Alaska’s Oil and Gas Taxes

The 2006 Reform, 2007 Reform, and Beyond

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Alaska State Legislature

December 9, 2008

- Marginal Effect of $1/bbl capital investment.

Who pays?

Way Simple Analysis	$/bbl	$/bbl	Diff
Destination Price West Coast	$ 121.36	$ 121.36	-
Less Transportation Cost	6.00	6.00	-
Gross Value at Point of Production	115.36	115.36	-
Royalty (12.5% of Gross Value)	14.42	14.42	-
Less Upstream Costs	**20.00**	**21.00**	**1.000**
"PTV" or net value	$ 80.94	$ 79.94	$ (1.000)
Taxable Barrels	87.5%	87.5%	
PTV / taxable bbl	92.50	91.36	
Production Tax - Progressivity Rate	25.0%	24.5%	
Production Tax - Base Rate	25.0%	25.0%	
Total Production Tax Rate	50.0%	49.5%	-0.46%
Royalty (12.5% of Gross Value)	$ 14.42	$ 14.42	$ -
Pre Credits Production Tax (rate * net)	40.47	39.61	(0.865)
Production Tax Credits (assumed)	(10.00)	(10.10)	(0.100)
Property Tax (Assumed)	0.50	0.50	-
State Income Tax (9.4% * net less taxes)	4.70	4.69	(0.003)
Federal Income Tax (35% * net less taxes)	15.85	15.83	(0.011)
Government Take	**$ 65.93**	**$ 64.95**	**$ (0.980)**

Marginal Effect of One Dollar 101

- Marginal Effect of $1/bbl increase in price.

Who receives?

Way Simple Analysis	$/bbl	$/bbl	Diff
Destination Price West Coast	**$ 120.36**	**$ 121.36**	**$ 1.000**
Less Transportation Cost	6.00	6.00	-
Gross Value at Point of Production	114.36	115.36	1.000
Royalty (12.5% of Gross Value)	14.30	14.42	0.125
Less Upstream Costs	20.00	20.00	-
"PTV" or net value	$ 80.07	$ 80.94	$ 0.875
Taxable Barrels	87.5%	87.5%	
PTV / taxable bbl	91.50	92.50	
Production Tax - Progressivity Rate	24.6%	25.0%	
Production Tax - Base Rate	25.0%	25.0%	
Total Production Tax Rate	49.6%	50.0%	0.40%
Royalty (12.5% of Gross Value)	$ 14.30	$ 14.42	$ 0.125
Pre Credits Production Tax (rate * net)	39.71	40.47	0.758
Production Tax Credits (assumed)	(10.00)	(10.00)	-
Property Tax (Assumed)	0.50	0.50	-
State Income Tax (9.4% * net less taxes)	4.69	4.70	0.011
Federal Income Tax (35% * net less taxes)	15.81	15.85	0.037
Government Take	**$ 65.00**	**$ 65.93**	**$ 0.931**

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Marginal Take – 10% Increase

		Before Project		With Project	
		Govt Take %	Dollars	Govt Take %	With Project
Taxable base	(1)		$ 100.00		$ 110.00
Government Take	(2)	50%	$ 50.00	55%	$ 60.50
Company Take	(3)		$ 50.00		$ 49.50

Company Take = Taxable Base less Government Take

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Government Take One Pager

All figures in millions of dollars unless otherwise indicated

			Spring 2008 Forecast Intrmd. Est.	Totals
1	Destination Value	($85.73/bbl * .721 mmbbl/day * 365)	22,592.4	
2	*less* transportation costs**	($6.27/bbl * .721 mmbbl/day * 365)	(1,652.3)	
	Equals value at point of production		20,940.1	
3	Calculate Royalty	(12.5% times value includes PF%)	2,617.5	2,875.3
{	*less* Upstream Operating costs**		2,148.0	
4{	*less* Upstream Capital costs**		2,130.0	
{	*Equals* PTV (Production Tax Value)		13,786.8	
5	Calculate Base Production Tax (25% of PTV)	(25% of PTV)	3,446.7	3,465.5
6	Calculate Progressivity Component of PT (0-50% of PTV)			1,875.0
7	Apply Production Tax Credits			(400.0)
	Production Tax is Base Tax plus Progressivity less Credits			4,940.5
{	Restate PTV as ANITA taxable income, *less* production tax, *plus* worldwide income	if 5% factor	131,744.7	
8{	Calculate and apply Alaska Apportionment Factor	(Tax/.094)	6,587.2	
{	Calculate AK Corporate Income Tax as 9.4% of Alaska taxable income			619.2
9	** Costs include state and local property taxes of 20 mills on oil and gas property.		estimated	287.7
	Note: may be difference between cost incurred and allowable costs		TOTAL:	8,722.7

Restate PTV as federal taxable income, subtract production tax and AK CIT, calculate marginal federal income tax

Source: Dept of Revenue Tax Division Spring 2008 Forecast, Total property taxes estimated from Tax Divisions FY 2007 Annual Report

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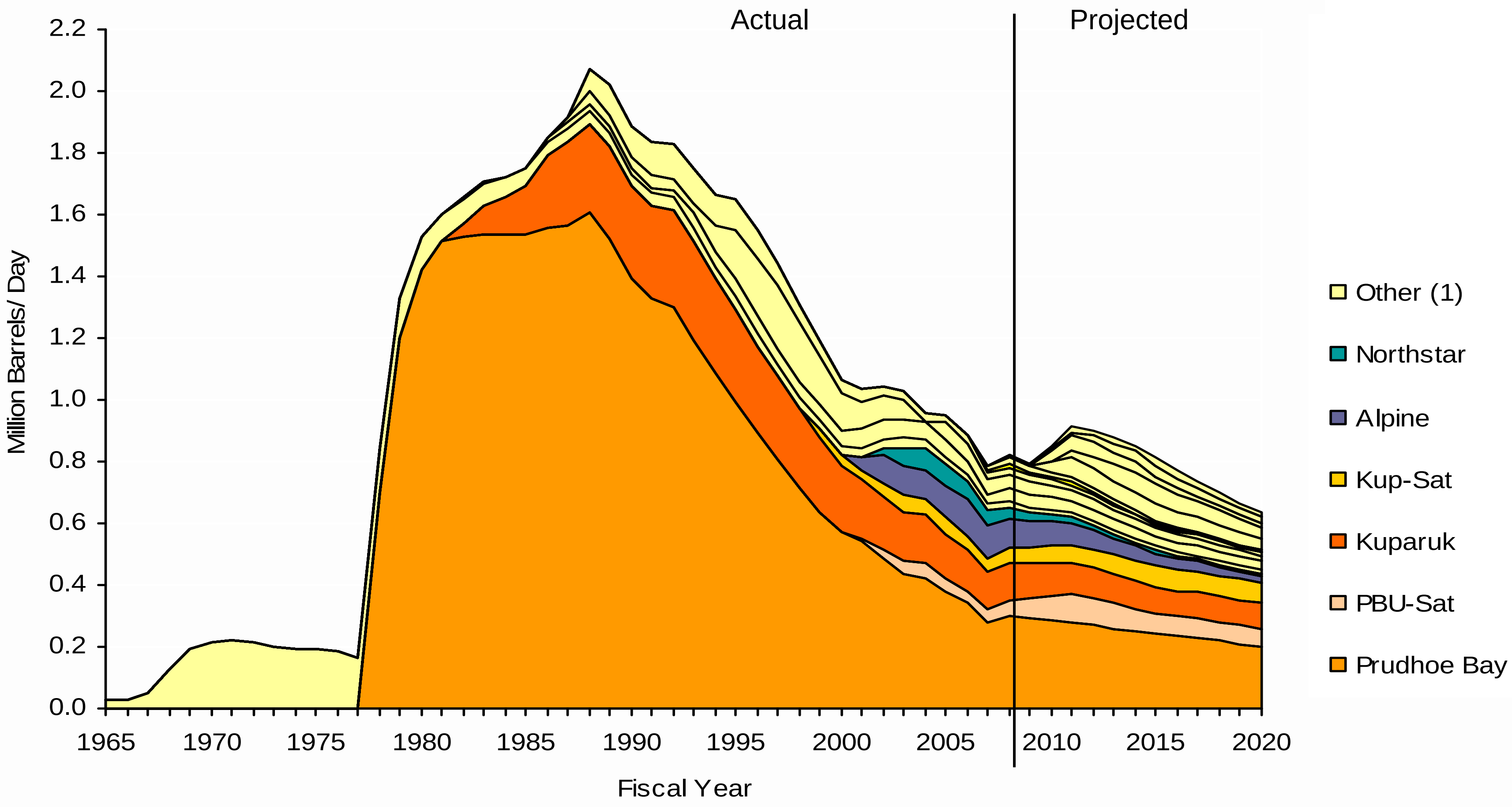
How did we get here - Volumes

Alaska Oil Production, 1965 - 2020



(1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.

Source: Alaska Department of Revenue, Fall 2006 Revenue Sources Book. extrapolated

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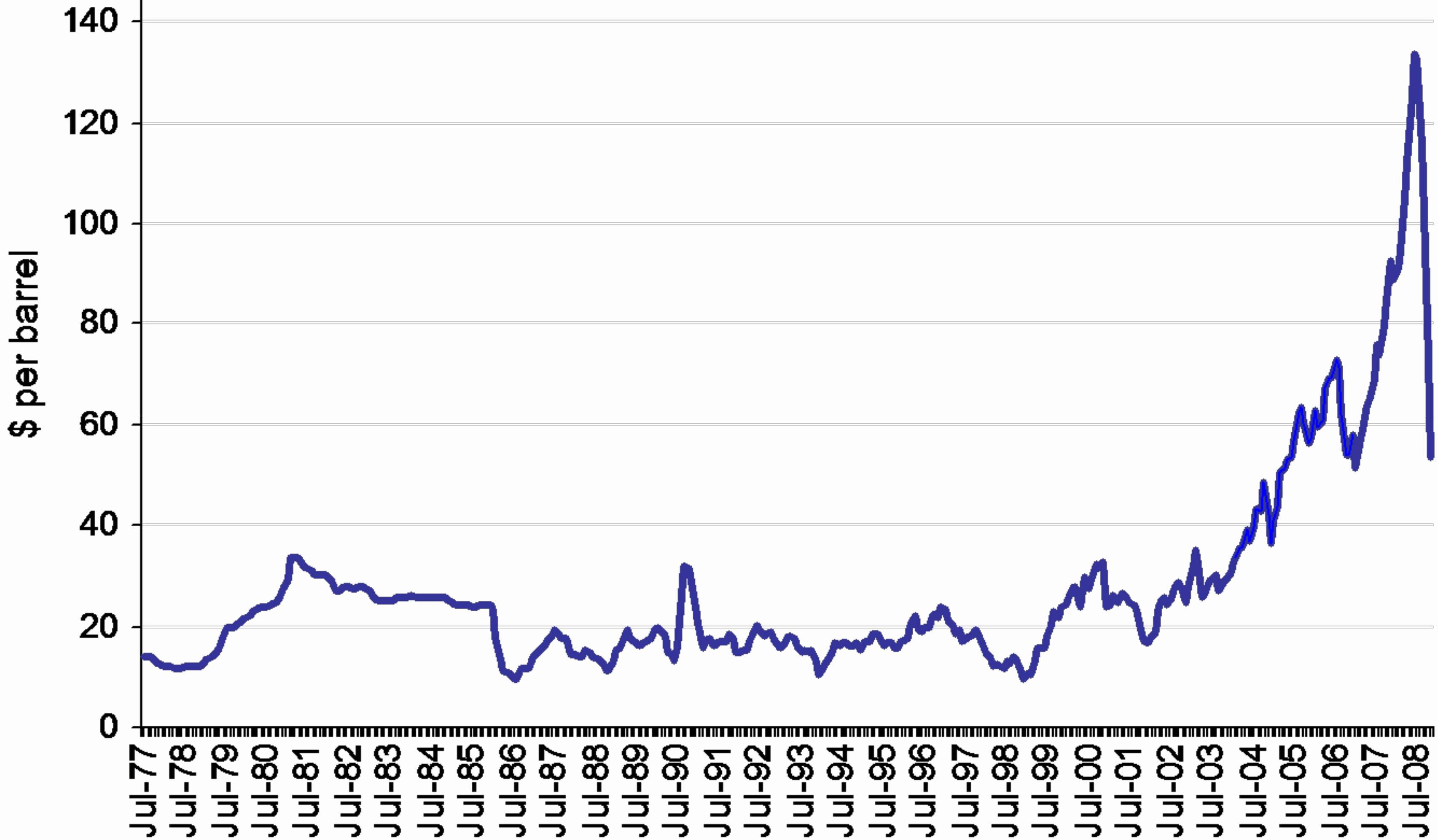
How did we get here - Price

ANS WC Price July 1977 - Nov 2008



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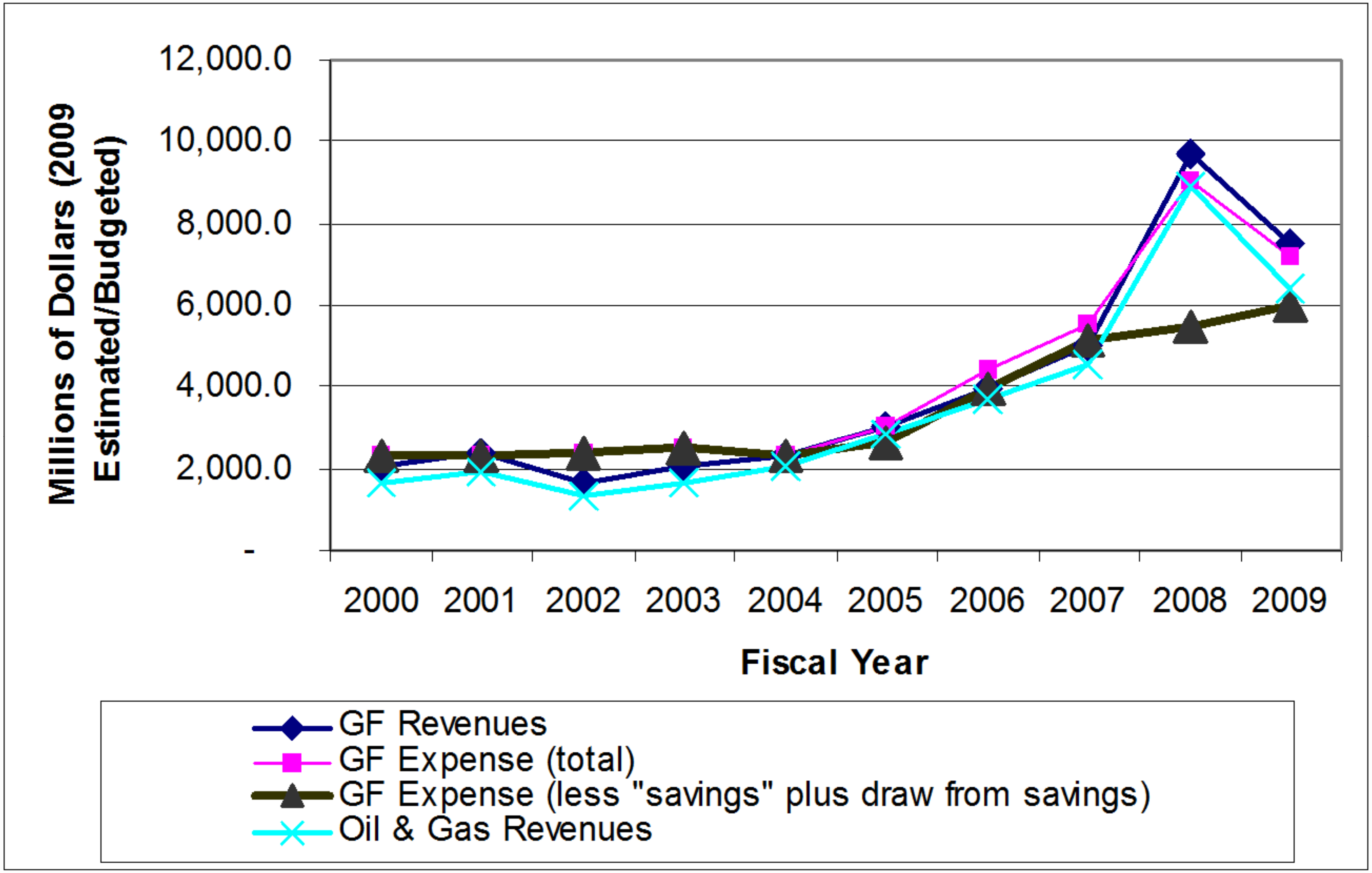
How did we get here - Spending



Source: Annual Fiscal Summaries from Leg Finance web site, supplemented with Spring 2008 RSB data

How did we get here - Setting the Stage Pre-2006

1973 -1981 Switch from Cook Inlet to North Slope

- New oil and gas property tax (AS 43.56)
- Switched Corporate Income Tax from Apportionment to Separate Accounting back to Modified Apportionment (AS 43.20)
- Experimented with Production Tax changing maximum and minimum rates, rate mechanisms (stair step, Economic Limit Factor (ELF), rounding rule, special rate first 5 years]

1981 – 2006 Quarter Century of relative stability for CIT and Property Tax

- 1989 and 2003 – 2 production tax law changes
- Production tax of nominal 15% of “gross value at point of production” for oil (after 5 years at 12.5%) times ELF so effective rate was about 7.5% by end of period

Three largest taxpayers agreed to Production Tax reform as part of Stranded Gas Development Act negotiation –

- 20% of “net,” 20% investment credit, no progressivity measure
- Two special sessions in the summer of 2006

How did we get here - PPT

- <u>2006 Production Tax Reform ("PPT")</u>
  - Switch from "gross to net"
  - Tax on 22.5% of PTV or "net value"
  - Progressivity (above $40 of PTV at rate of .25% per dollar)
  - 20% investment credit
  - 20% loss carryforward credit
  - 20%/20%/40% Exploration credits incorporated
  - Transitional Investment Expenditure Credits
  - Small producer credits of up to $12 million a year
  - US costs focus on unit operating agreement and working interest owner audits (with 18 exclusions)
  - Retroactive to April 1, 2006

How did we get here 2006 - 2007

- *In July 2006 ANS WC monthly price breaks $70 for first time*
- Aug 2006 Governor Murkowski loses in Republican primary
- Sept 2006 FBI raids 6 legislators offices (two of those have subsequently been convicted of felonies including bribery and are serving prison sentences of 5 years +)
- November 2006 Governor Palin Elected
- 2007 legislative session focuses on creation of AGIA license
- Sept 2007 Governor Palin announces special session that will reexamine production taxes – proposes "ACES" package of reforms
- *In Oct 2007 ANS WC monthly price breaks $80 for first time*
- *In Nov 2007 ANS WC monthly price breaks $90 for first time*
- November 2007 special session passes production tax reforms

How did we get here - ACES

- 2007 Production Tax Reform ("ACES")

  - Switch from gross to net maintained
  - Tax from 22.5% to 25% of PTV
  - Progressivity (above $30 of PTV, at rate of .4% per dollar)
    - Changed from $40 and .25%
  - 20% investment credit now spread over 2 years
  - 25% loss carryforward credit (from 20%) (2 years for transfer)
  - 30%/30%/40% Exploration credits incorporated (from 20%/20%)
    - Effective July 1, 2008
  - Transitional Investment Expenditure Credits ended/restricted
  - Small producer credits of up to $12 million a year
  - US costs focus from unit operating agreement and working interest owner audits to "allowed by dept. by regulation" (with 21 exclusions)
  - Retroactive to July 1, 2007

How did we get here – 4 fold increase in tax

	Production Taxes									Royalty	
Fiscal Year	Prod Tax Rev ($ 000 000)	Less CI gas ($000 000)	Apples to Apples Rev ($000 000)	2008$ / 2004 $	WC Price	Million bls daily Prod	Million bls annual Prod	Price times volume	2008$ / 2004 $	Royalty Rev ($ 000 000)	2008$ / 2004 $
	(A1)	(A2)	(A)	(B)	(C)	(D)	(E) = (D) * 365	(F) = (C) * (E)	(G)	(I)	(J)
2004	651.9	(24.7)	627.2		31.74	1.004	366.5	11,631.4		1,056.1	
2005	863.2	(24.4)	838.8		43.44	0.936	341.6	14,840.8		1,419.9	
2006	1,199.5	(33.2)	1,166.3		60.80	0.863	315.0	19,151.7		1,784.1	
2007	2,208.4	(6.0)	2,202.4		61.83	0.758	276.7	17,106.5		1,613.0	
2008 Forecast	4,940.5	(6.0)	4,934.5	7.9	85.73	0.734	267.9	22,967.9	2.0	2,143.9	2.0

Tax Increase attributable to changes in rules= 7.9/2 = 4

*Note: Tax revenues from some North Slope gas sales will be included in revenues with no corresponding volume effect.
That adjustment (adding .004 to the daily volume) will not materially affect the outcome. NS NGL are in both vols and $.
Fall 2007 History Data (2004, 2005, 2006) from Appendix A-4a, C-2a and B-1a of Revenue Sources Book
2007 data and 2008 **forecast** from Spring 2008 Revenue Sources "Book"
Actual 2008 revenues and price were consideraly higher - see DOR website for monthly values and revenue estimate
in Sept 1, 2008 Legislative Finance Division's State of Alaska Fiscal Summary

Government Take One Pager - Reminder

All figures in millions of dollars unless otherwise indicated

			Spring 2008 Forecast Totals
1	Destination Value		
2	*less* transportation costs**		
	Equals value at point of production		
3	Calculate Royalty	(includes PF%)	2,875.3
{	*less* Upstream Operating costs**		
4{	*less* Upstream Capital costs**		
{	*Equals* PTV (Production Tax Value)		
5	Calculate Base Production Tax (25% of PTV)		3,465.5
6	Calculate Progressivity Component of PT (0-50% of PTV)		1,875.0
7	Apply Production Tax Credits		(400.0)
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9	** Costs include state and local property taxes of 20 mills on oil and gas property.	estimated	287.7
	Note: may be difference between cost incurred and allowable costs	TOTAL:	8,722.7

Restate PTV as federal taxable income, subtract production tax and AK CIT, calculate marginal federal income tax

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Source: Dept of Revenue Tax Division Spring 2008 Forecast, Total property taxes estimated from Tax Divisions FY 2007 Annual Report

1. Production Tax Destination Value

- <u>"Higher of" under AS 43.55.020 (f)</u>

- Start of netback is higher of sales price at destination or "value of the oil or gas of the same kind, quality and character prevailing for that field or area during the calendar month…"

- 15 AAC 55.171 defines "prevailing value" for ANS oil delivered to the West coast as average spot derived from average of *Platts, Telerate* and *Reuters* reporting services

- Statutory "higher of" present since beginning of North Slope production

- Royalty leases also typically have a higher-of provision

2. Production Tax Transportation Costs

- <u>"Lower of" under AS 43.55.150 (a)</u>

- Actual Costs **<u>unless</u>**
  - Shipper affiliated with carrier or owner,
  - Contract for transportation is not arm's length; **<u>or</u>**
  - Method or terms are not reasonable in light of existing alternatives
- Then lower of actual or reasonable
- "The department shall determine the reasonable costs of transportation, using the fair market value of like transportation, the fair market value of equally efficient and available alternative modes of transportation, or other reasonable methods. Transportation costs fixed by tariff rates that have been adjudicated 'just and reasonable'… shall be considered prima facie reasonable."

- New with 2007 reforms

3. Royalties 101

- State owned land – State Royalties (which are exempted from production tax) (i.e. 7/8ths taxable).
- Federally owned land in state – Federal Royalties (which are exempted from production tax) (i.e. 7/8ths taxable) and all other state taxes apply.
  - (Royalties may be shared with State under federal legislation)
- Federally owned land not in state (off shore - outer continental shelf) Federal Royalties and no state taxes apply.
  - (In GOM federal royalties now shared with Gulf coastal states.)
- Privately owned land in state – Private Royalties (which are taxable at betwen1.667 to 5% of gross) while other 7/8ths taxable under regular production tax and all other taxes apply.

3. Royalties 101

Source: Kevin Banks presentation to House Finance Committee (Jan 22, 2008)

3. Royalties 101

- <u>Alaska State Royalties</u>
- In the lease – include both gas and oil
- Measured at point of production
- Older state leases 12.5% royalty (current average ~13%)
- Less field cost allowance in legacy fields such as Kuparuk and Prudhoe
- Can be taken in-kind (oil or gas) or in-value (money)
- Some newer leases have higher rates
- Also Net Profit Share Leases

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Restate PTV as federal taxable income, subtract production tax and AK CIT, calculate marginal federal income tax

Source: Dept of Revenue Tax Division Spring 2008 Forecast, Total property taxes estimated from Tax Divisions FY 2007 Annual Report

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4. Production Tax Value: Upstream Costs

- AS 43.55.165 allowable upstream costs
  - include both capex as spent and opex;
  - An activity does not need to be physically located on, near or within the premises of the lease or property (AS 43.55.165 (b) (2)
- **Lease expenditures are costs,**
- **other than items listed in (e)…**
- **Incurred …, to explore for, develop or produce oil or gas deposits located …in the state**
- **Allowed by … regulation [that are]**
- **…upstream of the point of production**
- **…ordinary and necessary**
- **…direct**
- **And a reasonable allowance … as determined by the department … for overhead**
  - Sept 2008 overhead proposal for after July 2007: 4.5%

4. Production Tax Value: Upstream Costs

- AS 43.55.165 (e); 21 disallowed kinds of costs

- (1) depreciation, depletion or amortization
- (12) non third party transaction unless "the producer establishes to the satisfaction of the department that the amount … does not exceed fair market value"
- (15) dismantlement, removal, surrender, abandonment, restoration
- (18) $.30 a btu equivalent barrel from Capital Expenditures for all production
- (19) any cost "that results in or is undertaken in response to a failure, problem, or event that results in an unscheduled interruption of, or reduction in the rate of, oil or gas production …"

  Unless "solely necessitated by an act of war,…natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effect of which could not have been prevented or avoided by the exercise of due care or foresight …"
- (20) costs incurred to construct, acquire or operate a refinery of crude oil topping plant … however the producer's lease expenditures include the … fair market value of the product

5. Production Tax 101

- Production Tax Value (PTV) is tax base for both annual base calculation of 25% and monthly progressivity calculation

- <u>Other aspects of the Production tax</u>
- Floor
  – 4% of gross when WC ANS price above $25/bbl
  – Phased out between WC ANS price of $25/bbl and $15/bbl
  – No effect on loss carry-forwards, calculation of PTV, or ability to carry credits forward
- Private Royalty Tax
- Conservation Surcharge – nickel a barrel
- CI and Instate Gas Use Ceilings (17 cents per mcf)
  – Implications for credits
  – Expire in 2022
- Monthly Reporting, Filing & Interest
  – 1/12 of credits & upstream costs every month

5. Production Tax Base Rate

- AS 43.55.011(e) Base Production Tax Rate of 25%
  - On Production Tax Value (PTV)
  - Which cannot be below zero

- Every year either qualified lease expenditures or PTV is reduced to zero. If there is PTV left it is taxed. If there are qualified lease expenditures left they are carried forward in form of credits.

- Loss carry forward credit is 25% of loss or amount that qualified lease expenditures would take PTV below zero.

6. Production Tax - Progressivity

- Progressivity under AS 43.55.011(g)
- **Monthly Calculation using**
- 1/12th of lease expenditures
- Current month prices
- Formula:
  - PTV per BTU equivalent barrel
  - Less $30
  - Then 4/10s of a percent for every dollar up to $62.5 or 25%
  - Then 25% + 1/10 of a percent for every dollar up $250 or 25%
  - Highest progressivity is 50% at PTV of $342.50
- Added to Base Production Tax of 25%
- Apply against PTV base

6. Production Tax - Progressivity

- <u>Progressivity under AS 43.55.011(g)</u>
- Sample Calculation

Destination Price/bbl	$ 115.00	assumption
Total Upstream and Downstream Cost/bbl	30.00	assumption
Production Tax Value (PTV)	85.00	calc
Calculate Progressivity Starting Point	(30.00)	law
Progressivity base/bbl	$ 55.00	calc
Progressivity Rate/$/bbl	0.40%	law
Progressivity Rate/bbl	22.00%	calc
Basic Production Tax Rate	25.00%	law
Combined Rate	47.00%	calc
Tax/bbl (Combined Rate * PTV)	$ 39.95	calc

7. Production Tax Credits

Credits under AS 43.55.023 and AS 43.55.025 generally can be

- Transferred (sold) to another person
- Saved and applied against future liabilities
- Sold back to state under terms of AS 43.55.028
  - Proceeds must be reinvested in state within two years
  - Only available to producers with less than 50,000 bbls a day of production (currently excludes "big 3")

- Original annual cap of $25 million per taxpayer repealed in 2007

7. Production Tax Credits

- Credits under AS 43.55.023
- AS 43.55.023 (a) investment credit of 20% of qualified capital investment
  - Only half can be taken in year of investment
- AS 43.55.023 (b) loss carry forward credit calculated as 25% of lease expenditures “not deductible in calculating PTV”
  - If transferred must be used over two years
- AS 43.55.023 (e) credit purchased from other company may not reduce tax to less than 80% of what would otherwise be due
- AS 43.55.023 (i) TIE credits – now generally repealed

7. Production Tax Credits

- <u>"New Area Development" Credit under AS 43.55.024 (a) - (b)</u>
- Up to $6 million a year against PTV from a New Area Development (not North Slope, not Cook Inlet)

- <u>"Small Producer" Credit under AS 43.55.024 (c) - (d)</u>
- Up to $12 million a year applicable against AS 43.55.011(e) taxes
- If not more than 50,000 BTU equivalent bbls a year
  - Phases out between 50,000 and 100,000 bbls
  - 1- [2 X (AP – 50,000)]/ 100,000

- Both AS 43.55.024 credits:
- Non-transferable, non-saleable, can't carry over
- Sunsets in 2016
  - Or if no production before 2006, but production starts before 2016, then 9 years of the credit.

- Test under AS 23.44.024 (e):
  - A producer must demonstrate… that its operation in the state … would not result in the division among multiple entities of any production tax liability that reasonably would be expected to be attributed to a single producer if the tax credit provisions …did not exist.

7. Production Tax Credits

- Credits under AS 43.55.025
- AS 43.55.025 (b) & (c) credit of 30% of exploration costs that have been pre-approved by the commissioner of DNR as new exploration target (must also be more than 3 miles from existing bottom hole, except in CI)
- AS 43.55.025 (b) & (d) credit of 30% of exploration costs more than 25 miles from a 2003 unit boundary
- AS 43.55.025 (b), (c) & (d) credit of 40% of exploration costs that meet both criteria
- AS 43.55.025 (b) & (e) credit of 40% for seismic costs
- AS 43.55.025 (l) credit of 5% for pre-2003 work if DNR considers making it public in state's best interest
- Data generated by activity that created credit becomes public
  - Well data after 2 years
  - Seismic data after 10 years
- Fully transferable or saleable or can be carried forward

7. Production Tax Credits

Simple Production Tax Example (No progressivity)	Year 1	Year 2 (Start second project)	Year 3 (Both projects profitable)
Destination Value	$ 100.0	$ 100.0	$ 200.0
Less Downstream Costs	(10.0)	(10.0)	(20.0)
Gross Value at the Point of Production	90.0	90.0	180.0
less Royalty	(11.3)	(11.3)	(22.5)
less Opex	(10.0)	(10.0)	(20.0)
less Capex	(10.0)	**(80.0)**	(10.0)
equals PTV (Production Tax Value)	$ 58.8	**no PTV**	$ 127.5
Calculation of Loss instead of negative PTV		$ (11.3)	
Base Production Tax Rate/Credit Conversion	25%	25%	25%
Base Production Tax Dollars	$ 14.7	$ -	$ 31.9
Investment Credit Year one (1/2 of 20% of capex)	(1.0)	(8.0)	(1.0)
Investment Credit Year two (1/2 of 20% of capex)		(1.0)	(8.0)
Loss Carry Forward Credit (25% of loss)		(2.8)	
Carry Unused Credits Forward		11.8	(11.8)
Tax Due	$ 13.7	$ -	$ 11.1

May be additional floor tax due in Year 2

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8. AK Corporate Income Tax 101

- <u>AS 43.20 Alaska Net Income Tax Act</u>
- A corporate income tax (CIT) rate of 9.4% for all income above $90,000
- Not separate accounting (9.4% of income from an Alaskan project)
- Instead apportionment where apportionment formula is:
  - CIT = 9.4%* AK App Factor * Everywhere Income

Where

- – Everywhere income = Federal taxable income plus any taxes based on or measured by net income added back
- – AK App Factor = the Alaska Apportionment Factor

8. AK Corporate Income Tax 101

- Sample Calculation

International Oil Company A

Figures in millions of dollars or barrel equivalents

	Alaska	Everywhere	Ratio
Sales	250	25,000	1%
PPE	4,000	40,000	10%
Production	250	1,000	25%

Alaska Apportionment Factor		12%
Assumed Income (before Taxes)	$	2,500.0
Alaska Apportioned Income		300.0
Alaska Tax Rate		9.4%
Alaska Corporate Tax	$	28.2

CIT = 9.4% * AK App Factor * Everywhere Income

CIT = 9.4% * 12%* $2,500 = $28.2

For incremental analysis: Most "separate accounting income" generated in the state will be apportioned off and taxed elsewhere; most of the income taxes collected in the state will have been generated from "separate accounting income" generated elsewhere.

9. Alaska Oil & Gas Property Tax 101

- AS 43.56 Oil and Gas Exploration, Production and Pipeline Transportation Property Tax

- Assessed Value
  - State centrally assesses “oil and gas property”
- Tax
  - State taxes at 2% (20 mills) a year. Allows credit for taxes paid on AS 43.56 property to localities
  - Localities that have property taxes can apply their general rates against “oil and gas property” and other property (tankers, office buildings, vehicles etc.)
    - No effective formal cap on local rate
    - Informal caps are state’s 20% rate and local pressures

9. Alaska Oil & Gas Property Tax 101

- 3 classes of property under AS 43.56.060

- Exploration property (rigs) (1% of 2008 Roll)
  - Sales Value
- Production Property (62% of 2008 Roll)
  - Cost during construction; Replacement cost new less depreciation (base on economic life of proven reserves) thereafter
- Pipeline Property (37% of 2008 Roll)
  - Cost during construction; “with due regard to the economic value of the property based on the estimated life of the proven reserves…” thereafter
  - 15 AAC 56.110 - “standard appraisal techniques such as replacement cost less depreciation, capitalization of estimated future net income, analysis of sales or other acceptable methods”
  - Current DOR focus is on cost methods

Government Take One Pager - Reminder

All figures in millions of dollars unless otherwise indicated

			Spring 2008 Forecast Totals
1	Destination Value		
2	*less* transportation costs**		
	Equals value at point of production		
3	Calculate Royalty	(includes PF%)	2,875.3
{	*less* Upstream Operating costs**		
4{	*less* Upstream Capital costs**		
{	*Equals* PTV (Production Tax Value)		
5	Calculate Base Production Tax (25% of PTV)		3,465.5
6	Calculate Progressivity Component of PT (0-50% of PTV)		1,875.0
7	Apply Production Tax Credits		(400.0)
	Production Tax is Base Tax plus Progressivity less Credits		4,940.5
{	Restate PTV as ANITA taxable income, *less* production tax, *plus* worldwide income		
8{	Calculate and apply Alaska Apportionment Factor		
{	Calculate AK Corporate Income Tax as 9.4% of Alaska taxable income		619.2
9	** Costs include state and local property taxes of 20 mills on oil and gas property.	estimated	287.7
	Note: may be difference between cost incurred and allowable costs	TOTAL:	8,722.7

Restate PTV as federal taxable income, subtract production tax and AK CIT, calculate marginal federal income tax

Source: Dept of Revenue Tax Division Spring 2008 Forecast, Total property taxes estimated from Tax Divisions FY 2007 Annual Report

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Conclusion – What's next?

- In-state energy focus
  - Voter created Alaska Natural Gas Development Authority (angda.org) "a public corporation focused on getting North Slope natural gas to Alaskan communities"
  - Other initiatives

- Ongoing DOR Regulations Project
- General Fund Deficit in 2009?
- Gasline sponsors' suggestions on fiscal issues

Production Tax Regulations Project

		Discussion Draft 1	Discussion Draft 2	Discussion Draft 3	Public Comment Draft 1	Public Comment Draft 2	Adopted
Project One - Lease Expenditures							
	10 Sections	Jan-08	Mar-08	Sep-08			
Project Two - NS PV, Civil Penalties, Mid Year Statutory Changes, CI reporting							
	33 sections	Feb-08			Apr-08	Sep-08	
	2 sections	Oct-08	8-Nov				
15 AAC 55. 173	NS Gas PV	Feb-08			Apr-08		Aug '08 effective as of Oct 1 '08
Project Three - Reporting Requirement							
15 AAC 55. 520	Reporting				Feb-08		May '08 effective as of June '08
Project Four - Reasonable Transportation							
	5 sections		Mar-08	May-08			
Project Five - Exploration Credits							
	6 sections				Aug-08		

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Production Tax Regulations Project

- Regulations are written by the department and are published in the Alaska Administrative Code
- Formal regulations process
  - Workshops and discussion drafts
  - Comment Draft (Adoption)
  - Lieutenant Governor actually adopts
- Regulations Work and Advisory Bulletins
- http://www.tax.alaska.gov/programs/programs/index.aspx?60652

- On the web: http://www.tax.state.ak.us/ >Programs > Oil & Gas Production Taxes > ACES Oil and Gas Production Taxes
- To be put on the DOR interested person email list for these projects please contact Shelly Boyer-Wood 907 269 6625

FY 2009 GF Budget – 7,523.3

FY 2009

At forecasted production of 0.701 mmbbls/day

ANS $/barrel	Total capital & operating costs In dollars/barrel $15	$18	$21
$50	3,356	3,044	2,743
$55	3,862	3,505	3,204
$60	4,509	4,060	3,663
$65	5,202	4,718	4,275
$70	5,942	5,423	4,946
$75	6,728	6,174	5,664
$80	7,562	6,974	6,430
$85	8,440	7,817	7,240
$90	9,367	8,709	8,099

Source: Appendix A2 DOR Fall 2007 <u>Revenue Sources Book</u>, Legislative Finance Division <u>State of Alaska Fiscal Summary</u> (Sept 1, 2008)

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TransCanada's AGIA application suggestion:

- "TransCanada would rely on the State of Alaska to take all feasible actions exclusively within its authority as a sovereign power to ensure a favorable economic environment for potential Shippers on the Project. Those actions include:
  - engaging with the ANS producers to reach agreement on a commercially reasonable and predictable upstream fiscal regime that balances the needs of the state and the ANS producers;
  - and encouraging robust exploration for and development of new natural gas resources and the commitment of such resources to the Project."

Source: TransCanada, Application for License, Alaska Gasline Inducement Act (November 30, 2007) page 2.5-52

- ConocoPhillips' Proposal (ConocoPhillips current owner with BP of Denali Project)

  "The predominant lessee risk that should be the focus of discussion with the State is the risk of unclear, unpredictable State taxes and royalties. In order to enable shippers to make long term shipping commitments, prospective shippers need clearly defined natural gas fiscal terms and an understanding of the period during which these terms will apply. Addressing these issues remains a critical component necessary to develop ANS natural gas resources and make this Project a reality."

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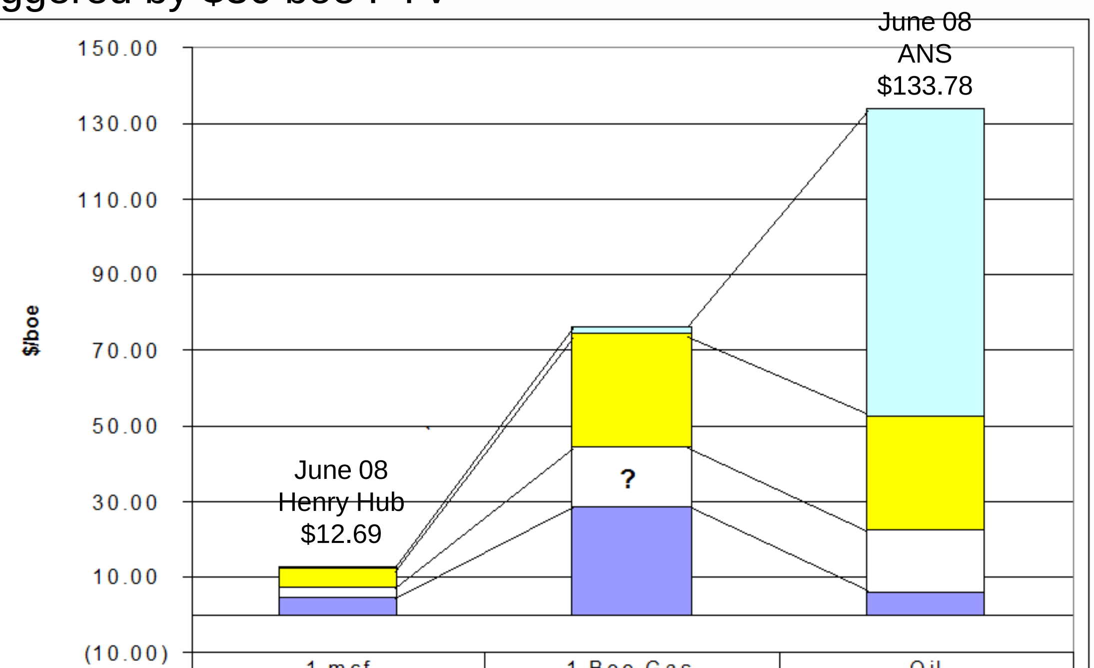
Source: ConocoPhillips, ANS Natural Gas Pipeline Proposal to the State of Alaska, (November 30, 2007) section IV page 5

Does the current fiscal regime meet these standards?

Gas exported from state and oil taxed at same rate – both part of combined progressivity calculation.

- Prices swings in one can effect tax on the other
- Gas converted to oil on Btu basis (roughly 6:1)
- Progressivity triggered by $30 boe PTV



	1 mcf	1 Boe Gas	Oil
Subject to progressivity June 2008	0.25	1.50	81.25
$30 no Progressivity zone	5.00	30.00	30.00
Upstream Costs ?	2.71	16.26	16.26
Downstream costs	4.73	28.38	6.27

Sources: Oil data from Spring 2008 RSB, Upstream Gas Cost is oil data on boe basis, Gas Downstream cost is Black & Veatch Estimate from Appendix G Alaska Gasline Determination, Oil price from DOR website, Gas Price from St Louis Fed Reserve website

Summary and Take Away Points

- Pendulums swing
- Current Shift from
  - Thinking of taxes as a drag on business activity, so they should be as low as they can be with the only constraint that state needed sufficient resources to finance government (without other major taxes?)
- To
  - Thinking of the tax system more like a royalty; “It’s our oil or gas” so government take should be as high as it can be with the only constraint that taxes do not drive away investment
- Mirrored by movements to make taxes more contractual and durable – i.e. more like royalty
- Anticipate further developments when and if switch from oil base to gas base – timing?

Thank You

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Appendix – DOR & DNR Sources

- Royalties administered by the Department of Revenue, Division of Oil and Gas which publishes an Alaska Oil & Gas Annual Report

  On the Web: state.ak.us > Departments>Natural Resources>Division of Oil and Gas>Annual Reports

- Property Taxes, Production Tax and Corporate Income Taxes administered by the Department of Revenue, Tax Division which publishes (semi-annually) the <u>Revenue Sources Book</u> and annual <u>Operations Report</u>
  - On the Web: state.ak.us > Departments>Revenue>Tax Division>Reports>Annual Report of Operations or Revenue Sources Book

Appendix - Sources - Alaska Law

- Statute –for example AS 43.55.165 (e)
  - Title 43 – Revenue – of the Alaska Statutes
  - Chapter 55 – Production Tax
  - Section 165 – Lease Expenditures
  - Subsection (d)
- Regulations – for example 15 AAC 55.171 (a)
  - Title 15 – Revenue – of the Alaska Administrative Code
  - Chapter 55 – Production Tax
  - Section 171 – Prevailing value for Oil
  - Subsection (a)

Also legislation – for example – SCS CSHB 2001(FIN) may contain uncodifed law such as transition provisions

On the Web: state.ak.us > Departments>Law>Department of Law>Legal Resources

Appendix Acronyms

- Acronyms used in this presentation

AAC	Alaska Administrative Code
ACES	Alaska's Clear and Equitable Share
AGIA	Alaska Gasline Inducement Act
ANITA	Alaska net Income Tax Act
ANS	Alaska North Slope
ANS WC	Alaska North Slope West Coast
ANWR	Artic Nation Wildlife Refuge
AS	Alaska Statute
BTU	British Thermal Unit
CI	Cook Inlet
CPA	Certified Public Accountant
DNR	Department of Natural Resources
DOG	Division of Oil and Gas
DOR	Department of Revenue
DV	Destination Value
ELF	Economic Limit Factor
FBI	Federal Bureau of Investigation
GF	General Fund
GVPP*	Gross Value at point of Production
IRC	Internal Revenue Code
IRS	Internal Revenue Service
KRU	Kuparuk River Unit
NPRA	National Petroleum Reserve - Alaska
NS	North Slope
OCS	Outer Continental Shelf
OOP	out of pocket
PBU	Prudhoe Bay Unit
PF	Permanent Fund
PP*	Point of Production
PPT	Proposed/Petroleum/Profits/Tax
PTV	Production Tax Value
RCNLD	Reproduction Cost New Less Depreciation
RIK	Royalty in Kind
RIV	Royalty in Value
RSB	Revenue Sources Book
SGDA	Stranded Gas Development Act
TAPS	Trans Alaska Pipeline System
TIE	Transition Investment Expenditure
USGS	United States Geological Survey
VPP*	Value at Point of Production

* See GVPP, VPP and PP

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