

COMMENTS ON SB305

Senate Finance Committee

March 12, 2010

Alaska State Department of Revenue

Topics

2

- Revenue Projections Under SB305 and Status Quo
- Cost Allocation
- Technical Issues Regarding SB305

Revenue Projections Under SB305

3

- Using the Single Year “Income Statement” Model assumptions from previous DOR presentations
 - ▣ How does SB305 compare to the Status Quo at different oil to gas price parities?

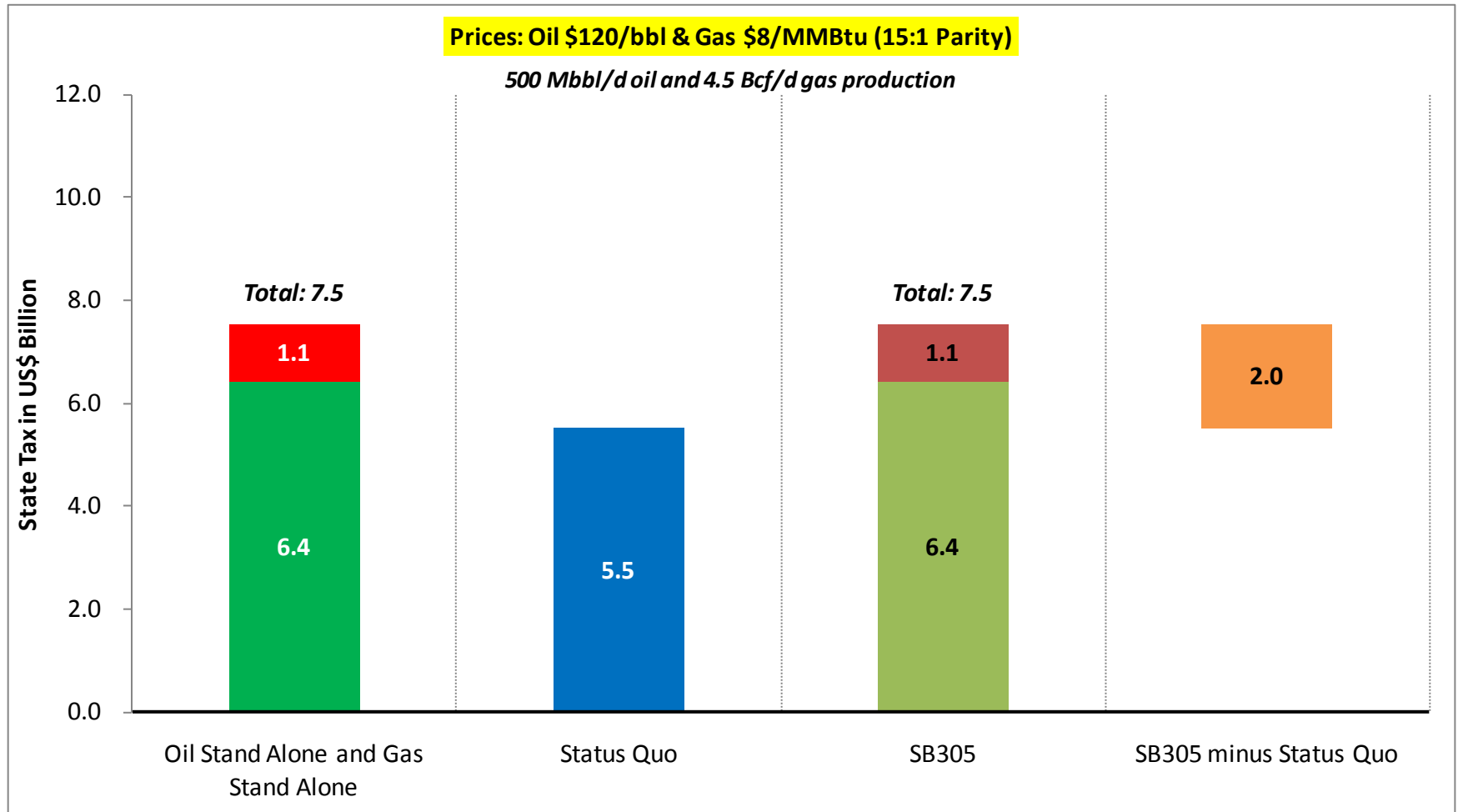
“Income Statement” Model Assumptions

4

- Consistent with DOR presentation to Senate Finance Committee on February 24, 2010
- Production
 - ▣ Oil: 500,000 bbl/d
 - ▣ Gas: 4.5 Bcf/d
- BOE conversion
6 Mcf = 1 BOE
- Costs allocation
 - ▣ Total Opex:
\$2,200,000,000
 - ▣ Total Capex:
\$2,200,000,000
 - ▣ Costs split 90%/10% for oil / gas
- Transportation
 - ▣ Oil: \$6.5/bbl
 - ▣ Gas: \$4.5/MMBtu

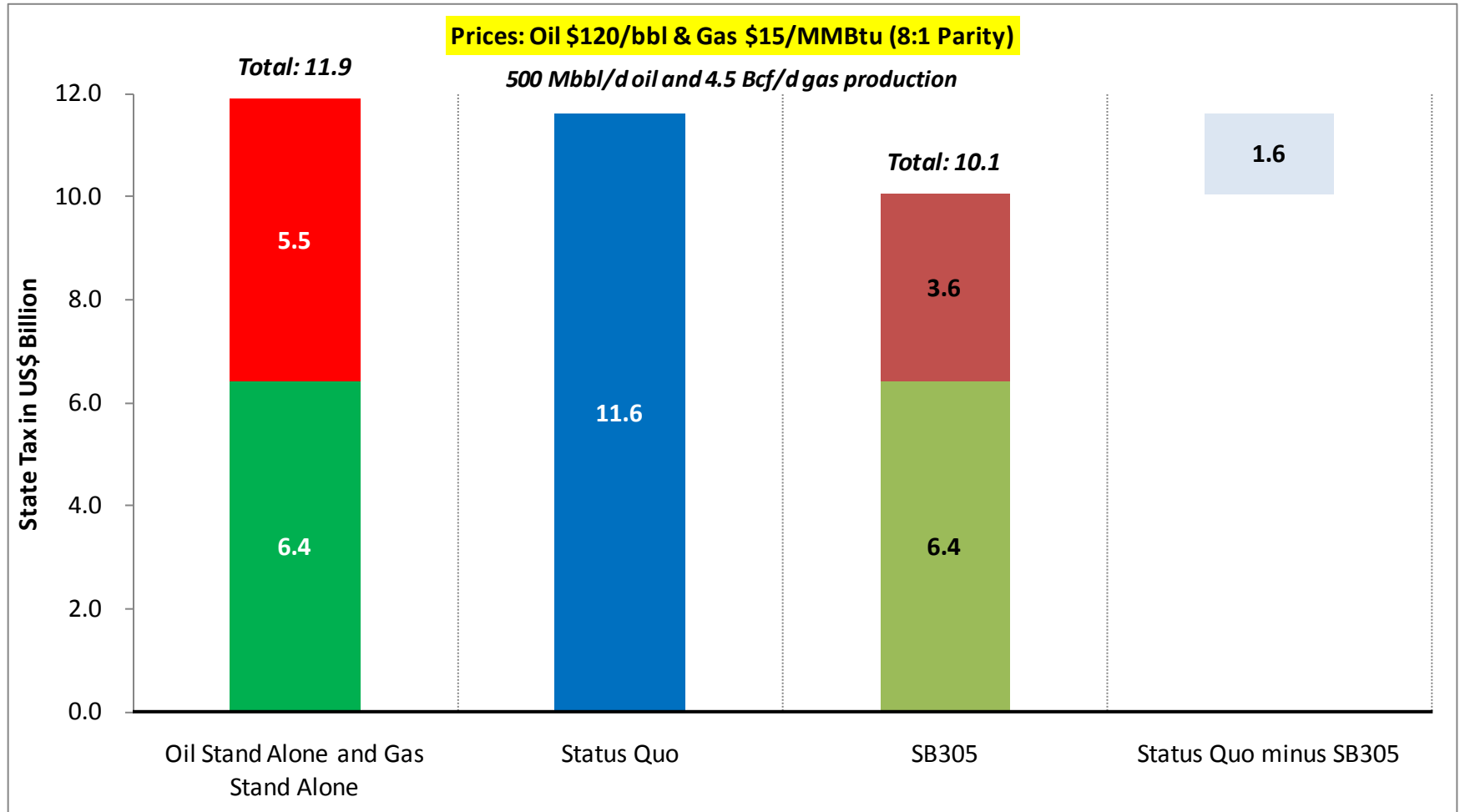
At high parity, SB305 > Status Quo

5



At lower parity, SB305 < Status Quo

6



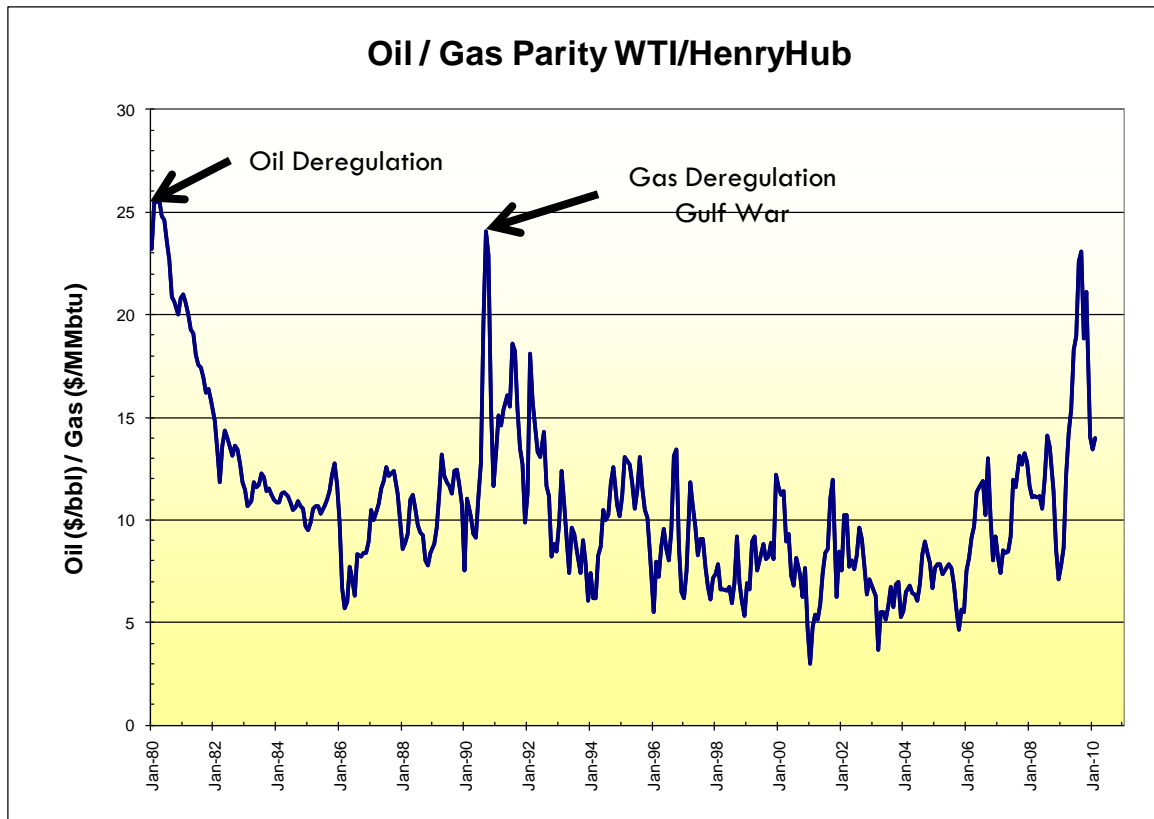
Observations

7

- SB305 can lead to higher or lower state revenue compared to the status quo, depending on oil price and gas parity.
- SB305 provides for a lower state share compared to the status quo when upside profits and gas prices are relatively high (no gas progressivity).
- SB305 imposes a higher tax burden compared to the status quo when gas prices are relatively low.

The Oil/Gas Price Parity Guess....

8



....Where will it be in 2020 – 2045?

Topics

9

- Revenue Projections Under SB305 and Status Quo
- Cost Allocation
- Technical Issues Regarding SB305

Cost Allocation Issues

10

- With a separate oil and gas tax system, how costs are allocated between oil and gas has a significant impact on overall taxes owed
- Because oil and gas are generally produced together, it is not easy or straight forward to determine the costs “applicable to the gas [or oil] produced”
- The cost allocation method could result in uncertainty, disputes, and delays
- Cost allocation should be specified in the statute, and is a very important policy decision

Different Cost Allocation Options

11

- Detailed item by item attribution methods
- Formula or Rule based attribution methods

Item by Item Attribution Methods

12

- Used elsewhere in the world
- Generally self certified by the producers, checked by the regulator
- Historically attribution differences have led to a considerable number of disputes especially where there is significant difference in oil and gas tax rates (as we would have under SB305)
 - ▣ producer versus government
 - ▣ producer versus producer
 - Different producers are affected differently, so to the extent that producers have any discretion in how costs are allocated, it could result in disputes between working interest owners and delay investment decisions

Formula or Rule Based Methods

13

- May not accurately reflect the “true” purpose of the cost
- Examples include attributing costs based on
 - ▣ Proportion of Production (BOE)
 - ▣ Proportion of Sales (e.g. Gross Value at Point of Production)
 - ▣ Proportion of Reserves
 - ▣ Rule of dominant use - either gas or oil
 - ▣ Deemed oil unless item is 100% gas related
 - ▣ Combination of any of the above

Impact of Cost Allocation Choices

14

- SB305 requires the allocation of costs to oil or to gas, but does not describe the allocation method or guiding principles:
 - ▣ Actual allocation of individual costs would be highly impractical and would require significant auditing resources.

- To examine the potential economic impact of the allocation method, we compared three cost allocation possibilities:
 1. Costs allocated based on relative BOE production
 2. Costs allocated based on relative gross value at Point of Production (PoP)
 3. Assumed “actual” cost split of 90/10 between oil and gas

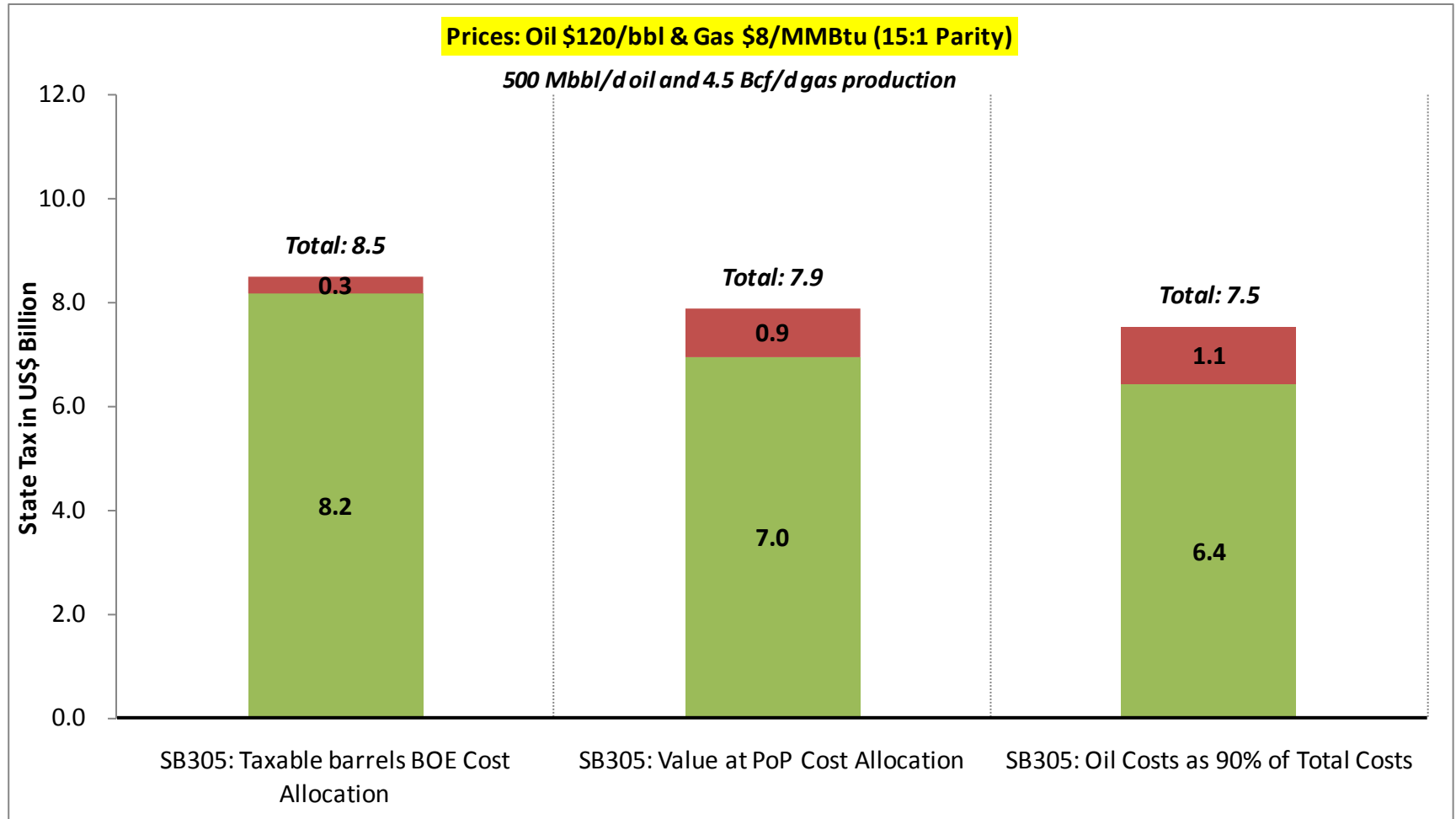
Cost Allocation Examples

15

	Oil	Gas	Total
Production (MMboe)	183	274	457
Gross Value at PoP (US\$MM) – \$120 and 15:1	20,714	5,749	26,463
Gross Value at PoP (US\$MM) – \$120 and 8:1	20,714	17,246	37,960
Split Based on BOE (%)	40%	60%	100%
Cost Allocation (US\$MM)	1,760	2,640	4,400
Split Based on Gross Value at PoP (%) – 15:1	78%	22%	100%
Cost Allocation (US\$MM)	3,444	956	4,400
Split Based on Gross Value at PoP (%) – 8:1	55%	45%	100%
Cost Allocation (US\$MM)	2,401	1,999	4,400
Split Based on assumed “Actual” (%)	90%	10%	100%
Cost Allocation (US\$MM)	3,960	440	4,400

Impact of Allocation Method on SB305 Revenue - Oil \$120/bbl and 15 Parity (\$8/MMBtu)

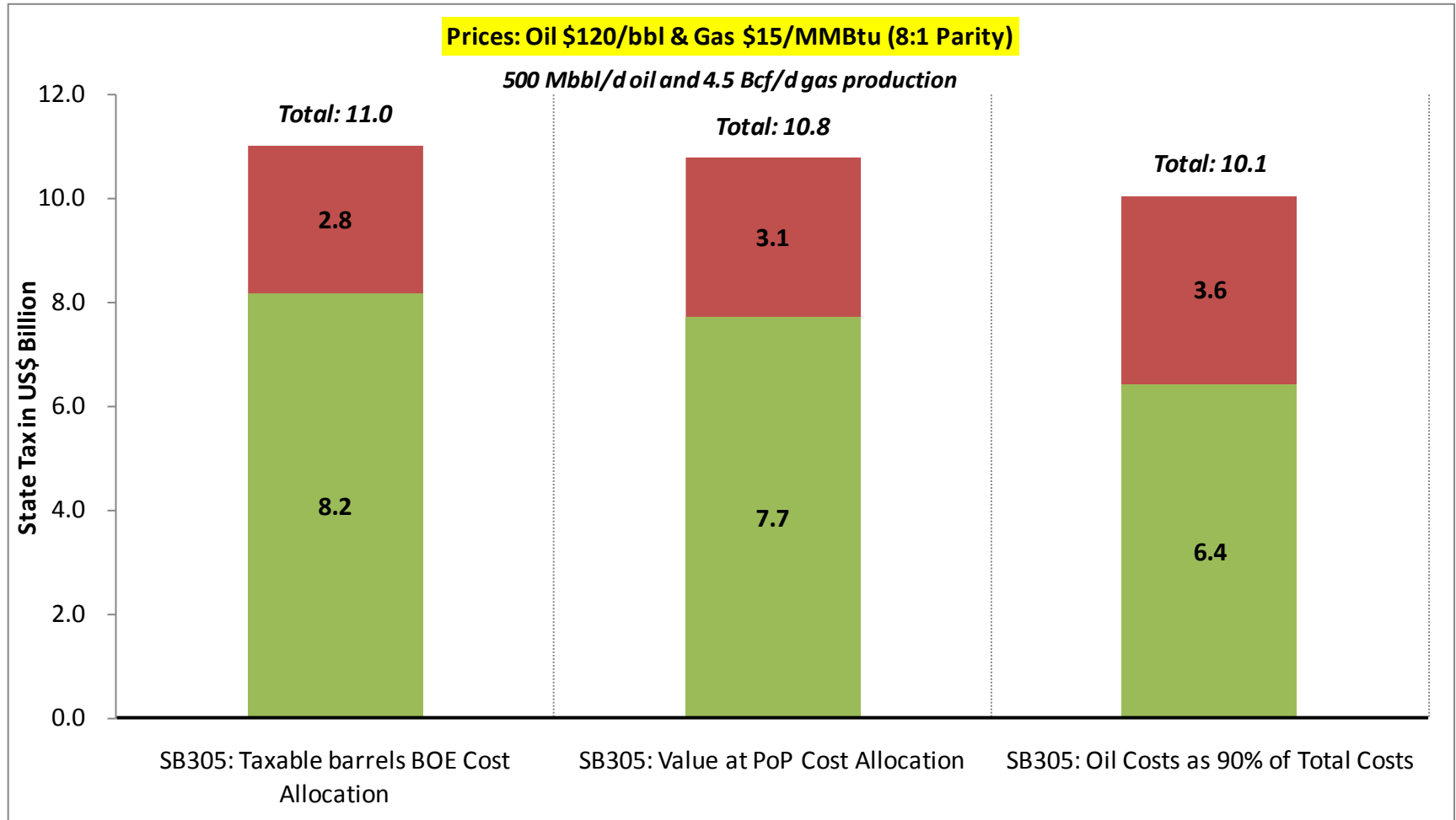
16



Impact of Allocation Method on SB305

Revenue - Oil \$120/bbl and 8 Parity (\$15/MMBtu)

17



Topics

18

- Revenue Projections Under SB305 and Status Quo
- Cost Allocation
- Initial Technical Issues Regarding SB305

SB305 Technical Issue

19

- Inconsistent treatment of negative production tax values - Current Monthly Installment Section .020 requires the tax estimates of NS, CI and other state areas to each be at least zero. SB305 lost this requirement when it deleted “greater of (i) zero...”. Lack of this provision means a negative value in one region can reduce the estimated monthly tax values in other regions resulting in a lower total estimated monthly production tax value than provided under current law.

SB305 Technical Issue

- Timing of Adjustments under AS 43.55.170 (reimbursements) - SB305 revises Section 160(a)(1) and (2) to reference Lease Expenditures as adjusted under AS 43.55.170. Unclear if the adjustment is to occur before or after the allocation process. If after, then department needs authority and direction to allocate the Section .170 adjustments between oil and gas lease expenditures.

Conclusions

- Separating oil and gas taxes is not a panacea, and can raise new and different risks to state revenues compared to the status quo
- With uncertainties in the oil and gas markets and wildly fluctuating price forecasts, the tax system needs to be responsive to a wide range of potential price scenarios
- To achieve the state's objectives the tax system must balance the desire for revenue with creating an attractive investment climate for a gasline

The End