A Topical Analysis of the ACES Bill

Robert E. Mintz, K & L Gates

October 21, 2007

A Few Background Basics:
The oil and gas production tax . . .

- is in AS 43.55
- is in addition to royalties, property tax, and income tax
- has existed since before statehood
- generally applies a percentage tax rate to the *value* of oil and gas produced
- unlike royalties, applies to production from private and federal leases as well as state leases

Core Provisions of HB 3001 (enacted in 2006)

- AS 43.55.011(e) – (i): tax levied on value of oil and gas produced
- AS 43.55.160: calculation of taxable value of oil and gas
- AS 43.55.165 & .170: determination of upstream costs that may be deducted in calculating taxable value of oil and gas

(cont.)

Core Provisions (continued)

- AS 43.55.023 & 43.55.024: new tax credits
- AS 43.55.020(a): monthly estimated tax payments and final payment on March 31 of year following production (because this is now an annual, not a monthly, tax)
- AS 43.55.030(a): just one annual return

AS 43.55.011(e) (current)

- There is levied on the producer . . . a tax for all oil and gas produced . . . equal to **22.5 percent** of the **production tax value** of the taxable oil and gas **as calculated under AS 43.55.160** . . .

- *Note*: "production tax value" is net value

AS 43.55.011(e) (continued)

Exceptions:

- **Tax does *not* apply to**
  - **- state or federal share**
  - **- landowner's royalty share (which is subject to a different tax provision)**
- **Cook Inlet production subject to ceilings based on past taxes (AS 43.55.011(j) & (k))**
- **North Slope production subject to a minimum tax depending on price of ANS (AS 43.55.011(f))**

AS 43.55.011(g) (current)

- For each month when the net value of a producer's oil and gas exceeds $40 per barrel, the tax rate under subsec. (e) is in effect increased by ¼ of a percentage point for each dollar per barrel over $40
- Informally known as "progressivity tax"
- Gas and oil are added together by treating 6 million Btu of gas as equivalent to one barrel of oil (see AS 43.55.011(h), 43.55.900(17), (18) & (24))

AS 43.55.011(e) (new)
Bill sec. 15

- **There is levied on the producer . . . a tax for all oil and gas produced . . . equal to the production tax value of the taxable oil and gas as calculated under AS 43.55.160 multiplied by the tax rate determined under (g) of this section.**

AS 43.55.011(g) and (h) (new) Bill secs. 17 and 18

- "The tax rate . . . is 25 percent plus" the progressivity tax rate
- The progressivity tax rate is 1/5 of a percentage point for each dollar per barrel over $30 net value
- Progressivity is calculated on an annual, not monthly, basis

North Slope Tax Floor Bill sec. 16

- New AS 43.55.011(f): minimum tax is 10 percent of gross value at the point of production of oil and gas from a unit (or nonunitized reservoir) that
- (1) has produced a cumulative total of 1 billion barrels; and
- (2) is producing over 100,000 barrels a day (average during the most recent calendar year)

Cook Inlet Tax Ceilings
Bill secs. 19 and 20

- Tax ceilings are not changed (conforming amendments only)
- Note: sec. 21 of the bill adds language dealing with Cook Inlet tax credits to be consistent with sec. 55, which clarifies how excess lease expenditures are treated

AS 43.55.160 (bill secs. 52-55)

- The basic principle is unchanged: taxable value = gross value at the point of production minus lease expenditures
- Wording has been changed:
- (1) monthly values are no longer needed (progressivity is now annual)

AS 43.55.160 (cont.)

- (2) bill is clearer and more specific on when a producer may or may not use lease expenditures for operations at one location as deductions for oil and gas produced at another location
- These rules are necessary to implement the different tax treatments of different areas and fields (Cook Inlet ceilings, North Slope floor, tax credit under AS 43.55.024(a))

AS 43.55.160 (cont.)

- **For instance:**
- **(i) To avoid undercutting the tax floor, deductions may not be “exported” from units subject to the tax floor (AS 43.55.160(f)(2))**
- **(ii) To avoid double-dipping re: Cook Inlet tax ceilings, deductions must first be used up in Cook Inlet and may not be shielded by the ceilings (AS 43.55.160(h) and (i))**

AS 43.55.165 (bill secs. 56-59, 64) Lease Expenditures

AS 43.55.165(a) and (b) are rewritten and reorganized:

- (1) for more clarity
- (2) to limit lease expenditures to only what the Department of Revenue allows by regulation

Lease Expenditures (continued)

- AS 43.55.165(c) and (d) are repealed.
- Those provisions allowed the Department to substitute cost billings under unit operating agreements in place of the general standards for determining lease expenditures.

Lease Expenditures (continued)

- **AS 43.55.165(e): the list of *excluded* costs is expanded:**
- **par. (6) – costs arising from violation of law or noncompliance with lease or permit obligation**
- **par. (15) – all dismantlement, removal, & restoration costs (costs are prorated for past production under current law)**

Lease Expenditures Exclusions (cont.)

- par. (19) - repair or replacement of facilities or equipment associated with an unscheduled drop in production or an oil spill or unpermitted release

- par. (20) – crude oil topping plant (but deduction is allowed for value added of product used in lease operations)

Tax Credits under AS 43.55.023 Bill secs. 26-31, 65

Changes to .023(a) – qualified capital investment expenditure credits :

- Only 50% of a credit may be used the first year
- For exploration, requirements are conformed to changes in .025 credits (see below)

Tax Credits under AS 43.55.023 (continued)

Changes to .023(a) (continued)

- Credits for capital expenditures in a unit subject to the tax floor may be applied only against tax on oil and gas production from that or another unit subject to the tax floor

Tax Credits under AS 43.55.023 (continued)

Change to .023(b) – carried-forward annual loss credit :

- No carry-forward for unused lease expenditures for units subject to the tax floor

Tax Credits under AS 43.55.023 (continued)

Change to .023(d) – transferable tax credit certificates:

- Two certificates will be issued, each for half of the credit
- One certificate cannot be used until the next year

Tax Credits under AS 43.55.023 (continued)

New subsection .023*(l)* :

- **Makes clear that a tax-exempt entity may not obtain a transferable tax credit certificate**

Tax Credits under AS 43.55.023 (continued)

AS 43.55.023(i) is repealed:

- This eliminates the transitional investment expenditure credits for investments that were made during the five years before April 1, 2006.

Tax Credits under AS 43.55.025
Bill secs. 36-44

- Sec. 36 - Existing 2016 sunset is uniformly applied
- Secs. 37 & 43 - Exploration well credit expanded to delineation wells within 2 drilling seasons (rather than being limited to discovery well or dry hole)
- Sec. 37 - Well must be completed or abandoned, not just suspended, before credit may be claimed

Tax Credits under AS 43.55.025 (continued)

- Sec. 37 - Costs excluded if due to gross negligence or health/safety/ environmental violation
- Sec. 38 – Clearer definition of requirement for new exploration target; 3-mile requirement deleted for Cook Inlet; DNR evaluation required in advance and after drilling

Tax Credits under AS 43.55.025 (continued)

- Sec. 39 – Data submission requirements are more specific
- Sec. 39 – Well data confidentiality limited to 24 months
- Sec. 39 - Two certificates will be issued, each for half of the credit; one certificate cannot be used until the next year

Tax Credits under AS 43.55.025 (continued)

- Sec. 39 - Makes clear that basic information about tax credit is public
- Sec. 40 - Makes clear that a tax-exempt entity may not transfer a tax credit certificate
- Sec. 44 - New five percent tax credit available for old seismic data if DNR determines that acquiring the data for public distribution is in state's interest

State Purchase of Tax Credits Certificates – Bill secs. 45 & 63

- New AS 43.55.028 establishes oil and gas tax credit fund to purchase credit certificates from explorers or small producers that have no tax liability to apply credits against
- Funded by appropriation of a percentage of production tax revenues
- Replaces existing cash refund authority under AS 43.55.023(f) (repealed by bill)

State Purchase of Tax Credits Certificates (continued)

- Retains existing criteria for refunds except eliminates $25 million maximum

Payment of the Tax
Bill secs. 22-25, 51

- Current system of monthly installment payments and final payment on March 31 is retained
- Installment payments now take account of the tax floor for units subject to the tax floor and also take account of Cook Inlet tax ceilings
- Installment payments do not take account of progressivity rate

Payment of the Tax (continued)

- **AS 43.55.110(f), Bill sec. 51 – Gives express authority to Department to require tax payments to be made electronically**

Reporting Requirements AS 43.55.030, 43.55.040

- **Bill sec. 46 – Makes clear that every oil or gas producer must file an annual return, whether or not tax is due**
- **Bill sec. 46 - Expands the list of specific information requirements for returns (note: Department retains general authority to require more information)**

Reporting Requirements (continued)

- Bill secs. 47 & 49 – Additional penalty of up to $1,000 per day for late filing or nonfiling of required returns or reports
- Bill sec. 48 – Requires explorers or producers to file an annual statement on expenditures (or adjustments) even if no oil or gas is produced during the year

Reporting Requirements (continued)

- **Bill sec. 48 – Makes clear that the Department may also require monthly reports from producers, explorers, and operators**
- **Bill sec. 49 – Adds express authority for the Department to require reporting of forward-looking information for revenue forecasting purposes**

Reporting Requirements (continued): Bill sec. 51

- **AS 43.55.110(e) – Gives express authority to Department to require returns and reports to be filed electronically**

Confidential and Public Information

- AS 38.05.035, Bill sec. 2 – broad authority for DNR to share oil and gas lease related information with DOR for purposes of administering the production tax
- AS 43.05.230, Bill sec. 13 – broad authority for DOR to share production tax related information with DNR

Confidential and Public Information (continued)

- Under both provisions, confidential information is still confidential
- AS 43.55.890, Bill sec. 61 – Makes clear that Department of Revenue may publish extensive production tax information aggregated among at least three producers or explorers

Additional Administrative Improvements

- AS 39.25.110, Bill sec. 10 – oil and gas auditors placed in exempt service
- Transition provision, Bill sec. 67 – current employees may opt to stay in classified service
- AS 43.05.260, 43.55.075, Bill secs. 14, 50 – statute of limitations for production tax is six years, not three years

Additional Administrative Improvements (continued)

- AS 43.55.075(b), Bill secs. 1, 50 - Legislative confirmation of Department of Revenue's interpretation of statute of limitations as applied to events that retroactively change amount of production tax or credit: period of limitations begins to run when a return is filed reflecting the change

Additional Administrative Improvements (continued)

- **AS 43.55.110(g), Bill sec. 51 – Gives express authority to the Department of Revenue to issue advisory bulletins interpreting production tax statute and regulations for guidance of taxpayers and others; non-binding unless Department provides otherwise**

Transition, Applicability, and Effective Dates

- Bill secs. 66, 72 – Most substantive changes in the production tax are prospective beginning Jan. 1, 2008
- Bill secs. 66, 71 – Changes to lease expenditure exclusions and use of unit operating agreements for lease expenditures are retroactive to April 1, 2006

Transition, Applicability, and Effective Dates (continued)

- **Bill secs. 66, 71 – Statute of limitations extension applies to still-open periods and retroactive to April 1, 2006**
- **Bill sec. 71 – Clarification that tax-exempt entities may not transfer tax credits applies back to beginning of the respective tax credit provisions**

Transition, Applicability, and Effective Dates (continued)

- Bill sec. 73 – Most other provisions of the bill take effect immediately
- Bill secs. 68, 70 – DOR and DNR may start developing regulations immediately, and regulations may be retroactive to applicability date of the statutory provisions they implement