FREQUENTLY ASKED QUESTIONS ON BALLOT MEASURE 1
September 20, 2020

These FAQs are being provided as part of the public hearing process required under AS 15.45.190. The purpose of these FAQs is to answer questions that have commonly been posed by the public and legislators regarding Ballot Measure 1 in a neutral and objective manner based on publicly available information about the Measure. The questions and responses were developed by the Department of Revenue, Department of Natural Resources and the Department of Law.

A. What is Alaska Ballot Measure 1?

Ballot Measure 1 (Measure) would increase the oil and gas production tax for qualifying North Slope production by imposing a new tax regime involving two alternative taxes depending on which tax is greater on a monthly basis. The Measure would make all tax filings and supporting information on this new tax regime a matter of public record.

B. What oil fields, units, or non-unitized reservoirs currently have qualifying production volumes under Ballot Measure 1?

The oil production impacted by the Measure are those areas that produce 40,000 barrels per day of oil and have produced 400,000,000 cumulative barrels. According to the Measure's sponsors, the current production that meet these criteria include Prudhoe Bay, Kuparuk, and Alpine. The production from these areas represent approximately 80% of the total North Slope production. If the Measure passes, then in the future, other production that meets these criteria would also become subject to these tax changes.

C. How is the current oil production tax calculated?

For North Slope oil and gas, the current annual oil and gas production tax levy is based on the greater of two different tax calculations; Gross minimum tax floor of up to 4% of gross revenues <u>or</u> a net profit tax (Production Tax Value) of 35%. The net profit tax calculation allows various deductions for lease expenditures and per-taxable-barrel credits. Taxpayers make monthly payments of the estimated annual tax.

D. **How would the Measure change the gross minimum tax calculation?**

The tax proposed by the Measure increases the gross minimum tax to 10% with an additional 1% for each $5 oil price increment above $50.00/bbl to a maximum of 15% gross tax. The gross tax would be calculated separately each month.

E. How would the Measure change the net profit tax calculation?

According to the sponsors of the Measure, the Measure would impose an "additional tax" of 15% for qualifying production on that share of production tax value that exceeds $50/bbl. If this amount is added to the existing net profit tax of 35%, this would bring the total marginal tax rate to 50%. (It should be noted that the Measure uses the term "additional tax" but it does not specify what the new tax is in addition to. For purposes of clarity, these FAQs refer to the interpretation put forward by the sponsors of the Measure. Ultimately, if the Measure is enacted, Department of Revenue would need to adopt *regulations to implement the initiative, which would involve determining how the language of the initiative fits into the current tax scheme.)*

F. How are lease expenditures impacted by the Measure?

Generally, the current tax statute allows lease expenditures to be aggregated for the entire North Slope and deducted by the taxpayer for the entire North Slope tax liability. The Measure restricts this by requiring lease expenditures to be deducted separately for each of the field, unit, or non-unitized reservoir that meets the qualifying production thresholds. Lease expenditures include both operating and capital costs for the upstream costs associated with production.

G. How would tax credits be impacted by this Measure?

The Measure would prohibit application of the per-taxable-barrel credits against the tax on production tax value for the qualifying oil. The Measure would prohibit application of any tax credits, carried-forward lease expenditures, or other offsets to reduce the tax below the gross minimum tax in the Measure.

H. Are the tax credit certificates of $743 million impacted by the Measure?

This Measure has no impact on existing tax credit certificates. Only explorers and small producers (daily average production of around 50,000 barrels or less), and not legacy field majority owners, were eligible to request purchase of tax credit certificates by the State.

I. What is the estimated production tax revenue impact to the State of Alaska of the proposed change in calculation of oil production tax?

The production tax revenue impact depends on the actual price of the oil, the actual volumes of oil produced, and the ultimate interpretation of the Measure that can only be determined post-enactment. For purposes of providing information to the public to make an informed decision, the following table presents one scenario of potential production tax revenue increases for fiscal year 2022, at various prices, and the percentage increase from the current oil tax revenues. In general, the calculations rely on the way the sponsors have described the Measure. These estimates are based on the Spring 2020 revenue forecast and assumes no changes in produced oil volume or company investment because of the tax change.

Estimated FY 2022 Production Tax ($ millions)				
ANS Price ($/bbl)	Current Law (SB21)	Ballot Measure 1 (BM1)	BM1 Incremental Revenue	Increase (%)
$35	$103	$327	$224	216%
$45	$191	$564	$373	196%
$55	$260	$846	$586	225%
$65	$321	$1,147	$827	258%
$75	$456	$1,472	$1,016	223%

J. What is a royalty payment and how are royalty revenues calculated?

Every barrel of oil that is produced in Alaska is charged a royalty. If the oil is produced from State lands, the royalty is paid to the State. If the oil is produced from Native, Federal or private lands, the royalty is paid to those respective landowners. State of Alaska royalty rates typically range from 12.5% - 16.66% and are set in the terms of the lease. The royalty payment (royalty revenue) is calculated based upon the price of oil per barrel at the time of production minus transportation costs to get that barrel to market. Royalties get paid first, before taxes and other costs, and regardless of whether or not a barrel of oil generates a profit from its sale. Royalty revenue increases when more oil is produced and decreases when less oil is produced, and royalty is not tied to taxes.

K. Are royalty payments that are made to the State impacted by this Measure?

No. Ballot Measure 1 does not propose to change royalty rates. Ballot Measure 1 proposes changes to production tax rates.

L. What does "Government Take" mean?

Government Take is an estimate of the total amount of revenue that all levels of government will collect from oil producers. Government take is important to oil company investors because it can be used to compare the economics of oil production in Alaska to other states and countries. The Government Take is frequently the largest cost for oil exploration and production companies.

M. What types of revenues does the Government collect (take) from the oil producers?

- a. *Production Taxes – **This is the tax that is the subject of the Measure.** Production taxes are collected based on complicated calculations that include the volume of barrels of oil produced, price of the oil, and costs to produce the oil. (See above FAQs B through I.)*
- b. *Alaska Corporate Income Taxes – This tax is levied on oil and gas C corporations as a percentage of their worldwide net income apportioned to Alaska net income.*
- c. *Royalty Payments – The State of Alaska (SOA) collects royalty payments as the landowner and the payment represents a percentage of the gross value of production.*
- d. *Property Taxes – Municipalities and the State of Alaska collect property taxes based on a percentage of the assessed value of the taxable oil and gas property in the State of Alaska.*
- e. *Federal Corporate Income Taxes – This tax is levied on businesses by the Federal government. It is assumed that all oil producers pay the maximum tax rate of 21%.*
- f. *Federal Royalty Payments – The royalties collected by the Federal government on federal lands. Depending on the location, a portion of this royalty is shared with the State of Alaska.*

N. How much does an oil producer take after the government collects its share of revenues?

The oil producers keep the amount of net profits after all taxes, royalties, transportation costs, and operating costs are paid.

O. What are the estimates of Government revenues and Producer Profits at different oil prices if the Measure passes?

The following chart provides estimates of the percentage of each entity's "take" of net profit from a barrel of oil at various oil price scenarios. This shows the percentage for different government entities and how much will remain for producers ("Producer Take"). Net profits are calculated as the gross value of production less transportation costs, deductible lease expenditures and government take. These estimates are based on a one-year analysis using fiscal year 2022 assumptions from the Spring 2020 Forecast. As mentioned in FAQ "I" above, these impacts depend on the actual price of the oil, the actual volumes of oil produced, and the ultimate interpretation of the Measure that can only be determined post-enactment. This provides one scenario based on the way the sponsors have described the Measure.

		Impacts of Ballot Measure 1				
Price/BBL	**Current Tax at $35/bbl**	**$35/bbl**	**$45/bbl**	**$55/bbl**	**$65/bbl**	**$75bbl**
State Take - Taxes	19%	47%	24%	28%	30%	31%
State Take - Royalty	66%	66%	30%	23%	20%	18%
State / Muni Take - Property Tax	27%	27%	9%	5%	4%	3%
Federal Take	0%	0%	8%	9%	10%	10%
Producer Take	-12%	-40%	30%	35%	37%	38%

**A negative percent indicates that the producer will realize negative cash flow because the government taxes and royalties are payable despite the low price of oil.*

P. **How has oil production been impacted historically when the price of oil drops and producers earn less profits?**

Of course, there are many factors that can impact production. But oil prices fell significantly during the timeframe of March to June 2020. A review of the actual production volumes for the months of April to June 2020 provides an historical view of how production changed when the price of oil fell and the "Producer Take" (defined above in O) went below an estimated cost of producing the oil.

The fiscal impact of reduced volumes of ~5.2 million barrels reduced State production taxes by ~$4.3 million and royalty revenues were reduced by ~$138 million because the barrels were not produced.

Q. **If the Measure passes, how will Alaska's tax structure compare to other oil producing jurisdictions?**

The State of Alaska has not undertaken any analysis and has not been involved with any third parties who have done so. Therefore, the State cannot verify the data that may have gone into any comparison.

Since it is publicly available, the following is a link to a presentation by IHS Markit consultants, who were engaged by the American Petroleum Institute to conduct an independent competitiveness study that attempts to document how Alaskan oil fields would compete for investments in the domestic and international markets if the Measure were enacted:
https://www.commonwealthnorth.org/events/#!event/2020/9/2/alaska-apos-s-competitiveness-in-oil-and-gas-markets.

It compares Alaska oil fields to Lower 48 oil fields in Colorado, New Mexico, North Dakota, Texas, and Wyoming. The international comparisons are made to Norway, UK, Guyana, Brazil, and Angola. The IHS presentation is an independent analysis and is provided for your reference via the following link:

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