ALASKA'S
OIL AND GAS TAX SYSTEM

Alaska Oil & Gas Association
Legislative Educational Seminar
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ALASKA'S OIL & GAS REVENUE

- Royalty
- Property Tax
- Corporate Income Tax
- Production/Severance Tax

ROYALTY

Landowner's share in production, reserved by the leases: RIK/RIV

Change only by mutual agreement

- **Courts can interpret a lease's terms**

Settlements have clarified lease terms about chargeable field costs & RIV valuation

State royalty revenue since State-hood = $46.6 billion

- **Over $11.5 billion went directly into Permanent Fund corpus, with over $1 billion more appropriated into it**

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PROPERTY TAX

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Tax is on property for oil and gas exploration, production or pipe-line transportation

- Enacted in the 1973 Special Session

Similar to local property taxes on homes and business property

- Taxpayers report the property they have; State assesses its value
- State’s tax is fixed at 20 mills (i.e., $^{20}/_{1000}$ of a dollar) per dollar of assessed value
- Credit for municipal tax on same property

$3.8 billion paid to State and $9.0 billion to municipalities since 1974

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CORPORATE INCOME TAX

Tax is on the net income attributed to a company's in-state business

- 9.4% of taxable income over $222,000, plus $10,830 on that first $222,000
- Rates and tax brackets are the same for oil companies and for other companies

Determining in-state income

- Easy if company 's business is 100% Alaskan
- For others, in-state income is based on the average of the percentages of its production (or payroll if not an oil company), property and sales that are in Alaska (apportionment)

$11.5 billion of oil-company income tax has been paid since Statehood

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CORPORATE INCOME TAX

SEPARATE-ACCOUNTING vs. APPORTIONMENT

Separate Accounting (old AS 43.21)

- **Production Income = GVPP* – (operating expense + deprecia-tion of capital expense)**
- **Pipeline Income = after-tax profit allowed by FERC/RCA, grossed up to pre-tax basis**
- **"Other" Income = income appor-tioned to Alaska using percent-ages for instate property, sales & payroll unrelated to production and pipeline transportation**

*** GVPP is short for Gross Value at the Point of Production.**

Today's Oil Tax System

- **AS 43.55 captures this now: PTV* = GVPP – (opex + capex as incurred), with a 35% rate instead of 9.4% under AS 43.21**
- **Under FERC/RCA rules, invest-ment on which profit is allowed has been recovered, so little (if any) profit left in tariffs**
- **Stronger apportionment factors**
  - **Field facilities and pipelines are in the property and sales factors**
  - **For oil and gas, potential profit per BOE (extraction) imputes more business income to Alaska than profit per dollar of payroll**

*** PTV is short for Production Tax Value.**

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PRODUCTION (SEVERANCE) TAX

Tax is an excise on the act of pro-ducing oil and gas from the ground

- Enacted in the 1955 Extraordinary Session

Tax is based on the value of the oil and gas produced, or its quantity

Exemptions

- State's own royalty oil and gas
- Federal government's royalty oil and gas, and any production exempted by Congress
- Exemptions provided by state statute

State has received over $58.2 billion in production tax since Statehood

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“GROSS” TAX vs. “NET” TAX

EXAMPLE. Suppose a McDonalds® sells $10,000 worth of hamburgers etc. each day. And suppose its wholesale cost for the products sold each day is $8,000, its costs for utilities, taxes, overhead, etc. are $1,000 a day, and wages for its staff are $900 a day – making a total daily cost of $9,900. This McDonalds® would be clearing $100 a day. (These hypothetical figures are solely to illustrate the difference between “gross” and “net” taxes, and no figure is intended to reflect any real McDonalds®.)

A “gross” tax would be a percentage of the $10,000 that this McDonalds® takes in.

A “net” tax would be a percentage of the $100 a day that this McDonalds® clears.

In this hypothetical example, a 1% gross tax would take away all that this McDonalds® is clearing, and anything more would put it in the red. But even a 10% net tax would leave it with $90 a day – 90% of what it’s clearing.

McDonalds® is a Registered Trademark of McDonalds Corporation.

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SIX PRODUCTION TAX SYSTEMS IN 11 YEARS

1) **Before February 2005: Economic Limit Factor ("ELF")**
2) **February 2005 – March 2006: "aggregated" ELF for Prudhoe Bay field and its satellites**
3) **April 2006 –June 2007: Petroleum Production (not "Profits") Tax (PPT)**
4) **July 2007 – end of 2013: Alaska's Clear & Equitable Share (ACES)***
5) **2014 – present: SB 21 and SB 138 (natural gas)**
6) **2016 – HB 247**

*** Some provisions of ACES, which was signed into law December 19, 2007, were retroactive to July 1, 2007; others to January 1, 2007; others to April 1, 2007, and still others did not become operative until March 31, 2008.**

SYSTEM 1
GROSS TAX WITH ELF

Tax rate for oil was equal to the higher of –

1. **a fixed, statutory percentage of the gross value at the point of production (GVPP), OR**
2. **X cents per barrel,**

TIMES

3. **the ELF for the field**

RATIONALE: As fields age, more and more of the value of their production is needed just to cover the operating costs to produce it. To avoid situations like a gross tax over 1% in the McDonalds® example, ELF scaled the tax rate down to zero just when the field reached its "break even" rate (rebuttably pre-sumed to be 300 b/d per well at first, but later locked in at 300 b/d per well).

In 1989 – to keep rates high for giant fields but cut the tax as an incentive for new, smaller fields – field size (relative to a 150,000 b/d field) was added to the ELF formula

SYSTEM 2
"AGGREGATED" ELF

Why "aggregate"? To increase the State's tax revenue

- **For Kuparuk – despite still being a giant – its production tax was heading to zero because its production per well was reaching the break-even rate of 300 b/d locked in by statute (e.g., 270,000 b/d from nearly 900 wells)**
- **Small fields (e.g., 10,000 b/d) had ELFs of 0.000000 because of the field-size factor (150,000 b/d) in the ELF formula, even though – with only 2 or 3 wells – they could actually be very profitable**

15 AAC 55.027 (effective 1/1/1995) had set up a process for small fields to use capacity in larger fields' production facilities, if OK'd by DOR, without being treated as part of the larger field (aggregation)

DOR's 1/12/2005 decision letter aggregated the Prudhoe Bay satellites (using capacity in Prudhoe production facilities) with the main field, raising the tax by 35% for the main field and by much higher percent-ages for the satellites, effective 2/1/2005

- **No parallel action for satellites of the Kuparuk River field**

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SYSTEM 3
PETROLEUM PRODUCTION TAX (PPT)

NORTH SLOPE

A "net" tax: for the North Slope "segment," allowable costs to produce oil and gas ("lease expenditures") were deducted from the "gross value at the point of production" (GVPP) of the oil and gas, and the result was the taxable net "production tax value" (PTV)

- **Base tax of 22.5% of the net PTV for the whole calendar year**
- **If PTV for a month was more than $40/BOE, "progressivity" tax applied; rate = (the month's PTV per BOE minus $40) times 1/4 of 1%, up to a maximum rate of 25%, reached when PTV per bbl was $140 or higher**
- **MAXIMUM TAX RATE: 47.5%**
- **Minimum tax of 4% of GVPP (3% if ANS spot price during the year averages over $20 but less than $25, 2% if over $17.50 but less than $20, 1% if over $15 but less than $17.50, and zero if less than $15)**
- **Monthly installments during the year with "true up" to actual ANS prices and lease expenditures by March 31 of the following year**

COOK INLET

Tax for oil or gas from each field was capped at the average rate under ELF for that oil or gas during the last 12 months before PPT

SYSTEM 4
ACES

For the North Slope (except "(o) gas")

- **Base tax of 25% of net PTV instead of 22.5% under PPT**
- **Threshold for progressivity lowered to $30/bbl instead of $40 under PPT**
- **Progressivity rate rose faster than PPT and went higher: 0.4 (instead of 0.25) of a %-age point per dollar between $30 and $92.50 (when progressivity reached 25%), and then 0.1 of a %-age point per dollar above $92.50 up to a maximum progressivity rate of 50% (reached at $342.50)**
- **MAXIMUM TAX RATE: 75%**
- **Minimum tax (based on GVPP) unchanged from PPT**
- **Monthly installment payments of base tax and progressivity with March 31 true-up to actual costs & prices**
- **Mid-year transition from PPT to ACES created huge problems in allocating costs between the first and second halves of 2007**

ACES cut off the ELF-based tax caps for Cook Inlet after 2021

Pipeline transportation cost is required to be the lower of the regulated tariff (if not stale) or the tariff that DOR determines to be reasonable (11/14/14 notice of reasonable tariffs for 2008 – 2013)

6-yr statute of limitations for production tax audits

PROGRESSIVITY'S DEFECTS

1. **Impossible to estimate production tax for new projects**

   Why? Because each project not only adds to size of the net "pie" that progressivity taxes, but it also increases the width of the progressivity "slice" of the "pie" for both the project and everything that is already in that "pie"

   - **For projects A, B and C, the sum of the progressivity tax for each – calculated separately – is less than the tax for all three together**
   - **Also, if tax is calculated for A first, that tax is less than it is if A's tax is calculated after B's tax or C's, and less still if A's tax is calculated last**

2. **When oil prices fluctuate up and down, progressivity results in significantly more tax than when oil prices are flat during the period, even though the average price for the year is the same and, hence, the total taxable "net" for the year is the same**

SYSTEM 5, PART A
SB 21 (ch 10, SLA 2013)

North Slope

- **Progressivity ended at the end of CY 2013 to keep Alaska competitive during high prices**
- **Base tax rate 35% instead of 25%, but with a "stair step" credit of up to $8/bbl to keep Alaska competitive when prices are middle or low**
  - **This credit cannot be applied against minimum tax**
- **Incentives for additional development and production:**
  - **20% gross-value reduction (GVR) for "new" ANS, with a further 10% GVR if the "new" production is "made up entirely of [state] leases that have a royalty share of more than 12.5 percent"**
  - **$5/bbl tax credit**

Simple interest after 12/31/2014 on underpaid tax at 3 percent-age points above Federal Reserve APR to member banks

SB 21 was affirmed in the August 2014 referendum election

SYSTEM 5, PART B
SB 138 (ch 14, SLA 2014)

Main focus of SB 138 was advancing the proposed AK LNG Project with an option for State participation as an owner through Alaska Gasline Development Corporation (AGDC)

Tax parts of SB 138

- **Production tax for ANS gas after 2021 set at 13% of GVPP, with the gas share of lease expenditures flowing into the net PTV for ANS oil**
- **Payment of production tax on ANS gas for the AK LNG Project could be made with physical gas, instead of with money**
- **Allowed higher limits on municipal property tax on oil & gas property for municipal operations, if the municipality's overall millage is below certain targets (North Slope Borough proposed)**
- **Under already existing law a segment of the AK LNG Project, or the Project itself, that is owned by AGDC us exempt from state/municipal property tax (*see* AS 31.25.260(a))**

SYSTEM 6
HB 247 (ch 4, 4SSLA 2016)

With one exception, the substantive changes in HB 247 take effect 1/1/2017

- The exception is to have an "immediate" effective date for Bill Section 22, which allows a tax credit under AS 43.55.025(m) for exploration wells spudded before 7/1/2017 but not completed by that date

HB 247 deals primarily with oil and gas tax credits

Cook Inlet tax rates: cap on tax for gas extended indefinitely; cap on tax for oil set at $1.00/bbl

Interest on underpaid tax

- For production tax only, quarterly compound interest will accrue after 2016 "for the first three years after a tax becomes delinquent" at an APR of 7% plus the implicit APR in the Fed Funds rate at the start of the quarter, with no interest "after the first three years"
- Interest for all other taxes remains simple interest 3 %-age points above Fed Funds APR

Regulations to implement HB 247 have been proposed, but not yet adopted – AOGA was critical of many of the proposals

TAX CREDITS – OVERVIEW OF CURRENT LAW (AS 43.55.023)

Tax credits under AS 43.55.023

- Cannot reduce the producer/explorer's own tax liability for a year below zero, but unused part may be applied in a later year
- Transferable as a certificate issued by DOR
  - Party earning the credit applies to DOR for a certificate; entities exempt from production tax cannot apply (not applicable to large producers)
  - DOR has a limited time to review the application and issue a transferable certificate with a face amount that DOR believes the credit to be
    - DOR may later audit the applicant, and if the certificate's face amount is more than the amount of the audited credit, the applicant (not the transferee) is liable for the difference
  - The tax-credit certificate does not expire, but can only be applied against the tax under AS 43.55.011(e)
  - The transferee cannot reduce its tax liability below 80% of what it would otherwise be, but the unused portion of the face-value of the certificate can be used in later years until the credit fully used
- The Oil & Gas Tax Credit Fund can purchase certificates for sec. 023 credits

AS 43.55.023(a) - QUALIFIED CAPITAL EXPENDITURE (QCE) TAX CREDIT

AS 43.55.023(a), enacted as part of PPT

Rationale: A tax credit for capex comes at the front end of an investment's life when it has the greatest economic effect on the decision to invest (e.g., on Net Present Value, Internal Rate of Return, etc.)

Evolution

- **Enacted as part of PPT; credit = 20% of the QCE; available for exploration QCE if data is shared with DNR**
- **ACES: not more than half the credit may be applied in a single calendar year, but the rest carries forward; provisions about data-sharing with DNR modified to conform with exploration credits under AS 43.55.025(f)(2)**
- **SB 21 ended credit for North Slope QCEs incurred after 2013**
- **HB 247 cut the credit to 10% of for non-Slope QCEs, and ended the credit for Cook Inlet QCEs incurred after 2017**

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AS 43.55.023(b) – NET OPERATING LOSS ("NOL") CREDIT

Rationale

- In most "net" tax systems NOLs carry forward as a cost in calculating next year's "net"
- With progressivity, carrying unused lease expenditures forward as a cost would increase the lease expenditures in the later year and thus reduce (or eliminate) progressivity – a tax credit would avoid this

Evolution

- NOL credit under PPT was 20% (versus 22.5% base tax rate)
- NOL credit under ACES was 25% (matching 25% base tax rate)
- NOL credit under SB 21
  - North Slope: 45% for 2014 & 2015 NOLs and 35% for post-2015 NOLs (versus 35% base tax rate)
  - Cook Inlet & Middle Earth: 25% for post-2013 NOLs (same as before SB 21)
- NOL credit under HB 247
  - North Slope: 35% of NOLs
  - Cook Inlet & Middle Earth: 15% for 2017 NOLs and post-2017 NOLs only for Middle Earth
  - A gross-value reduction for "new" production must be added back in calculating a post-2016 NOL

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TAX CREDITS – OVERVIEW OF CURRENT LAW (AS 43.55.024)

Tax credits under AS 43.55.024

- **Credits under AS 43.55.024 are non-transferable, do not carry forward to later years, and cannot be bought by the Oil & Gas Tax Credit Fund**
- **Sec. 024(a) credit (Middle Earth only)**
  - **Credit of up to $6 MM each year against tax liability under AS 43.55.011(e) for Middle Earth production, but can't reduce that liability below zero**
  - **Credit is unavailable after later of –**
    (1) 2016, or
    (2) for a producer without commercial production in Middle Earth before 4/1/2006, the 9th calendar year after the calendar year when the producer first has commercial production in Middle Earth, provided this first production is before 5/1/2016
- **Sec.024(c) credit (statewide)**
  - **Credit of $12 MM a year for producers with 50,000 b/d of taxable production or less; credit scales down to zero as taxable production increases from 50,000 to 100,000 b/d**
  - **Regardless of amount, the credit can't reduce the producer's tax below zero**
  - **Credit becomes unavailable like the 024(a) credit, except production is not limited to Middle Earth**

TAX CREDITS – OVERVIEW OF CURRENT LAW (AS 43.55.025)

Tax credits under AS 43.55.025

- There are many detailed credits for many specific exploration activities, with different amounts or percentages for different activities, and with different expiration dates; some have already expired
- Generally, to qualify for these credits, the explorer must provide data from the exploration activity to DNR
- The explorer earning a credit may apply to DOR for a credit certificate, and DOR will audit the costs and confer with DNR to verify the credit amount before issuing the certificate
- A producer purchasing such a certificate may apply the face amount of it against its own production tax, but not below zero – the unused part of the credit can be used in later years until fully used

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OIL AND GAS TAX CREDIT FUND (AS 43.55.028)

The Fund may purchase tax credit certificates with money appropriated to it for this purpose

- **Governor Walker vetoed all but $30 MM of the appropriation to the Fund for FY 2016 and vetoed the entire appropriation for FY 2017**

HB 247

- **Limits the total amount of credits purchased from a person during a calendar year to $70 MM – unclear whether this $70 MM is the face value of the certificates purchased, or the amount paid for them**
- **Requires DOR, in allocating money to purchase credits, to “grant a preference, between two applicants, to the applicant with a higher percentage of resident workers in [its] workforce”**
  - **this leaves questions about how and when this “preference” will work in practice**
  - **the proposed regulations to implement this did not clearly answer these questions**
- **Calls for DOR to offset against a certificate-holder’s tax certificate any “outstanding liability to the state directly related to the applicant’s or claimant’s oil or gas exploration, development, or production” and pay that person only the portion of the certificate’s face value in excess of that liability**

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