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Answers to questions on Rules CS

Please note that, in the interest of expedience, where I have made reference to specific fiscal regimes, the details cited were accurate to the best of my knowledge when I last did specific research on these fiscal regimes; I haven't checked for updates or changes in the last year or two, since these are used for illustrative purposes only, and given the timeframe of legislative discussion, I wanted to be able to get these answers back as quickly as possible.

Regarding net profit systems elsewhere in the world:

a. **Do they let you recover costs?** Recovery of costs is the defining feature of any net profit tax; it is deductibility of costs that differentiates net from gross taxes. The ability to carry forward costs that cannot be deducted in the year in which they were incurred because the company is in a loss position is similarly common to almost all net profit taxes (whether broad-based, economy-wide income taxes, or specific petroleum sector taxes). Alaska has always been unusual in providing this carry-forward ability through a separate credit; the overwhelming majority of jurisdictions simply do this by having undeducted expenses (losses) be carried forward to deduct against future years' income or cashflow.
   Exceptions:
   i. The only example I am aware of of a net profit system that does not allow carry forward of expenses is in Trinidad & Tobago, and there it applies only to very small components of the overall fiscal regime. There, the core of the fiscal regime is a 50% Petroleum Profits Tax, under which losses may be carried forward indefinitely. However, there are small components of the regime – an unemployment levy and a petroleum production levy (5% and 4% tax rates respectively) which are notionally levied on a net basis, but which do not allow carry forward of losses. This is about the only example I can think of at the moment of a net tax (in this case a very small piece of the overall system) that does not allow carry forward of losses.

b. **Do they cap how many years you can carry forward losses? If so, how many years?** Some jurisdictions allow unlimited carry forward of undeducted expenses, other systems impose a cap with regard to the number of years of carry forward. In my experience, specific petroleum rent taxes are more likely to have unlimited carry forward, while limitations on carry forward are more often found in general corporate income taxes.
   Details:

   i. In the US at the general federal income tax level, US Code 172(b)(1)(A) allows taxpayers to carry losses backward (ie use against past liability, for a refund) 2 years, and forward 20 years.
   ii. Alaska, to my understanding, mirrors the federal code in the carry forward and backward it allows for state corporate income tax. Most US states follow the federal example in allowing 20 years of carry forward, although several states limit to 15, 12 or 10 years, and a few limit to 7 or 5.
   iii. Internationally, many of the petroleum net-tax jurisdictions that look most like Alaska's production tax (ie UK, Australia, Norway) allow unlimited carry-forward, and in many cases allow for carry forward with some form of interest/uplift to maintain the time value of those deductions.
   iv. In Australia, undeducted expenses are carried forward indefinitely at an uplift rate of the long-term government bond rate + 5% each year (or + 15% for the case of exploration-related expenses). The purpose of this uplift is to maintain the time value of money for companies of these undeducted costs.

v. In the UK similarly, many undeducted costs receive a 10% annual uplift, for a maximum of 6 years, although carry forward itself is not limited, and losses can also be carried backward one year.
vi. In Norway, for the first four years of development costs are 'uplifted' (ie the deduction value is increased) by 5.5% each year, so that after four years the costs are worth 22% more than the actual costs incurred. This figure was previously 30% (7.5% per year) and was reduced in 2013.
vii. The Netherlands has different carry-forward rules for their petroleum profit tax (the State Profit Share, or SPS) and their corporate income tax. For corporate income tax, losses can be carried forward up to 9 years and back 1 year, while for SPS losses can be carried forward indefinitely, and back 3 years.
viii. In a wide range of other countries where corporate income tax is a key part of the overall fiscal regime, time-limited loss carry-forward is common place, with the most common limits being 5, 7, 10 or 15 years.

c. **What considerations should we think about if we cap the number of years you can carry forward?** The desire to cap the number of years that expenses may be carried forward to protect the state is certainly very reasonable. The key thing that must be understood is that unlike the regimes referred to above that limit the number of years that losses may be carried forward, Alaska has in place the gross minimum tax, which will effectively become binding against losses as a result of switching from a NOL credit to a system of simply deducting carried-forward expenditures.

This means that, in a persistent low-price environment, it could take companies many more years than might otherwise be the case to be in a position to have sufficient liability above the floor gross tax amount to be able to deduct carried forward expenses. For this reason, a time limit at the shorter end of the spectrum referred to above (for instance, 5 years) may not be reasonable.

In my opinion, given the presence of the 4% gross minimum floor, a 7 year limit on how long expenses may be carried forward is probably the minimum that might be reasonable. Companies may have some significant concerns about the possibility that a permanent loss of deduction value could occur through the combination of such a limit and the gross floor; however in general I think many companies will also understand that if we remain in this challenged a price/cost environment for multiple years, the political willingness of the state to maintain an indefinite buildup of undeducted costs (either as costs or as credits) is going to be limited – an explicit, statutory limit may in some ways be preferable to an implicit but uncertain, political limit.

Finally, with the proposed phase-out of refundable NOL credits, it is important to point out that for explorers or new developers without current production, any clock for a time-limited carry forward would likely need to start at the commencement of regular production. One might also want to consider a longer time-horizon for recovery of costs for such companies, since new developers evidently have far more costs to recover (relative to their future revenue) in most cases than legacy producers who are temporarily in a loss situation as a result of low prices.

Please don't hesitate to let me know if there are further questions on these matters.

Best regards,

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