THE STATE of ALASKA
GOVERNOR BILL WALKER

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April 7, 2017

The Honorable Neal Foster and the Honorable Paul Seaton
Alaska State Representatives
Co-Chairs, House Finance Committee
State Capitol Rooms 410 and 505
Juneau, AK 99801

Dear Co-Chairs Foster and Seaton:

The purpose of this letter is to provide you with responses to the questions asked of the Department of Revenue (DOR) during Tax Director Ken Alper's presentations to the House Finance Committee on March 21 and 22, 2017. Please see the questions in italics and our responses immediately below the questions.

Tuesday, March 21, 2017

1. ***How much would the oil and gas corporate income tax have been in FY 2016 if it was not for the large refunds that the state paid out?***

   In FY 2016, Unrestricted General Fund (UGF) revenue from oil and gas corporate income tax was a net negative $58.8 million. Approximately $86.9 million in refunds were paid in FY 2016, so without these refunds revenue could have been approximately $28.1 million. As described in committee, the FY 2016 refunds were due to overpayments of estimated tax during calendar year 2014. Note, the petroleum corporate income tax received in FY2014 was $307.6 million; in FY 2015 it was $94.8 million. These refunds could be seen as reducing what "should have been" paid in these prior years.

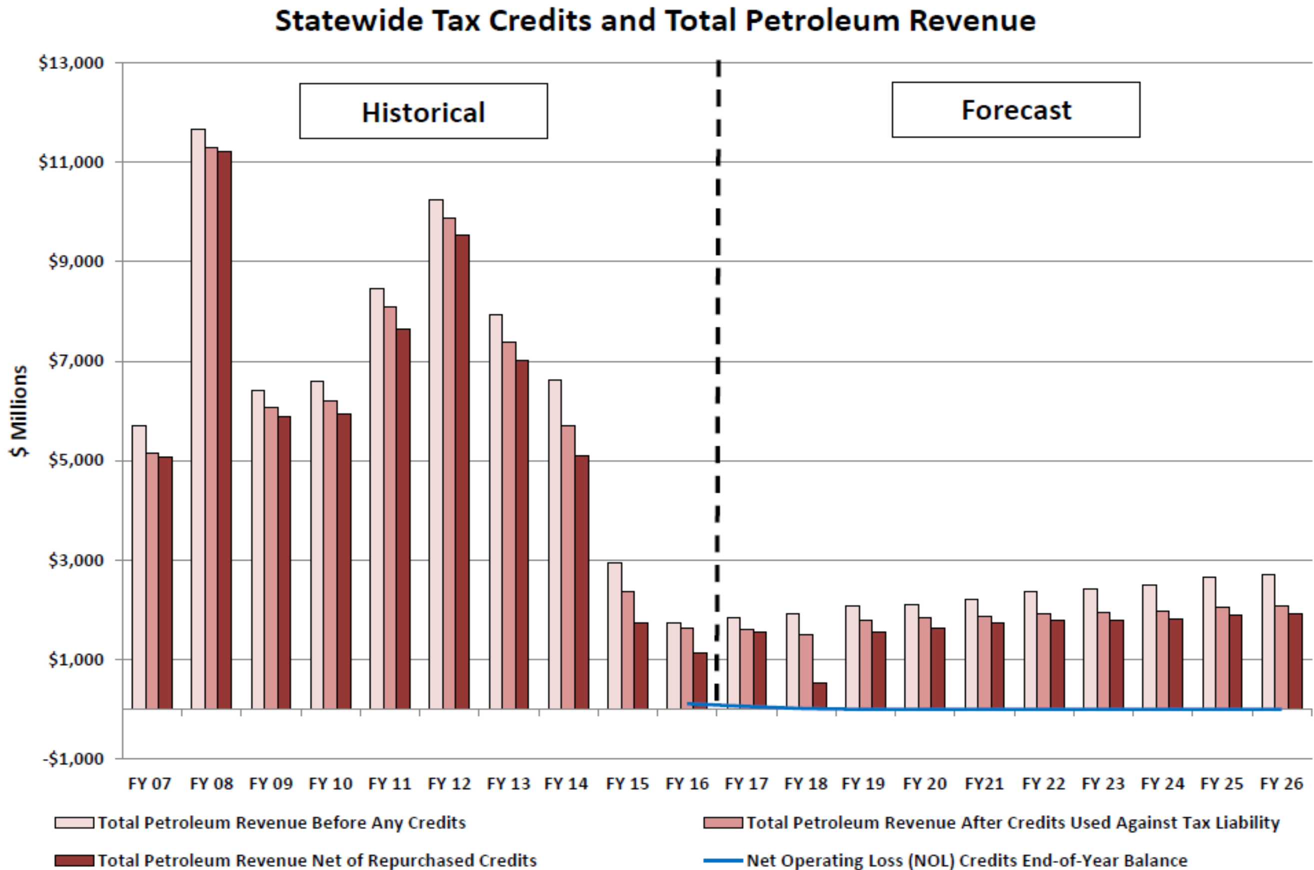
2. ***Create similar chart for Gross Value Reduction (GVR) Oil as Slide 11.***

   The following chart shows the estimated tax per barrel of Gross Value Reduction (GVR) oil from the North Slope. GVR oil currently qualifies for a $5 per-barrel credit and production tax can go below minimum tax and down to zero production tax. This chart is based on the average price and costs from the Fall 2016 *Revenue Sources Book* for ANS oil price, transportation and lease expenditures.

SB21 Tax Calculation at Different Prices						
per one barrel of taxable GVR oil; FY17 costs per Fall 16 RSB						
Price	**$40**	**$60**	**$80**	**$100**	**$120**	**$140**
Transportation	$9.33	$9.33	$9.33	$9.33	$9.33	$9.33
GVPP	$30.67	$50.67	$70.67	$90.67	$110.67	$130.67
Lease Expenditures	$30.88	$30.88	$30.88	$30.88	$30.88	$30.88
PTV (net)	-$0.21	$19.79	$39.79	$59.79	$79.79	$99.79
GVR (20% of GVPP)	-$6.13	-$10.13	-$14.13	-$18.13	-$22.13	-$26.13
Adjusted PTV	-$6.34	$9.66	$25.66	$41.66	$57.66	$73.66
Tax at 35%	-$2.22	$3.38	$8.98	$14.58	$20.18	$25.78
Per-BBL Credit	$5	$5	$5	$5	$5	$5
Tax per Net	-$7.22	-$1.62	$3.98	$9.58	$15.18	$20.78
Minimum Tax	$1.23	$2.03	$2.83	$3.63	$4.43	$5.23
Tax Due	**$0.00**	**$0.00**	**$3.98**	**$9.58**	**$15.18**	**$20.78**
Tax as % of Price	0%	0%	5%	10%	13%	15%
Tax as % of GVPP	0%	0%	6%	11%	14%	16%
Tax as % of PTV	n/a	0%	10%	16%	19%	21%

3. ***Provide updated graph (Slide 20) with royalty revenue – both restricted and unrestricted.***

The following graph has been revised to include total Petroleum Revenue which includes all petroleum-related revenue received during the fiscal year. This includes unrestricted revenue, as well as restricted royalties deposited to the Permanent Fund and School Fund, settlements deposited to the Constitutional Budget Reserve Fund, and federal shared royalties deposited to the NPRA Fund.



4. ***Create similar charts (Slide 25) separated for Cook Inlet and North Slope and include an interest provision as if that fund had been invested.***

   The following charts have been revised to separate out the North Slope and Non-North Slope amounts for the Oil and Gas Tax Credit Fund. The charts assume that the Oil and Gas Tax Credit Fund would be split according to the production tax, revenue, and credits for each area. The interest rate used for this analysis is the General Fund and Other Non-segregated Investments (GeFONSI) rate for each year of the analysis as provided by the Treasury Division.

   This analysis provides interesting information. Most notably, had the credit funding formula in AS 43.55.028(b) and (c) been followed since the beginning of the program, and had Cook Inlet and other non-North Slope credits been carved out of the formula, there would be an adequate amount in the .028 fund to pay the current outstanding North Slope credits. However, another funding source would have needed to be identified for the nearly $1.2 billion (through FY2016) in credits earned in Cook Inlet and other non-North Slope areas of the state.

Oil and Gas Tax Credit Fund: Hypothetical North Slope only
Budgeted vs. Actual vs. Statutory Tax Credit Fund Formula
(Beginning with the first budget cycle after the passage of ACES in November 2007)

Fiscal Year	Original Appropriation (statewide) ($million)	Actual Claimed Credits ($million)	Actual Production Tax ($million)*	Plus Credits Against Liability ($million)	AS 43.55.011 Revenue ($million)	Oil Price Per Spring 16 Forecast	Credit Cap per AS 43.55.028(c)	Interest**	End of Year Fund Balance
Actual									
FY09	not to exceed $175	$186	$3,096	$328	$3,424	$85.73	$342	$0	$156
FY10	unspec **	$246	$2,856	$402	$3,258	$65.70	$326	$5	$241
FY11	est. $180	$411	$4,538	$344	$4,882	$73.32	$488	$4	$323
FY12	est. $400	$320	$6,132	$347	$6,479	$94.70	$648	$5	$656
FY13	est. $400	$261	$4,038	$536	$4,574	$110.44	$457	$2	$854
FY14	est. $400	$281	$2,584	$907	$3,491	$109.61	$349	$5	$927
FY15	est. $450	$224	$358	$650	$1,008	$95.24	$101	$4	$808
FY16	est. $700	$213	$139	$61	$200	$39.99	$30	$7	$632

*For purposes of this analysis, interest is calculated based on the prior year's "End of Year Fund Balance." The interest rate applied is the historical rate of return for the General Fund investment pool.

**For purposes of this analysis, Non-North Slope production tax revenue, after credits against liability, is assumed to be $5 million per year.

Oil and Gas Tax Credit Fund: Hypothetical Non-North Slope only
Budgeted vs. Actual vs. Statutory Tax Credit Fund Formula
(Beginning with the first budget cycle after the passage of ACES in November 2007)

Fiscal Year	Original Appropriation (statewide) ($million)	Actual Claimed Credits ($million)	Actual Production Tax ($million)*	Plus Credits Against Liability ($million)	AS 43.55.011 Revenue ($million)	Oil Price Per Spring 16 Forecast	Credit Cap per AS 43.55.028(c)	Interest**	End of Year Fund Balance
Actual									
FY09	not to exceed $175	$7	$5	$6	$11	$85.73	$1	$0	($6)
FY10	unspec **	$4	$5	$10	$15	$65.70	$2	($0)	($9)
FY11	est. $180	$39	$5	$17	$22	$73.32	$2	($0)	($46)
FY12	est. $400	$33	$5	$16	$21	$94.70	$2	($1)	($77)
FY13	est. $400	$108	$5	$14	$19	$110.44	$2	($0)	($183)
FY14	est. $400	$312	$5	$12	$17	$109.61	$2	($1)	($495)
FY15	est. $450	$404	$5	$14	$19	$95.24	$2	($2)	($899)
FY16	est. $700	$287	$5	$9	$14	$39.99	$2	($7)	($1,191)

*For purposes of this analysis, interest is calculated based on the prior year's "End of Year Fund Balance." The interest rate applied is the historical rate of return for the General Fund investment pool.

**For purposes of this analysis, Non-North Slope production tax revenue, after credits against liability, is assumed to be $5 million per year.

5. ***Can Hilcorp use the Qualified Capital Expenditure (QCE) Credit for their recent gas leak and the repairs needed?***

   First, DOR looked to see if the pipeline in question was upstream or downstream of the point of production. Many pipelines are considered downstream and any associated costs would not be an allowable lease expenditure regardless - instead the costs (if allowable) would be built into the tariff calculation. In this case, the Middle Ground Shoal Fuel Gas System pipeline is considered upstream of the point of production, so it is possible that the costs associated with the maintenance and repair of this work could be allowable as a deductible lease expenditure and qualify for a QCE tax credit if the costs are capital expenditures.

   Secondly, the question becomes whether the costs would meet the specific restriction related to spills and deferred maintenance per AS 43.55.165(e)(19). This interpretation is based on information that is publically available. Until more is known about the specific work done and the circumstances that led to the spill, a definitive determination cannot be made whether the costs meet the criteria described herein.

6. ***Translate a $1 per barrel oil tax cap in Cook Inlet to an effective tax rate on net.***

   In the Fall 2016 revenue forecast, DOR does not directly forecast Cook Inlet oil prices or transportation deductions. However, DOR does forecast Cook Inlet oil production and lease expenditures. If it is assumed that Cook Inlet oil gross value per barrel is similar to North Slope, then the per-taxable-barrel gross value would be about $44 per barrel, with lease expenditures of about $30 per barrel, for a net profit of about $14 per barrel. Assuming a company paid the $1 per barrel oil tax cap, this would equate to about a 7% effective tax rate on net. This estimate would vary significantly by company and field.

7. ***What would the Cook Inlet oil tax rate need to be to generate similar revenue to the North Slope?***

   Oil production on the North Slope pays the higher of a gross minimum tax or a net profits tax less certain credits, primarily the per-taxable-barrel credit. Oil production in Cook Inlet pays the lower of $1 per-taxable-barrel, or a net profits tax with no per-barrel credits.

   The calculation of gross value accounts for differences in transportation costs and crude oil quality prior to calculating the gross value at point of production for tax calculation purposes. At current prices, most oil production on the North Slope effectively pays a 4% gross tax rate, due to the minimum tax. Meanwhile, most oil production in Cook Inlet effectively pays a $1 per barrel tax. Director Alper mentioned in testimony that at a $50 per barrel wellhead value, this equates to a 2% gross tax. At the $44 wellhead value referenced in the previous answer, it would be 2.3%. The simplest way to apply an equivalent tax in Cook Inlet would be to extend the North Slope gross tax rate to Cook Inlet.

Wednesday, March 22, 2017

8. ***Can the DOR share whatever information they can on the refinery credits (who, how much, when)?***

   The In-State Refinery Tax Credit began on January 1, 2015, and is a credit for qualified infrastructure expenditures for in-state oil refineries incurred after December 31, 2014, and before January 1, 2020. The credit may not exceed 40% of total qualifying expenditures or $10 million per tax year per refinery, whichever amount is less. The credit can be applied against corporate income tax liability and carried forward for up to five years, or purchased by the state via the Oil and Gas Tax Credit Fund. The authorizing statute will sunset on December 31, 2019.

   There are currently three refineries in the state that qualify for this credit. To date, no refineries have received cash credits for this tax credit. The Fall 2016 *Revenue Sources Book* is forecasting the cash purchase of these credits by the State of $20m per year in Fiscal Year 2018 through 2021 and $10m in 2022, based on the eligibility requirements (see Table 8-4). PetroStar has publicly stated their intent to use this credit for their asphalt plant project.

9. ***List of companies between the 15,000 and 50,000 barrels per day (bpd) oil and gas production threshold.***

   Based on information available publicly from the Alaska Oil and Gas Conservation Commission (AOGCC) and the Department of Natural Resources (DNR), there is currently one company that is between the 15,000 and 50,000 bpd production and that is Eni. Hilcorp has been producing around 50,000 taxable bpd and that can vary from month-to-month. One thing to remember is that the threshold to be eligible for cash credits is tied to taxable barrels not produced barrels.

There were also questions asked related to comparing Alaska's oil and gas tax system to other regimes. Those questions were sent to the Legislative's consultant, Rich Ruggerio with Castle Gap Advisors, to address in his presentations this past week. We do not intend to provide written responses to these questions as we believe they are best addressed by your consultants with Castle Gap Advisors.

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

Sincerely,

Randall Hoffbeck
Commissioner