THE STATE of ALASKA

GOVERNOR BILL WALKER

Department of Revenue
TAX DIVISION

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March 31, 2016

The Honorable Pete Kelly
Alaska State Representatives
Co-Chair Kelly, Senate Finance Committee
State Capitol Room 532
Juneau AK 99801

Dear Co-Chair Kelly,

The purpose of this letter is to provide you with responses to the questions asked in your letter dated March 25, 2016. Please see questions in italics and our responses immediately below the questions.

1. *Could you please provide the list of companies that will receive oil and gas tax refundable credits for work completed in calendar year 2014 and calendar year 2015 (delineated by calendar year)? Similarly, could you provide the list of companies who are conducting work in calendar year 2016 and are anticipated to receive oil and gas credits through the FY 2018 budget?*

   The particular companies receiving tax credits, the specific amount of the credits, and the types of credits received are confidential information under AS 43.40.230. This makes it difficult to discuss important issues with both legislators and the general public. In the governor's original tax credit bill, HB 247 / SB 130, Section 8 would provide an exception to the confidentiality statutes, making the sort of information you are seeking public information. The current version of the bill, CSHB 247(RES) does not contain that provision.

   Attached are two maps that list the activities of different companies, one for the North Slope and one for Cook Inlet, produced by the Department of Natural Resources. These maps may be helpful in identifying companies or projects that could be eligible for tax credits.

2. *Please identify which companies are eligible for the small producer credit, broken down by North Slope and Cook Inlet.*

   Specific companies that are eligible for or are currently receiving the small producer credit is confidential information under AS 43.40.230. However any company with less than 100,000 taxable barrel of oil equivalent per day (BOE) statewide qualifies for the credit for the first nine years of commercial production. After a company has more than 50,000 taxable BOE, the credit phases out to zero once a company reaches production of 100,000 taxable BOE. In practice, this means other than the three major producers, nearly all producers in Alaska would be eligible.

   Because the Small Producer Credit will be closed for new applicants on May 1 of this year, it means that we expect to see a "slow sunset" of the program between now and 2025. In other words, if a company first earned the credit in 2008, they are now in their last year of eligibility. But a company who has their first production before May 1st will have credit eligibility for the next nine years.

The small producer credit can only be used to offset a tax liability; it cannot be refunded or carried forward. Therefore, it is not unusual for a producer to not gain the full $12 million value. I have previously testified that the amount of small producer credits claimed since the creation of the program in FY07 is approximately $400 million, with roughly $340 million of that from operations on the North Slope and $60 million from Cook Inlet.

In addition to the activity maps mentioned in our response to question 1, we are also attaching current DNR maps that list all the working interest owners of the various fields on the North Slope and Cook Inlet, and their percentages of ownership. Note that if a company operates in multiple areas of the state, their production statewide counts towards the taxable BOE limit.

3. *Is the Department of Revenue holding off on issuing credit certificates to any companies?*

   No. Credit certificates are still being issued to companies. The great bulk of the credits that have been paid out this fiscal year are based on expenditures that occurred in calendar year 2014. Many of those credits had a statutory deadline of 120 days after the tax true-up date, which occurred in late July, 2015. Currently, we are going through our work pool on roughly a first in- first out priority.

   As you know, we initially estimated $700 million in credit demand for FY16. The difference between the $500 million appropriation cap and the $700 million estimate is largely made up of quarterly filings for the “spending” credits from Cook Inlet. In other words, Net Operating Loss credits are only applied for at the time of a company’s tax filing true-up in March, because that is when the “operating loss” is finalized. However, the 20% Capital (QCE) credit and 40% Well (WLE) credit can be applied for at any time. These credits are not available on the North Slope, but are often applied for quarterly by producers and developers in other areas of the state.

   If we had unlimited resources and funds, many of those quarterly applications would likely be reviewed, certificated, and paid during Fiscal Year 2016. However, we are not obligated to do so until next July. Importantly, many of these applicants will also request Operating Loss credits, and it is more efficient for our staff to review all the applications related to a given set of expenditures concurrently.

4. *Has the Department of Revenue received credit certificates for which they have held off on cashing?*

   AS 43.55.028(g) empowers DOR to adopt regulations to provide procedures for allocating money when there is a shortfall in the tax credit fund at the end of a fiscal year. That regulation is at 15 AAC 55.325(d). Essentially, the regulation establishes a first in, first out priority.

   Unless there was a specific legal issue, which would of course be confidential, we have not withheld credit repurchases. There was a single case at the end of the last fiscal year, when the FY16 budget was still unresolved, where we had to partially pay a certificate until the FY16 fund transfer could be finalized. That certificate was our highest priority once additional funds were available.

5. *What is the dollar amount of credits that exceeded the Governor’s $500 million cap for FY16 that got carried over into the FY17 budget*

   Attached is an analysis that was provided to the House Resources Committee on 3/25/2016 that provides detail from the FY 2017 refunded credits estimate. As of March 8, 2016, there are $900 million worth of credit certificates that have been requested since we completed the batch that were paid in FY15. Of that amount, about $473 million has already been paid out in FY 2016, leaving about $27 million in the tax credit fund.

   Based on 2015 monthly reports, around $160 million in additional refunded credit applications are expected by March 31, 2016, along with the end-of-year tax true-ups. This equals $1,060 million in refundable credits based on activity through December 31, 2015, with about $587 million of those still in-process. Once the last $27 million is paid from the FY2016 appropriation, there will be $560 million in refundable credits remaining that will be in our queue for FY 2017. This is based only on spending through the end of CY 2015.

As described in the response to Question 3, we also expect quarterly applications for the "spending" credits (QCE and WLE) for work done in calendar year 2016. We anticipate a greater than originally expected group of applications for exploration credits. Because this credit is scheduled to sunset for the North Slope and Cook Inlet on July 1 of this year, we are finding that there is substantial exploration work that was prioritized in order to qualify. Currently, exploration work on the North Slope is eligible for 75% in credits; last year the total was 85%. Finally, we anticipate at least some applications for refundable Refinery and LNG Storage credits this year.

Only some of the applications described in the above paragraph would be paid in FY17, with the rest coming due in FY18. However, as we described in the 3/25 analysis, the FY17 portion of the above applications, when added to the $560 million in-hand, will result in a total estimated obligation of $821 million. This has been rounded up to the $825 million that we reported in the preliminary Spring Forecast.

6. *Of the Net Operating Loss (NOL) credits, could you identify how much are given to companies in preproduction and how much are given to small producers (companies producing under the 50,000 barrel threshold)?*

   Of the $500 million of credits that will be repurchased in FY 2016, around $315 million are expected to be Net Operating Loss (NOL) credits. Of those NOL credits, approximately 80% were earned by companies in pre-production and 20% were earned by small producers. Companies classified as pre-production were those that did not report commercial production as of 3/28/2016.

   The number of producers claiming an NOL credit is, of course, highly dependent on the price of oil and the profitability of their operations.

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

Sincerely,

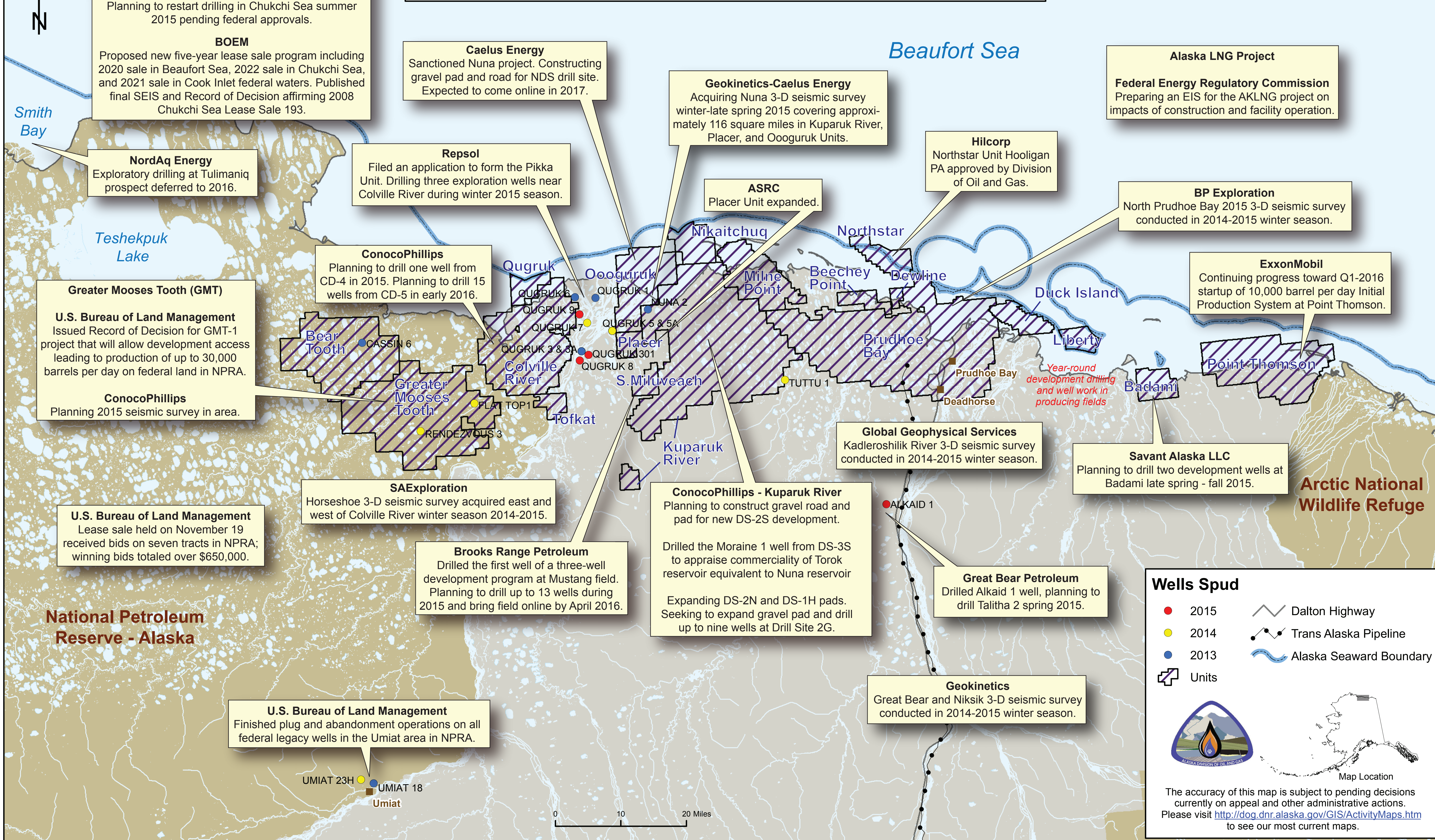
Ken Alper
Tax Division Director

Attachments:

- DNR North Slope Oil and Gas Activity Map
- DNR Cook Inlet Oil and Gas Activity Map
- DNR North Slope Oil and Gas Working Interest Owners Map
- DNR Cook Inlet Oil and Gas Working Interest Owners Map
- FY 2017 Refunded Credits Estimate Detail

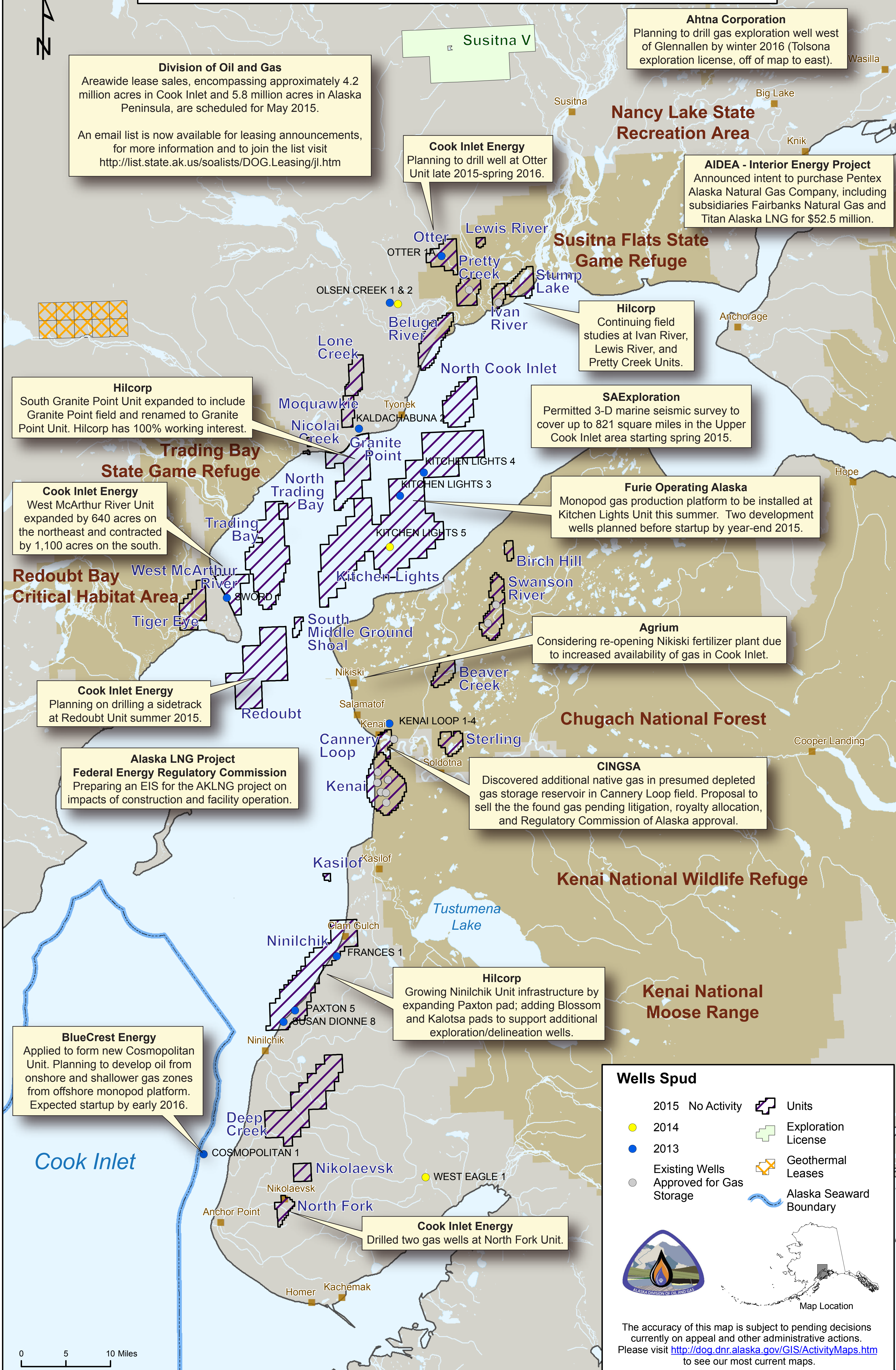
North Slope Oil and Gas Activity

State of Alaska, Department of Natural Resources, Division of Oil and Gas, as of May 2015



Cook Inlet Oil and Gas Activity

State of Alaska, Department of Natural Resources, Division of Oil and Gas, as of May 2015



Working Interest Ownership of the North Slope

State of Alaska, Department of Natural Resources, Division of Oil and Gas, as of March, 2016

Working Interest Ownership of the Cook Inlet

State of Alaska, Department of Natural Resources, Division of Oil and Gas, as of March, 2016

Title:	**Detail of FY 2017 refunded credits estimate in preliminary Spring 2016 forecast**
Preparer:	Dan Stickel, Assistant Chief Economist, 465-3279
Purpose:	Provide explanation of FY 2017 estimate of credits for refund made in the preliminary spring 2016 forecast, of $825 million.
Data Source:	Preliminary Spring 2016 forecast
Key Assumptions:	All assumptions are per preliminary Spring 2016 forecast, which was released on Monday, March 21. Final forecast will be released in early April. All amounts based on current law.
Disclaimer:	The Department of Revenue is in the process of reviewing and updating the data on which this analysis is based. As a result, future analysis could have different results.

Detail of FY 2017 refunded credits estimate in preliminary Spring 2016 forecast

Prepared 3/22/16 by Dan Stickel

Detail of FY 2017 refunded credits estimate ($ millions)		
Refundable credits already in queue (based primarily on CY 2015 spending)		
Credit certificates / cases in progress as of March 8, 2016	$	900
Credit applications expected March 31 based on 2015 monthly reporting	$	160
Total credits already earned for activity through 2015	$	1,060
FY 2016 refunded credits appropriation	$	500
FY 2017 refundable credits already in queue	**$**	**560**
Additional credits expected to be available for refund in FY 2017 (based primarily on CY 2016 spending)		
Credits under AS 43.55.023 (NOL, capital, well lease)	$	186
Credits under AS 43.55.025 (exploration credits)	$	57
Credits under AS 43.20 (LNG storage, refinery investment)	$	18
Sum of additional FY 2017 refundable credits expected	**$**	**261**
Total forecast of credits eligible for refund in FY 2017	**$**	**821**
(note, this number is rounded up to the nearest $5 million)		

Discussion

For FY 2017, expected credits for refund increased by $200 million to $825 million. This is largely due to two factors:
1. Lower oil prices more than offset reductions in overall spending, resulting in an increase to net operating losses subject to NOL credits.
2. Claimed exploration credits and spending that qualifies for exploration credits has exceeded expectations, as companies complete projects ahead of the July 1, 2016 sunset for North Slope and Cook Inlet.

The increase in refunded credits would be expected given the reduced price assumption. Note that applying the revised price assumption to the Fall 2015 forecast would also yield an estimate of $825 million for FY 2017 refunded credits.

Reduced price expectations also impacted credits for companies not eligible for refunds (those with greater than 50,000 BOE of production). Expected carryforward NOL credit balance for such companies is now forecast at approximately $600 million at end of FY 2017, compared to only $1 million under Fall 2015 forecast.

Estimates are preliminary and may be revised for final spring forecast which will be released in early April. That forecast will incorporate information received in annual tax returns due March 31.