

Alaska's Production Tax – 2007 Special Session Update

Presentation to IAEE Anchorage

By

Dan E. Dickinson, CPA

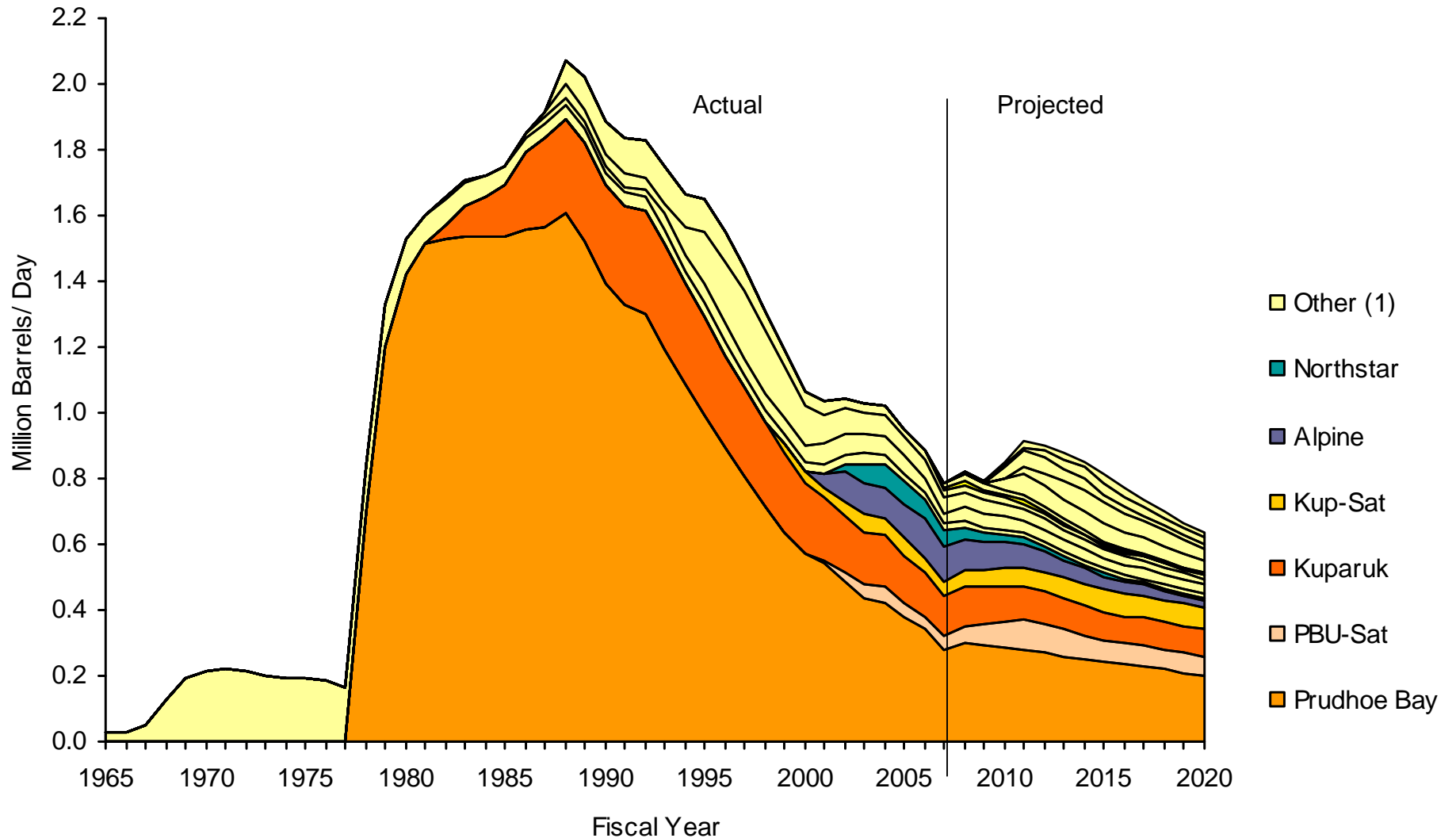
4 Themes

- Significant tax increase at current prices
 - Equitable share appears to be a range, not a point
- This tax is complex
 - Public data different from compliance
- Sea change in Juneau
 - Taxes vs. State Share/royalty
- This is just the beginning
 - Possible Implications for the future

Why was special session called?

- Cloud of corruption over prior legislation
- “Promises” of fiscal note not kept
 - Costs higher than anticipated
 - Note – FY 2007 revenues about as forecast due to offsetting estimating errors – Costs higher, Prices higher, volumes lower.
- Implication that taxpayers cut themselves a fat hog
- Concerns with Investment Climate

Alaska Oil Production, 1965 - 2020



Source: Alaska Department of Revenue, Fall 2006 Revenue Sources Book. extrapolated

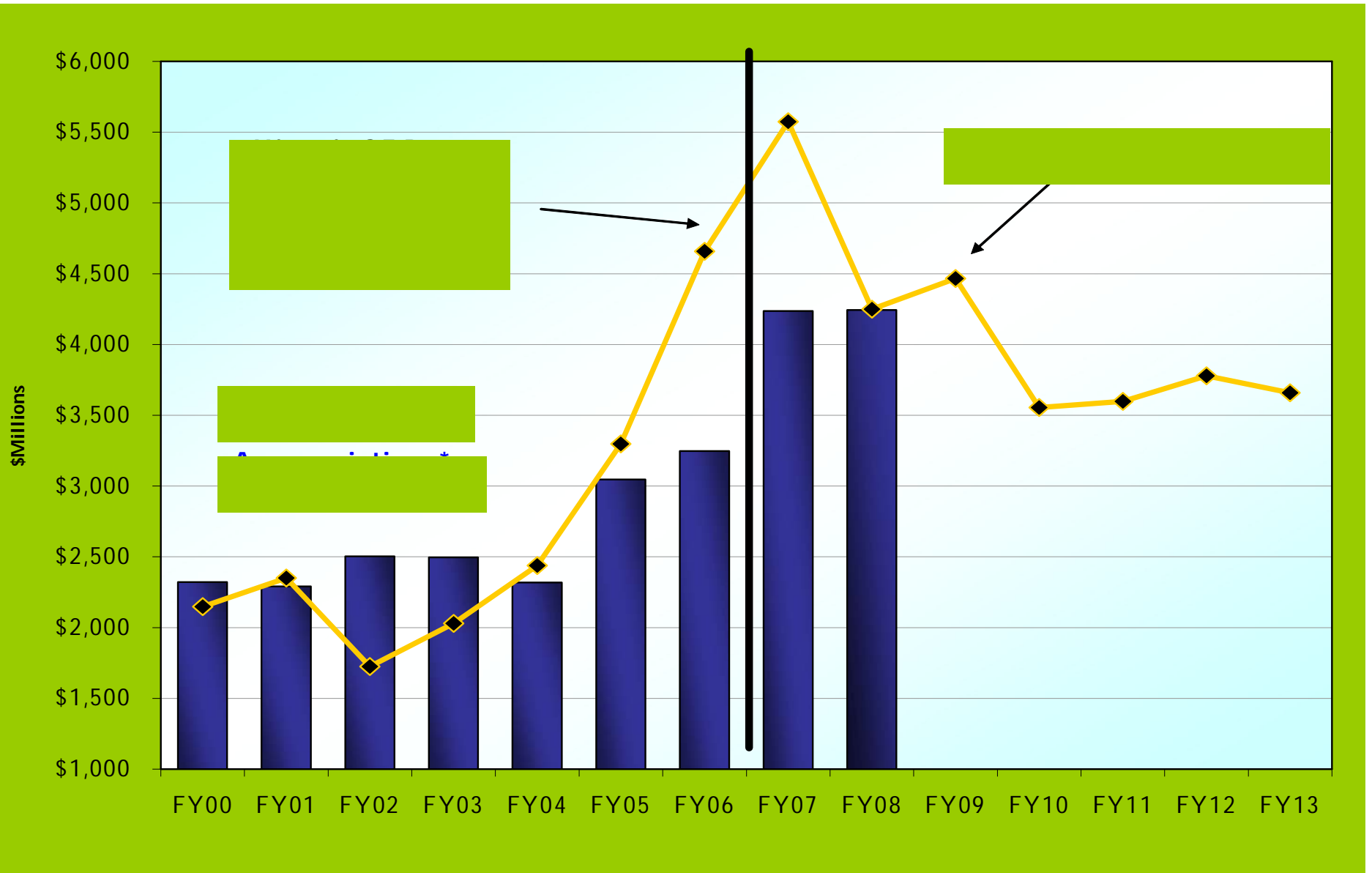
(1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.

12.14.2007

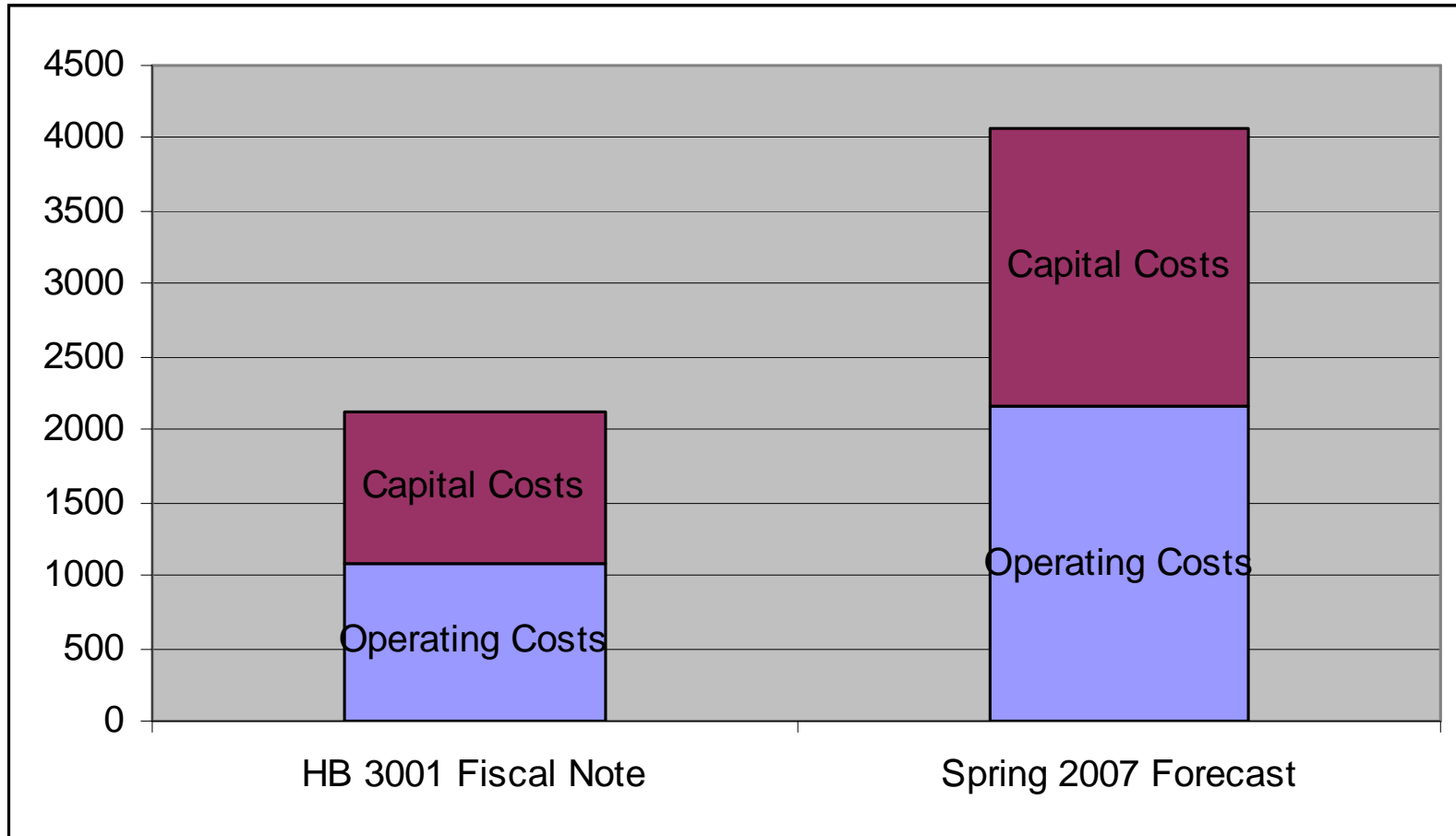
DATE E. DICKINSON Presentation to
IAEE

4

Increasing Costs



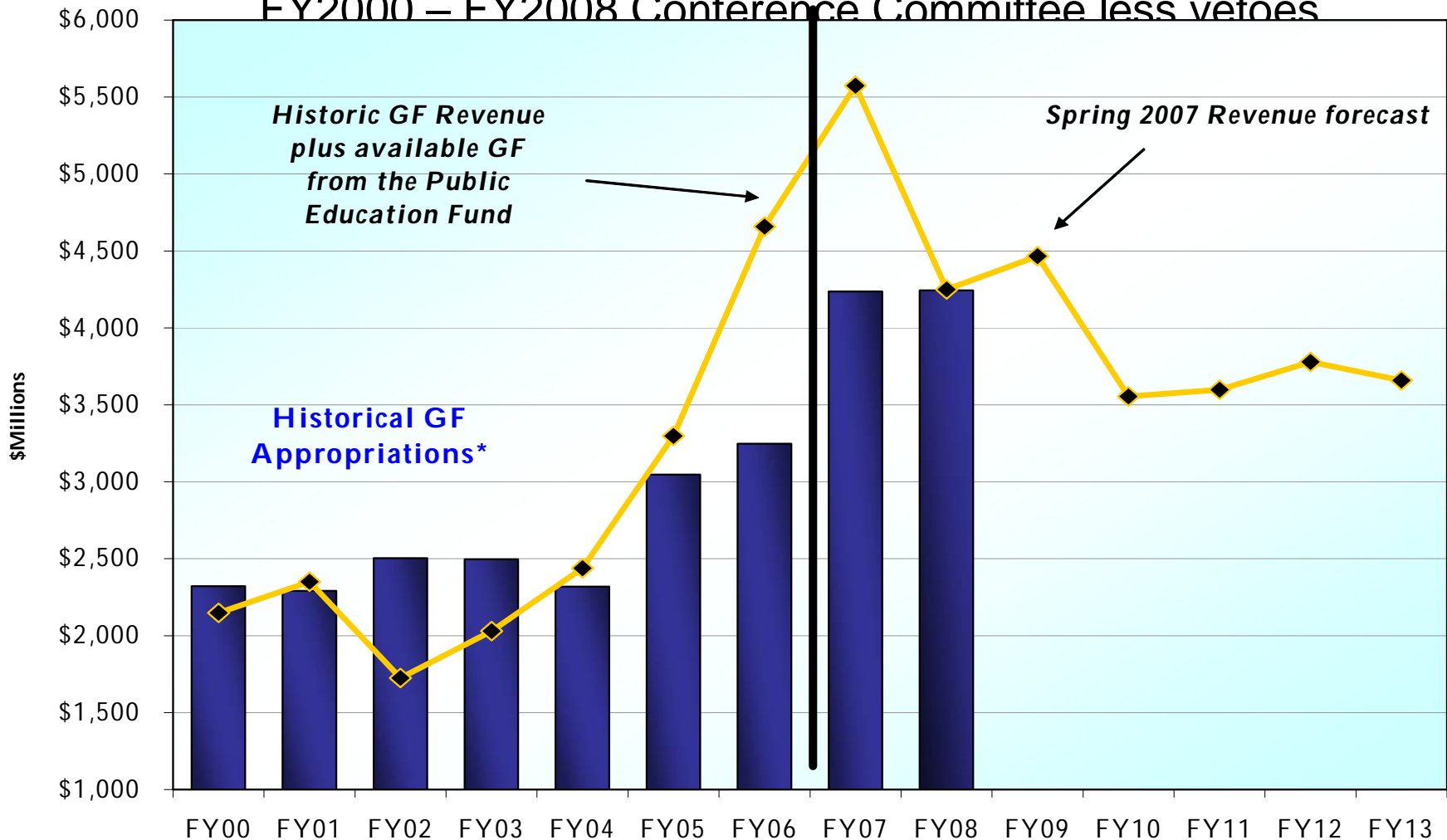
FY 2007 Operating Cost Assumption (\$millions)



Source: DOR August 3, 2007 report

General Fund Revenue including Public Education Fund versus Appropriations*

FY2000 – FY2008 Conference Committee less vetoes



*Excludes appropriations to Public education Fund and some other savings accounts. For example, FY07 excludes \$1.000 appropriation to Public Education Fund, \$182.7 million appropriation to Power Cost Equalization Endowment, \$50.0 million to CBR and estimated \$104.7 appropriation to the Alaska Capital Income Fund.

12.14.2007

Dan E. Dickinson Presentation to

CSHB 2001 (FIN) am

<i>Senate Bill</i>	<i>House Bill</i>
Resources	Oil and Gas
Judiciary	Resources
Finance	Finance
	Passed House 28/12
	Senate Finance
	Passed Senate 14/5/1
	House Concurred 26/13/1

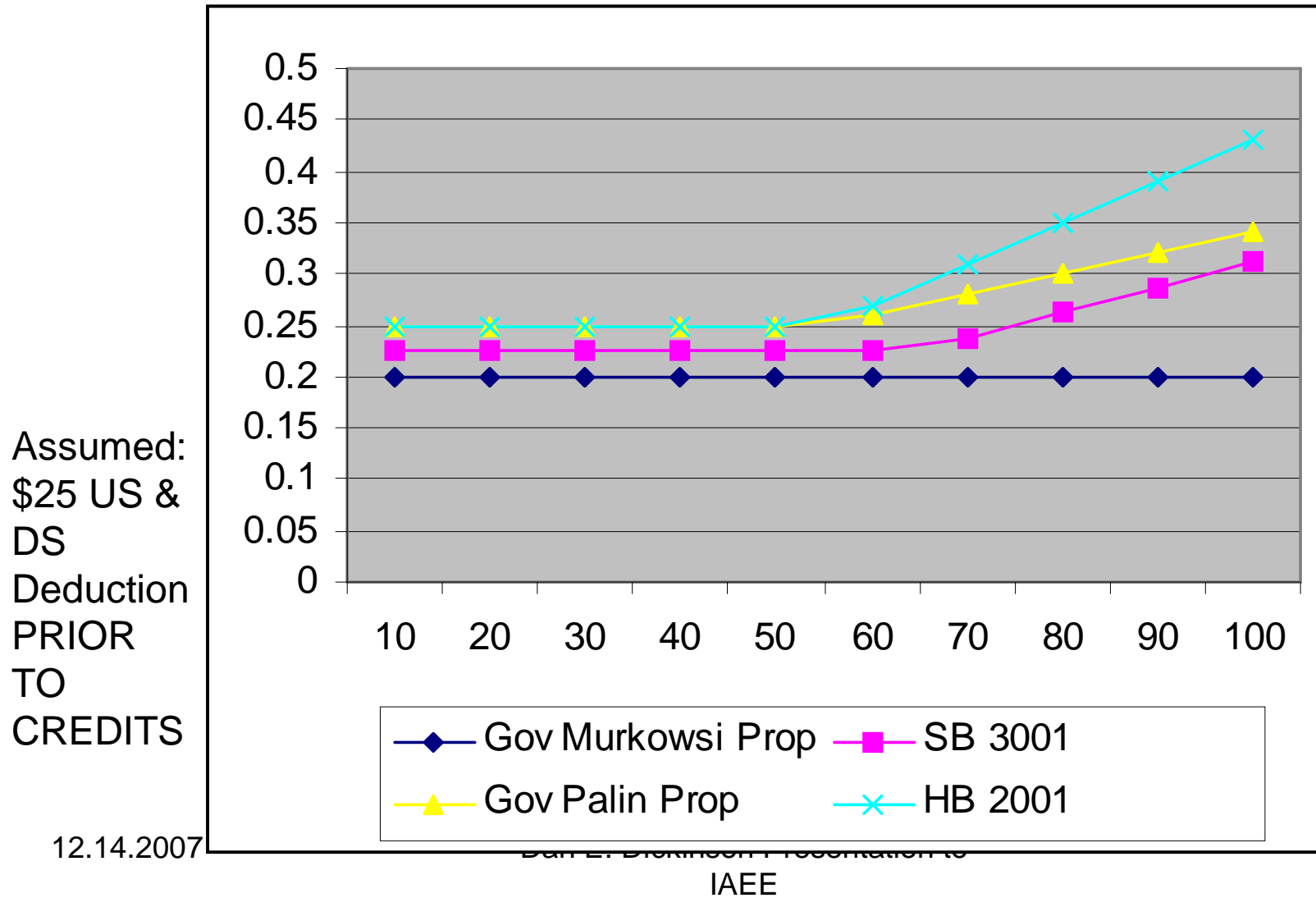
Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u>	<u>SB/HB 2001 (ACES) as introduced</u>	<u>CS HB 2001(FIN)am</u>
Base Rate			
	<i>AS 43.55.011 (e) & (g)</i>	<i>Bill Sections 15 & 17</i>	<i>Bill Sections 15</i>
Base Tax Rate	22.50%	25%	25%
Progressivity			
	<i>AS 43.55.011(g) & (h)</i>	<i>Bill Sections 17,18</i>	<i>Bill Sections 17</i>
\$/bbl Starting point	\$40 net	\$30 net	\$30 net
Tax/\$ of Price Index	0.25%	0.20%	0.40%
Average Value over	month	year	month
Cap	25% of net	25% of net	50% of net (flattens to .1% at \$92.5)
Gross Value Floor			
	<i>AS 43.55.011(f)</i>	<i>Bill Section 15, 16, 32-35, & 41-42</i>	<i>Bill Section 16, 32-35</i>
Base Rate	North Slope ranges from 0% to 4%	Prudhoe; Kuparuk 10%	North Slope ranges from 0% to 4%
Apply credits against floor?	.024 and .025	None	None
Gas Ceilings thru 2022			
	<i>AS 43.55.011</i>	<i>Bill Section 20, 55</i>	<i>Bill Section 20 & 21, 57</i>
Where	CI	CI	CI + gas used in the state
Interaction with credits	implicit	explicit importing from regs	explicit high-level statement of rules

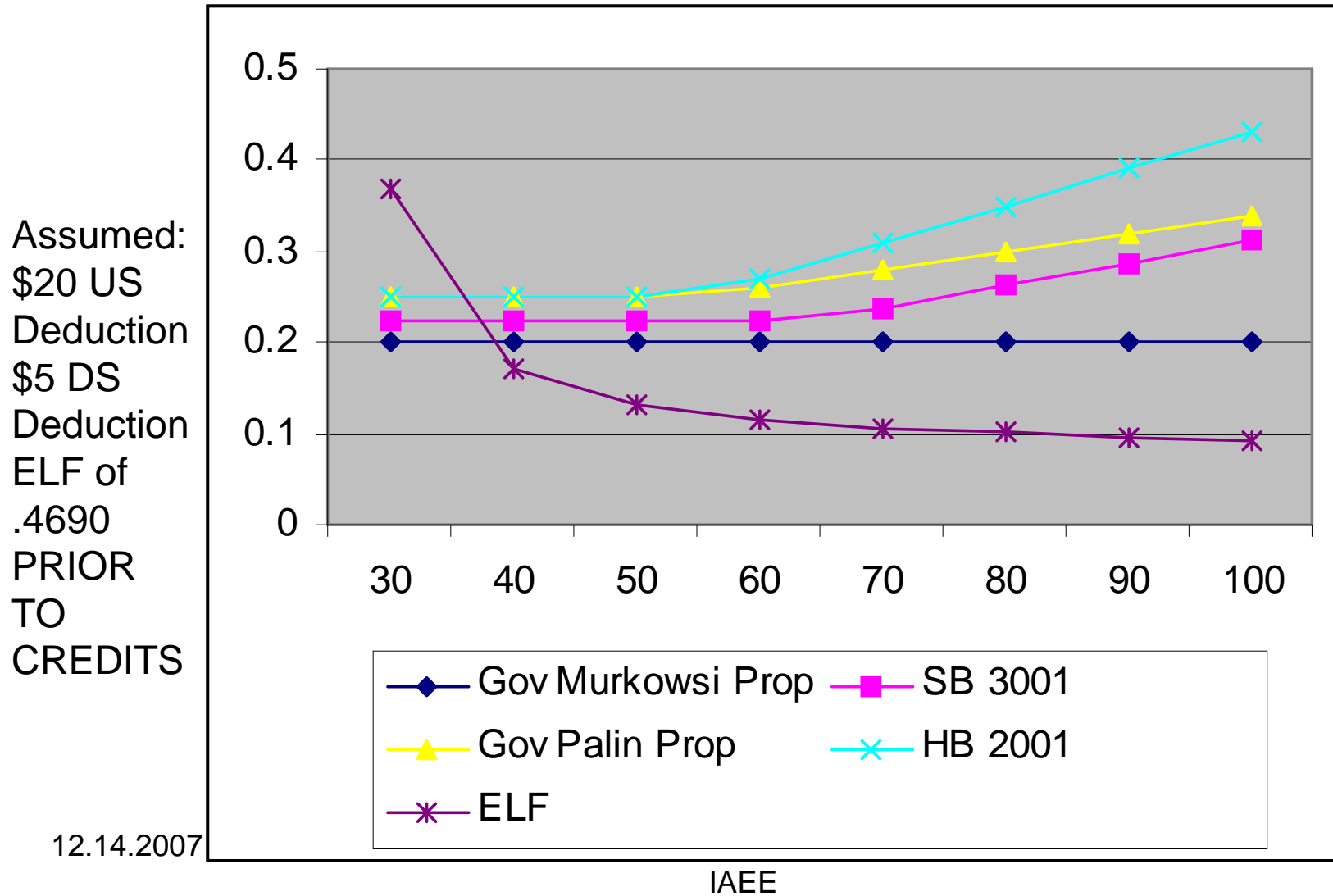
% Increase

	ACES		
	2006 Law	Proposal	2007 law
ANS West Coast/per barrel (Oct-Nov 07)	\$ 91.56	\$ 91.56	\$ 91.56
Total tax deductible costs/taxable bbl	25.00	25.00	25.00
"margin"/taxable barrel	<u>66.56</u>	<u>66.56</u>	<u>66.56</u>
Progressivity Starting point	40.00	30.00	30.00
Subject to Progressivity Tax	\$ 26.56	\$ 36.56	\$ 36.56
Progressivity Tax per dollar	<u>0.0025%</u>	<u>0.0020%</u>	<u>0.0040%</u>
Progressivity Rate	<u>0.0664%</u>	<u>0.0731%</u>	<u>0.1462%</u>
Percent increase @ these inputs		10.12%	120.24%
Tax Rate	22.5%	25.0%	25.0%
Percent increase @ these inputs		11.1%	11.1%

Proposed and Enacted Tax Rates on Net, 2006 -2007 per ANS WC Price

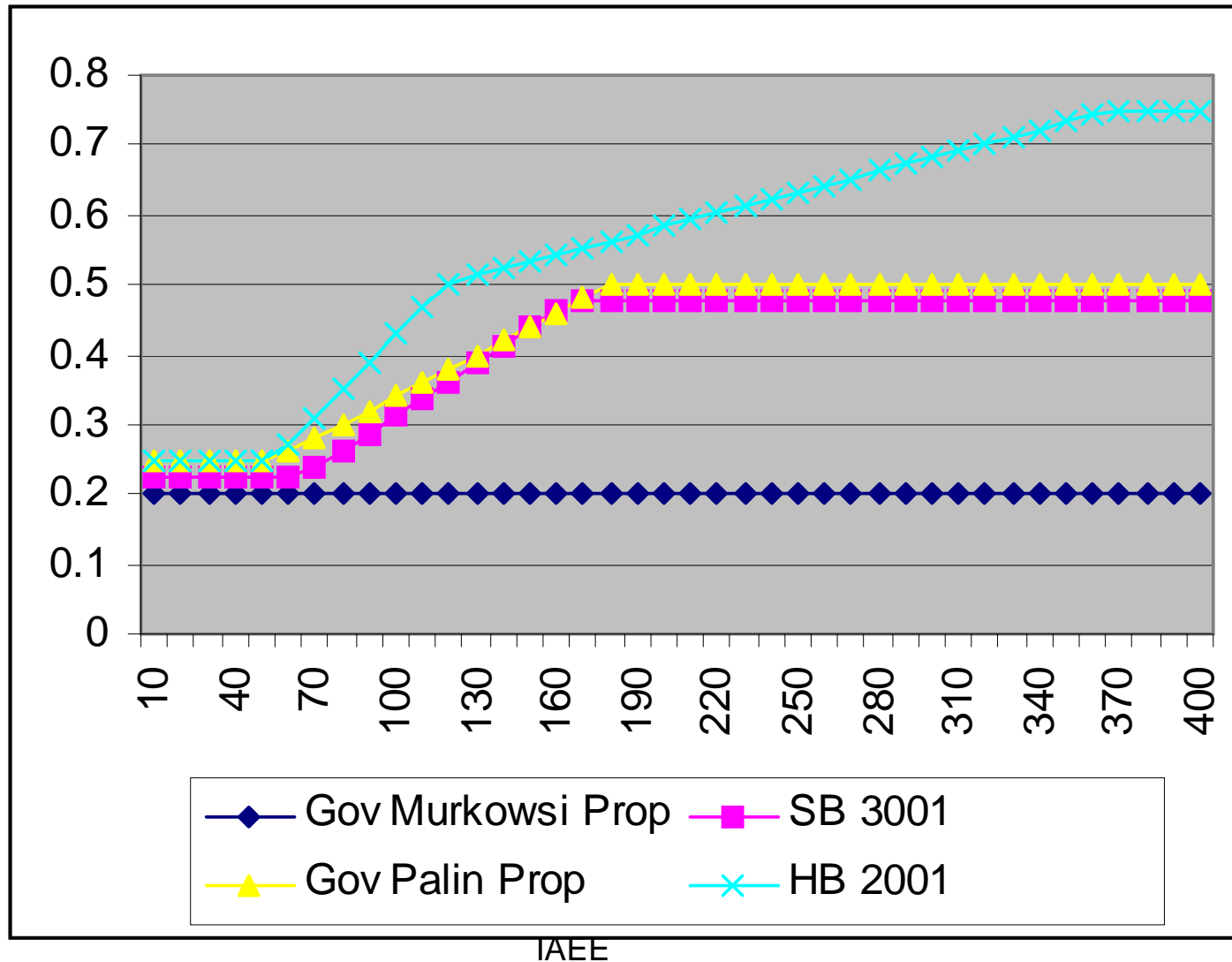


Proposed and Enacted Tax Rates on Net, 2006 -2007 per ANS WC Price



Proposed and Enacted Tax Rates on Net, 2006 -2007 per ANS WC Price

Assumed:
\$25 US &
DS
Deduction
PRIOR TO
CREDITS



12.14.2007

Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u>	<u>SB/HB 2001 (ACES) as introduced</u>	<u>CS HB 2001(FIN)am</u>
Investment Credits	AS 43.55.023	Bill Section 26-31,	Bill Section 25-31
Investment Credits	Taken in year of investment	1/2 in each of two years	1/2 in each of two years
Loss Carry Forward Credits	20%	25%	25%
Transitional Investment Credits	Yes	Not after January 1, 2008	All taxpayers allowed application of TIE matching spending in April 1 2006 - Dec 31, 2007, even if application deferred

Exploration Credits	AS 43.55.025	Bill Section 36 - 44	Bill Section 36-45
Rates	20; 40%	20; 40%	30;40%
General &Admin Costs	disallowed	bad acts I	costs arising from Bad Acts III - criminal
DNR approval required for .025 (c)?	In CI, to avoid 3 mile limit	Always	Always, w/ language changes
Confidentiality of well data	10 years	2 years	2 years, or if DNR declines to, or private landowner declines
Pre-existing well	One drilling season	Two consecutive drilling seasons	Two consecutive drilling seasons
"DNR TIE" Credits for pre 2003 seismic work?	no	5%	5%

Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u>	<u>SB/HB 2001 (ACES) as introduced</u>	<u>CS HB 2001(FIN)am</u>
Exceptions to Tax Credits			
		<i>Bill Section 31, 40</i>	<i>Bill Section 30,64</i>
Tax Exempt entities take credits?	silent	no	Municipally owned can
State Purchase of Credits			
	<i>AS 43.55.023 (f) & (g)</i>	<i>Bill Section 45</i>	<i>Bill Section 46</i>
Paid from:	"appropriations made by law"	oil and gas credit fund, funded from production taxes	oil and gas credit fund, funded from production taxes
Annual dollar cap per taxpayer?	\$25 million	none	none
ARM Board Purchases?	n/a	n/a	n/a

Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u>	<u>SB/HB 2001 (ACES) as introduced</u>	<u>CS HB 2001(FIN)am</u>
Downstream Costs	<i>As 43.55.150</i>		<i>Bill Section 53</i>
Downstream Tanker and Pipeline Costs	=Actual	=Actual	lower of actual or reasonable
TAPS Costs = TAPS tariff	Properly on File	Properly on File	Unaffiliated, arm's length transactions

Allowable Lease Expenditures	<i>AS 43.55.165</i>	<i>Bill Section 56 - 59</i>	<i>Bill Section 54 -- 63</i>
Allowed by regulation	no language	must be	must be
Use producer audits of operators?	Explicit	Explicit repealed; Implicit	Explicit repealed; Implicit
Net Profit Shares?	no deduction	no deduction	no deduction, except for DNR NPSL leases
Disallow bad acts II?	yes	add violation of law, lease or license	add violation of law, lease or license
Internal Transfers	FMV	FMV	disallowed unless proven to not exceed FMV
DR&R Allowed?	Allocated	No	No
"Corrosion" Issue	\$.30 a bbl disallowed	\$.30 + unscheduled interruption disallowed	\$.30 + unscheduled interruption disallowed
Field Topping Plants allowed?	Yes	No	No
Public Outreach costs	not explicit	not explicit	no; listed
Opex	actual	actual	2006 with 3% annual increase in '07, '08 and '09

Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u> <i>AS 43.05.230 and royalty statutes</i>	<u>SB/HB 2001 (ACES) as introduced</u> <i>Bill Sections 2-9,11-13,46 -49, 61 64</i>	<u>CS HB 2001(FIN)am</u> <i>Bill Sections 2-9,11-13, 47- 51,</i>
Information			
forward looking information required	none	information "necessary to forecast ... revenues under AS 43.55". Penalty up to \$1000 a day.	information "necessary to forecast ... revenues under AS 43.55". Penalty up to \$1000 a day if demanded information not forthcoming.
Disclosure of tax information	if aggregated to "prevent the identification of particular returns."	if aggregated w/2 other producers, no requirement to prevent identification	if aggregated w/2 other producers, no requirement to prevent identification
DNR sharing royalty information w/ DOR	limited ability	expanded ability	expanded ability
DOR sharing tax information with DNR	limited ability	expanded ability	expanded ability
Statute of Limitations	<i>AS 43.05.260</i>	<i>Bill Sections 14,50 new AS 43.55.075</i>	<i>Bill Sections 14,51 new AS 43.55.075</i>
State assessment must be issued within	3 yrs	6 yrs	6 yrs
DOR Auditors	<i>As 39.25.100</i>	<i>Bill Sections 10, 67</i>	<i>Bill Sections 10, 69</i>
DOR & DNR auditors exempt employees?	no	yes	2 DNR and 4 DOR exempt master auditors authorized.

Summary of Special Session Action

<u>Issue</u>	<u>Prior ("current") Law</u>	<u>SB/HB 2001 (ACES) as introduced</u>	<u>CS HB 2001(FIN)am</u>
Intent Language		<i>Bill Section 1</i>	<i>Bill Section 1</i>
overall intent of legislation	n/a	no	included
long standing interpretation of SOL	n/a	included	included
Use of retroactivity dollars	n/a	n/a	to public education fund, incremental dollars to other listed investments and energy cost needs
encourage availability of affordable gas	n/a	n/a	yes

Admin	<i>AS 43.55.020(a)</i>	<i>Bill Sections 22, 51</i>	<i>Bill Sections 22, 52, 23-25,42,46</i>
Monthly Estimated payments	Estimated payments without ceilings, refund due taxpayer at year end	Ceilings applied monthly	Ceilings applied monthly
Non Binding Advisory Bulletins	no	yes	yes
Whistleblower language	No	No	yes - with limitation for bad faith, up to \$.5mm
Required 2011 Report -	Yes	Yes	Yes

Effective Date		<i>Bill Section 66, 72, 73</i>	<i>Bill Section 1, 64-66</i>
Generally	n/a	Jan 1 2008	July 1 2007
Muni Not for Profits & Credits "corrosion related"	n/a	n/a	July 1 2003
New Opex rules based on 2006 reported	n/a	April 1 2006	April 1 2006
End of TIE	n/a	n/a	Jan 1 2007
DNR advanced approval for 25 credits	n/a	Jan 1 2008	Jan 1 2008
			July 1 2008

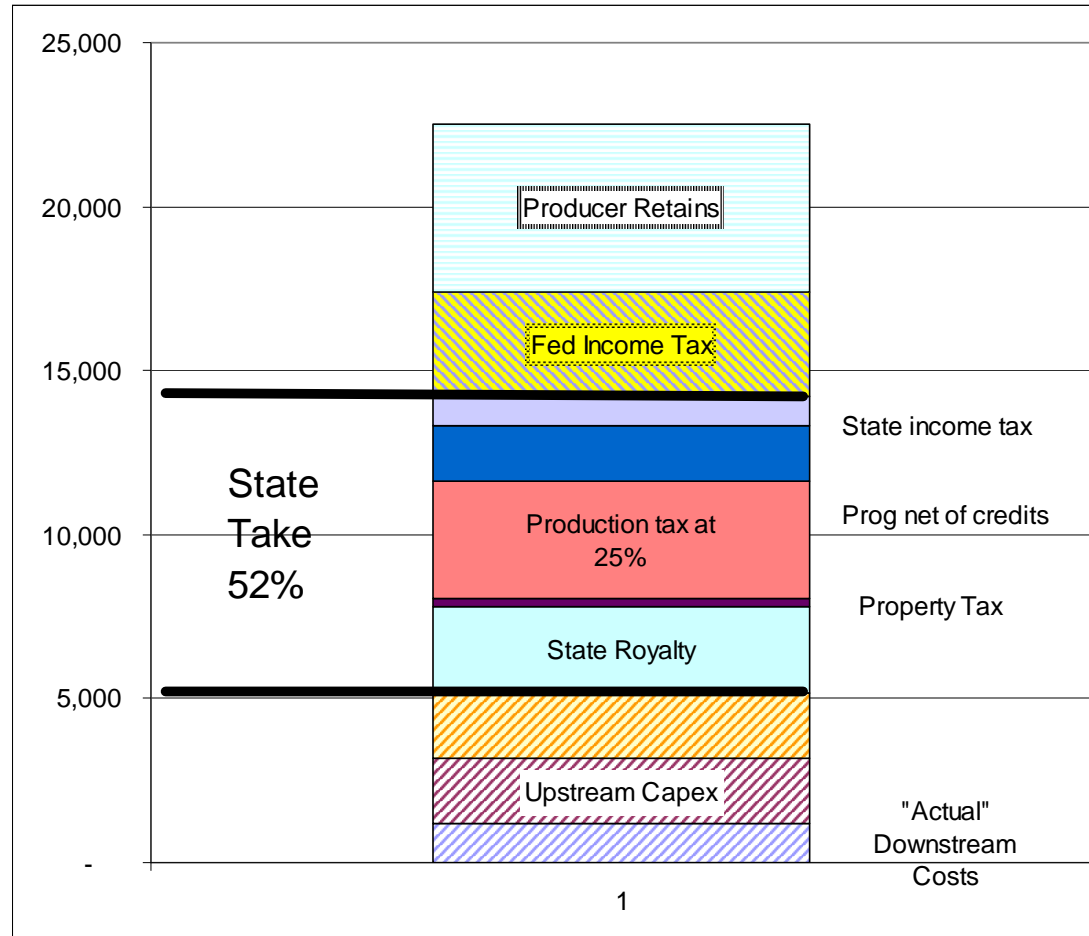
12.14.2007

Dan E. Dickinson Presentation to IAEE

Adjustment to net calculation

- Opex for 2007, 2008 and 2009 is 2006 increased by 3% a year.
- Capex has automatic disallowance of \$.30 a barrel (in law from beginning)
- Costs must be upstream of point of production, ordinary and necessary and direct costs of exploring, developing and producing – **and** allowed by regulation.
- Dept can write general regulations based on unit operating agreements, but repealed section which allowed use of actual audited results.

250 million Barrels @ 90 \$/bbl =
22.5 billion dollars.



- What happened and what insights can be gained for the future.

“Climate for tax hike was unexpected”

- Gregg Erickson writing in 12/2/07 ADN:
- “The big lesson of the session was that the political climate was far more favorable for a tax increase than the governor, the producers and most politicians had guessed.”
 - Veco
 - Global Bandwagon
 - Bad News
 - Industry Disinvestment

Sea Change in Legislature

- Old Paradigm – Taxes are a “tax” on productivity and economic growth; Taxes bad - constrained by need to finance government.
- New Paradigm – Resources have a special role under constitution; state resource taxes good - constrained only by investment climate.

Comparison with Mayor's 2007 Task Force

- Task Force: "...the task force felt that the business activities taxes' exportability was a weakness and that incorporating it into Anchorage's fiscal regime would work against citizens taking ownership in their government." (page 3 September 19, 2007 final report)

Future Implications for Gasline

- Implications for Fiscal Stability
 - “poster case” for instability or “need to move out from under the cloud”
- State has illustrated will to change new and untested fiscal system retroactively if
 - World take climate changes
 - Costs are higher reducing govt. take
 - Forward looking estimates do not pan out
- OR were changes triggered by corruption?

Future Implications for Gasline

- Governor can be “dragged kicking and screaming” from campaign positions
- 2006 Legislature more assertive than Murkowski Administration
- 2007 Legislature more assertive than Palin Administration

Implications for the future

- AS 43.55.165 (e) “lease expenditures do not include...
- (6) costs arising from ...failure to comply with an obligation under a lease...”
- ***No .023 (investment and loss carry forward) credits or any deductions for costs if they arise from a failure to comply with the lease.***

Future Implications for Gasline

- Revisiting the production tax before an open season?
 - Carve out gas from progressivity?
 - Restructure credits to separate oil and gas investment?
 - Special regime for distance gas?