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of ALASKA
GOVERNOR BILL WALKER

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The Honorable Click Bishop
Chair, Senate Community and Regional Affairs Committee
State Capitol Room 115
Juneau AK 99801

Senator Bishop:

Thank you for the opportunity to present to the Senate Community and Regional Affairs Committee. Several questions were asked of the Department of Revenue in the hearing on SB 100 held Thursday, January 28, 2016. These questions are reprinted here in italics and the responses from the Department of Revenue follow.

1. *Is the State's interest in the AKLNG project exempt from federal income taxation? (MacKinnon)*

   Currently the States interest ownership through AGDC is exempt. However as the project progresses with the State being a 25% owner and the remainder owned by private taxable entities the future tax exempt status is an open question. DOR, in coordination with AGDC, is currently formulating a formal request for a ruling by the IRS on whether the Alaska Gasline Development Corporation (AGDC) will be subject to federal income tax on its Project related revenues. That request cannot be submitted until the commercial agreements for the Project are finalized as the Project commercial structure will be a required element for IRS review.

2. *How much of the AKLNG project is on State land? (MacKinnon)*

   Since the premise of the hearing was property tax and PILT, I am assuming that the question primarily referred to State taxability rather than the ownership of the land. The Alaska LNG Gas Treatment Plant (GTP) and two feeder pipelines from Point Thomson and Prudhoe Bay, estimated to cost approximately $15 billion or about 27.3 percent of total project capital expense, will be located 100 percent within the North Slope Borough.

   The Alaska LNG main gas pipeline will have an estimated 304 miles (37.8 percent) of its total length outside of organized boroughs and municipalities (State-only property tax). Of the eight compressor stations planned for the main gas pipeline, three of the eight (37.5 percent) will be located outside of organized boroughs and municipalities (State-only property tax). The main gas pipeline and compressor stations component of the Alaska LNG project 42-inch line are estimated to cost about $15 billion (27.3 percent) of total project capital expense. Of the estimated $15 billion, the eight initial compressor stations represent 20 percent of that cost, or about $3 billion.

The project's LNG liquefaction plant, storage and loading facilities, estimated to cost approximately $25 billion or about 45.5 percent of the total project capital expense, will be located 100 percent within the Kenai Peninsula Borough.

3. *What is the gas price per Mcf in the model? What gas price does the Project have to realize to break even after payment of the Payment in Lieu of Tax (PILT)? (MacKinnon)*

   Breakeven price for the Alaska LNG Project includes several cost streams in addition to the PILT. Many of the estimates for these cost components are in development or are unknown at this point in time (i.e. for Project financing the stakeholders will need to survey the financial markets closer to final investment decision). Breakeven price is most sensitive to project capital costs and cost of capital; breakeven prices will ultimately differ for each of the stakeholders as each stakeholder may finance their portion of the project differently. While the PILT payments make up a portion of the breakeven price, it is not expected to be a driving factor in a go or no go decision.

4. *How much of the 25 percent State share is the property tax? (Stedman)*

   Property tax makes up no part of the calculation of the State's ownership interest in the Alaska LNG Project. The State's ownership share is expected to be approximately 25 percent, consistent with the sum of Royalty in Kind (RIK) and Production Tax as Gas (TAG) as a percentage of the total gas supply for the Project.

5. *How do other jurisdictions do property tax payments for this type of project, such as British Columbia? Do they use impact payments, PILTs, traditional property tax, or something else? (Stedman)*

   It is difficult to benchmark property tax systems and community impact payments around the world. Different jurisdictions emphasize different responses to impacts. Some governments focus on quantitative measurements of mitigation measures and others are satisfied with more qualitative benefits as compensation. Some governments ask for fixed-fee payments others ask for per-unit payments. In general, the guiding principle for community impact mitigation is to compensate local governments for the impact of resource development on local land and livelihoods and to enable local governments to share in the benefits flowing from the development of their land.

   In British Columbia property tax is payable on an annual basis by owners of real property. Property tax is based on the assessed value of the property, as determined by the BC Assessment Authority, and the property tax rate. Property tax rates are determined by the municipality in which the property is located based on the classification of the property (i.e., the asset class). [1]

   The 2013 municipal tax rates for Prince Rupert and Kitimat were set at approximately $33.26 and $63.74, respectively, per $1,000 of assessed value for "major industry" property (class 4B in Prince Rupert / class 4 in Kitimat). Based on these rates, the annual

[1] KPMG LLP, 2014, Insights and Update on Proposed BC LNG Tax Regime.

municipal tax cost in Prince Rupert and Kitimat would total approximately $33.3 million and 63.7 million, respectively, for each $1 billion of assessed value.

The proposed Kitimat LNG Terminal Project is a co-venture between Shell Canada, PetroChina, Korea Gas, and Mitsubishi The project could cost up to $40 billion and would initially consist of two processing units called trains, each able to produce 6.5 MTA of LNG.[2]

It is expected that the introduction of LNG activities to these municipalities will cause a significant reduction in municipal tax rates for all taxpayers as the total annual tax collection at current rates would far exceed municipal budget requirements. Nonetheless, agreements must be reached between the communities and the LNG proponents to ensure the LNG industry's share of the municipal tax burden is fair and reasonable.

WCC LNG is a proposed project to develop and operate a liquefied natural gas (LNG) export facility at Tuck Inlet in Prince Rupert, British Columbia. Exxon Mobil Corp. and their partners plan to spend up to $25 billion on the project terminal facility, similar in cost to the LNG and terminal facilities for the ALKLNG project. WCC LNG project partners will pay the City of Prince Rupert $18 million over two-years. WCC LNG has already paid a $1 million non-refundable deposit and will pay another $7 million within 30 days of zoning of the site and an additional $10 million at a later date.[3]

Woodfibre LNG is a smaller, $1.7 billion capital cost, natural gas liquefaction and export facility located at a former pulp mill site, Squamish, B.C. Woodfibre LNG is proposing to pay $2 million a year in property tax to the District of Squamish when the facility begins operations, and increase that amount 2.5 percent a year, up to $3 million a year, in property tax. More work needs to be done on property tax, but we felt it was important to make a proposal given the level of community interest in potential property tax revenue from Woodfibre LNG. In addition, as part of its export approval Woodfibre LNG committed to developing a local hiring strategy, local training strategy, and regional procurement strategy.[3]

6. *Could DOR provide committee with any examples of other jurisdiction tax systems that the Producers provided to the project/Commissioner, if not confidential? (Bishop)*

   After discussions with the producers they have indicated that the contracts they have with other jurisdictions are confidential business sensitive documents which are not available for public release.

7. *Please provide more detail on project economics, State revenue value stream, etc. and how AKLNG property tax fits in with it, how large a portion of the value stream is property tax? (Stedman)*

   State revenues from the AKLNG project include royalties, production tax, property taxes, and State corporate income taxes. Property taxes are proposed to be based on the

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[2] Kane, Laura, 2016, LNG Canada gets permit for export facility in Kitimat, B.C.; The Globe and Mail.

[3] Gaffney Cline & Associates, 2015, LNG Community Impact Mitigation, Global Overview, presentation to the Municipal Advisory Gas Project Review Board on July 1, 2015.

throughput in the AKLNG project, and are a more certain revenue stream for the State than the other three (royalties, production tax, and State corporate income tax). The other three revenue streams for the State from AKLNG - royalties, production tax, and State corporate income tax – are dependent on LNG prices, volumes and project costs including capital cost, operating costs and financing costs. Of these variables, LNG prices are the largest driver of State revenues. Assuming LNG prices that are indexed to crude oil, and a long-term oil price range of $40-80/bbl (2015$), property taxes as a percentage of the total expected State revenues can range from 15 percent to over 80 percent. As oil prices fall, property taxes becomes a larger percentage of the total State revenues, conversely as oil prices rise, property tax becomes a smaller percentage of the total State revenues.

8. *Does inclusion of the agreement with the Producers on property tax in the Fiscal Agreement prevent the legislature from appropriating the PILT revenues for the 25 year term of the Fiscal Agreement? (Stedman)*

   The Fiscal Agreement, as currently anticipated by the State, would only apply to the agreed upon fixed Construction-related PILT (CPILT) amount and the negotiated Operations-related PILT (OPILT) target amount and calculation process. The Legislature will retain authority to appropriate and allocate the property tax revenues received from the Project.

Please let me know if you have additional questions or need clarification on any of the answers above.

Sincerely,

Randall J. Hoffbeck
Commissioner