THE STATE of ALASKA
GOVERNOR BILL WALKER

Department of Revenue
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March 20, 2016

The Honorable Benjamin Nageak and the Honorable David Talerico
Alaska State Representatives
Co-Chairs, House Resources Committee
State Capitol Rooms 126 and 104
Juneau AK 99801

Dear Co-Chairs Nageak and Talerico,

The purpose of this letter is to provide you with responses to the questions asked of the Department of Revenue regarding House Bill 247 during our presentations to the House Resources Committee on March 7-8, 2016. Please see questions in italics and our responses immediately below the questions.

1. *Clarify whether annual State revenues shown in conjunction with the life cycle modeling reflected all State revenues or only general fund unrestricted revenues and whether they reflected State and municipal property tax or only State property tax.*

   The State revenues shown with the life cycle modeling include all State revenues, including restricted royalties, and only the State share of the property tax.

2. *Provide individual and summary slides for life cycle modeling of the following:*
   a. A field with a 1/6 royalty share and 30% GVR
   b. A field where a portion of the leases are privately owned
   c. A Cook Inlet gas development
   d. A field in "middle earth" including consideration of the LNG storage facility and refinery infrastructure credit

   Supplemental slides with the requested analysis are attached.

   Note that for the Cook Inlet gas analysis, we created a representative cost and production profile that is similar in magnitude to a representative gas field presented by Enalytica. For the "middle earth" analysis, we used this same Cook Inlet gas field profile, and simply applied the middle earth fiscal regime to that field. For middle earth, we did not directly account for LNG storage facility and refinery infrastructure credits. The reason for this is that the life cycle model is intended to model an upstream development from the standpoint of a producer, and these credits would likely fall outside the scope of any particular upstream development. They are, however, important components of the state's overall regime regarding oil and gas development.

3. *Provide the committee with land ownership and credits analysis as referenced by Director Alper in committee hearings.*

   The requested analyses are attached. Note that the land ownership analysis is slightly revised from an earlier version provided to the committee. This analysis includes a simple model that enables the user to estimate the state's royalty revenue (and, if applicable, production tax on private royalties) for a given project.

   We also include below a summary of the revenue from oil and gas operations on federal lands in Alaska. The table summarizes the revenue disbursed to the State of Alaska for its share of the revenues received by the federal government.

Federal Disbursements to Alaska for Oil and Gas Royalties

Federal Land Designation	FFY 2013	FFY 2014	FFY 2015
Federal Offshore (8g)	$2,940,962	$2,519,780	$1,957,767
Federal Onshore	$15,695,140	$17,624,835	$16,200,909
Total Federal Disbursements	**$18,636,102**	**$20,144,615**	**$18,158,676**

Source: Office of Natural Resources Revenue

4. *Provide an example of Section 18 of the bill applied to a 750 million barrel field. Also provide an example of Section 18 of the bill applied to a field with 1/6 royalty.*

   The question was asked to determine the potential "upside" cost of the circumstance in which the Gross Value Reduction (GVR) is used to increase the size of a net operating loss (NOL) and associated credit. The examples below show how a $10 per barrel loss couples with the 20% GVR and the 30% GVR scenarios to create even larger net operating losses for credit purposes. When multiplied by production of 100,000 taxable barrels per day, the size of the credit is increased substantially. Such scenarios could occur in an environment similar to our current one, in which oil prices sharply decline in a relatively short period of time. Specifically, the 20% GVR scenario could result in a NOL credit that equaled 56% of the actual loss, or $77 million more than a NOL credit based on 35% of the actual loss. The 30% GVR scenario could result in a NOL credit that equaled 67% of the actual loss, or $115 million more than a NOL credit based on 35% of the actual loss.

750 mmbo Field - 20% GVR-Eligible Production increasing Size of a Net Operating Loss and Proposed Change*

	Current Law	Proposed Change
West Coast Price ($/tax bbl)	$40	$40
Transportation ($/tax bbl)	-$10	-$10
Wellhead Value ($/tax bbl)	$30	$30
Lease Expenditures ($/tax bbl)	-$40	-$40
Net Value before GVR ($/tax bbl)	-$10	-$10
Wellhead Value from above ($/tax bbl)	$30	$30
Gross Value Reduction Rate (%)	x 20%	x 20%
Gross Value Reduction ($/tax bbl)	$6	$6
GVR-Adjusted Net Value ($/tax bbl)	-$16	-$16
Base Tax Rate (%)	x 35%	x 35%
Base Production Tax before Credits ($/tax bbl)	$0.00	$0.00
Minimum Tax Rate (%)	4%	4%
Wellhead Value ($/tax bbl)	$30	$30
Minimum Tax ($/tax bbl)	**$1.20**	**$1.20**
GVR Credit per-Tax-Barrel ($/tax bbl)	$5	$5
Production Tax after credits ($/tax bbl)	**$0.00**	**$0.00**
Net Operating Loss Credit Rate (%)	x 35%	x 35%
Net Operating Loss Credit ($/tax bbl)	-$5.60	-$3.50
NOL per barrel times 100,000 taxable b/d ($M)	-$204	-$128
Difference ($M)		**-$77**

*Assumes oil price decrease when field is producing at near peak rate. Proposed change here includes only changes to the law on the GVR creating or increasing a net operating loss.

750 mmbo Field - 30% GVR-Eligible Production increasing Size of Net Operating Loss and Proposed Change*	Current Law	Proposed Change
West Coast Price ($/tax bbl)	$40	$40
Transportation ($/tax bbl)	-$10	-$10
Wellhead Value ($/tax bbl)	$30	$30
Lease Expenditures ($/tax bbl)	-$40	-$40
Net Value before GVR ($/tax bbl)	-$10	-$10
Wellhead Value from above ($/tax bbl)	$30	$30
Gross Value Reduction Rate (%)	x 30%	x 30%
Gross Value Reduction ($/tax bbl)	$9	$9
GVR-Adjusted Net Value ($/tax bbl)	-$19	-$19
Base Tax Rate (%)	x 35%	x 35%
Base Production Tax before Credits ($/tax bbl)	$0.00	$0.00
Minimum Tax Rate (%)	4%	4%
Wellhead Value ($/tax bbl)	$30	$30
Minimum Tax ($/tax bbl)	**$1.20**	**$1.20**
GVR Credit per-Tax-Barrel ($/tax bbl)	$5	$5
Production Tax after credits ($/tax bbl)	**$0.00**	**$0.00**
Net Operating Loss Credit Rate (%)	x 35%	x 35%
Net Operating Loss Credit ($/tax bbl)	-$6.65	-$3.50
NOL per barrel times 100,000 taxable b/d ($M)	-$243	-$128
Difference ($M)		**-$115**

*Assumes oil price decrease when field is producing at near peak rate. Proposed change here includes only changes to the law on the GVR creating or increasing a net operating loss.

5. *Provide possible language for a revised Section 22 that would limit data collected to only what is currently collected.*

   We have been working with the Department of Law and the Department of Natural Resources, Division of Oil and Gas, and have developed language that we believe will resolve the committee's concerns that the publicly released data is the same as what currently occurs.

   The requested language was provided to the co-chair's staff on 3/14; a copy is attached with this memo. Please note that this revision substantially adds to the length of the current Section 22, because instead of referencing data sharing language in AS 43.55.025 it creates new language in AS 43.55.023.

Additional clarification from the hearings:

During our presentations, a question was asked regarding how costs are allocated between oil and gas production for tax calculation purposes, and was answered incorrectly. Per Department of Revenue regulation, in instances where allocation of lease expenditures is necessary, those lease expenditures are allocated based on BTU-equivalent barrels of oil produced.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

Sincerely,

Randall J. Hoffbeck
Commissioner

Attachments:

- Supplemental Life-cycle modeling analysis slides
- Applicability of State Royalty, Tax, and Credits by Geographic and Legal Ownership of Land. with Royalty Revenue model
- Proposed rewrite of Sec. 22 of HB247, DNR data sharing and public release

Title:	**Applicability of State Royalty, Tax, and Credits by Geographic and Legal Ownership of Land**
Preparer:	Dan Stickel, Assistant Chief Economist, 465-3279
Date:	3/12/2016
Purpose:	To provide a summary of applicability of royalty and taxes for land with various geographic location and ownership.
Data Source:	All information is per state and federal law.
Key Assumptions:	All laws in place as of March 2016.
History:	This is the second version of this document; updated to clarify tax rate that applies to private landowner royalties for gas production.
Disclaimer:	The Department of Revenue is in the process of reviewing and updating the data on which this analysis is based. As a result, future analysis could have different results.

Assumptions for Revenue Estimates	**Price of Oil**	**$50**
	Transport Cost	**$10**
	Volume in BBL / Day	**10,000**
	Royalty Rate	**12.50%**

Applicability of State Royalty, Tax, and Credits by Geographic and Legal Ownership of Land

Revised 3/12/16 by Dan Stickel

Land status	Revenue component: Production tax / credits	Royalty	Corporate Income Tax	Property Tax	Royalty or Tax on Pvt. Royalty (revenue in $millions)
Offshore beyond 6 miles - Federal OCS	Do not apply	Federal royalties applies; zero shared back to state (in Alaska; other states do receive shared royalties)	Not included in apportionment factor	Does not apply	$ -
Offshore 3-6 miles - Federal OCS 8(g) area	Do not apply	Federal royalties applies; 27% shared back to state with no restrictions	Not included in apportionment factor	Does not apply	$ 4.9
State lands	All credits available; tax applies to all taxable production	State royalty applies	All property, production, and sales included in apportionment factor	Applies to all oil and gas property	$ 18.3
NPR-A - federal owned	All credits available; tax applies to all taxable production	Federal royalty applies; 50% of royalties are shared back to state but must be used for benefit of local communities	All property, production, and sales included in apportionment factor	Applies to all oil and gas property	$ 9.1
ANWR	All credits available; tax applies to all taxable production	Federal royalty applies; 90% shared back to state with no restrictions (under current law)	All property, production, and sales included in apportionment factor	Applies to all oil and gas property	$ 16.4
Other federal land	All credits available; tax applies to all taxable production	Federal royalties applies; 90% shared back to state with no restrictions	All property, production, and sales included in apportionment factor	Applies to all oil and gas property	$ 16.4
Private land (including Alaska Native Corporation)	All credits available; tax applies to all taxable production	Privately negotiated royalty applies; not shared with state. However state levies 5% (oil) or 1.667% (gas) gross tax on the value of private landowner royalty interest as part of production tax	All property, production, and sales included in apportionment factor	Applies to all oil and gas property	$ 0.9

Notes:
Offshore submerged lands in the 0-3 miles category treated same as similar onshore land.

AM-5
03/14/16
12:20 pm

A M E N D M E N T

OFFERED IN THE HOUSE BY ______________________

TO: HB 247

Page 18, line 2:

Delete "section"

Insert "subsection"

Page 18, lines 3 - 10:

Delete all material and insert:

"(q) For a credit under this section,

(1) a producer or explorer shall comply with the notice and information requirements in this subsection for lease expenditures incurred for

(A) a seismic survey, except that seismic data collected within the boundaries of a unit by a producer in that unit is not subject to the notice and information requirements of this subsection;

(B) an exploration or stratigraphic test well;

(2) a producer or explorer shall

(A) notify the Department of Natural Resources, within 30 days after completion of seismic or geophysical data processing or completion of well drilling, whichever is the latest, for which the lease expenditures are claimed, of the date of completion and submit a report to the department describing the processing sequence and providing a list of data sets available;

(B) provide to the Department of Natural Resources, within 30 days after the date of a request, unless a longer period is provided by the

Department of Natural Resources, specific data sets, ancillary data, and reports identified in (A) of this paragraph; in this subparagraph,

(i) a seismic or geophysical data set includes the data for an entire seismic survey irrespective of whether the survey area covers nonstate land in addition to state land or land in a unit in addition to land outside a unit;

(ii) well data includes all analyses conducted on physical material, and well logs collected from the well, results, and copies of data collected and data analyses for the well, including well logs; sample analyses; testing geophysical and velocity data including seismic profiles and check shot surveys; testing data and analyses; age data; geochemical analyses; and tangible material;

(3) that, notwithstanding any provision of AS 38, information provided under this subsection will be held confidential by the Department of Natural Resources,

(A) in the case of well data, until the expiration of the 24-month period of confidentiality described in AS 31.05.035(c), at which time the Department of Natural Resources will release the information after 30 days' public notice unless, in the discretion of the commissioner of natural resources, it is necessary to protect information relating to the valuation of unleased acreage in the same vicinity, or unless the well is on private land and the owner, including the lessor but not the lessee, of the oil and gas resources has not given permission to release the well data;

(B) in the case of seismic or other geophysical data, for 10 years following the completion date, at which time the Department of Natural Resources will release the information after 30 days' public notice, except as to seismic or other geophysical data acquired from private land, unless the owner, including a lessor but not a lessee, of the oil and gas resources in the private land gives permission to release the seismic or other geophysical data associated with the private land;

(4) notwithstanding any contrary provision of AS 38, AS 40.25.100, or AS 43.05.230, the following information is not confidential after the credit, based on the

lease expenditures, has been applied or, in the case of a transferable certificate, after the certificate has been issued:

(A) the producer or explorer's name;

(B) the location of the well or seismic exploration;

(C) the date on which the information required to be submitted under this subsection will be released."