

**SB**

**305**

**(FILE 3)**

W. A. Corbus  
Feb. 24, 2006

Presentation to Resource Committees - HB 488/SB 305  
PPT Summary

1. PPT is a Governor's bill, this Administration strongly supports it and encourages its timely enactment
2. Thank you for giving the Department of Revenue 3 days to make presentations on the PPT, the bill itself and to answer your questions and thank you speakers for all your work devoted to preparing your presentations
3. The proposed PPT legislation will:
  - a. Replace a broken ELF based severance tax
  - b. Encourage badly need investment in oil and gas exploration, development and production
  - c. Provide special incentives for small explorers
  - d. Enhanced State revenues, particularly during periods of high oil prices
4. During the last three days there have been many good questions and thought provoking dialogue. I want to make it very clear that the Governor made the important policy calls on several of the matters discussed at length:
  - a. 20% tax rate
  - b. 20% tax credit rate
  - c. \$73 million exemption
5. The Governor had two targets for Pedro van Meurs:
  - a. increase State revenues based on what Producers are paying in similar oil regimes around the world;
  - b. increase incentives to explore and invest in the 50mm to 150 mm barrel fields
6. From August 2005 to February 2006, Pedro suggested a 20% - 15% plan. He then provided a range of alternatives to the House and Senate Finance Committees three weeks ago. His final proposal was 25% - 20%.

7. While the Governor appreciates Pedro's recommendation, the Governor wanted to tilt toward more exploration and investment. So he reduced the tax rate to 20%
8. The Governor believes that more exploration will help fill TAPS and thus mean more money to the State over time than a 25% tax rate.
9. I'd like to remind us all that the Governor has done a marvelous and unexpected thing for Alaska. He has gotten the Producers to agree to increase their Production Tax rate by 100% AND to build a gasline!
10. This Administration believes that this will optimize State revenues from oil and gas over the long run
11. Again, the Administration encourages the enactment of HB 488/SB 305

Library  
*Senate Resources Committee*

*Revised Logsdon Presentation*  
2-24-06 Senate Resources

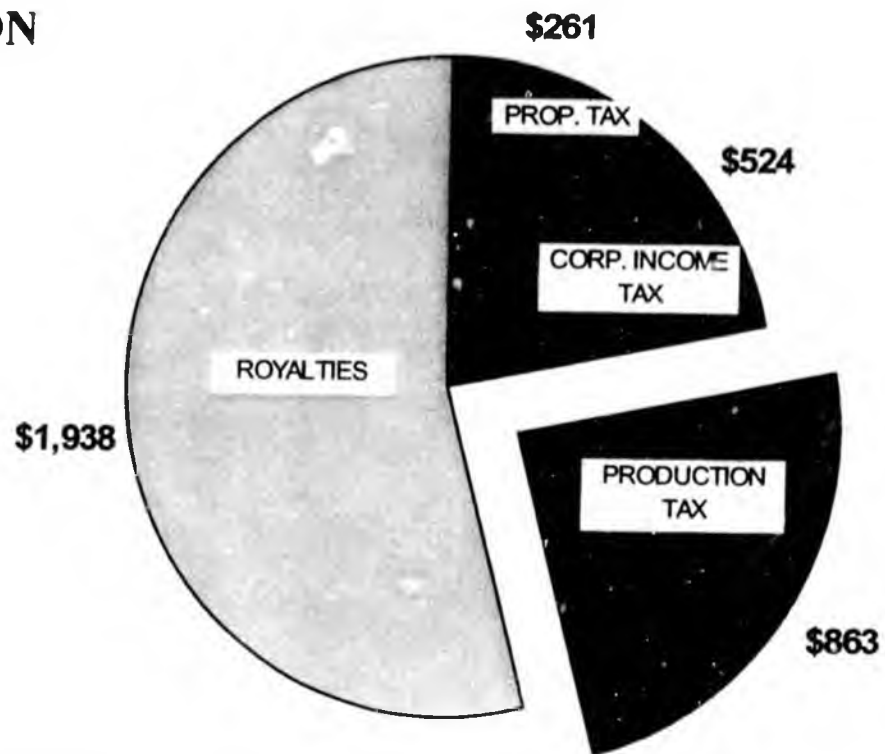
# Alaska's Production Tax

Theory and Practice

## Alaska's CURRENT Oil Fiscal System by Source FY '05

**TOTAL**

**\$3631 MILLION**



Alaska Dept. of Revenue Fall '05 Revenue Sources  
Property taxes includes Municipalities  
Royalties include Permanent Fund

# Alaska's Oil and Gas Fiscal Regime

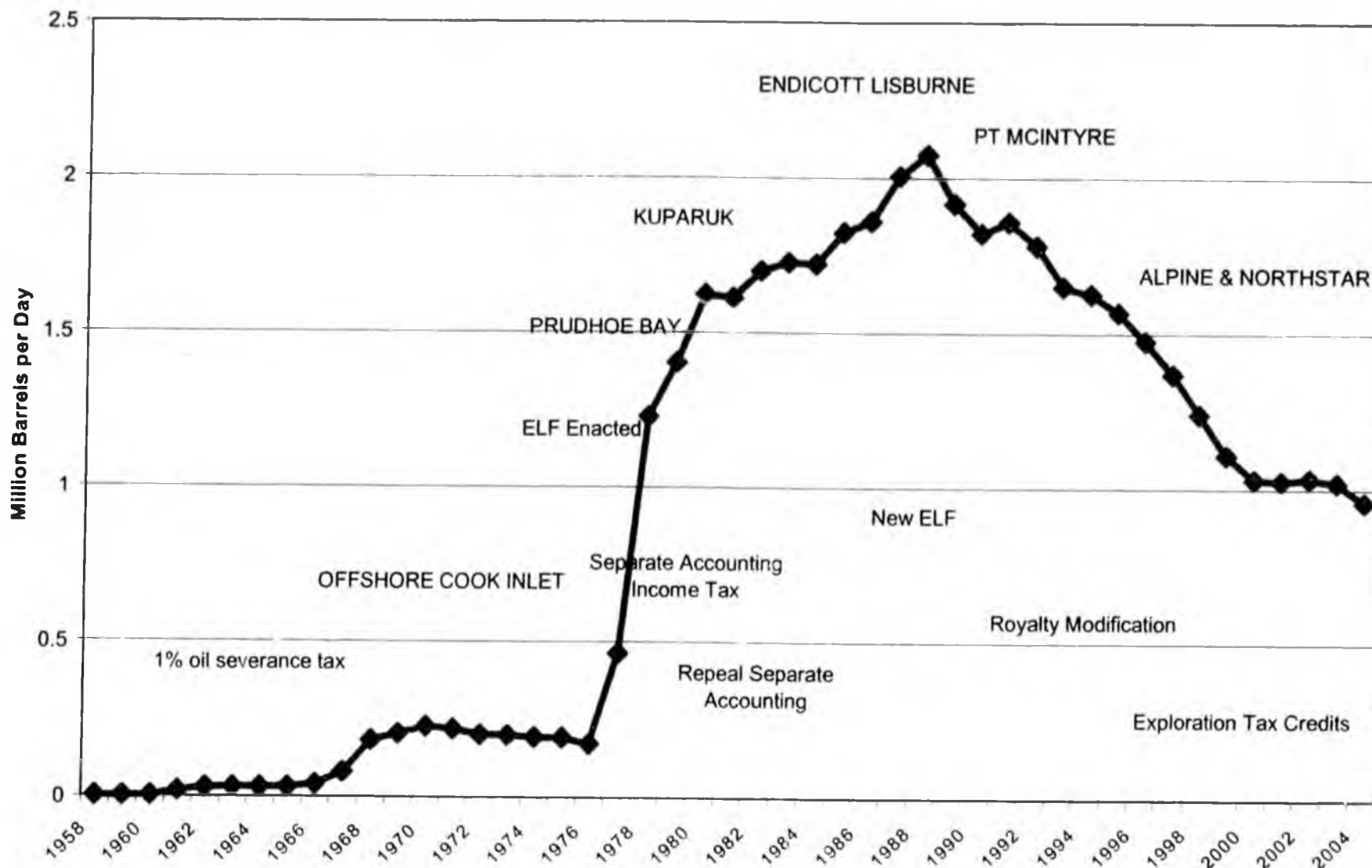
**Royalty:** State ownership share of the resource removed and sold from State lands.

**Production tax :** Tax on the severing of the resource from the State as either a % of value or a minimum cents per barrel or mcf.

**Property Tax:** Levied on the assessed value of production and transportation hardware at a rate of 20 mils

**Corporate Income Tax:** World-wide income allocated to Alaska based on three factors: production, property and sales (includes tariffs)

## Alaska Oil Production and Major Fiscal Adaptations 1958 - 2004



An International Perspective on  
Petroleum Fiscal Systems

Norwegian Petroleum Directorate

# The fiscal policy

## Objective

---



- ◆ Government objective

- Maximise Government take
  - Get as high share of the profit as possible
- Maximise value of the petroleum resources



*The goal is to create a win-win situations between the state and the oil companies*

- ◆ Companies objective

- Maximise shareholders interest (private or public)

## **The fiscal policy**

### **Government objective**

---



- ◆ Important to create a win-win situations between the state and the oil companies
  
- ◆ The bargaining relationship depends mainly on profitability and risk
  - the government has to take the mother earth and the geological potential into consideration when it design the fiscal packages
  
- ◆ Crucial to relate the fiscal packages on the geological basis and where on the geological learning curve that province is

# The fiscal policy Challenge

---



- ◆ The challenge of the fiscal policy:
  - Ensure as high share of the value as possible for the Government
  - Encouraging the exploration and exploitation of valuable resources
  
- ◆ One has to find a correct balance between the state interest and the oil companies.

# The fiscal policy

## The fiscal package

---



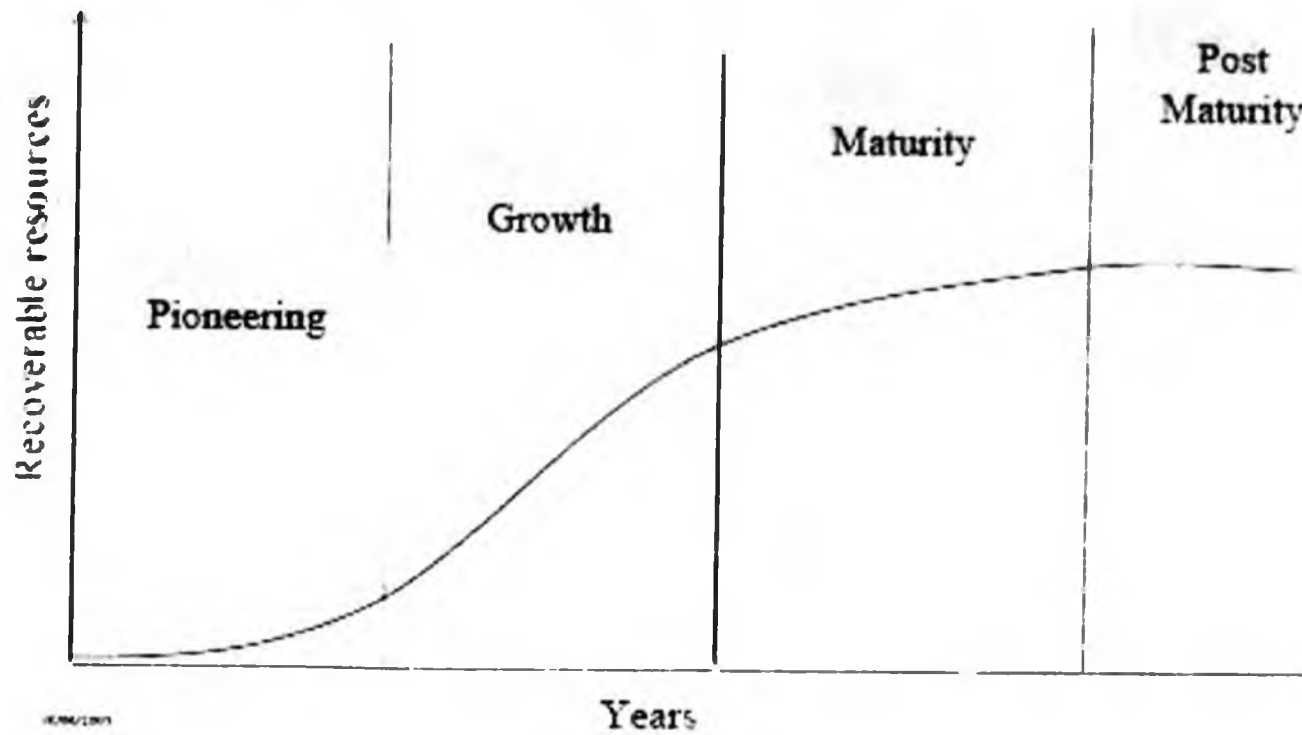
- ◆ The fiscal packages can be characterized both by the
  - The tax level
  - The tax system
  
- ◆ The fiscal policy can create disincentives to explore or to exploit the petroleum resources due to either the tax level or the tax system
  
- ◆ A key question to any fiscal package is whether it will influence the investment decision of the investor adversely with respects to the nation optimal decisions.

# The fiscal package

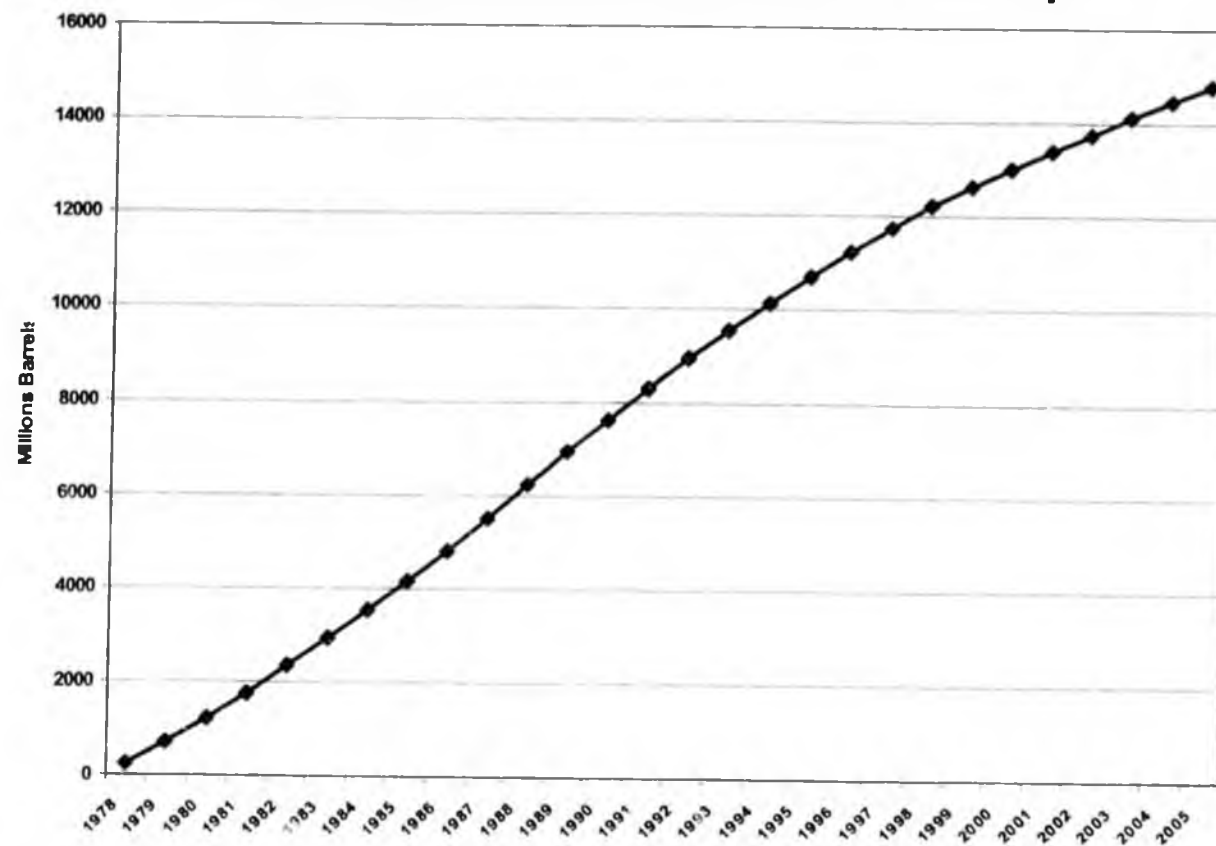
Relate to the geological basis and the geological learning curve



The geological learning curve



## Cumulative Production Alaska North Slope



# What Have Experts Told Us Repeatedly

- Taxes on net are more economically efficient because they allow investors to recover their investment and rate of return.
- This ensures a competitive area to invest in.
- Governments need to style their fiscal system around their geology.
- Alaska is a high cost environment

- Alaska thus is not a particularly attractive place to explore and develop with its current system (no sharing of upstream costs in a high cost environment)
- Alaska could change its system to both increase its government take and encourage investment.

## A Sample of these Experts

- The 1978 study by Walter Levy and Associates which lead to the adoption of separate accounting.
- The primary conclusion in the 1989 Alex Kemp/Gaffney/Motamen study following the ELF change.
- The conclusions in the 1994 Arthur D. Little/John Gault Study

- Woods MacKenzie in its 2004 study of international fiscal systems also described Alaska as a high cost regressive system that did have a good ranking thanks to high oil prices and the discovery of the lucrative Alpine field in 1994.
- 2005, Pedro Van Meurs recommends net profit system to replace ELF to provide State revenue upside and encourage investment

# Why has the State Been Reluctant to Change the System?

- Throughout the 1990's significant concern about low prices.
- This led implicitly to a desire to give up some upside potential to protect against catastrophic low prices (see FY 1999)
- Changing oil fiscal regimes is not taken lightly--especially in a declining production environment.

# Conclusions

- Alaska can take a positive step to making its tax system more efficient by changing the petroleum production tax
- We will still have our royalty share calculated before upstream cost deduction
- We will still have a piece of world-wide corporate income as long as the companies produce in Alaska

# Conclusions

- We will also have a property tax
- At the same time if prices stay anywhere near as high as they have been over the last three years, we will generate more revenue for the state AND
- Provide significant new incentive to spend investment dollars exploring for and developing oil and gas in the State

Library  
*Senate Resources Committee*

SB 305

HB 488

The Rest of the PPT Story  
House and Senate Resource  
Committees of the Legislature

Dan E. Dickinson, CPA

Robert E. Mintz, DOL

February 24, 2006

## Section 1 & 11

- Clarify AS 43.55.020 (f) to reflect consistent department interpretation, upheld in formal hearing decision in 1996
- Prevailing Value is used to set a taxable value for internally refined barrels
- May be moot for a taxpayer using "DNR" or formulaic valuation

## Sections 2 & 3

- Clarify state income tax code that production tax is not a tax “based on or measured by net income”
- Ensures that the PPT is deductible for state income tax purposes.

## Section 4 & 16

- 1 Amends current statute (AS 43.05.230 and 43.55.040) to clarify rules for using one taxpayer's information to determine another taxpayers tax
- Generally limited to Prevailing value calculation, which may be moot for taxpayer electing alternative valuation formula
- 1 Taxpayer recipients of information are brought under confidentiality provisions of AS 43.05.230

## 7 Section 5

- *Repeals and Reenacts AS 43.55.011(a)*
- *A tax for all oil and gas ... less any oil or gas...exempt from taxation. The tax is equal to 20 of the net value...*

## Section 6

- Amends AS 43.55.017 (a) to conform language to the IRC code to which it refers

## Section 7

- *Repeals and Reenacts AS 43.56.020 (a)*
- *Ninety percent...is due on the last day of each calendar month. The remaining portion is due on March 31...*

## Section 8

Existing statute has a separate tax on oil and on gas, while the PPT has a common rate for oil and gas, so a bunch of “ors” need to be changed to “ands;” that is the only change in this section, and it is not noted when it occurs later.

## Section 9 (part one)

- ❑ Amends AS 43.55.020 (d), which deals with private royalties.
- ❑ Note: State and federal royalty interests are tax free, so a producer pays tax typically on 7/8ths of its production from these leases.
- ❑ Private royalty interests are not tax free, so a producer pays tax on 8/8ths of its production from these leases
- ❑ However, law authorizes producer to pass severance taxes on to royalty owner.

## Section 9 (part two)

- When tax was gross at the point of production, this was straightforward.
- However, net value tax is harder to define and apply to a specific lease: (i) statewide costs, and (ii) since royalty owners don't share in lease costs, it can be argued they ought not share in the resulting tax deduction or credit.
- New formula:  $(TT / nR \text{ bbls}) * \text{private royalty bbls}$ 
  - where
  - TT = Total tax paid by producer
  - nR bbls = non royalty barrels.

## Section 9 (part three)

- | Assume taxpayer produced 100 bbls from each of 2 leases, one with a 12.5% state royalty and the other with a 12.5% private royalty share
- | Gross value at the point of production was \$10 per bbl, with lease expenditures of \$875
- | Calculation of tax:
- |  $\$10 * (100 + 87.5 \text{ bbls}) = \$1,875$
- |  $\$1,875 - \$875 \text{ lease expenditures} = \$1,000$
- |  $\$1,000 * .20 = \$200 \text{ Tax}$
- | Amount passed on to private royalty owner:
- |  $\$200 / (87.5 + 87.5) = \$1.14 \text{ per barrel}$
- |  $\$1.14 * 12.5 \text{ barrels} = \$14.29$

## Section 10

- Repeals and Reenacts AS 43.55.020 (e)
- Simplifies three tiered system where flared gas was either tax free, taxed, or subject to tax and a penalty.
- Now gas and oil are tax free if used for necessary lease operations. (If AOGCC determines they have been wasted, then they are taxed.)

# Section 12

- | *New AS 43.55.024: "Tax credits for certain losses and expenditures"*
- └ *(a) 20 % capital credit*
- | *(b) 20 % loss carry forward*
- └ *(c) credits are non-refundable*
- | *(d) certificating credits for transfer*
- | *(e) limits on uses of credit certificates*
- └ *(f) audit adjustments of certificates*
- | *(g) authority to write regulations*
- | *(h) definitions including "qualified capital expenditure"*

## Section 13, 14 and 15

- ☐ Conforming changes to 43.55,030(a)
- ☐ Gross/net, and/or, simplified reporting
- ☐ Repeals the \$25 a day filing penalty which predated the 43.05 civil penalties
- ☐ Requiring the March 31 true-up filing

## Section 17

Amends AS 43.55.080

- Conforms statute to constitution
- Namely: recognizes that money from resolved disputes goes into Budget Reserve Fund and not into the general fund

## Section 18 and 19

- Conforming language and update style updates for AS 43.55.135 and .150 (a)

## Section 20

- ▣ Adds 43.55.150 (d)
- ▣ *The department may allow a producer...to calculate the gross value at the point of production of oil or gas ...upon ... a royalty value...accepted by [DNR] or [US DOI] ...or another formula prescribed by ... [DOR]*

## Section 21 (part one)

- *Adds AS 43.55.160 Determination of net value of oil and gas*
- *(a) gross value less lease expenditures and 1/72 of transitional investment expenditures*
- *(b) carry forward of lease expenditures that would cause a loss*
- *(c) definition of qualified lease expenditures*
- *(d) examples of and exclusions from direct costs*
- *(e) adjustments for amounts received by producer.*
- *(f) ability to annualize lease expenditures*

## Section 21(part two)

- ⌋ (g) *Transitional investment expenditures*
- ⌋ (h) *inflation of \$40 floor for TIEs*
- ⌋ (i) *\$73 million allowance*
- ⌋ (j) *limitation on those qualified to use (i)*
- ⌋ (k) *allocation between in-state and out-of-state expenditures*
- ⌋ (l) *authority to write regulations*
- ⌋ (m) *use of “producer” includes “explorer”*
- ⌋ (n) *exploration and drilling of stratigraphic test wells*

## Sections 22 through 29

- Amends AS 43.55.200 and 300  
Concerning Conservation Surcharges
- 100% still due every month
- Now creditable against the PPT
- Oil used on lease does not incur the surcharge
- Conforming language changes (extend to AS 43.55.160)

## Section 30 & 32

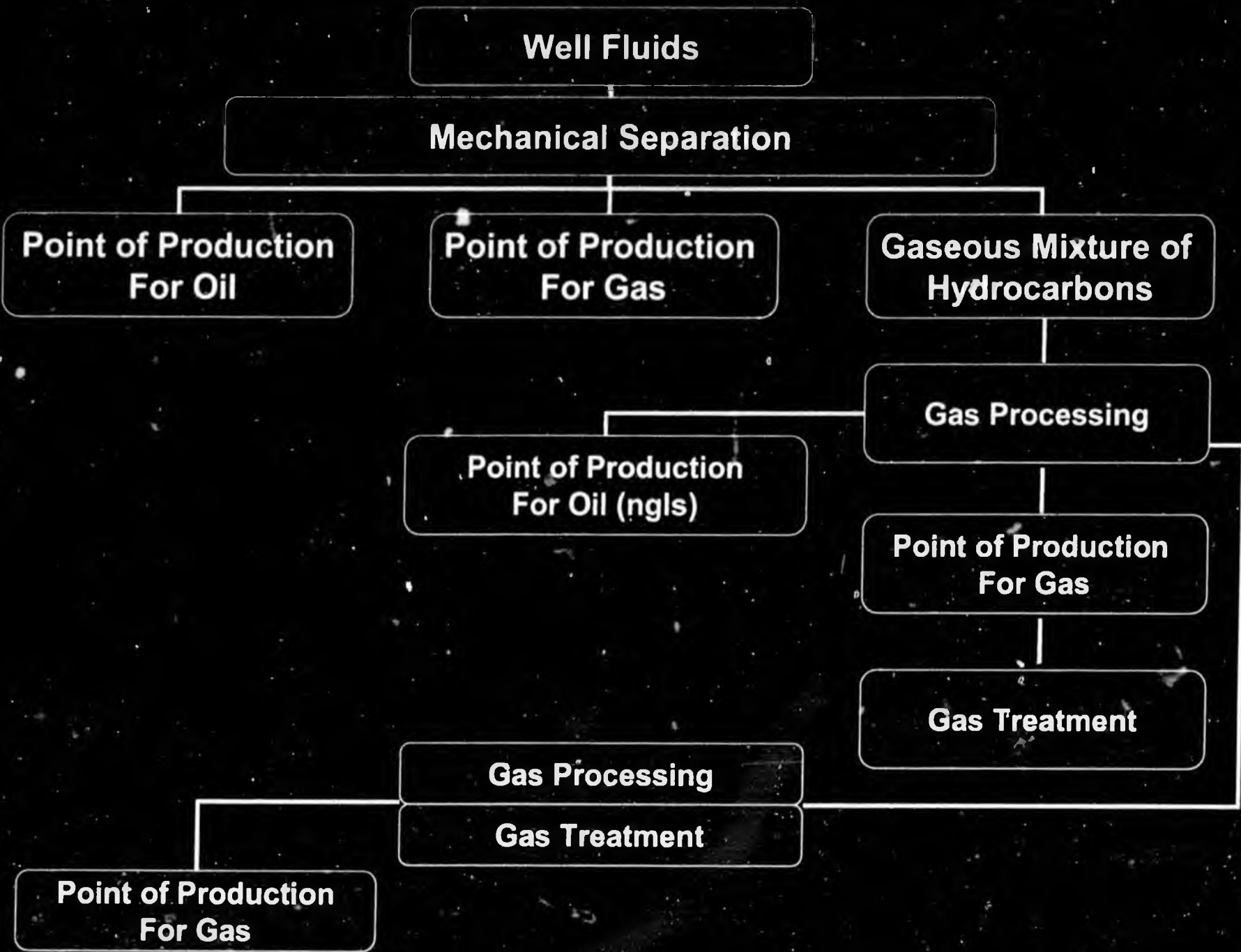
- New definition of “gas”
- Point of production moved downstream
- Gas processing now included in Upstream
  
- New definition of “oil”
- Liquid hydrocarbons recovered by mechanical separation or gas processing

# Section 31

- Redefine “gross value at the point of production”
- Oil pt.-of-prod. definition essentially unchanged (but if there is gas processing, the pt.-of-prod. for extracted liquids is downstream of processing)
- Gas pt.-of-prod. is downstream of any gas processing
- If there is a combined processing/ treatment plant facility, pt.-of-prod. is further upstream point where processing ends or treatment begins

## Section 33

- Define “gas processing” and define “gas treatment”
- Gas processing: physical processes that extract liquid hydrocarbons, upstream of a sales line or gas treatment plant
- Gas Treatment: removing non-hydrocarbon substances and conditioning gas for sales line



# Title 34

- Repeal of superseded provisions, including individual gas and oil taxes, ELF, and some definitions

## Section 35 through 40

- Applicability: Sections pertinent to taxing oil and gas under the PPT apply to oil and gas produced starting July 1, 2006
- Applicability: Prevailing value clarification of existing law applies to all oil and gas
- Half-year conventions for 2006
- Note: no 2006 ELF based safe Harbor

## Section 35 through 40 (cont.)

- ❑ Department may develop PPT implementing regulations immediately
- ❑ Conforming changes to statute captions (by Revisor)
- ❑ Sections enacting PPT take effect July 1, 2006
- ❑ Sections implementing other changes take effect immediately

ADDED INFO 2-24-06  
Sen. Resources

SB 305      HB 488

The Rest of the PPT Story  
House and Senate Resource  
Committees of the Legislature

Dan E. Dickinson, CPA

Robert E. Mintz, DOL

February 24, 2006

Section 1 & 11

- Clarify AS 43.55.020 (f) to reflect consistent department interpretation, upheld in formal hearing decision in 1996
- Prevailing Value is used to set a taxable value for internally refined barrels
- May be moot for a taxpayer using "DNR" or formulaic valuation

## Sections 2 & 3

- Clarify state income tax code that production tax is not a tax “based on or measured by net income”
- Ensures that the PPT is deductible for state income tax purposes.

## Section 4 & 16

- Amends current statute (AS 43.05.230 and 43.55.040) to clarify rules for using one taxpayer's information to determine another taxpayers tax
- Generally limited to Prevailing value calculation, which may be moot for taxpayer electing alternative valuation formula
- Taxpayer recipients of information are brought under confidentiality provisions of AS 43.05.230

## Section 5

- *Repeals and Reenacts AS 43.55.011(a)*
- *A tax for all oil and gas ... less any oil or gas...exempt from taxation. The tax is equal to 20 of the net value...*

## Section 6

- *Amends AS 43.55.017 (a) to conform language to the IRC code to which it refers*

## Section 7

- *Repeals and Reenacts AS 43.56.020 (a)*
- *Ninety percent...is due on the last day of each calendar month. The remaining portion is due on March 31...*

## Section 8

Existing statute has a separate tax on oil and on gas, while the PPT has a common rate for oil and gas, so a bunch of "ors" need to be changed to "ands;" that is the only change in this section, and it is not noted when it occurs later.

## Section 9 (part one)

- Amends AS 43.55.020 (d), which deals with private royalties.
- Note: State and federal royalty interests are tax free, so a producer pays tax typically on 7/8ths of its production from these leases.
- Private royalty interests are not tax free, so a producer pays tax on 8/8ths of its production from these leases
- However, law authorizes producer to pass severance taxes on to royalty owner.

## Section 9 (part two)

- When tax was gross at the point of production, this was straightforward.
- However, net value tax is harder to define and apply to a specific lease: (i) statewide costs, and (ii) since royalty owners don't share in lease costs, it can be argued they ought not share in the resulting tax deduction or credit.
- New formula:  $(TT / nR \text{ bbls}) * \text{private royalty bbls}$
- where
- TT= Total tax paid by producer
- nR bbls = non royalty barrels.

## Section 9 (part three)

- Assume taxpayer produced 100 bbls from each of 2 leases, one with a 12.5% state royalty and the other with a 12.5% private royalty share
- Gross value at the point of production was \$10 per bbl, with lease expenditures of \$875
- Calculation of tax:
- $\$10 \times (100 + 87.5 \text{ bbls}) = \$1,875$
- $\$1,875 - \$875 \text{ lease expenditures} = \$1,000$
- $\$1,000 \times .20 = \$200 \text{ Tax}$
- Amount passed on to private royalty owner:
- $\$200 / (87.5 + 87.5) = \$1.14 \text{ per barrel}$
- $\$1.14 \times 12.5 \text{ barrels} = \$14.29$

## Section 10

- Repeals and Reenacts AS 43.55.020 (e)
- Simplifies three tiered system where flared gas was either tax free, taxed, or subject to tax and a penalty.
- Now gas and oil are tax free if used for necessary lease operations. (If AOGCC determines they have been wasted, then they are taxed.)

## Section 12

- *New AS 43.55.024: "Tax credits for certain losses and expenditures"*
- *(a) 20 % capital credit*
- *(b) 20 % loss carry forward*
- *(c) credits are non-refundable*
- *(d) certifying credits for transfer*
- *(e) limits on uses of credit certificates*
- *(f) audit adjustments of certificates*
- *(g) authority to write regulations*
- *(h) definitions including "qualified capital expenditure"*

## Section 13, 14 and 15

- Conforming changes to 43.55.030(a)
- Gross/net, and/or, simplified reporting
- Repeals the \$25 a day filing penalty which predated the 43.05 civil penalties
- Requiring the March 31 true-up filing

## Section 17

Amends AS 43.55.080

- Conforms statute to constitution
- Namely: recognizes that money from resolved disputes goes into Budget Reserve Fund and not into the general fund

## Section 18 and 19

- Conforming language and update style updates for AS 43.55.135 and .150 (a)

## Section 20

- *Adds 43.55.150 (d)*
- *The department may allow a producer...to calculate the gross value at the point of production of oil or gas ...upon ... a royalty value...accepted by [DNR] or [US DOI] ...or another formula prescribed by ... [DOR]*

## Section 21 (part one)

- *Adds AS 43.55.160 Determination of net value of oil and gas*
- *(a) gross value less lease expenditures and 1/2 of transitional investment expenditures*
- *(b) carry forward of lease expenditures that would cause a loss*
- *(c) definition of qualified lease expenditures*
- *(d) examples of and exclusions from direct costs*
- *(e) adjustments for amounts received by producer.*
- *(f) ability to annualize lease expenditures*

## Section 21(part two)

- (g) *Transitional investment expenditures*
- (h) *inflation of \$40 floor for TIEs*
- (i) *\$73 million allowance*
- (j) *limitation on those qualified to use (i)*
- (k) *allocation between in-state and out-of-state expenditures*
- (l) *authority to write regulations*
- (m) *use of "producer" includes "explorer"*
- (n) *exploration and drilling of stratigraphic test wells*

## Sections 22 through 29

- Amends AS 43.55.200 and 300  
Concerning Conservation Surcharges
- 100% still due every month
- Now creditable against the PPT
- Oil used on lease does not incur the surcharge
- Conforming language changes (extend to AS 43.55.160)

## Section 30 & 32

- New definition of "gas"
- Point of production moved downstream
- Gas processing now included in Upstream
  
- New definition of "oil"
- Liquid hydrocarbons recovered by mechanical separation or gas processing

## Section 31

- Redefine "gross value at the point of production"
- Oil pt.-of-prod. definition essentially unchanged (but if there is gas processing, the pt.-of-prod. for extracted liquids is downstream of processing)
- Gas pt.-of-prod. is downstream of any gas processing
- If there is a combined processing/ treatment plant facility, pt.-of-prod. is further upstream point where processing ends or treatment begins



## Title 34

- Repeal or superseded provisions, including individual gas and oil taxes, ELF, and some definitions

## Section 35 through 40

- Applicability: Sections pertinent to taxing oil and gas under the PPT apply to oil and gas produced starting July 1, 2006
- Applicability: Prevailing value clarification of existing law applies to all oil and gas
- Half-year conventions for 2006
- Note: no 2006 ELF based safe Harbor

## Section 35 through 40 (cont.)

- Department may develop PPT implementing regulations immediately
- Conforming changes to statute captions (by Revisor)
- Sections enacting PPT take effect July 1, 2006
- Sections implementing other changes take effect immediately