NEW SUSTAINABLE ALASKA PLAN

Pulling Together to Build Our Future

Oil and Gas Tax Credit Reform

SB5005

Presentation to Senate Finance Committee

July 13, 2016

Bill Title

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to oil and gas lease expenditures and production tax credits for municipal entities; relating to the interest applicable to delinquent tax; and providing for an effective date."

Purpose of Bill

SB5005 is a smaller, more targeted credit reform and minimum tax package than HB247

- Addresses “North Slope NOL” issue
- Re-introduces several smaller parts of HB247 that did not pass
- Increases the minimum tax at certain prices
- Technical fixes to HB247 sections that may have implementation issues

History of Oil and Gas Production Tax Credits

Update: FY 2007 thru '16, $8.0 Billion in Credits

North Slope

- $4.4 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- $2.3 billion refunded credits
  - New producers and explorers developing new fields

Non-North Slope (Cook Inlet & Middle Earth)

- $0.1 billion credits against tax liability
  - Another $500 to $800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- $1.2 billion refunded credits (most since 2013)

Work Done Since January

- Spring 2016 Revenue Forecast includes large expected operating losses from major producers, which would offset minimum tax payments for several years
- Forecast also updates FY17 demand for refunded credits to $775 million (includes $200 million that had been vetoed from the FY16 budget, carried forward)
- HB247 passes after over 60 hearings with substantial reforms in Cook Inlet credits and how North Slope “Gross Value Reduction” is treated
  - FY17 budget passes with $30 million GF funding for credits via statutory formula, plus $430 million from other funding sources in the HB247 fiscal note
  - Governor Walker vetoes the additional $430 million, leaving only the $30 million from the formula

Potential NOL Carry-Forward Liability

Oil and Gas Tax Credit Fund: Budgeted vs. Actual vs. Statutory Tax Credit Fund Transfer Cap

(Beginning with the first budget cycle after the passage of ACES in November 2007)

Credit Claims and Carried-Forward Lability for FY17 and Beyond Include Program Changes Made in HB247

Fiscal Year	Original Appropriation ($million)	Actual Claimed Credits ($million)	Actual Production Tax ($million)	Plus Credits Against Liab ($million)	AS 43.55.011 Revenue ($million)	Oil Price Per Spring 16 Forecast	Credit Cap per AS 43.55.028(c)	End Year Fund Balance	Non-Cashable Carried-Forward Liability	Total Credit Oblig
Actual										
FY09	not to exceed $175	$193	$3,101	$334	$3,435	$85.73	$343	$150	$0.0	n/a
FY10	unspec **	$250	$2,861	$412	$3,273	$65.70	$327	$228	$0.0	n/a
FY11	est. $180	$450	$4,543	$361	$4,904	$73.32	$490	$268	$0.0	n/a
FY12	est. $400	$353	$6,137	$363	$6,500	$94.70	$650	$565	$0.0	n/a
FY13	est. $400	$369	$4,043	$550	$4,593	$110.44	$459	$655	$0.0	n/a
FY14	est. $400	$593	$2,589	$919	$3,508	$109.61	$351	$413	$0.0	n/a
FY15	est. $450	$628	$363	$664	$1,027	$95.24	$103	($112)	$0.0	($112)
FY16	est. $700	$500	$144	$70	$214	$39.99	$32	($580)	($357)	($937)
Forecasted										
FY16	est. $700	$500	$144	$70	$214	$39.99	$500	$0	($357)	($357)
FY17	$460	$760	$59	$135	$194	$38.89	$30	($730)	($605)	($1,335)
FY18	n/a	$445	$16	$205	$221	$43.79	$33	($1,142)	($715)	($1,857)
FY19	n/a	$285	$11	$250	$261	$48.89	$39	($1,388)	($690)	($2,078)
FY20	n/a	$190	$13	$305	$318	$54.48	$48	($1,530)	($515)	($2,045)
FY21	n/a	$150	$33	$325	$358	$60.29	$36	($1,644)	($245)	($1,889)
FY22	n/a	$150	$110	$275	$385	$61.64	$39	($1,756)	($130)	($1,886)
FY23	n/a	$150	$217	$205	$422	$63.05	$42	($1,864)	($50)	($1,914)
FY24	n/a	$150	$212	$170	$382	$64.45	$38	($1,975)	$0	($1,975)
FY25	n/a	$150	$275	$95	$370	$65.90	$37	($2,088)	$0	($2,088)

Regional Impacts of HB247

Cook Inlet

- Complete phase-out of NOL, QCE, and WLE by 2018
- Extends “tax caps” on gas indefinitely and adds a $1 / bbl “tax cap” on oil
- Municipal utility pro-ration of costs

Middle Earth

- Reduces the NOL, QCE, and WLE credit rates
- Extends “Frontier Basin” exploration credit for one year to July 2017

North Slope

- GVR “Graduation” provision after three to seven years
- GVR can’t be used to increase an NOL

Statewide

- $70 million per company per year cap ($61 with discount)
- Interest rates increased for 3 years, then drops to zero
- Transparency, local hire, state obligation offsets, surety bond

Fiscal Impact of HB247

Revenue

- $0 to $25 million <u>increase</u> through FY21 due to loss of Cook Inlet credits used against tax liability, plus new $1 / bbl oil tax
- $40 to $115 million <u>tax cut</u> beginning FY22 due to above combined with up to $20 million from sunset of GVR tax break, but offset by extension of Cook Inlet gas tax caps

Spending

- Full impact of credit cuts won’t be seen until FY19
- Annual <u>savings</u> $65 to $115 million. Largest portion is Cook Inlet cuts, less from the per-company cap and the fix to the GVR / NOL interaction issue

Original HB247 Components Not Passed

- Minimum tax increase to 5%
- Floor “hardening” against various credits
- Per-barrel credit migration (“true up”) issue
- GVPP cannot go below zero for a field
- Restrict repurchase to companies with < $10 billion revenue and sunset NOLs after 10 years
- Interest rate increase limited to three years, and then reduced to below current rate after that

House-Passed HB247 Components Not Passed

(in addition to components of Governor's original bill)

- Cash payments limited to companies with less than 15,000 bbl / day
- NOL credit rate ramps down to 25%
- No NOLs earned by companies with production over 15,000 bbl / day
- Cook Inlet tax cap sunset moved up to 2019
- ARM Board alternative purchase option

Major Features of SB5005

1. North Slope Operating Loss (NOL) credit phased out: 35% today to 15% in 2017 and zero in 2018
   - Effectively sets a tax rate that can't go below zero for non-profitable companies
   - Impacts major producers by preventing credits from carrying forward, indirectly "hardening" the minimum tax floor
   - Impacts independents by eliminating credits earned during the development stage prior to a company's profitability

New language not in any version of HB247

Major Features of SB5005

2. Reduces eligibility for cash credits from 50,000 bbl / day to 15,000

   Was in House-passed HB247

3. Minimum tax increased to 5% when the price of oil is greater than $55 / bbl
   - Current 4% rate is at all prices above $25; would remain in effect between $25 and $55
   - Current “crossover” between minimum tax and SB21 profits tax is about $75-$80 / bbl

   Gov orig. bill had a 5% minimum tax at all prices. House-passed HB247 had a 5% minimum above $65

Major Features of SB5005

4. "Migrating Credits" fix preventing per-barrel credits from being used in another month than the month they were earned
   - Important volatility protection for the state

   In both the Gov. Orig. and House versions of HB247

5. Gross Value at the Points of Production can't go below zero for a lease or property
   - Protects the state from effective negative taxation at high-transportation cost fields

   In both the Gov. Orig. and House versions of HB247

Major Features of SB5005

6. Interest Rate on delinquent taxes changed from HB247 amendments
   - Change from 7% + Fed compounding, for three years and then zero after that; to 5% + Fed compounding, for four years and 5% + Fed, with simple interest after that
   - Substantial concern that zero interest rate will make it difficult to settle tax cases. Also it may kick in immediately even if a delinquency has paid only the 3%-4% “SB21” rate for three years
   - Changes applied to all taxes rather than carving out the O&G Production Tax

Language was in House-passed HB247

Major Features of SB5005

7. Technical correction to Sec. 30 of HB247. Fixes error in the municipal entity / only a portion of production is sold / proration of costs issue.

New language

8. Allows for seismic and geophysical data to be released in less than 10 years if the lease for which the data was acquired is terminated.

New language

Implementation Cost

- The changes anticipated in this bill will require additional 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
- The fiscal note from HB247 included $1.2 million in capital funds for this purpose
- We are not requesting any additional funds with this bill
- We do not anticipate any additional costs to administer the tax program
- We are beginning the scoping process for the major regulatory changes to implement HB247

Sectional Analysis

Sec. 1. Amends interest rate language changes in Sec. 8 of HB247. Changes apply to all tax types. Rate is set at 5% over federal discount rate, compounding, for four years after a tax becomes delinquent, and 5% simple interest thereafter.

Sec. 2. Increases the minimum tax rate in AS 43.55.011(f) to 5% at oil prices greater than $55. Currently it is 4% at any oil price above $25 per barrel, stepping down at lower prices. The minimum tax applies only to production from the North Slope.

Sec. 3. Changes the description of monthly installment payments in AS 43.55.020(a), to conform with the higher minimum tax rate in Sec. 2. and the per-barrel credit monthly calculation in Sec. 6. *(long technical section).*

Sec. 4. Conforming change related to underpayments caused by a regulation change.

Sectional Analysis (continued)

Sec. 5. Modifies the carried-forward annual loss credit (NOL) in AS 43.55.023(b) so that the North Slope rate is reduced from 35% to 15% in 2017, and to zero thereafter.

Sec. 6. Modifies the calculation of the per-taxable barrel credit for North Slope production, so that the credits claimed against production taxes in a given month cannot exceed the credits earned in that month.

Sec. 7. Allows for seismic and geophysical data to be released in less than 10 years if the lease for which the data was acquired is terminated.

Sec. 8. Reduces the threshold for a company to eligible for cash repurchase of tax credits from 50,000 bbl / day to 15,000 bbl / day.

Sectional Analysis (continued)

Sec. 9. New section specifying that the Gross Value at the Point of Production, defined as sales price less eligible transportation costs, may not be less than zero

Sec. 10. Technical correction to Sec. 30 of HB247. This section fixed the circumstance in which a municipal entity has an interest in oil and gas production, and sells only a portion of that production to an outside party, ensuring that their ability to deduct lease expenditures and claim credits is limited in proportion to their taxable production.

Sec. 11. Applicability language related to data sharing changes in Sec. 7.

Sec. 12. Applicability language related to interest rate changes in Sec. 1. and company size threshold in Sec. 8.

Sectional Analysis (continued)

Sec. 13-14. Transition language enabling DOR and DNR to draft regulations to implement the changes in this Act, and establishing that regulations may be retroactive to the effective date if they are finalized after the effective date.

Sec. 15. Immediate effective date for the data sharing, transition and regulatory language.

Sec. 16-21. Effective dates maintained for changes to sections that were also amended in HB247 (Sec. 1, 3, 5, 6, 8, and 10).

Sec. 22. Effective date of January 1, 2017 for the rest of the Act (limited to the minimum tax change in Sec. 2).

NEW SUSTAINABLE ALASKA PLAN

Pulling Together to Build Our Future

Thank You!

Contact Information

Randall Hoffbeck
Commissioner
Department of Revenue
Randall.Hoffbeck@Alaska.gov
(907) 465-2300

Ken Alper
Director, Tax Division
Department of Revenue
Ken.Alper@Alaska.gov
(907) 465-8221