

NEW SUSTAINABLE

**ALASKA**

PLAN



*Pulling Together to Build Our Future*

## **Oil and Gas Tax Credit Reform**

**CS HB247(RLS)\D**

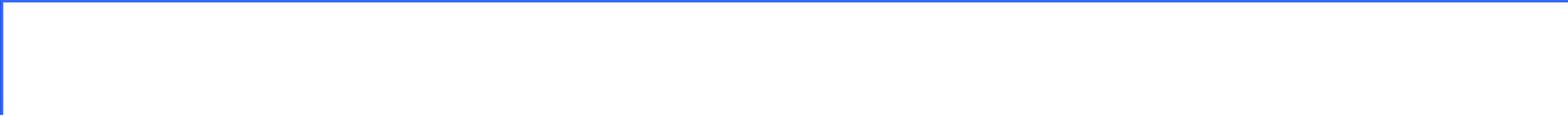
Department of Revenue

**Initial Response to Rules Committee Proposal**

May 11, 2016

# *Major Bill Concepts in Governor's Proposal*

- 1. Exploration Credits-** *sunset and transition*
- 2. Cook Inlet Drilling Credits-** *phase out while retaining operating loss credits*
- 3. Repurchase Limits-** *limit cash outlay*
- 4. Remove Exceptions / Loopholes**
- 5. Strengthen Minimum Tax-** *prevent certain credits from going below the floor, plus increase to 5%*
- 6. Other Provisions-** *technical cleanup, transparency, interest rate reform*



# Credit Cost in Perspective

# *Credit Cost in Perspective*

**FY 2007 thru 2015, \$7.4 Billion in Credits**

## **North Slope**

- \$4.3 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- \$2.1 billion refunded credits
  - New producers and explorers developing new fields

## **Non-North Slope (Cook Inlet & Middle Earth)**

- \$100 million credits against tax liability
  - Another \$500 to \$800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- \$900 million refunded credits (most since 2013)

## *Credit Cost in Perspective*

### **Total Petroleum Revenue FY 2007 thru 2015**

#### **North Slope**

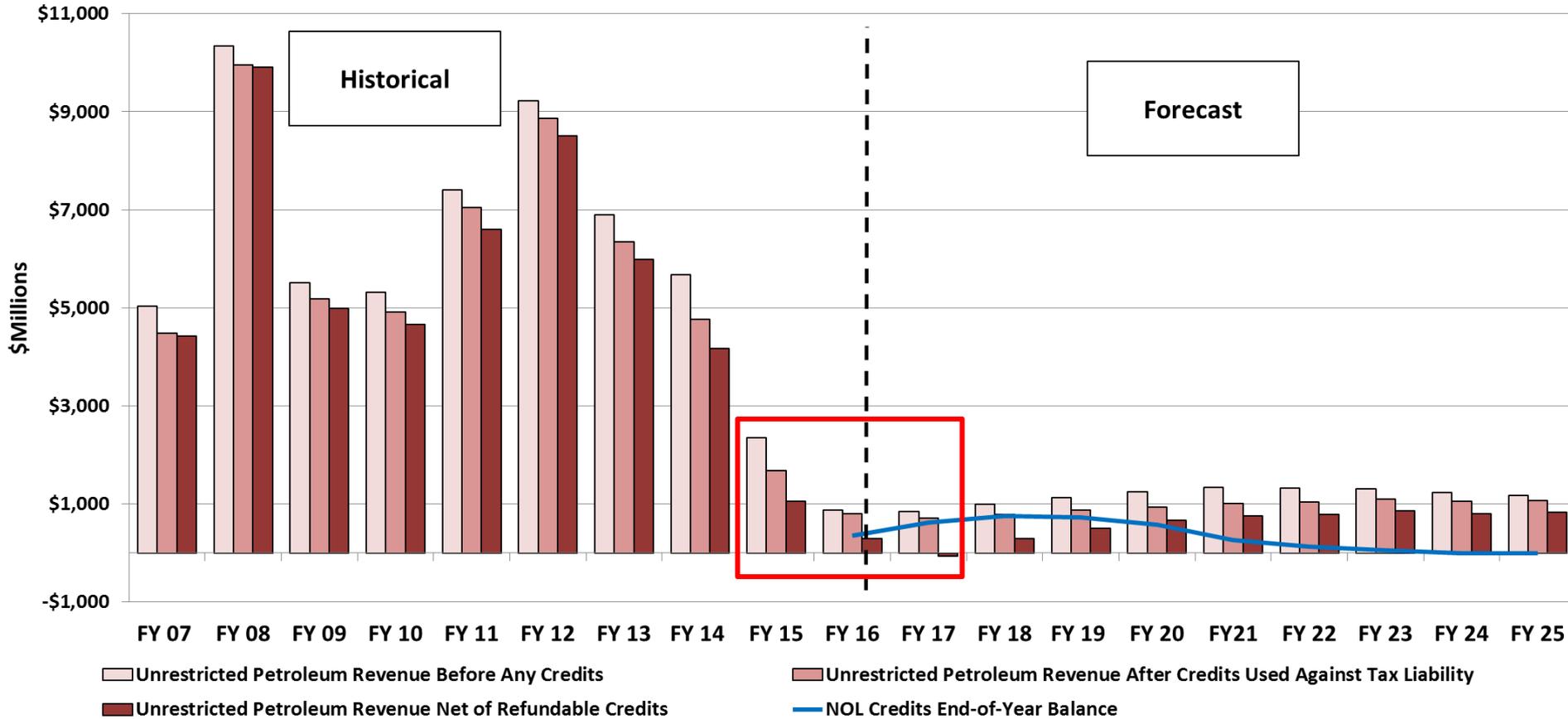
|                           |                      |
|---------------------------|----------------------|
| Production Tax            | \$32.8 billion       |
| Royalties (unrestricted)  | \$15.0 billion       |
| Other GF Revenue          | \$4.7 billion        |
| <u>Restricted Revenue</u> | <u>\$8.7 billion</u> |
| Total                     | \$61.1 billion       |

#### **Non-North Slope (Cook Inlet & Middle Earth)**

|                           |                      |
|---------------------------|----------------------|
| Production Tax            | <\$0.1 billion       |
| Royalties (unrestricted)  | \$0.5 billion        |
| Other GF Revenue          | \$0.3 billion        |
| <u>Restricted Revenue</u> | <u>\$0.2 billion</u> |
| Total                     | \$1.0 billion        |

# Credit Cost in Perspective

Statewide Tax Credits and Unrestricted Petroleum Revenue



## *Credit Cost in Perspective*

- FY16 Appropriation Capped at **\$500 million**
  - \$473 million paid out to date
  - About \$200 million North Slope, \$273 million non-NS
  - \$27 million left in fund with \$4 million in-process claims
- Current DOR Work Pool **\$675 million**
  - \$10 million in older NOL credits
  - \$22 million in older exploration credits
  - \$552 million in 2015 NOL, QCE, WLE credits
  - \$60 million in 2015 exploration credits
  - \$31 million expected via amended returns
- Remaining \$120 million will be some CY2016 quarterly QCE and WLE's, "last minute" exploration claims, and the first LNG storage and refinery claims

## *Credit Cost in Perspective*

### **Of the \$3 billion in state-refunded credits through the end of FY15:**

- \$1.45 billion went to six North Slope projects that now have production
- \$650 million went to 13 North Slope projects that do not have any production. Some of these are abandoned, and some are in process
- \$450 million went to six non-North Slope projects that have production
- \$450 million went to eight non-North Slope projects that do not have any production

## *Credit Cost in Perspective*

### **North Slope Refundable Credits**

Of the \$1.45 billion that was spent between FY07-FY15 supporting six producing projects:

- Total production through end of FY15 is 38.5 million barrels
- Total credits = **\$37.30** / barrel
  - This number will decrease over time due to additional production from these fields
- Lease expenditures for these projects, through FY15, were \$4.94 billion
  - Credit support was **29%** of lease expenditures

## *Credit Cost in Perspective*

### **Cook Inlet Refundable Credits**

Of the \$450 million that was spent between FY07-FY15 supporting six producing projects:

- Total production through end of FY15 is 55.9 million BOE (much of this was gas)
- Total credits = **\$7.80** / BOE or about **\$1.30** / mcf
  - This number will decrease over time due to additional production from these fields
- Lease expenditures for these projects, through FY15, were \$1.09 billion
  - Credit support was **40%** of lease expenditures

## *Credit Cost in Perspective*

### **Cook Inlet Tax Caps**

- Estimated value to industry \$550-\$850 over the years 2007-2013
- Total Production Estimate
  - Gas: ~ 250 million cubic feet / day for seven years = 640 BCF of gas or 106 million BOE
  - Oil: ~ 10,000 barrels / day for seven years = 26 million BOE
  - Total Production = 132 million BOE
- Using midpoint \$700 million estimate, value of caps = **\$5.30** / barrel or **\$0.88** / mcf
- **Sum of Credits + Tax Caps: \$2.18 / mcf**

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# **Response to Rules Committee Substitute**

- 1. Introduction**
- 2. Positive Features**
- 3. Concerns**
- 4. Summary of Fiscal Impact**

## *Introduction*

- The Rules Committee Substitute makes progress towards meeting several administration goals
  - Reducing future spending / rolling back credit programs
  - Limited strengthening of “floor”
  - Transparency

## *Introduction*

- It also maintains several features that have been in many or most versions of HB247 / SB130
  - Inability to increase an operating loss using GVR
  - Substantial ramp down of Cook Inlet credits
  - Restores compound interest, with rate increase, for delinquent taxes
  - Municipal utility lease expenditure pro-rationing
  - Repeal of dormant programs and obsolete sections
  - Surety bonding with local vendor priority
  - Local hire repurchase priority

## *Introduction*

- However, there are several major and minor concerns with the structure of the bill
  - Maintains large future liability through carried-forward lease expenditures
  - Shift in favor of incumbent producers and away from support for independents
  - Ongoing liability without any state pre-approval or other filter
  - Delay in GVR “graduation”
  - Hidden or inadvertent CAPEX tax cut
  - New and technical language changes that could have unintended consequences

# *Positive Features*

## **Reduces Future Spending**

- \$75 million per company per year cap (for transition years; only small producers or developers)
  - No repurchases after 2020
  - Cook Inlet credits eliminated in 2019
  - At full implementation in FY2021, about a \$300 million bill in total fiscal impact (revenue plus savings)

### **However:**

- Extended transition period could lead to large credit liabilities outside existing forecasted projects

## *Positive Features*

### **Limited Strengthening of Minimum Tax “Floor”**

- With the elimination of Net Operating Loss credits, the minimum tax is hardened against future losses
  - The \$0-\$8 per barrel credit, which is currently limited by the floor, becomes a somewhat hardened limit
  - No fiscal impact until FY2020, because losses from before the effective date will take three years to be “used up,” zeroing out taxes from major producers

### **However**

- Does not change ability to use \$5 per barrel credit for “GVR” production to go below minimum tax
- Small Producer and Exploration credits, until they sunset, can also be used to go below the “floor”

# *Positive Features*

## **Transparency**

- Annually makes public the name of each person / company who received cash credits, and the total amount repurchased

### **However:**

- No information about what the credits were used for
- Written to exclude the so-called “corporate income tax” credits (Gas and LNG storage, Refinery)
- With imminent elimination of cash credits, this is a fairly limited amount and duration of public information
- Although this would be controversial, we believe there is strong benefit in making public the amount of carried-forward lease expenditures claimed by companies.

## *Concerns with Rules CS*

### **Future liability through carried-forward lease expenditures**

- Since Spring 2016 Forecast, administration emphasis has been on potential NOLs from major producers
- Substantial discussion of reducing, scaling, or eliminating the size of the NOL credit
- Issue is side-stepped by eliminating the credit but retaining carried forward “lease expenditures”
- This enables losses to be monetized against future taxes at the full 35% tax rate
- At end of fiscal note period (FY26), producers will hold losses that will offset \$715 million in future taxes

## *Concerns with Rules CS*

### **Shift in favor of incumbent producers and away from support for independents**

- Non-producers must also carry-forward their expenditures, eliminating cash support
- Our modeling showed that the administration's initial proposal of \$25 million cap did not have dramatic impact on smaller projects, but greatly reduced the economic viability of larger ones
- Zero cash support after 2019 would impact different companies very differently
  - Incumbent producers will be able to monetize their losses as soon as prices recover, whereas independents must wait for production

## *Concerns with Rules CS*

### **Ongoing liability without any state pre-approval or other filter**

- No limit on potential state liability
- Could be corrected with pre-approval process or a state loan mechanism
- During transition period, the “plan of development” filter includes plans of exploration, which could broaden the potential applicants
- “Smith Bay” issue: a \$100 million exploration project in a remote location that is many years from viable

## *Concerns with Rules CS*

### **Hidden or inadvertent CAPEX tax cut**

- (We were told this will be fixed by amendment)
- Repeal of AS 43.55.165(e)(18) as a conforming amendment to elimination of the QCE credit
- This adds 30 cents / barrel in allowable deductions, which actually costs the state \$15-\$20 million / year once prices get above minimum tax level

## *Concerns with Rules CS*

### **Delayed GVR graduation**

- In amendments during SB21, and in prior committees, has been in five to seven year range
- Ten years greatly reduces benefit to the state as by that point many fields are well into their decline
- Reverse of Enalytica analysis: if longer term benefit has minimal impact on producers, it is also of minimal benefit to the state

## *Concerns with Rules CS*

### **New and technical language changes that could have unintended consequences**

- In the 3-year transition period, credits can be earned by any company with a plan of development, including majors (should just be non-producers)
- Definition of “regular” production for time clock to graduate the GVR (suggesting “sustained” definition)
- Carried-forward lease expenditures are not kept separate by “segment,” which can distort the eventual net profit tax paid once the expenditures are applied
- Carried forward expenditure change in .160(a) doesn’t account for the tax changes scheduled for 2022, which is in .160(h). Need to replicate this language.

# Summary of Fiscal Impact

## Summary Analysis of Bill Versions (\$millions) (based on Spring 2016 Forecast)

|                                      | FY 2017        |                       |                   | FY 2018        |                       |                   | FY 2019        |                       |                   | FY 2020        |                       |                   |
|--------------------------------------|----------------|-----------------------|-------------------|----------------|-----------------------|-------------------|----------------|-----------------------|-------------------|----------------|-----------------------|-------------------|
|                                      | HB247<br>(GOV) | CS HB247<br>(FIN) amd | CS HB247<br>(RLS) | HB247<br>(GOV) | CS HB247<br>(FIN) amd | CS HB247<br>(RLS) | HB247<br>(GOV) | CS HB247<br>(FIN) amd | CS HB247<br>(RLS) | HB247<br>(GOV) | CS HB247<br>(FIN) amd | CS HB247<br>(RLS) |
| <b>Reduced Spending</b>              |                |                       |                   |                |                       |                   |                |                       |                   |                |                       |                   |
| <b>Credits Eliminated or Reduced</b> |                |                       |                   |                |                       |                   |                |                       |                   |                |                       |                   |
| North Slope                          | \$15           | \$0                   | \$0               | \$15           | \$15                  | \$15              | \$25           | \$25                  | \$30              | \$20           | \$25                  | \$115             |
| Cook Inlet / Mid Earth               | \$35           | \$20                  | \$5               | \$65           | \$50                  | \$30              | \$45           | \$45                  | \$45              | \$35           | \$50                  | \$110             |
| <b>Credits Deferred</b>              |                |                       |                   |                |                       |                   |                |                       |                   |                |                       |                   |
| North Slope                          | \$30           | \$0                   | \$0               | \$80           | \$0                   | \$0               | \$95           | \$0                   | \$0               | \$45           | \$0                   | \$0               |
| Cook Inlet / Mid Earth               | \$0            | \$0                   | \$0               | \$30           | \$0                   | \$0               | \$40           | \$0                   | \$0               | \$20           | \$0                   | \$0               |
| <b>Budget Subtotal</b>               | <b>\$80</b>    | <b>\$20</b>           | <b>\$5</b>        | <b>\$190</b>   | <b>\$65</b>           | <b>\$45</b>       | <b>\$205</b>   | <b>\$70</b>           | <b>\$75</b>       | <b>\$120</b>   | <b>\$75</b>           | <b>\$225</b>      |
| <b>Increased Revenue</b>             |                |                       |                   |                |                       |                   |                |                       |                   |                |                       |                   |
| Floor "Hardening"                    | \$130          | \$0                   | \$0               | \$185          | \$0                   | \$0               | \$185          | \$0                   | \$0               | \$160          | \$0                   | \$70              |
| Floor Increase to 5%                 | \$45           | \$0                   | \$0               | \$45           | \$0                   | \$0               | \$55           | \$0                   | \$0               | \$80           | \$0                   | \$0               |
| CI Credit Repeal                     | \$15           | \$5                   | \$0               | \$10           | \$15                  | \$0               | \$15           | \$15                  | \$10              | \$15           | \$15                  | \$15              |
| <b>Revenue Subtotal</b>              | <b>\$190</b>   | <b>\$5</b>            | <b>\$0</b>        | <b>\$240</b>   | <b>\$15</b>           | <b>\$0</b>        | <b>\$255</b>   | <b>\$15</b>           | <b>\$10</b>       | <b>\$255</b>   | <b>\$15</b>           | <b>\$85</b>       |
| <b>Total Bill Impact</b>             | <b>\$270</b>   | <b>\$25</b>           | <b>\$5</b>        | <b>\$430</b>   | <b>\$80</b>           | <b>\$45</b>       | <b>\$460</b>   | <b>\$85</b>           | <b>\$85</b>       | <b>\$375</b>   | <b>\$90</b>           | <b>\$310</b>      |
| <b>NOL Carry-Forward</b>             | <b>\$773</b>   | <b>\$595</b>          | <b>\$610</b>      | <b>\$1,128</b> | <b>\$708</b>          | <b>\$720</b>      | <b>\$1,226</b> | <b>\$666</b>          | <b>\$660</b>      | <b>\$1,223</b> | <b>\$498</b>          | <b>\$685</b>      |

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**Thank You!**

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