

Technical Aspects of CS for HB 308 (Version E)

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House Resources Committee

Feb 8, 2010

6 Changes in CSHB 308

- Interest rate is lower of fed funds +2 or 11%
- Interest not due on retroactive regs changes prior to implementation
- Change progressivity from .4% to .2%
- Tax rate tied to resident hire
- 30% credit for well work
- Restore 3 year statute of limitations

Structure of CS for HB 308

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26-LS1328/E

Key Provision

Need
2011

section:	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	Eff Dt
Interest rate is lower of fed funds + 2 or 11%						6																			25	
Interest not due on retroactive regs changes prior to implementation						7								14											25	
Change progressivity from .4 % to .2 %											11													24		
Housekeeping - reference to interest	1				5	6		8	9	10		12	13			16		18	19		21	22			25	
Tax rate tied to Resident hire		2	3	4											15			18					23		25	
30% credit for well work																	17							24		
Restore 3 year statute of limitations																				20					25	

6 Changes in CSHB 308

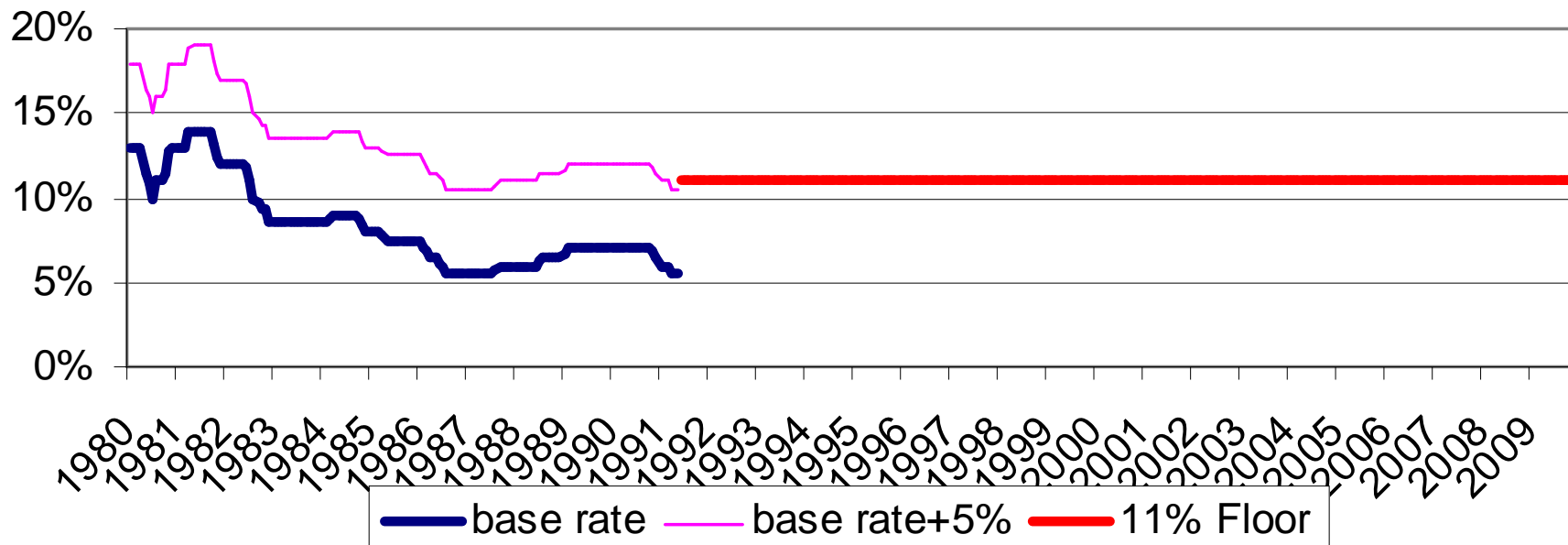
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Interest rate in AS 43.05.225

- Proposed interest would be lower of fed funds rate + 2 or 11%(section 6)
- The interest rate applies to all 20 Alaska Tax Types*
- Current law – higher of fed funds + 5 or 11%
- Also applies to late royalty payments.
- **Compounded** Quarterly
- Effective date should be end of year, or at the very least, quarter.
- Implemented in 1991 amidst settlement of major production tax and royalty litigation going back to 1977 and era of simple interest.

Interest Rates: The view from June 1991

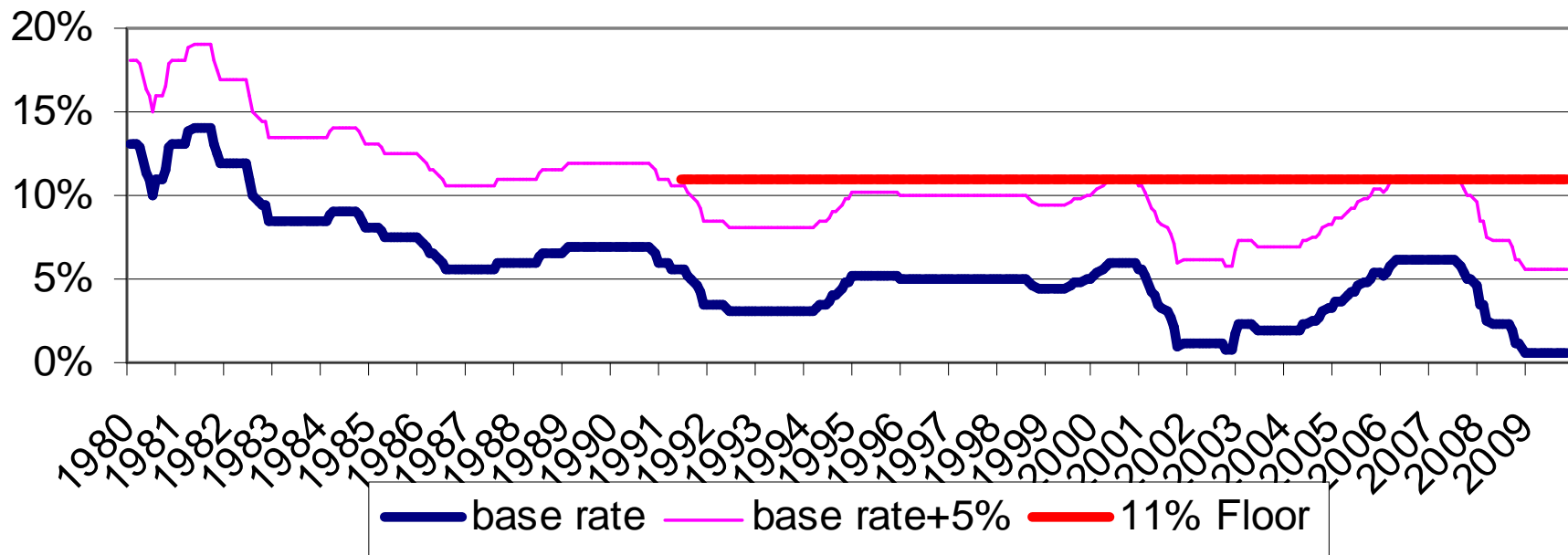
Rate charged member banks by the 12th Federal Reserve District 1980 - June 1991



Source: Federal Reserve Bank of San Francisco (frbsf.org)

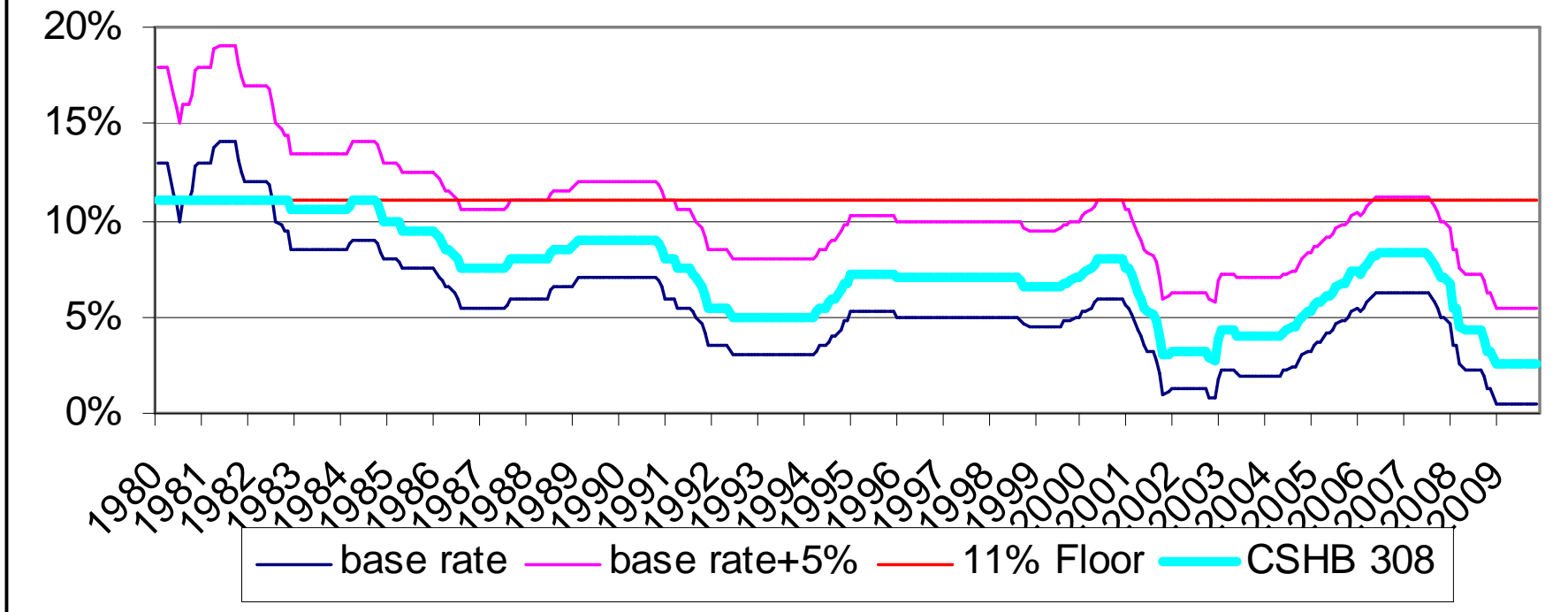
Interest Rates – The 11% floor since 1991

Rate charged member banks by the 12th Federal Reserve District 1980 - 2010



Looking back: What would the rate have been under CS HB 308

Rate charged member banks by the 12th Federal Reserve District



Alaska compared with federal rate

- How are federal interest rates computed under IRC:

	Over Payments of Tax	Under Payments of Tax
Non- Corporate	Fed Funds + 3%	Fed Funds + 3%
Corporate	Fed Funds + 2%	Fed Funds + 3%
Corporate - Large	Fed Funds + ½%	Fed Funds + 5%

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Governor Parnell's Proposal vs. HB 308

Governor Parnell press release January 14 2010:

“Allow for the waiver of interest charges on late payments due to the retroactive application of new regulations.”

CS HB 308 mandates that interest will not accrue on “an increase in tax liability that is the direct result of the adoption of regulation with retroactive application” until 30 days after the effective date of the regulation.

(section 7)

How is interest calculated?

- Production Tax is due on last day of the month following the month of production (AS 43.55.020 (a)).
- Amount of tax due change because of because of audit, revised reporting by taxpayer, retroactive revision of tariff due to a regulatory order in a rate case, retroactive change in regulations.
- Interest is charged back to when original tax is due.
- In a settlement Department can compromise amount of tax and amount of Penalty. (AS 43.55.070) – No mention of interest.

Regulations required retroactive to July 2007*

- In 2007 reforms (“ACES”) Department charged with a number of specific responsibilities for regulations, as well as general implementation.
 - AS 43.55.150 “the department shall determine the reasonable cost of transportation, using the fair market value of like transportation, the fair market value of equally efficient and available modes of transportation **or other reasonable methods.**”
 - AS 43.55.165(a) “**...a producer’s lease expenditures for a calendar year are ... costs ...allowed by the department by regulation...**”
 - Production tax is a yearly tax – however, effective dates of most of 2007 reform was July 1, 2007, so ways of combining two half years had to be implemented.
 - New reporting requirements (AS 43.55.030 & .040)
 - *New rules for exploration credits (AS 43.55.025)

Status of Regulations Affecting Returns after July 2007

	Discussion Draft				Public Comment Draft		Adopted
	1	2	3	4	1	2	
Project One - Reporting Requirement							
15 AAC 55. 520 Reporting					Feb-08		May '08 effective as of June '08
Project Two - NS PV, Civil Penalties, Mid Year Statutory Changes, CI reporting							
35 sections	Feb-08	Oct-08	Nov-08		Apr-08	Sep-08	Sep '09 effective as of Oct '09
Project Three - Exploration Credits							
6 sections					Aug-08	Jun-09	Nov '09 effective as of Dec '09
Project Four - Lease Expenditures							
10 Sections	Jan-08	Mar-08	Sep-08				Jan '10 effective as of Feb '10
Project Five - Reasonable Transportation							
5 sections	Mar-08	May-08	Jan-09				
6. Other Projects							
15 AAC 55. 173 NS Gas PV	Feb-08				Apr-08		Aug '08 effective as of Oct 1 '08
Facility Sharing	Oct-08	Nov-08	Feb-09	Jul-09			
Credit Safeguards	Nov-08						
"Affiliated" definition	Jan-09						
PV of oil					Jan-10		

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What is Progressivity?

- Base Production Tax rate is 25% (AS 43.55.011(e))
 - Combined Progressivity Tax (on same base) can range from 0 to 50%
 - Sum= Total tax rate can range from 25% to 75%
 - Progressivity rate is calculated as net value of all the (oil and gas produced less royalty)/taxable barrels (boe)= PTV/per barrel
 - No progressivity charge when PTV/bbl < \$30,
 - Current Law:
 - For each dollar above \$30, .4% added to tax rate
 - At PTV/bbl of \$92.5, rate drops to .1% for each dollar
- HB 308: drop rate to .2%, increase bend-over point to \$155 (Section 11)

Progressivity Effect

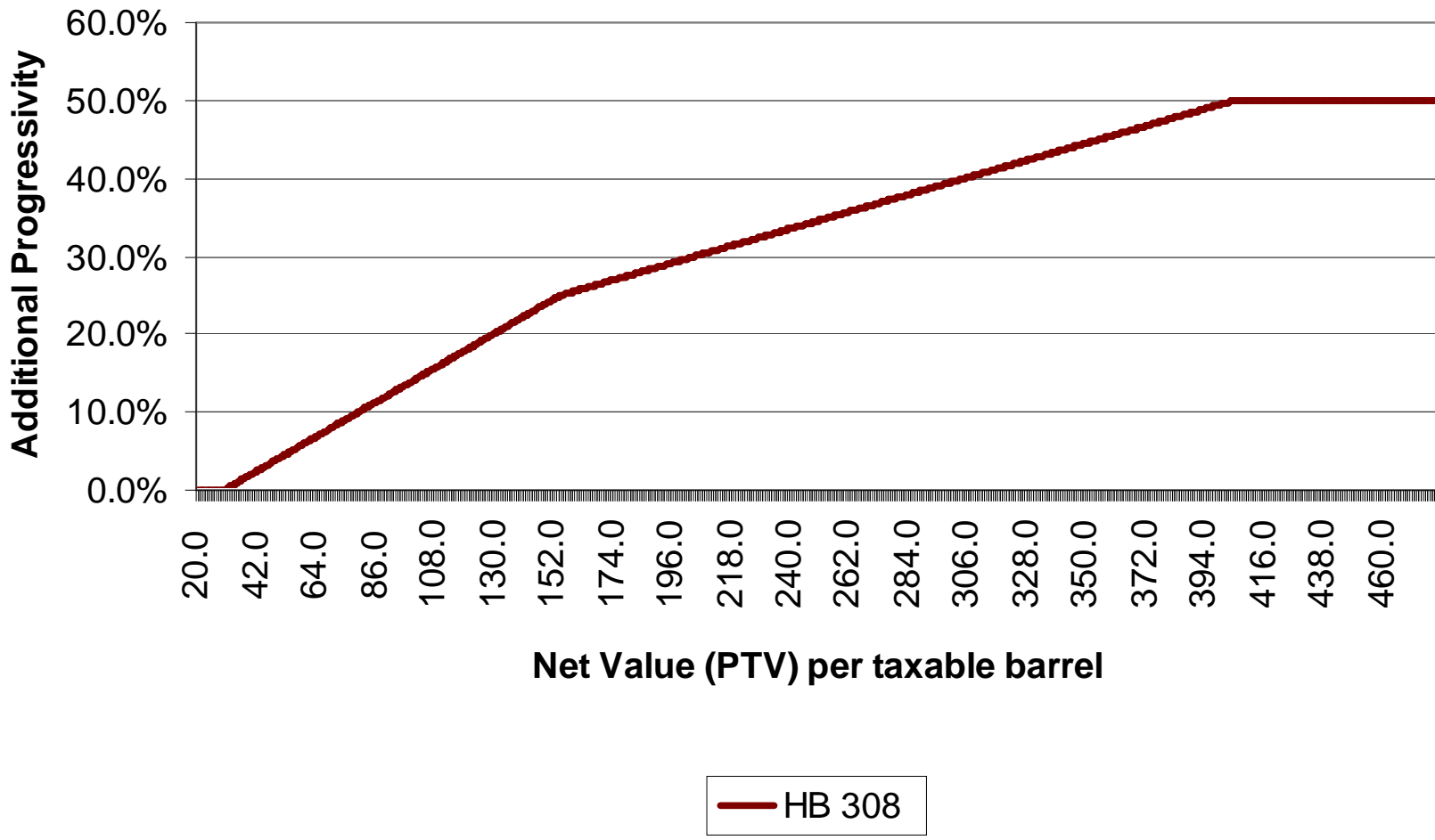
- FY 2008 Estimate (year of high prices)
- 25% Base tax – \$4.2 billion
- Progressivity – \$3.2 billion
- (less credits of \$.5 billion)

- Compare to FY 2008
- Royalties (2.4 to GF, .8 to PF) \$3.2 billion
- Oil and Gas Income Taxes \$.6 billion
- Oil and Gas Property Taxes (State and Local) \$.4 billion

Source: State of Alaska DOR Revenue Sources Book (Fall 2008)

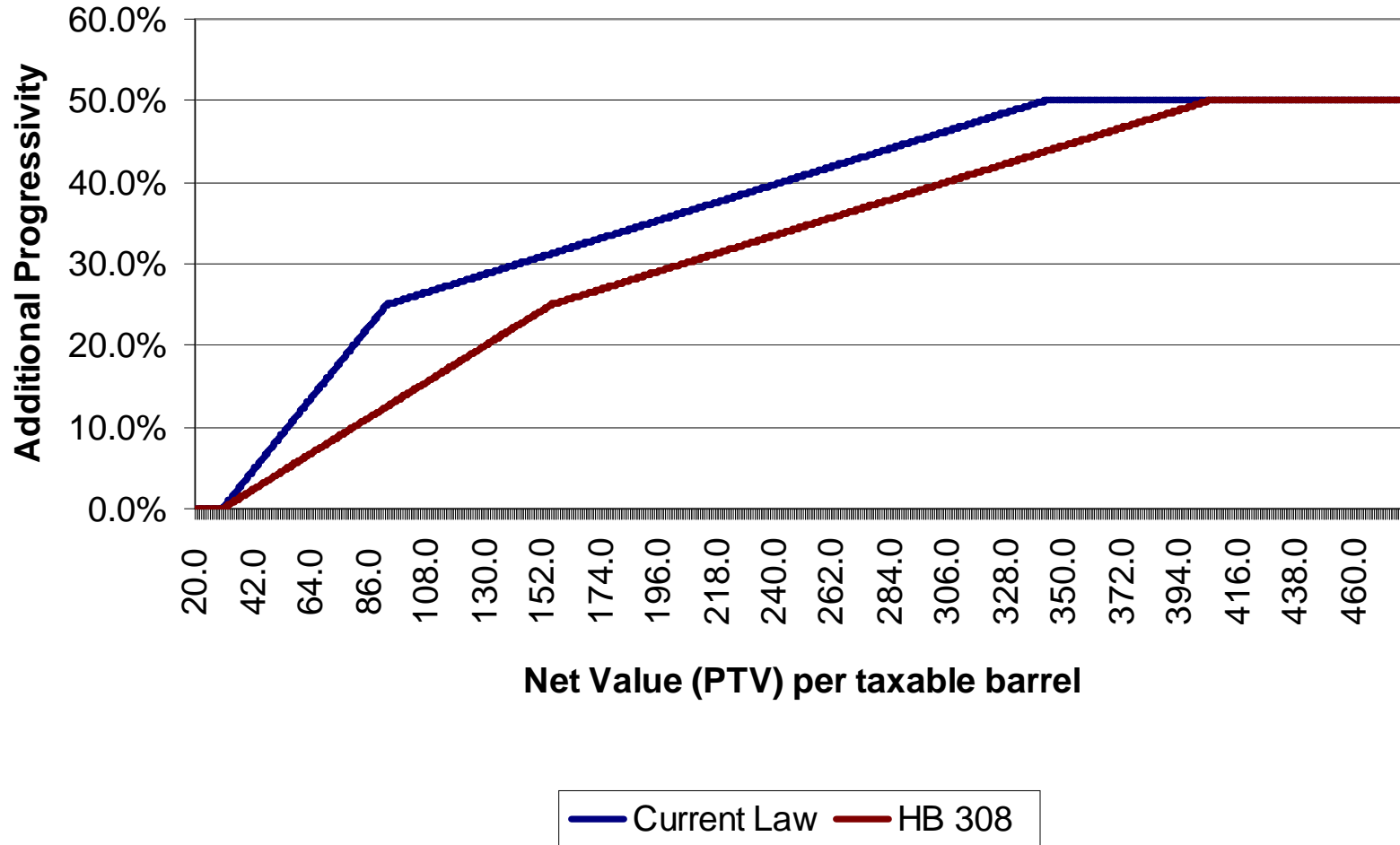
Progressivity Only

Nominal Progressivity Rate in HB 308



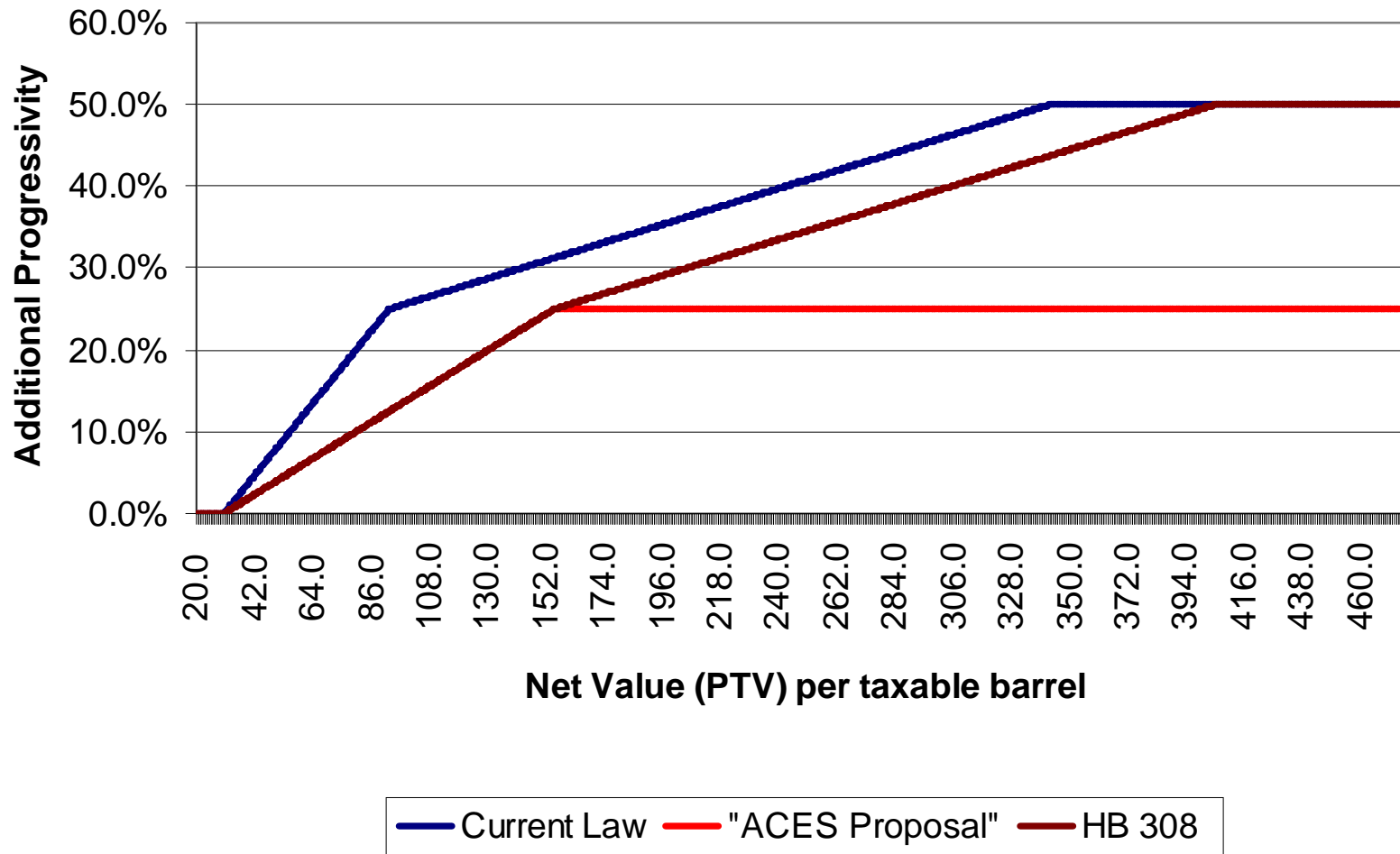
Progressivity Only

Comparison of Nominal Progressivity Rates in HB 308 and Current Law



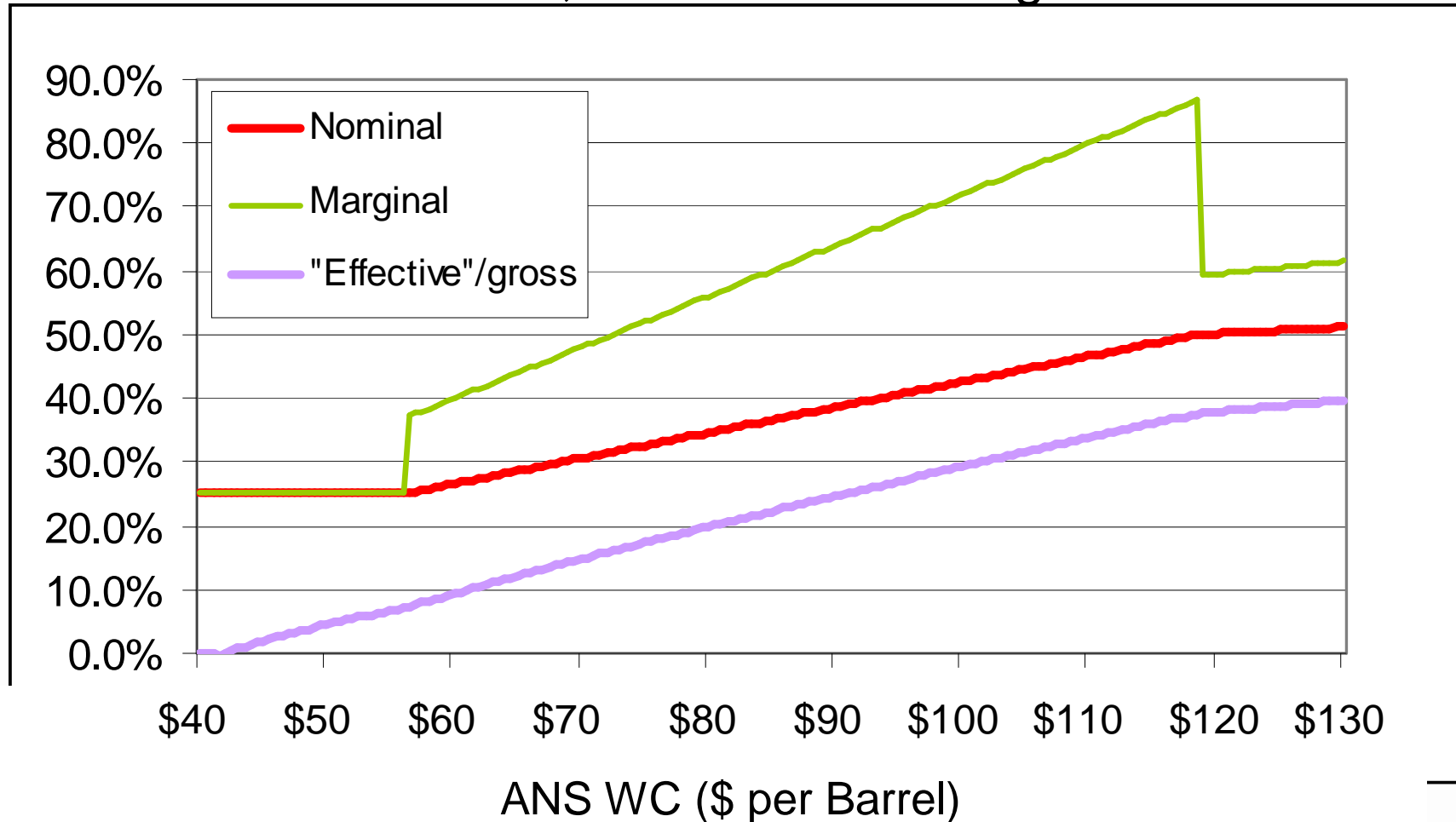
Progressivity Only

Comparison of Nominal Progressivity Rates in HB 308, Current Law, and Gov Palin's "ACES" Proposal



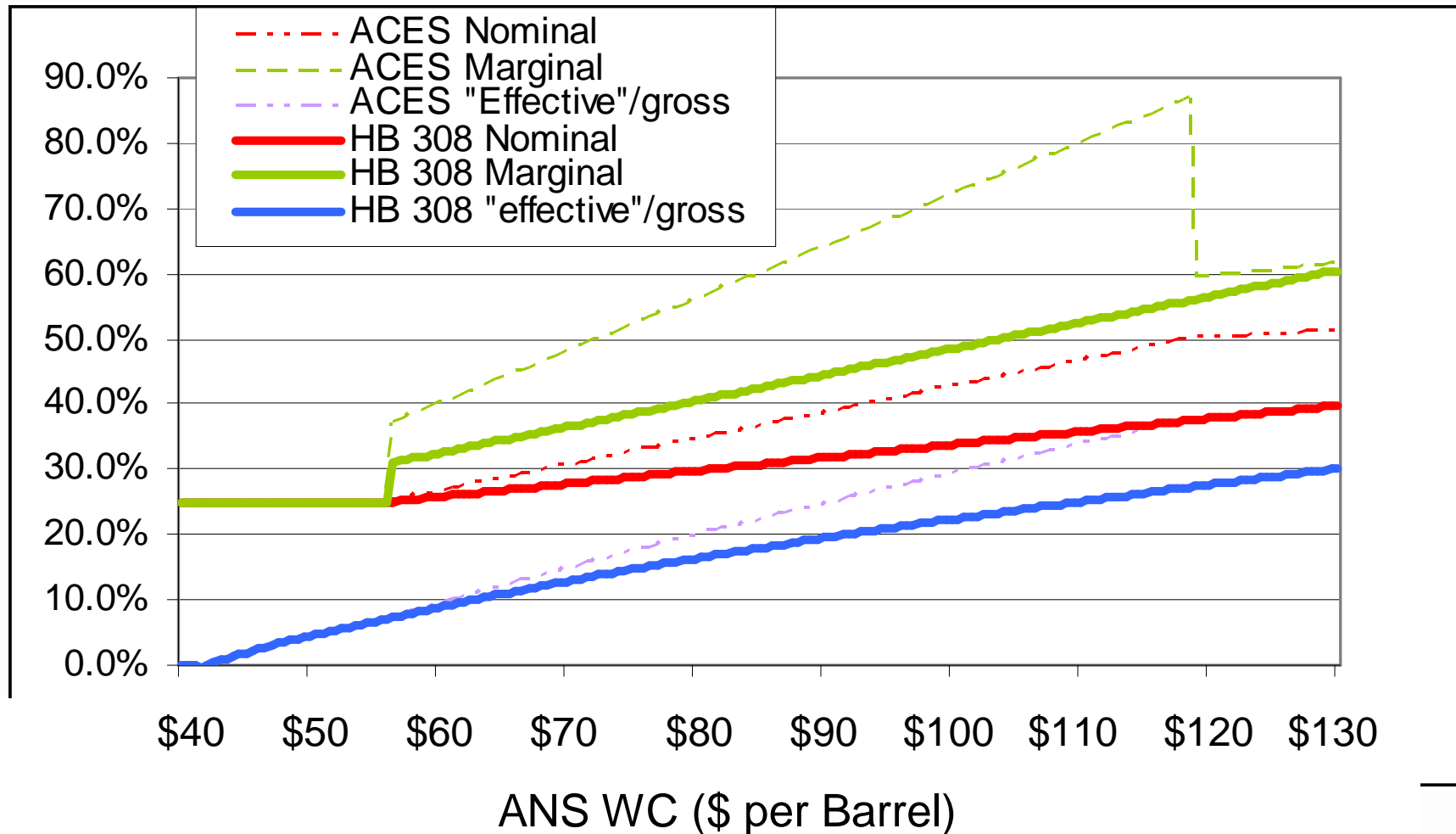
Production Tax: Progressivity + 25%

- Reproduction of Figure G from DOR January 14 Report
- “ACES Nominal, Effective and Marginal Rates”

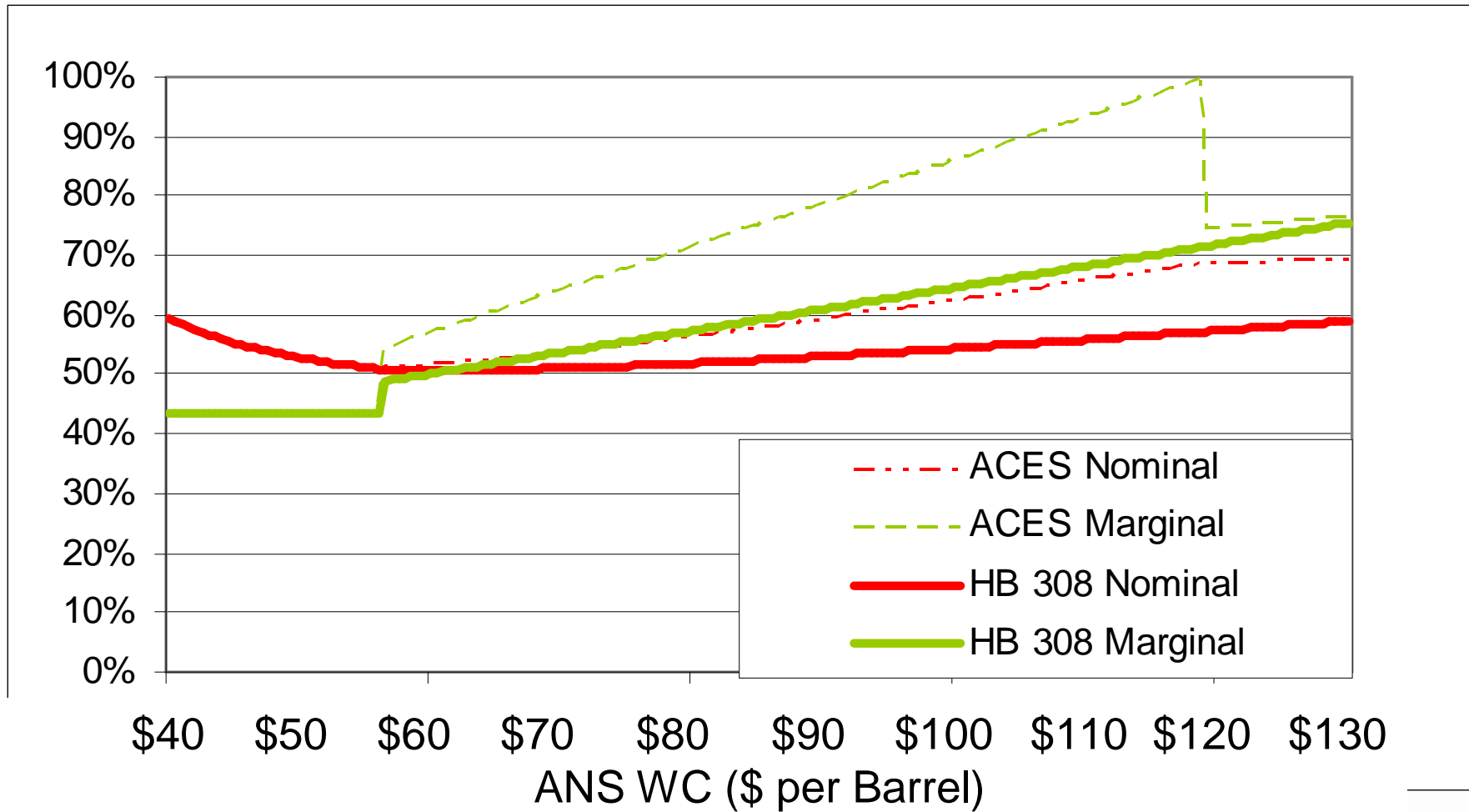


Production Tax: Progressivity + 25%

- Add HB 308 Nominal, Marginal and "effective"/gross

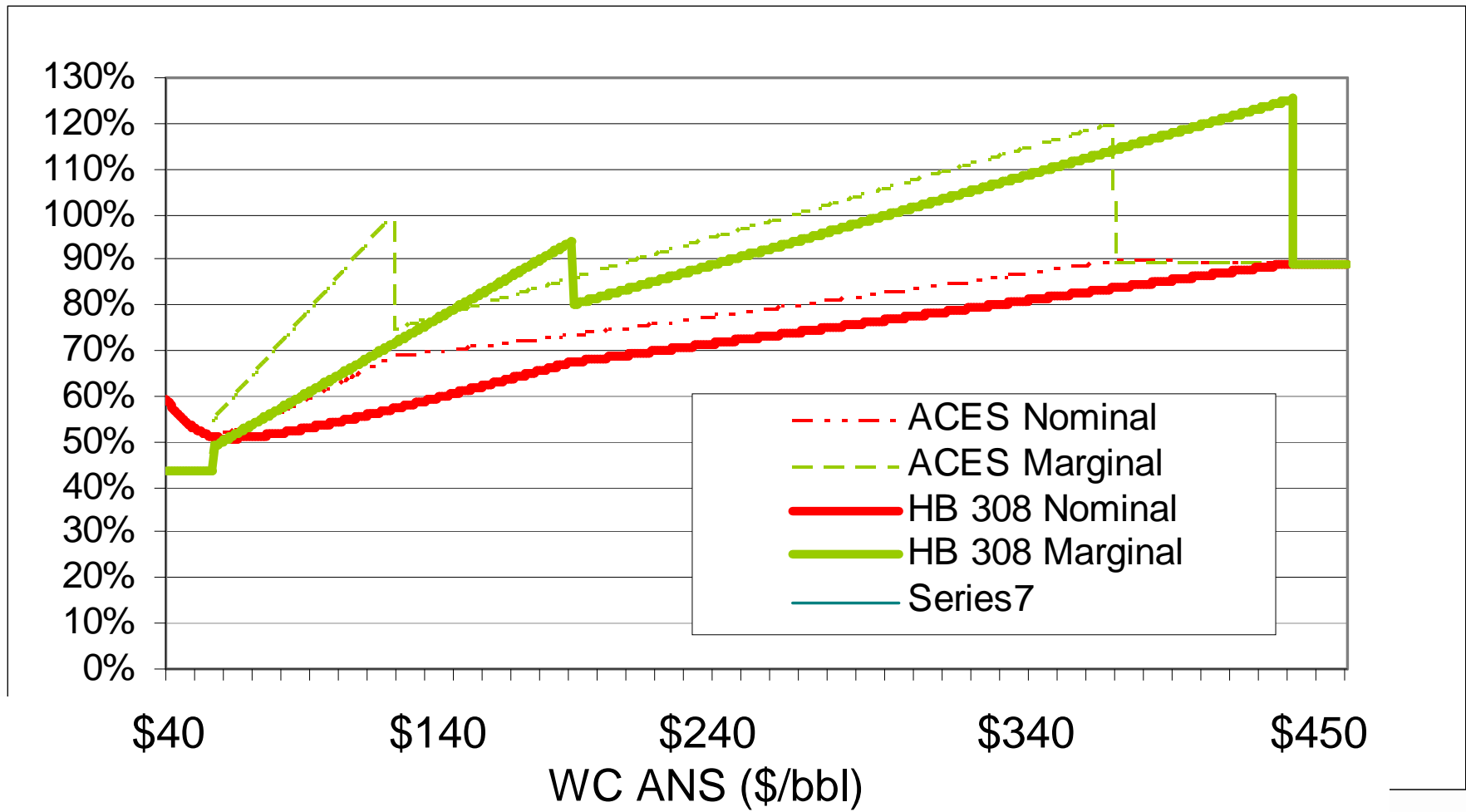


Total State of Alaska Take (Prod/Prop/Inc Tax + Royalty)



2.8.2010

Total State of Alaska Take (Prod/Prop/Inc Tax + Royalty)



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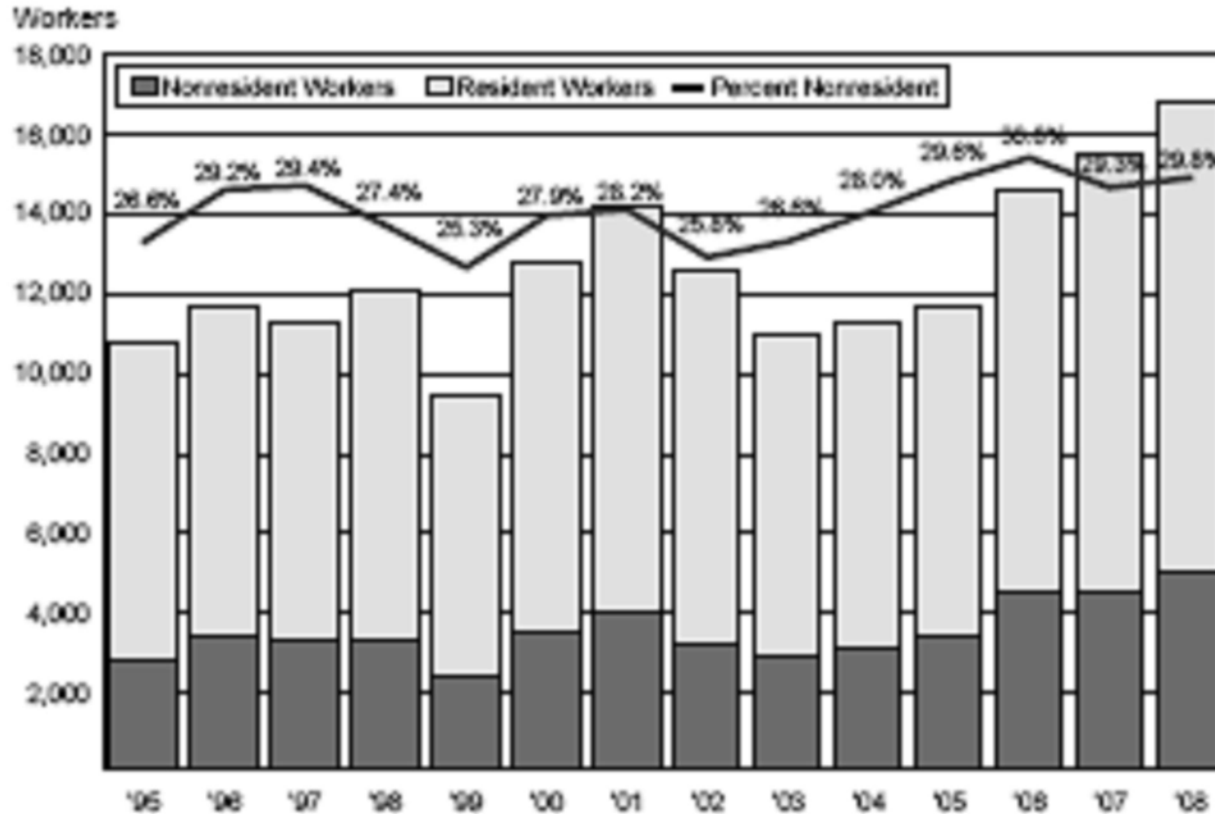
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Rate tied to Resident Hire

- General Approach – (section 15)
- Base Tax rate (in AS 43.55.011(e)) is 25%, and Taxpayers makes monthly payments at that rate
- Any direct labor that is a lease expenditure is accounted for as Resident or non-Resident.
- At the end of the year total hours of labor are used to calculate a ratio for the year: or resident hire %
- New effective rate is calculated:
 - 20% for a 100% Resident Hire ratio up to
 - 25% (current law) for an 80% Resident Hire ratio.
- Taxpayer can then apply for a rebate of the difference for the prior year.
- Note: effective date should be beginning of a year.

Non Resident Workers

6 Oil Industry Number and Percent Nonresident Workers Alaska 1995-2008



Note: Private Sector Only

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Source: Nonresidents Working in Alaska, 2008, State of Alaska, Dept of Labor and Workforce Development (Jan 2010) <http://www.labor.state.ak.us/research/reshire/nonres.pdf>

Details to be Addressed

- Main Issue – What level of detail required?
- All payments are either a return to capital, labor or land
- How far down ought a taxpayer to drill –
 - Can a module just be module, or is it comprised of labor and machinery?
 - And is the machinery just machinery or is comprised of labor and smaller components?
 - Does a fixed priced contract end the inquiry?
- Structure of Industry in Alaska:
 - Producers (taxpayers) have employees & hire
 - Operator who has employees & hires
 - Contractors, and buys “stuff”

Who are the Employers in the Oil and Gas Industry

- EM, BP and CP are largest taxpayers

Ranking in Top 100	Total Employees			Non Resident %
5 ASRC	2250	2499	Oil Field Services	24.1%
8 CH2MHill	1750	1999	Oil Field Services	35.5%
9 BP Exploration			Oil & Gas Extraction	27.7%
17 Conoco Phillips	1000	1249	Oil & Gas Extraction	20.7%
36 Nabors Alaska Drilling	500	749	Oil Field Services	
43 Schlumberger Technologies			Oil Field Services	30.5%
49 Udelhoven Oilfield System Services			Oil Field Services	30.5%
52 Peak Oilfield Service Company	250	499	Oil Field Services	26.8%
69 Norcon			Oil Field Services	23.2%
73 Chevron			Oil & Gas Extraction	
78 Halliburton			Oil Field Services	32.3%
95 Doyon Drilling			Oil Field Services	
Veritas Dgc Land Inc				47.9%
Baker Hughes Oilfield Operations Inc.				54.1%

NOTE: Does Not Include "Catering/Security", Engineering, Transportation, Communications, Construction

Sources: State of Alaska, Dept. of Labor and Workforce Development, 100 Largest Private Employers, 2008 (Alaska Economic Trends, July 2009), Nonresidents Working in Alaska, 2008 (Jan 2010)

Effect on Tax Receipts (for each 1% change in BPT)

	<u>PTV est.</u> (in Millions of Dollars)	<u>5%</u>
FY2008	\$ 16,837.7	\$ 841.9
FY2009	9,313.1	465.7
CY 2008 (Avg.)		<u>\$ 653.8</u>

Non Resident Workers in industry in 2008 5043

Direct cost for 100% compliance (\$mm) \$ 0.12964

Direct cost for 100% compliance (\$) \$ 129,639

Calculation of benefit to stay would be increase in local payroll, plus a multiplier effect.

Effect of 1% change in rate on tax (\$mm)

In This example (2008)		\$ 130.8
Using DOR forecasted prices	closer to	\$ 100.0

Sources: State of Alaska, Dept. of Labor and Workforce Development, Nonresidents Working in Alaska, 2008 (Jan 2010), derivations from figures in Dept of Revenue, Revenue Sources Book (Fall 2009)

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Investment Credits

- Section 17 adds 30% well work credit to investment credits
- Under Current Law –
- 30% Credit for exploration wells (AS 43.55.025)
- 40% Credit for seismic work outside of existing unit,
 - or exploration wells 25 miles from existing unit, and
 - 3 miles from any prior well (or with certification from DNR that it is for a new target in the Cook Inlet)
(AS 43.55.025)
- 20% Credit for any capital investment (AS 43.55.023(a))
- No change to Exploration Credits AS 43.55.025 under this bill

Investment Credits

- Credit (i) only available under one program and (i) has to otherwise qualify as lease expenditure:
- Proposed Change:
- **No change:** 30% Credit for exploration wells (AS 43.55.025)
- 20% Credit for any capital investment (AS 43.55.023(a))
 - **Would be boosted to 30% for well related capital**
- **Well related operational costs also eligible for 30%**
- **Costs include work for purposes of well “sidetracking, deepening, recompletions, workovers, injection, seismic**
- **-”up to the flange connecting the well head to the well line”**

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- Section 20 Restores statute of limitations to three years for production tax - time for the state to complete a production tax audit (or, agree to an extension with taxpayer or issue a blue sky assessment)
- Three year rule would begin with 2011 tax year
- Note: in the case of False or Fraudulent returns, or failure to file a return, may proceed “at any time”

- Prior to 2007, SOL was three years for all tax types under AS 43.05.260 –
- In 2007 production tax pulled out and extended to 6 years in AS 43.55.075

Thank You

Dan E. Dickinson CPA

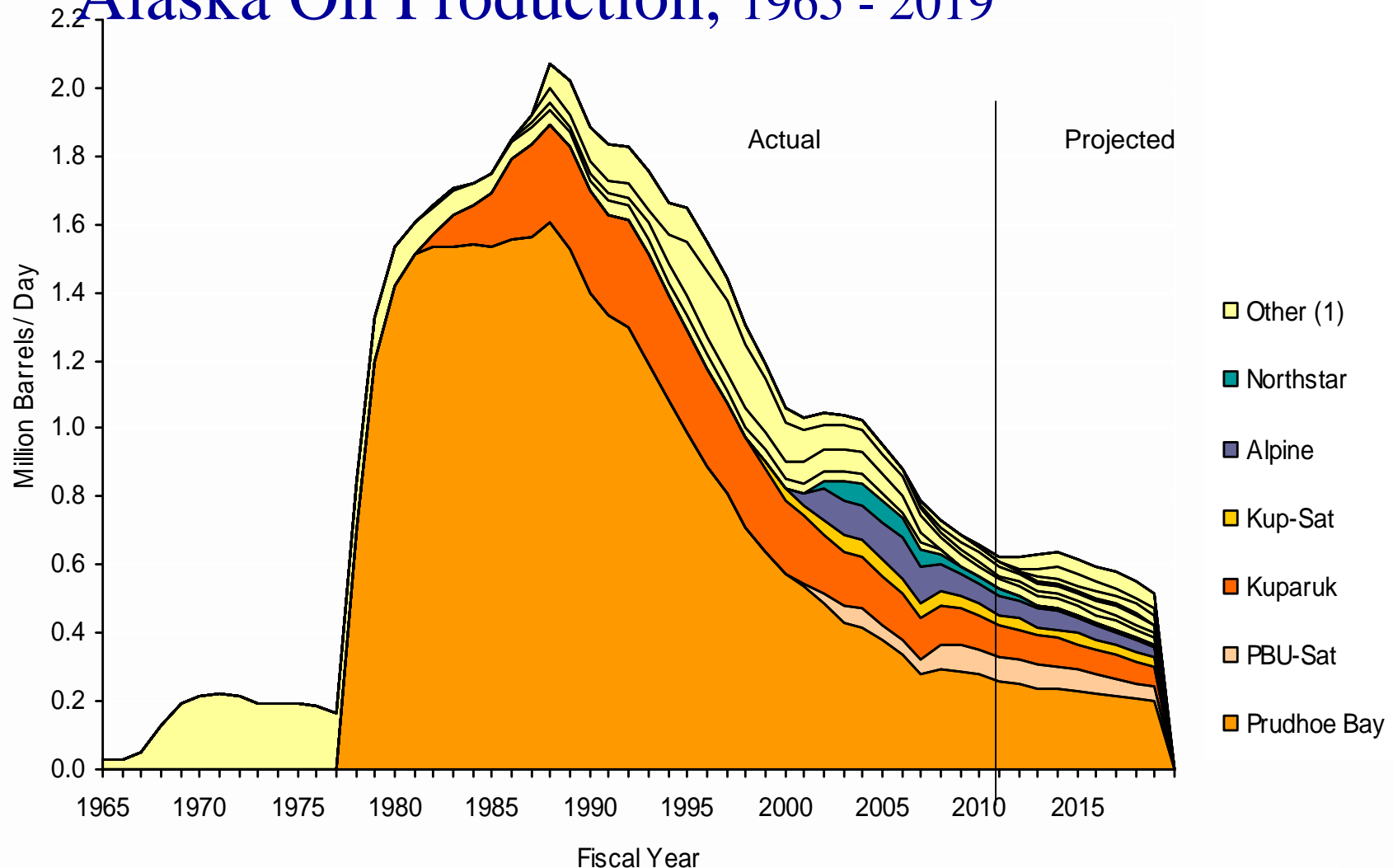
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<http://www.dedcpa.com/>

Alaska Oil Production, 1965 - 2019



Source: Alaska Department of Revenue, Fall 2009 Revenue Sources Book. Extrapolated
 (1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.