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CS HB 111(FIN)

Oil and Gas Production Tax and Credits: Analysis of House Finance Committee Substitute

Presentation to House Finance Committee

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April 7, 2017

Changes in Finance Committee Substitute

1. **Minimum Tax (Floor)**
2. **Treatment of North Slope NOLs**
3. **North Slope Production Tax**
4. **GVR / New Oil Provisions**
5. **Other (mainly non-fiscal) Provisions**
6. **Items from Resources CS that are removed in this version**
7. **Fiscal Analysis**

Minimum Tax (Floor)

In these sections **purple printing** indicates new or changed sections in CS HB111(FIN)

Rate

- HB111(RES) increased the floor to 4% at all prices below $25 and to 5% at prices above $50
- HB111(FIN) keeps current minimum tax: 1% above $15; 2% above $17.50; 3% above $20, and 4% above $25

"Hardening" versus Credits

- HB111(RES) prevented all credits from being used below the minimum tax
- HB111(FIN) does not harden the floor vs. the small producer credit

Minimum Tax (Floor)

"Hardening" for GVR-eligible "New" Oil

- Current law, the $5 per-barrel credit can reduce tax liability to zero
- HB111(RES) created a hard "adjusted" minimum tax where the 20%-30% reduction was applied before calculating the minimum tax. Effective minimum tax rate of 2.8% to 3.2%
- HB111(FIN) keeps the adjusted minimum tax structure, although by eliminating the 30% GVR the effective minimum tax is always 3.2% of gross

Treatment of North Slope NOLs

Carry-Forward

- The 35% “Net Operating Loss” credit for the North Slope is eliminated, and replaced with a carry-forward structure
- HB111(RES) allowed for 50% carry-forward of losses, with “uplift” of ~8.5% / year for seven years
- HB111(FIN) allows for 100% of losses to carry forward, although without “uplift”
  - o After seven years, carried forward value begins to decrease by 10% per year
  - o Carried forward expenditures can only be used to offset value from the lease or property where they were incurred (“ringfence”)

North Slope Tax Rate

- Current (SB21) law is 35% of Production Tax Value (PTV) less a per-barrel credit between $0 and $8
- HB111(RES) shifted the per-barrel credit by $2 at a wide range of oil prices
- HB111(FIN) reduces the base tax rate to 25% and eliminates the sliding scale per barrel credit
  - Matches original proposal for SB21 at oil prices below about $90-95
- Adds a bracket of “progressivity,” with a 15% surtax on that portion of PTV greater than $60
  - The “bracketed” structure is very different from ACES, without marginal tax issues. More like HB110 (2011)
  - Effective tax rates closely track SB21 above $100 oil
  - Aligns value of carry-forward with the effective tax rate

Gross Value Reduction (GVR)

- HB111(FIN) keeps the 3.2% modified hard floor introduced in CSHB111(RES)
- Keeps the $5 per barrel credit, which was eliminated for legacy production
  - o Likely effect of this is that GVR production will pay no more than the minimum tax at nearly all possible prices
- Eliminates the 30% GVR for high royalty fields. All GVR-eligible production will only receive the 20% benefit

Other Changes

Interest Rates

- No change from Resources. The “zero after three years” provision for delinquent production taxes is eliminated

Transparency & Reporting

- Technical changes from Resources. Annual DOR report expanded to include credits earned but not cashed, as well as more lease expenditure information
- Reporting of lease expenditures by lease is the basis of the data used to build the “ringfence”

GVPP can’t go below zero

- Keeps same language from H(RES) version

Other Changes

Migrating Credits

- Issue is made moot due to repeal of the sliding scale per barrel credit in AS 43.55.024(j)

Assignment

- Repeals ability to assign certificates to a financer in AS 43.55.029

Cook Inlet Working Group

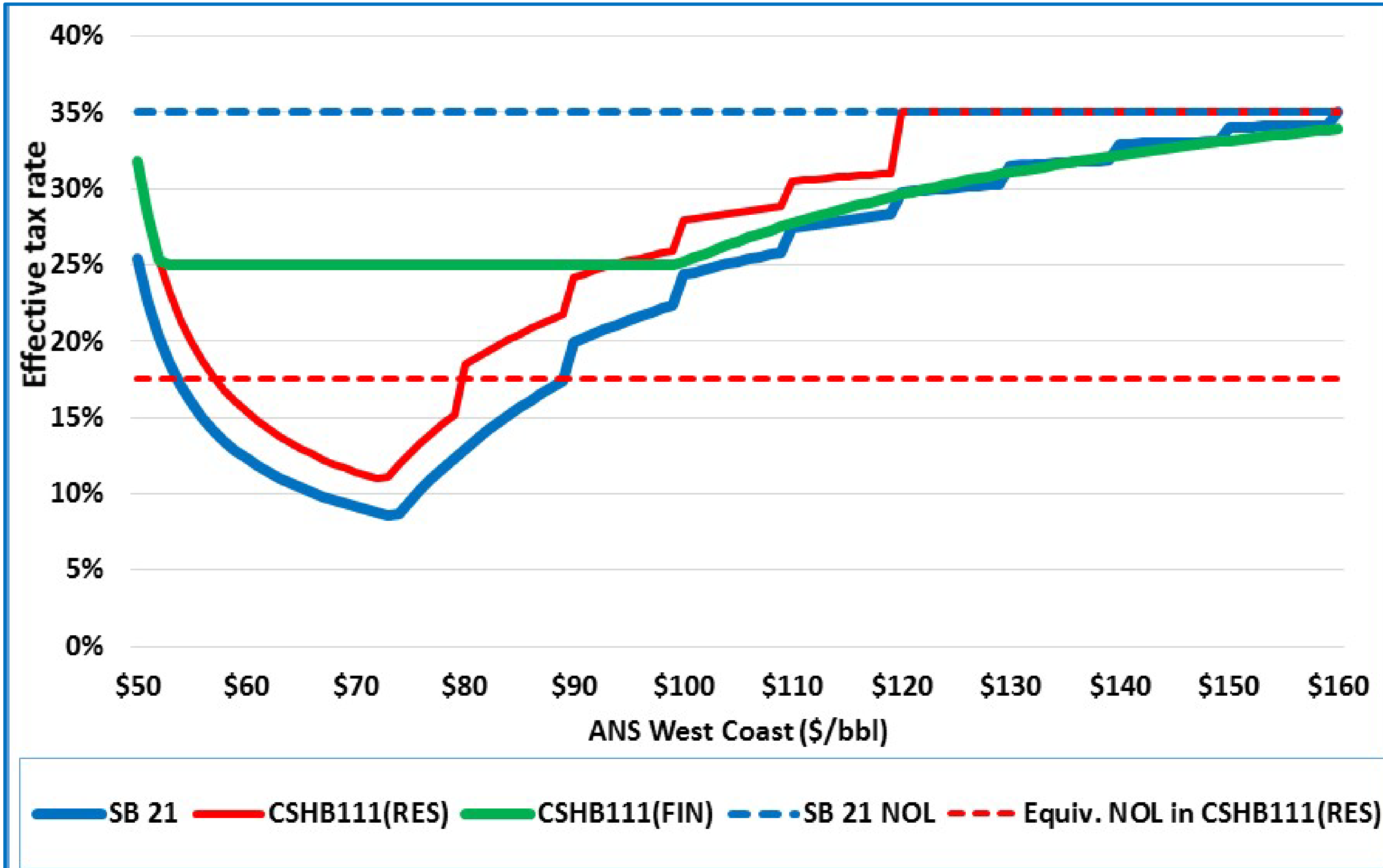
- Although CSHB111(FIN) does not address any Cook Inlet tax or credit issues, it establishes a new legislative working group to look at possible future changes

Items Removed from Resources Version

- Intent language regarding appropriations
- Executive sessions / legislative access to confidential information
- DNR Pre-approval process
- Dry Hole Credit
- No changes made to per-company credit cap, haircut, or barrels per day cash thresholds

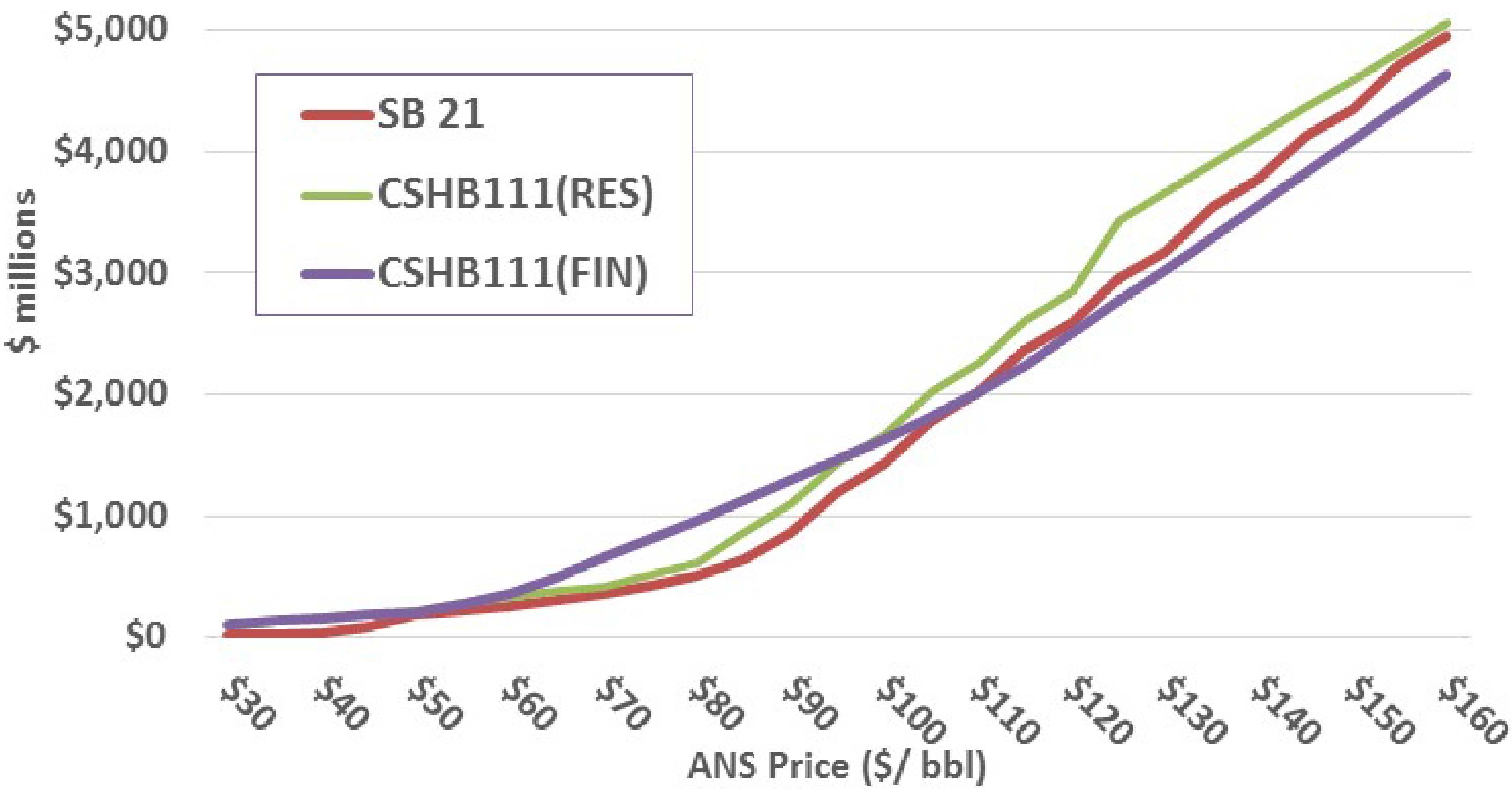
Fiscal Analysis

Effective Tax Rates (Legacy / non-GVR oil)



Fiscal Analysis

Total Production Tax Revenue (FY2019)



Based on Fall 2016 forecast for FY 2019. Does not include impact on credits available for purchase, or lease expenditures available for carry forward.

Fiscal Analysis

Fiscal Note Summary- Tax

- The tax impact is concentrated in the $55 to $90 oil price range
  - Difference between the current effective tax rates, based on 35% of net less the per-barrel credit, and a flat 25% of net
  - “Crossover” between gross and net taxes moves substantially lower, from about $75 to about $55
- Comparably small revenue impact at higher prices

Fiscal Analysis

Fiscal Note Summary- Budget

- Additional impact due to near-total elimination of cash payments for tax credits (reduced spending)
  - Long term forecast for this is $150 million / year
  - Does not include what “would be” the liability for possible future large projects
  - The associated projects don’t come into production during the fiscal note period

Fiscal Analysis

Fiscal Note Table- impact at forecast prices

Provisions in CSHB 111 (FIN) \M and their Estimated Fiscal Impact based on Fall 2016 Forecast ($millions) - Fall 2016 FC PRICE   Revised 4-7-17 by Dept. of Revenue

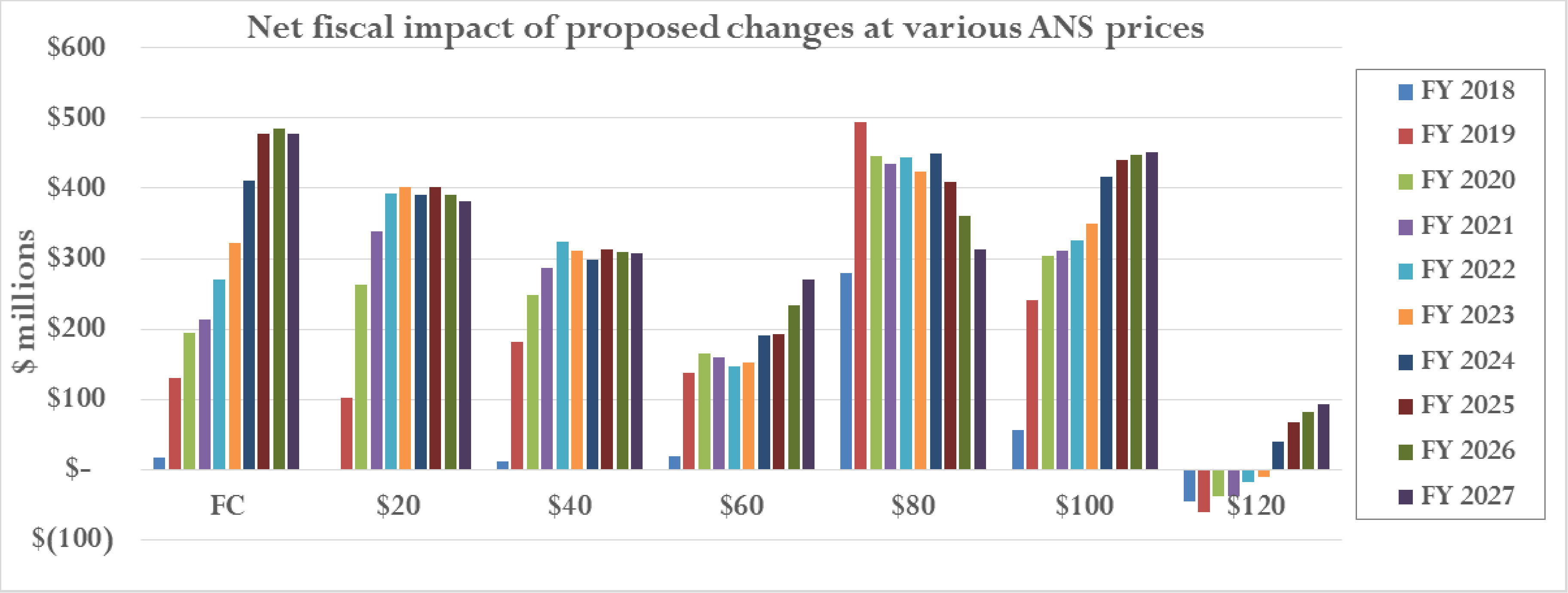
Description of Provision	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
1. Effective 1/1/18, Operating loss credit eliminated for North Slope and replaced with carry-forward lease expenditures provision. A company may carry forward 100% of North Slope lease expenditures not deducted against tax, but can only use to offset gross value from the lease or property whre earned. After 7 years, carry-forward reduced by 10% of original value each year.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
2. Only small producer credits can reduce tax below the minimum tax effective 1/1/18.	$20	$15	$0	$0	$0	$0	$0	-$10	-$25	-$5
3. Existing minimum tax rates retained, and GVR reduces basis for minimum tax, effective 1/1/18.	$0	$0	$0	$0	-$5	-$5	$0	$0	$0	$0
4. Effective 1/1/18, base tax rate for North Slope changed from 35% of PTV to 25%; an additional 15% progressive surcharge applies to that portion of PTV above $60 per barrel.	$0	-$10	-$10	-$15	-$20	-$20	-$35	-$45	-$60	-$70
5. Sliding scale per-taxable-barrel credits eliminated, effective 1/1/18.	$5	$210	$185	$250	$340	$405	$510	$610	$630	$620
6. Gross value at point of production (GVPP) cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
7. Interest on delinquent taxes continues to accrue after 3 years, retroactive to 1/1/17.	Indeterminate - likely positive for state.									
8. Eliminate 30% GVR option effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone.	-$5	-$130	-$85	-$135	-$170	-$190	-$200	-$215	-$200	-$210
Total Revenue Impact	**$20**	**$85**	**$90**	**$100**	**$145**	**$190**	**$275**	**$340**	**$345**	**$335**
A. Budget impact of operating loss and carry-forward lease expenditures changes effective 1/1/18.	$0	$45	$105	$115	$125	$135	$135	$140	$140	$140
B. Budget impact of only small producer credits can reduce tax below minimum tax effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
C. Budget impact of minimum tax changes effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of North Slope tax rate changes effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
E. Budget impact of eliminating sliding scale per-taxable-barrel credits, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
F. Budget impact of GVPP cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
G. Budget impact of interest accrual changes, retroactive to 1/1/17.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
H. Budget impact of eliminating 30% GVR option effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Budget Impact	**$0**	**$45**	**$105**	**$115**	**$125**	**$135**	**$135**	**$140**	**$140**	**$140**
Total Fiscal Impact - (does not include potential changes in investment)	**$20**	**$130**	**$195**	**$215**	**$270**	**$325**	**$410**	**$480**	**$485**	**$475**

Tax impact of carry-forward lease expenditure balances - current law	$14	$0	$0	$0	$0	$0	$0	$0	$0	$0
Tax impact of carry-forward lease expenditure balances - proposed	$90	$150	$225	$280	$335	$390	$455	$520	$580	$640
Change in year-end balance due to proposal	**$76**	**$150**	**$225**	**$280**	**$335**	**$390**	**$455**	**$520**	**$580**	**$640**

NOTE: The fiscal impact of this proposal is an estimate based on the Fall 2016 revenue forecast. Estimates shown here are draft / preliminary based on our interpretation of possible changes, and do not include any changes in company behavior as a result of this proposal. We reserve the right to make modifications to estimates for any forthcoming fiscal notes.

Fiscal Analysis

Fiscal Note Table- impact at range of prices



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Thank You!

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