

ADMINISTRATION REVIEW OF CSHB308

February 10, 2010

Alaska Departments of Revenue

CSHB 308- House Resources

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Resident Worker Tax Rebate

CSHB 308 House Resources

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- Administration Challenges:
 - ▣ Producers only or Producers and Contractor workforce?
 - ▣ Rebate Use and Payment Mechanism Unclear
 - ▣ Authority to enforce Resident Worker criteria unclear
 - ▣ No legal authority to adjust tax, post audit
 - ▣ No legal authority to verify contractor data

Tiered Structure of Rebate Eligibility

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| Percentage Resident Hire | Rebate Amount |
|---------------------------------|----------------------|
| 80.0% | 2.0% |
| 82.5% | 4.0% |
| 85.0% | 6.0% |
| 87.5% | 8.0% |
| 90.0% | 10.0% |
| 92.5% | 12.0% |
| 95.0% | 14.0% |
| 97.5% | 16.0% |
| 100.0% | 20.0% |

Resident Hire Provision on Three Hypothetical Companies

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| Current Company Status | | | | | |
|-------------------------------|-------------|----------------------|--------------------------|-------------------------|-------------------------------------|
| Companies | # Employees | # Resident Employees | # Non-resident Employees | Resident % of Workforce | Current Tax Liability before Rebate |
| Company A | 500 | 435 | 65 | 87.0% | \$100,000,000 |
| Company B | 1,000 | 820 | 180 | 82.0% | \$500,000,000 |
| Company C | 2,000 | 1,600 | 400 | 79.5% | \$1,500,000,000 |

| Current Status and Target Resident Hire Percentage | | | | | |
|---|------------------|--------------------|--------------------------|--------------------------------|----------------------------|
| Companies | Current Rebate % | Current Tax Rebate | Additional Rebate Sought | Target Resident % of Workforce | Number of Employees Needed |
| Company A | 6.0% | \$6,000,000 | \$2,000,000 | 87.5% | 20 |
| Company B | 2.0% | \$10,000,000 | \$10,000,000 | 82.5% | 29 |
| Company C | 0.0% | \$0 | \$30,000,000 | 80.0% | 50 |

Impact of Tax Rebate Provision

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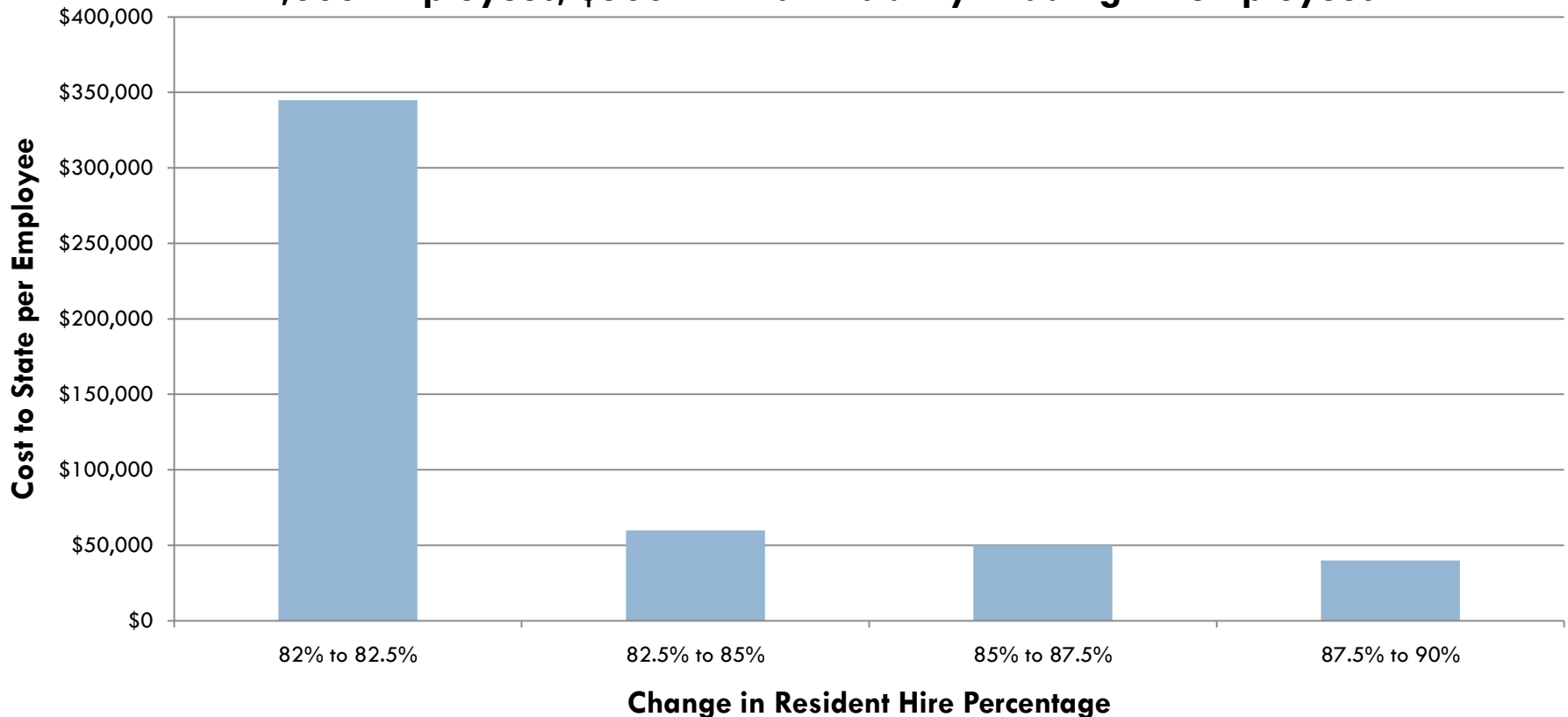
**Least Cost to State per Employee for \$2 million Rebate
Small Company A
500 Employees, \$100M in Tax Liability- Adding 20 employees**



Impact of Tax Rebate Provision

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**Least Cost to State per Employee for \$10 million Rebate
Medium Company B
1,000 Employees, \$500M in Tax Liability- Adding 29 employees**



Impact of Tax Rebate Provision

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**Least Cost to State per Employee for \$30 million Rebate
Large Company C
2,000 Employees, \$1,500M in Tax Liability- Adding 50 employees**



What Labor Costs qualify as Lease Expenditures?

Deductible Lease Expenditures - Labor

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- Basically, two classes of allowable employee expenses for the operator:
- 1st - any employee on site of oil or gas exploration, development, or production operations including infrastructure and support operations
- 2nd – employees having special and specific engineering, geological or other technical skills need not necessarily be “on-site”, but costs are limited to handling of specific problems or operating conditions involving oil or gas exploration, development, or production operations, or the support of those operations and only that portion of time actually devoted to the exploration, development or production operations
- Contractor Labor is 100% deductible

Examples of Allowable Labor - Type 1

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- Employees working on-site or in the field
 - Drillers
 - Roughnecks
 - Roustabouts
 - Electricians
 - Plumbers
 - Pipefitters
 - Welders
 - Mechanics

Examples of Allowable Labor - Type 1

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- Employees working in infrastructure or support operations:
 - Camps
 - Operations centers
 - Staging pads, roads, bridges, landing areas, and similar transportation structures
 - Communications systems
 - Medical
 - Emergency
 - Security
 - Repair & maintenance shops

Examples of Allowable Labor – Type 2

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- Employees with special and specific engineering, geological or other technical skills:
 - Engineers
 - Geologists
 - Environmental specialists
 - Employees engaged in field automation systems
 - Employees engaged in computer applications specific to the oil or gas operations

Overhead contains Labor Costs

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- Joint operating agreements typically include a section to allow the operator to recover certain indirect and overhead costs incurred offsite of the exploration, development, or production operations but are still in support of and for the benefit of those operations. These costs are not directly billed but recovered through an overhead allowance or other mechanism. They do include labor costs.

Typical Overhead Labor

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- ▣ Technical Supervisors
- ▣ Drafting, engineering aids
- ▣ Accounting
- ▣ Clerical
- ▣ Legal activities
- ▣ Off-site computer and communications activities

Non-deductible Lease Expenditures - Labor

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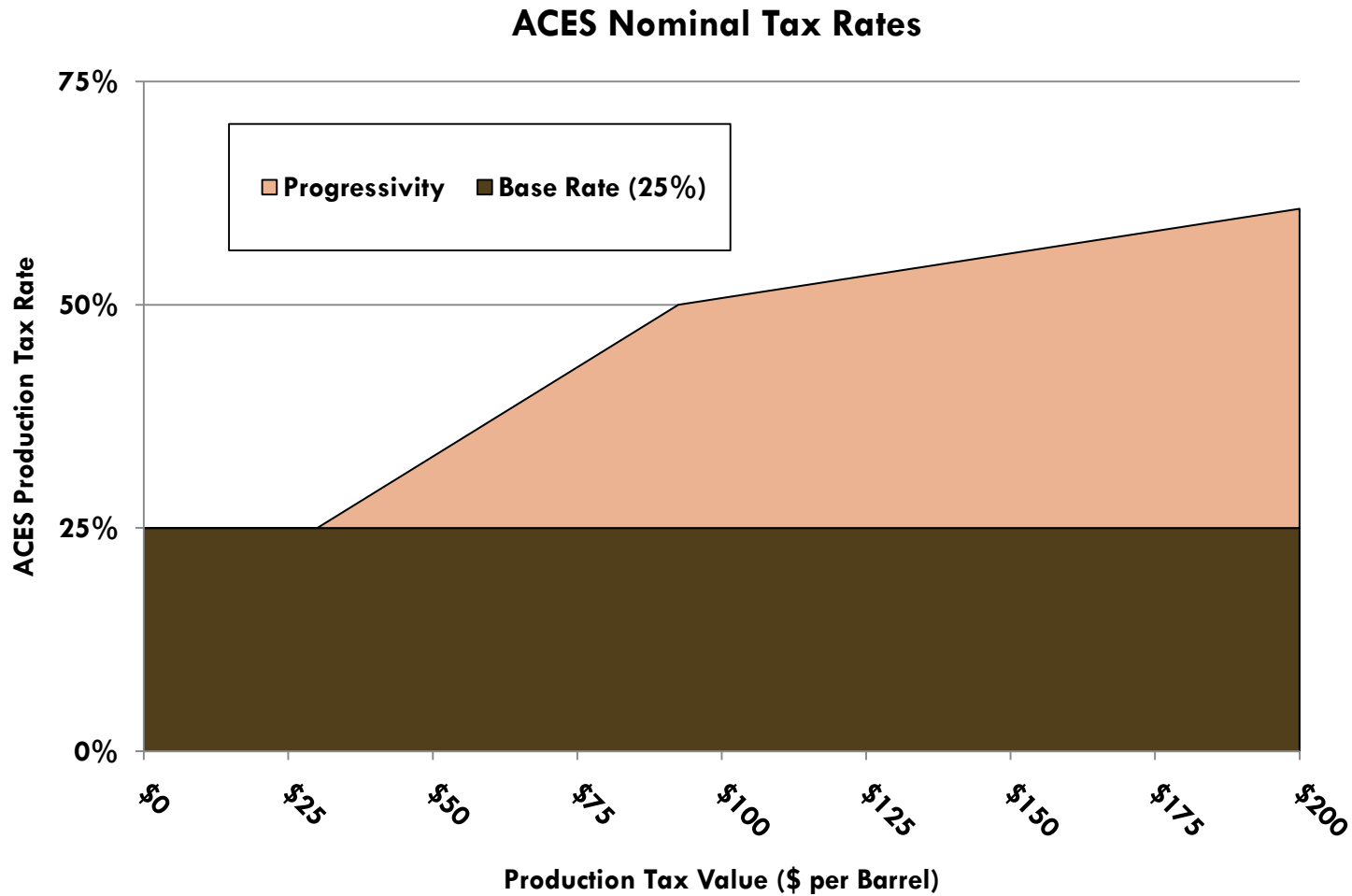
Examples of Labor Not Allowed as Lease Expenditure:

- ▣ Tax
- ▣ Legal
- ▣ Accounting
- ▣ Labor expenses that are for the benefit of an individual lessee or producer only, and not necessarily for the benefit of the joint operations
- ▣ Community, public, and government relations

Progressivity Rate Change

ACES Nominal Tax Rates

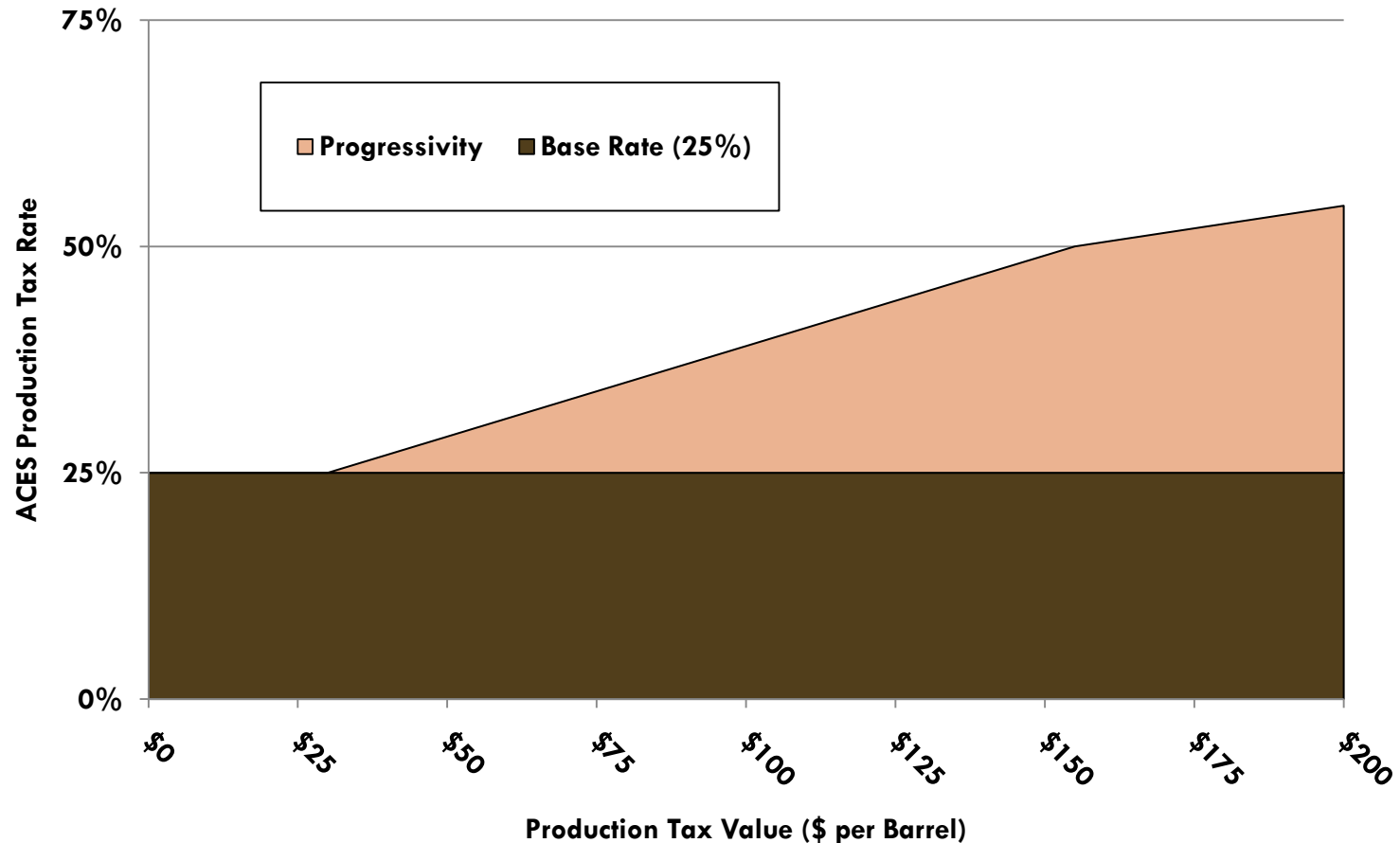
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CSHB 308 Nominal Tax Rates

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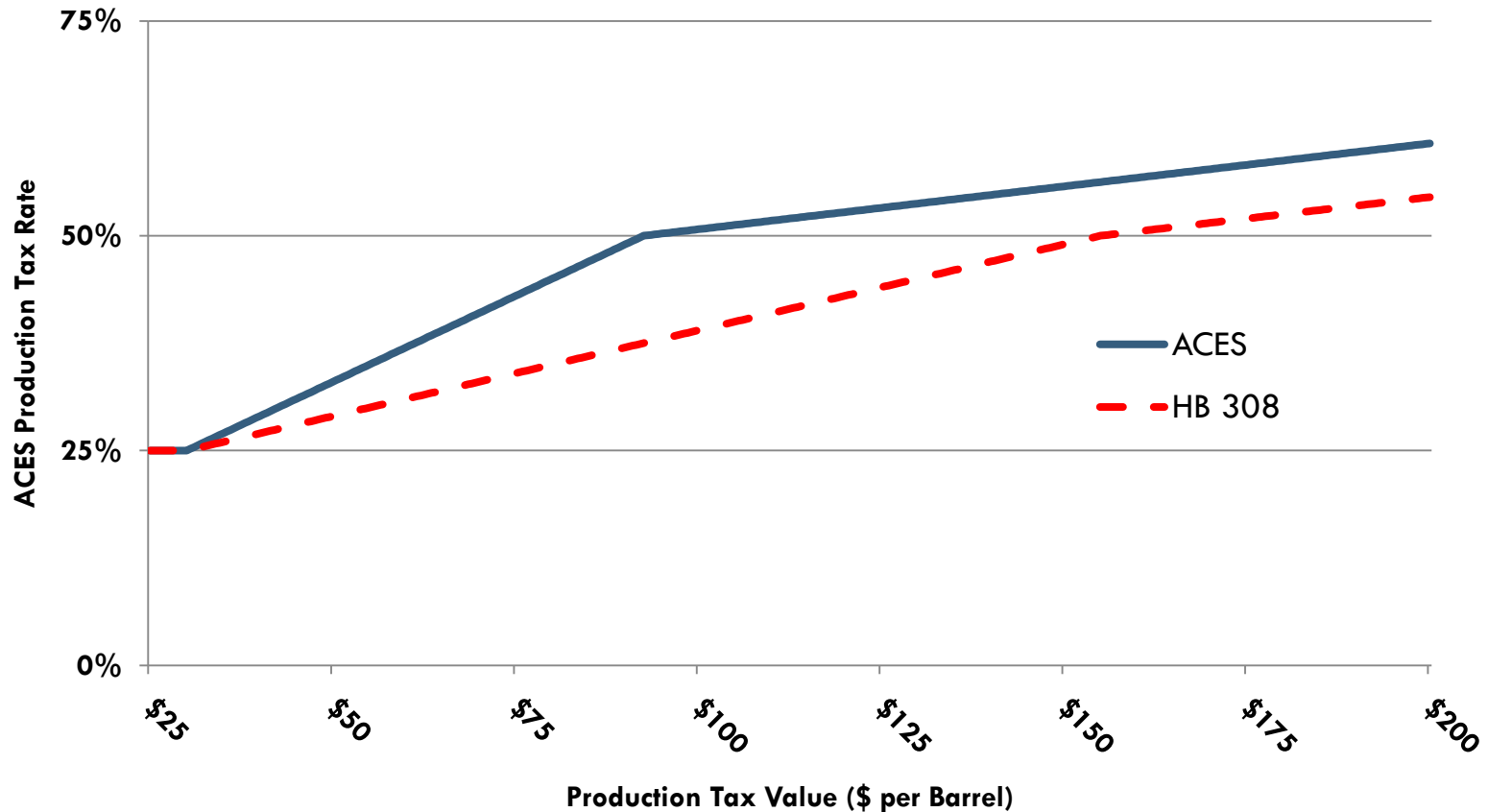
HB 308 Nominal Tax Rates



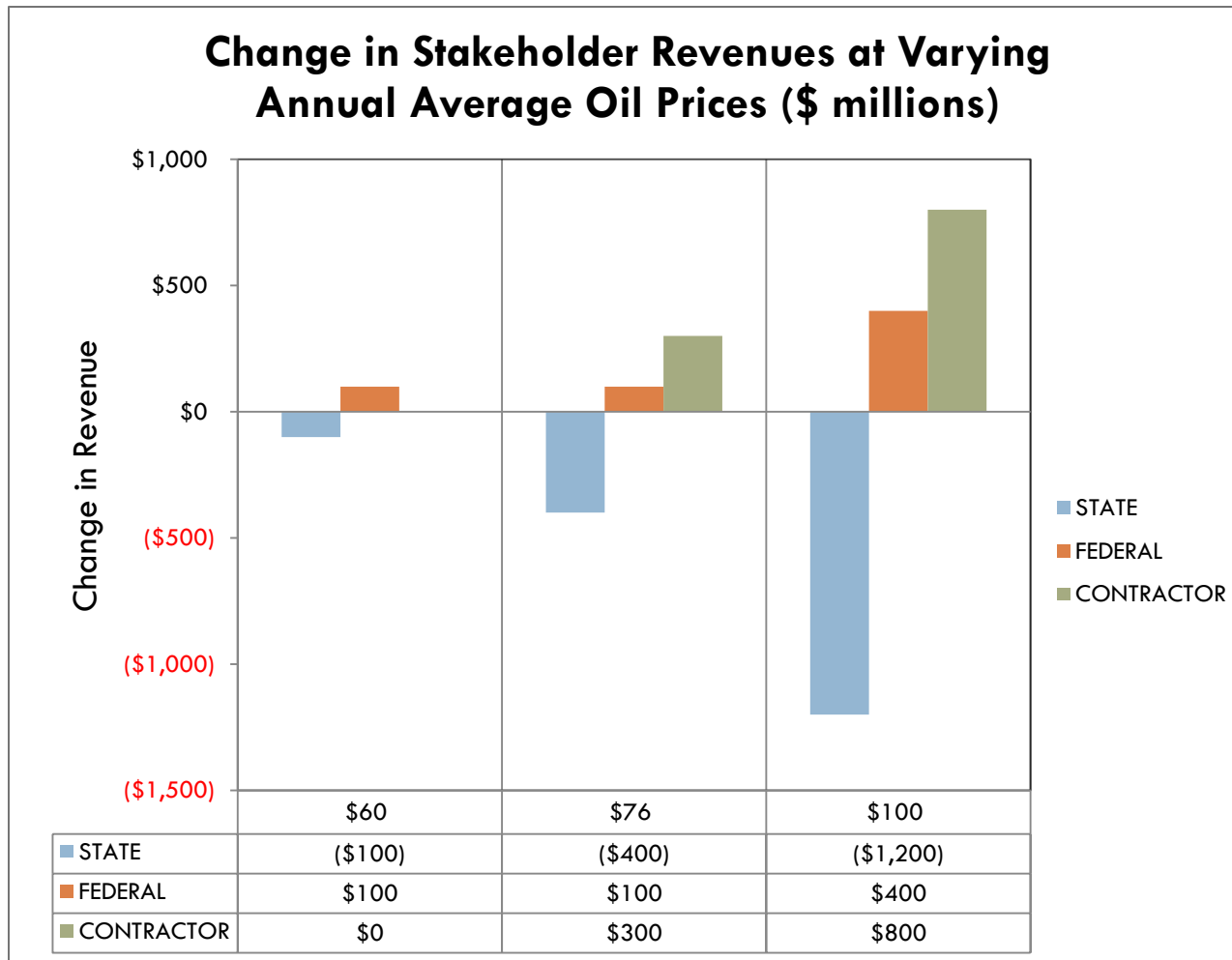
ACES and CSHB 308 Nominal Tax Rates

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ACES and HB 308 Nominal Tax Rates



Revenue Impact of CSHB308 Due to Changes in Progressivity



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Interest Rate Changes

CSHB308 GOV Bill Comparison

- Retroactive Interest Waiver

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Underpayment

- is not considered delinquent until after 30 days after the effective date of the reg. with retro-active application

Governor's Bill

Underpayment

- interest is waived before the 1st day of the 2nd month following the month in which the reg. became effective
 - (A) dept. determines that producer's underpayment was a result of the reg. not being in effect when the payment was due and
 - (B) the producer made a good faith estimate of tax obligation in light of the regs. then in effect, and paid the estimate . Underpayment not considered delinquent

CSHB308 GOV Bill Comparison

- Retroactive Interest Waiver

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Overpayment

- is not considered delinquent until after 30 days after the effective date of the reg. with retro-active application

Governor's Bill

Overpayment

- if overpayment occurred because reg was not in effect, interest does not begin to accrue earlier than:
 - (A) the 1st day of 2nd month following the month in which the reg became effective
 - (B) 90 days after an amended return is filed, if the overpayment was for a period for which an amended return was required to be filed before the reg became effective

Under current law, interest is not allowed if an overpayment is refunded within 90 days - CS HB308 does change this long-standing rule)

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**Well Related Expenditures
30% Credit**

Well Expenditure Comparison

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| CS HB 308 | DOR Draft to Gov |
|--|---|
| amends AS 43.55.023: | amends AS 43.55.025 |
| well sidetracking | development well activity |
| well deepening | goods |
| well workover | services |
| injection well | rentals of personal property reasonably required for re-drilling, casing, cementing, or logging |
| well-related seismic work | Completing workover operations or other operations intended to increase or enhance well production from known/unknown production pool |
| intangible drilling and development costs | May not be for an injector well, or stratigraphic test well |
| up to the flange and connecting the well head to the well line | |

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Statute of Limitations Change for Production Tax Assessments

Production Tax Audit Status

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Audit

8 PPT/ACES audits in progress
(Apr – Dec 2006)

2 PPT/ACES audits pending
(2006 year)

1 ELF audit in process
(2003, 2004, 2005)

3 - .023 Credit Audits
(2006 ~\$700M in expenditure)

All Taxpayers 2007 / 2008

Current audit status

Est. 03/31/2010

Beyond 3/31/2010

Beyond 6/30/2010

Target 3/31/2010

Not started

3 versus 6 year assessment

Audit Information Requirements

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Audit information required under ELF

- Production data
- Sales contracts / invoices
- Quality bank data
- Marine transportation detail
- Pipeline Tariffs data

Audit information required under ACES

- Production data
- Sales contracts / invoices
- Quality bank data
- Marine transportation detail
- Pipeline tariffs / reasonable cost data
- Lease expenditures (capex, opex)
- Facility sharing agreements
- Joint operating agreements
- Joint interest billing invoices
- Unit ballot agreements
- .023, .025, TIE, NOL credits

2/10/2010

3 versus 6 year assessment

Audit Information Requirements

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Factors to consider

- With a “net tax” more areas of audit exposure
- Delays in taxpayers providing data (e.g. marine data)
- Volume of lease expenditure detail (greater than 1 million lines of detail data for a tax year is not uncommon) all manually processed.
- Determinations that exclusions under AS 43.55.165 (e) not included in lease expenditures
- Processing, tracking and auditing tax credits absorbs audit resources (lack of automated tax system)
- Challenges associated with auditing Alaska hire compliance
- Shorter time frame will yield more appeals and litigation

The End