska LNG (AKLNG) Project**
- **Key Changes:**
  - **Allowed State participation in the project**
  - **Allowed State to ensure its gas supply by authorizing DNR to consider changes in certain royalty provisions and DOR to take project production tax as gas**

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# WHY SB 138?

- **Key Changes (con't):**
  - **Fixed gas production tax rate at 13% on gross value versus PTV**
  - **State participation share ~25% (royalty + production tax)**
  - **Ensured no adverse impact to state oil and gas corporate income tax**
  - **No changes to current oil and gas property tax on existing properties**

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# ARE MAPA AND SB 138 CHANGES WORKING?

- **Industry investment is up, and oil production is predicted to increase**
- **AKLNG Project progressing and further along than any other major gas pipeline project before**

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