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ALASKA
PLAN

Pulling Together to Build Our Future

Oil and Gas Tax Credit Reform

Department of Revenue

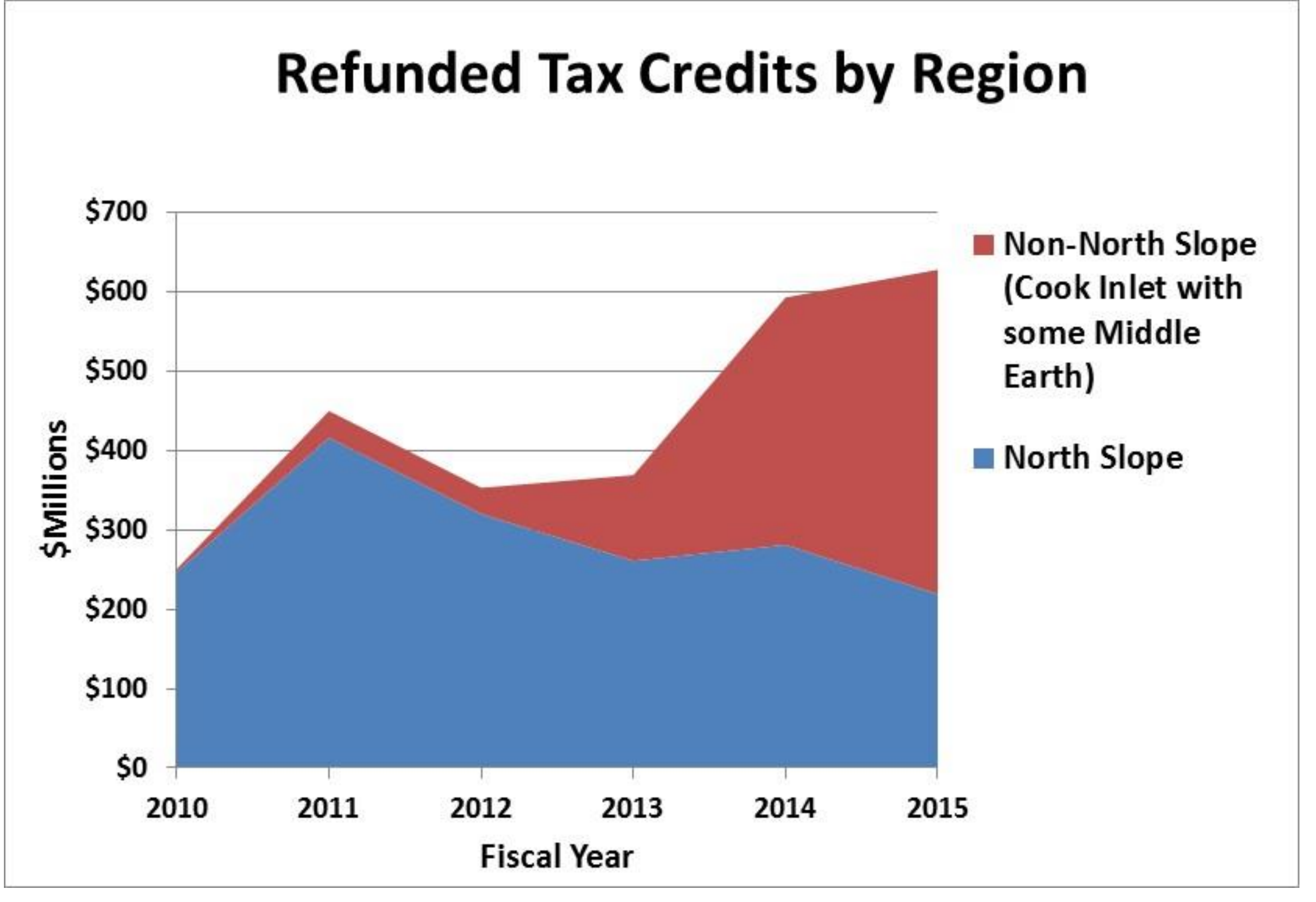
Initial Reaction to CS HB 247(RES)\P

Presentation to House Resources Committee

March 21, 2016

History of Oil and Gas Production Tax Credits

- Tremendous growth in non-North Slope (almost entirely Cook Inlet) refunded credits since FY10



History of Oil and Gas Production Tax Credits

Of the $500 million in authorized credit repurchases for FY16:

- About <u>$473 million</u> has already been paid
  - About $200 million from North Slope and $273 million from Cook Inlet / Interior
  - 58% non-North Slope, similar to FY15 data
- Nearly all are 2014 NOL's and Cook Inlet Drilling
- Still expect $700 million total demand, but
  - Most of the applications DOR has in-hand don't need to be issued until next July

Major Bill Themes

- Reduce the state's annual cash outlay;
- Protect Net Operating Loss credits as a playing field leveler between legacy producers and newcomers;
- Limit repurchases;
- Strengthen the minimum tax;
- Be more open and transparent;
- Honor and pay credits earned to date and through any transition period.

Major Bill Concepts in Governor's Proposal

1. Exploration Credits
2. Cook Inlet Drilling Credits
3. Repurchase Limits
4. Remove Exceptions / Loopholes
5. Strengthen Minimum Tax
6. Other Provisions

Exploration Credits

HB247 Proposed / Kept in CS

- Allowing the .025(a) “alt. credit for exploration” to expire on 7/1/16, for North Slope and Cook Inlet
  - 025(a) credits remain for “Middle Earth” until 2022
- Also allowing the “Jack up Rig” and “Frontier Basin” credits to expire at the same time
- Preemptively repeal other exploration credit programs that are not currently being used, in AS 38.05.180(i) and AS 41.09.

Changes in Committee Substitute

- **Removes .025 DNR data requirements from .023(b)**

Cook Inlet Drilling Credits

Changes in Committee Substitute

- Orig proposal was to repeal 20% Capital (QCE; .023(a)) and 40% Well (WLE; .023(l)) credits on 7/1/16, while maintaining the 25% Operating Loss (NOL)
- **Phase-out of WLE in 2017-2018; QCE in 2022**
- **NOL reduced from 25% to 10% in 2017**

Impact of Changes

- Phase-in of reduction in Cook Inlet cash support; Original bill proposed reducing to **25%** in FY2017. CS reduces to **30%** halfway through FY2018
- By preserving "capital" and reducing "loss" credits, increases payments to producers (who pay zero taxes)

CS sets path for broader Cook Inlet tax reform by 2022

Repurchase Limits

Changes in Committee Substitute

- **Increases cap to per company / per year payments from $25 million to $200 million**
- **Eliminates payment ineligibility for large (>$10 bil.) companies, Alaska resident hire provision, and 10-year carry forward sunset**

Impact of Changes

- Provides limited cash flow protection to the state in event of a large “outlier” project such as proposed by Armstrong
  - Modeling showed annual credits from a similar project of up to $800 million
  - Multiple partners could each receive $200 million

Repurchase Limits (cont'd)

Historic Notes on large annual credits:

Over the 2007-2016 history of the tax credit program:

- There has only been **one** instance of a company who ever received **> $200** million in a single year
- **Five** times ever when one company received between **$100 - $200** million in one year
- **11** times ever when one company received between **$50 - $100** million in one year

Remove Exceptions / Loopholes

CS retains two proposed changes to prevent artificially inflated net operating losses

- Can’t use GVR (new oil value reduction) to increase the size of a Net Operating Loss (has led to credits greater than 100% of loss)
- If a municipal entity owns production and sells only a portion of that production to an outside party, only the pro-rata share of expenses can be deducted against revenue

Strengthen Minimum Tax

CS eliminated- items that impact legacy producers:

- Can’t use an operating loss credit, to reduce payments below the 4% floor
- Prevent per-taxable-barrel credits earned in one month from being used against another month’s taxes at true-up
- Increase in minimum tax from 4% to 5%

CS eliminated- items that impact new oil producers:

- Extend minimum tax to GVR-eligible “new” oil
- Not allow small producer credit to reduce tax payments below the floor

Other Provisions

Interest Rate Reform

- CS preserves fixing the error in SB21 that prevents compound interest on underpayments and assessments
- **Keeps current 3% above federal discount rate, versus 7% as proposed in HB247**

Confidentiality / Transparency

- **Eliminates making public, as proposed in HB247, the name of each company and how much they received in state repurchased credits**

Eliminates provision in which Transportation Costs can't reduce Gross Value below zero

Preserves authority to use Credit certificates to satisfy obligations to the state before repurchase

Bill CS Impact: Example Scenarios

North Slope Major Producer

- No change at any price

Bill CS Impact: Example Scenarios

North Slope New or Smaller Producer

- Higher oil prices: no change
- If company has an operating loss, the Gross Value Reduction cannot be used to increase the size of the loss to earn a larger NOL credit

Bill CS Impact: Example Scenarios

North Slope New Project Developer

- No change at any price
- Very large new projects limited by $200 million / company / year cap
    - At a 35% NOL, that requires a bit over $570 million / year in capital spending for a single company to reach the limit

Bill CS Impact: Example Scenarios

Cook Inlet Existing Producer

- Cook Inlet tax caps maintained
- Credit support reduced to 20-30% in 2017 and 20% in 2018-2021
- Capital credit repealed in 2022 in anticipation of new Cook Inlet tax regime
  - In 2022, absent a change, Cook Inlet will have a 35% tax with 10% NOL and no per-barrel or capital credit

Bill CS Impact: Example Scenarios

Cook Inlet New Field Developer

- In 2017, will receive about 35% credit support (blend of 20% capital and 30% well, plus 10% NOL)
- Beginning in 2018, repeal of Well credit and reduction of NOL to 10% results in 30% credit support (20% capital + 10% NOL)
- Very large new projects limited by $200 million / company / year cap

Bill CS Impact: Example Scenarios

Interior / Frontier Area Explorer

- With repeal of Well credits and reduction of NOL, development projects will only receive 30% credit support beginning in 2018 (20% Capital + 10% NOL)
- However, exploration credits have been extended through 2022, meaning qualified expenditures will continue to receive 50% (40% Exploration + 10% NOL)

To-date Cost of Sunsetting Credits

Exploration Credits (various) 2007-sunset

- North Slope Refunded: $270 million
- North Slope Against Liability: $190 million
- Non-North Slope Refunded: $160 million
- Non-North Slope Against Liability: $0

Small Producer Credits 2007-2016

- North Slope Against Liability: $340 million
- Non-North Slope Against Liability: $60 million
- (these cannot be refunded)

Total: slightly over $1 billion

Revenue Impact, Changes in CS

Preliminary Analysis of Bill Changes ($millions)

(based on Fall 2015 Forecast)

	FY17		FY18		FY19	
	HB247	CS HB247(RES)	HB247	CS HB247(RES)	HB247	CS HB247(RES)
Reduced Spending						
Credits Eliminated or Reduced						
North Slope	$50	$25	$30	$30	$25	$25
Cook Inlet / Mid Earth	$150	$20	$125	$30	$75	$30
Credits Deferred						
North Slope	$100	$0	$120	$0	$50	$0
Cook Inlet / Mid Earth	$100	$0	$50	$0	$50	$0
Budget Subtotal	**$400**	**$45**	**$325**	**$60**	**$200**	**$55**
Increased Revenue						
Floor "Hardening"	$50	$0	$50	$0	$0	$0
Floor Increase	$50	$0	$50	$0	$50	$0
Revenue Subtotal	**$100**	**$0**	**$100**	**$0**	**$50**	**$0**
Total Bill Impact	**$500**	**$45**	**$425**	**$60**	**$250**	**$55**

Implementation Cost

Transition

- Original bill was written with an effective date of 7/1/16 for nearly all changes
- **CS moves most changes to 1/1/17, with the full repeal of the Well Lease Expenditure credit on 1/1/18**
- The bill still includes a fund capitalization fiscal note for $926,575,000, to the .028 fund
  (The difference between the number in the operating budget and $1,000,000,000)
- **The capitalization will cover all FY17 expected spending, but with the changes made in the committee substitute, additional appropriation will be needed in FY18 and beyond**

Implementation Cost

- The changes anticipated in this bill still require somewhat substantial reprogramming of the Tax Revenue Management System (TRMS) and Revenue Online (ROL) which allows a taxpayer to file a return online and update the current tax return forms
- We have requested an estimate from the software developer, and currently assume a one-time cost of about $1.5 million to accomplish this (no change)
- We do not anticipate any additional costs to administer the tax program
- There will also be a need for substantial amendments to existing regulations to fully implement the changes

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Thank You!

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