

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 2950

Produce or Pay

These two concerns are
addressed in the concept of:

“Produce or Pay”

Produce or Pay

In the Produce or Pay concept the production of each company is split into:

- Base Production, and
- Incremental Production

The Base Production is determined on the basis of the 2005 production in terms of barrels equivalent.

Base Production

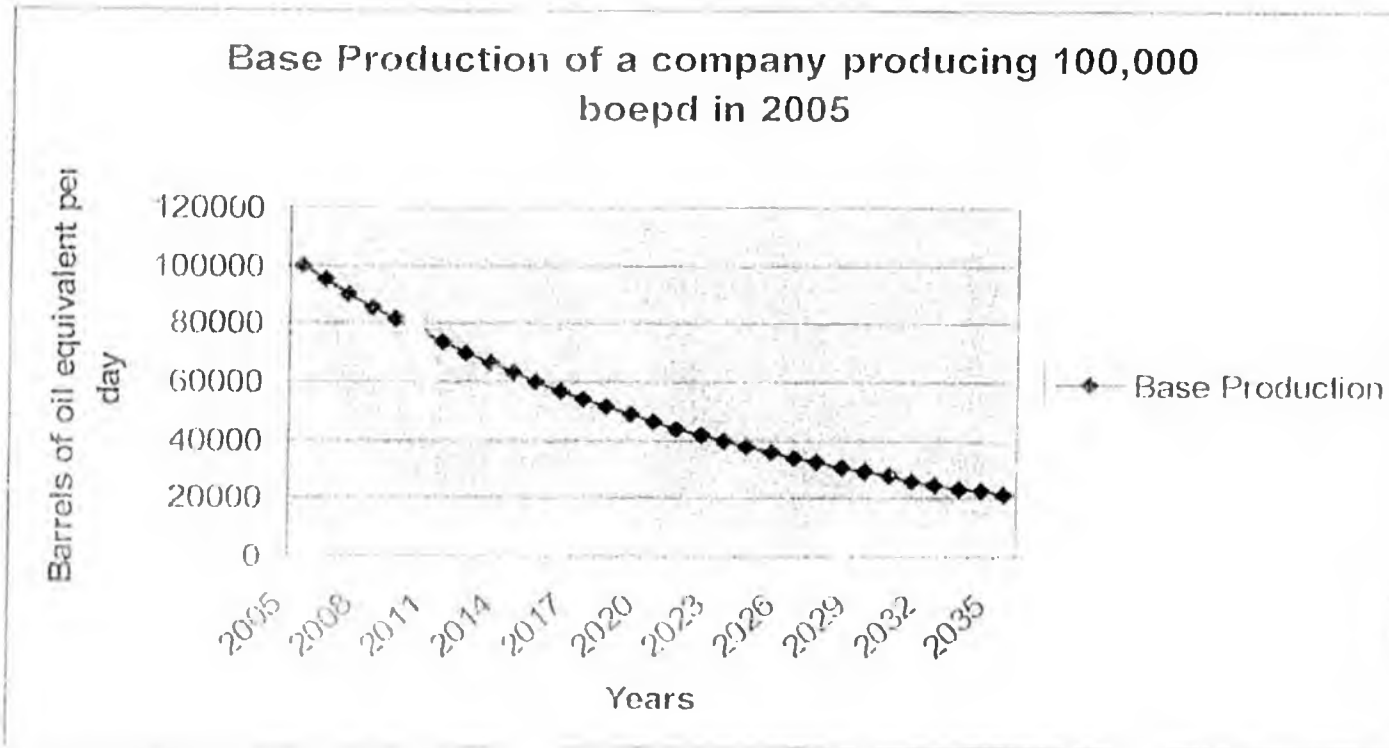
The 2005 base production is determined as 75% of this production.

For 2006 and future years a 5% decline per year is being used relative to 2005 on an exponential basis. This matches the way in which oil and gas fields typically decline.

Any production of a company in excess of the base production is incremental production.

If actual production is less than the base production all production is considered base production.

Base Production



The curve illustrates a typical base production curve based on a 5% per year decline.

Base Production

Geological and engineering evidence indicates that current actual decline curves for oil and gas are steeper than 5%.

Current actual decline of the various mature reservoirs under a "do nothing" scenario may range from 8% to 12% or more.

With current levels of ongoing investment companies may be able to reduce the decline rate to 5%. Therefore, the 5% decline rate is based on the fact that oil companies need to continue the current levels of re-investment in the State.

Tax Rates

It is proposed to have the following tax rates:

- Base Production: 25%
- Incremental Production: Initially 15%, going up by 0.5% per year from 2012 onwards until by 2031 the two rates are merged at 25%.

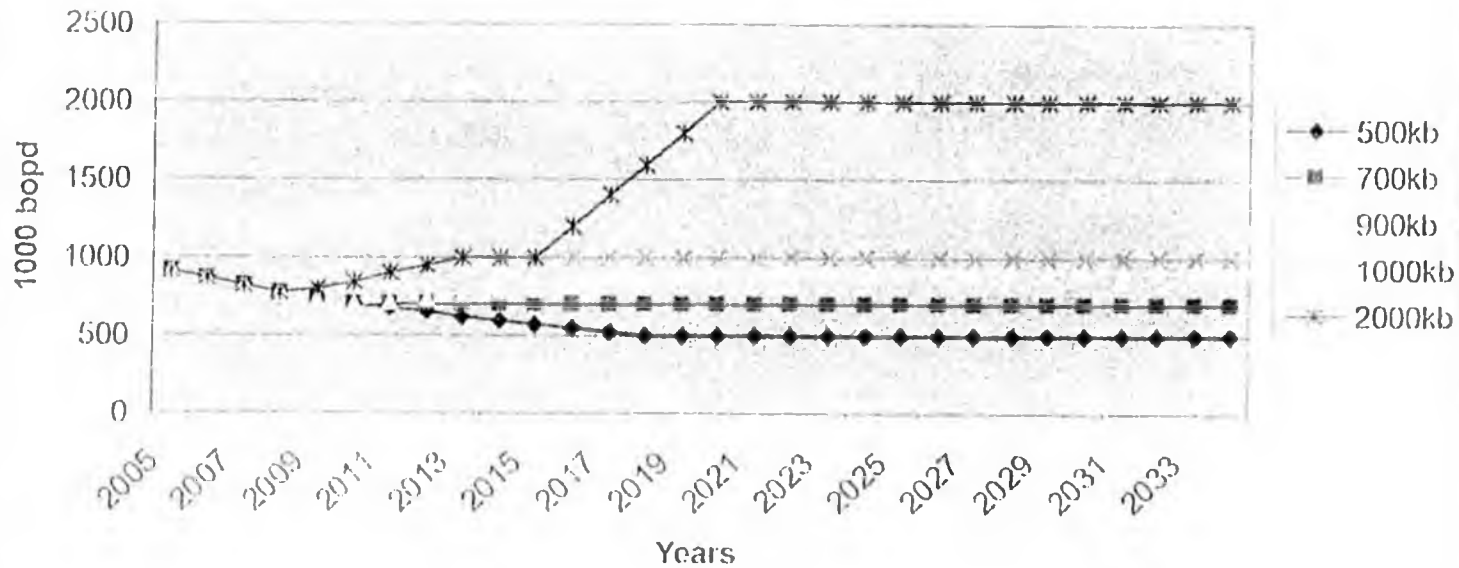
Production Scenarios

Five oil production scenarios were developed to test the weighted average tax rates on an Alaska wide basis. These scenarios are based production reaching the following flat levels:

- 500,000 bopd
- 700,000 bopd
- 900,000 bopd
- 1,000,000 bopd
- 2,000,000 bopd (ANWR opening up)

Production Scenarios

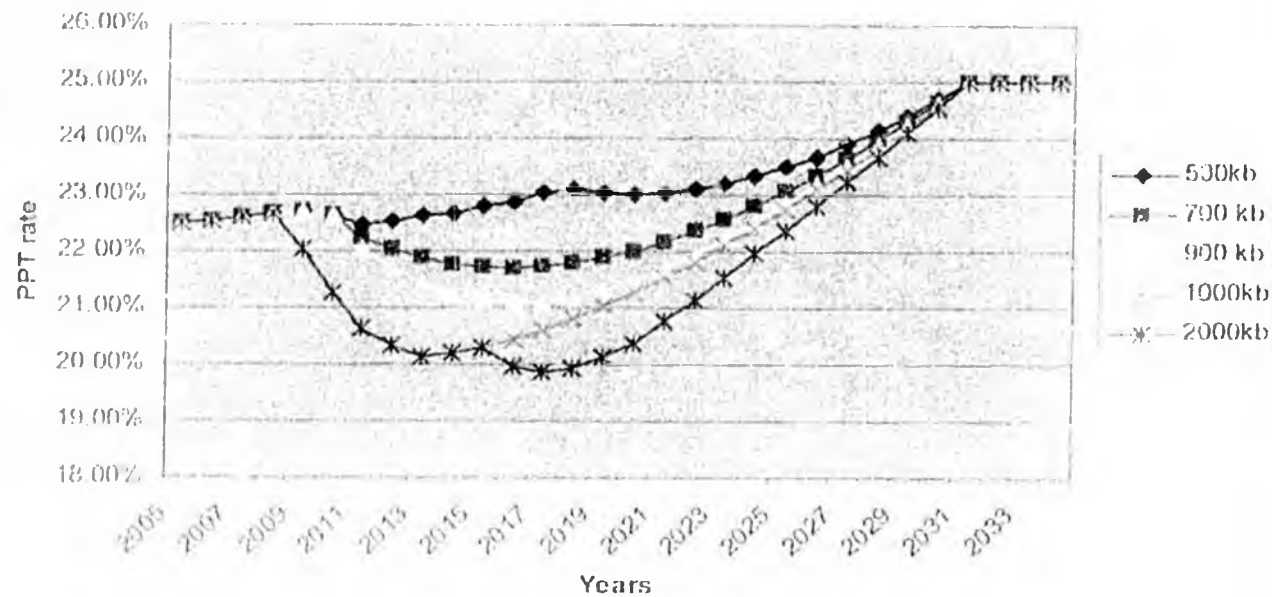
Alaska wide production scenarios



Five production scenarios, including an ANWR scenario going up to 2 million barrels per day

Alaska wide blended rate

Alaska blended rate based on a 5% decline



If the Alaska oil industry would rapidly develop further oil production, the blended rate may reach as low as 20%. If they do not actively pursue further developments, the blended rate would not decline below 22.5%.

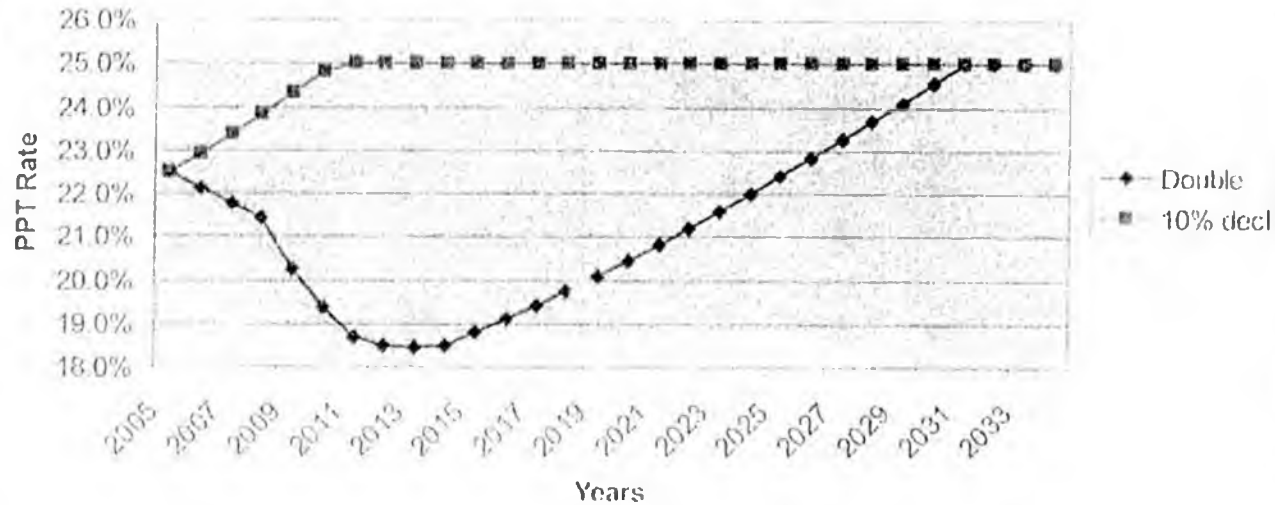
Effect on Individual Companies

The blended rate of individual existing oil and gas producers would vary more than the Alaska wide rate depending on their efforts:

- Companies which pursue a harvesting approach would rapidly pay a blended rate of 25%.
- Companies which let production decline at a 5% rate would pay 22.5% going up to 25%
- Companies which strongly maintain or increase production could benefit from a rate less than 22.5% for up to two decades until the rate goes up to 25%.

Effect on Individual Companies

Blended PPT rate for a company under two production scenarios



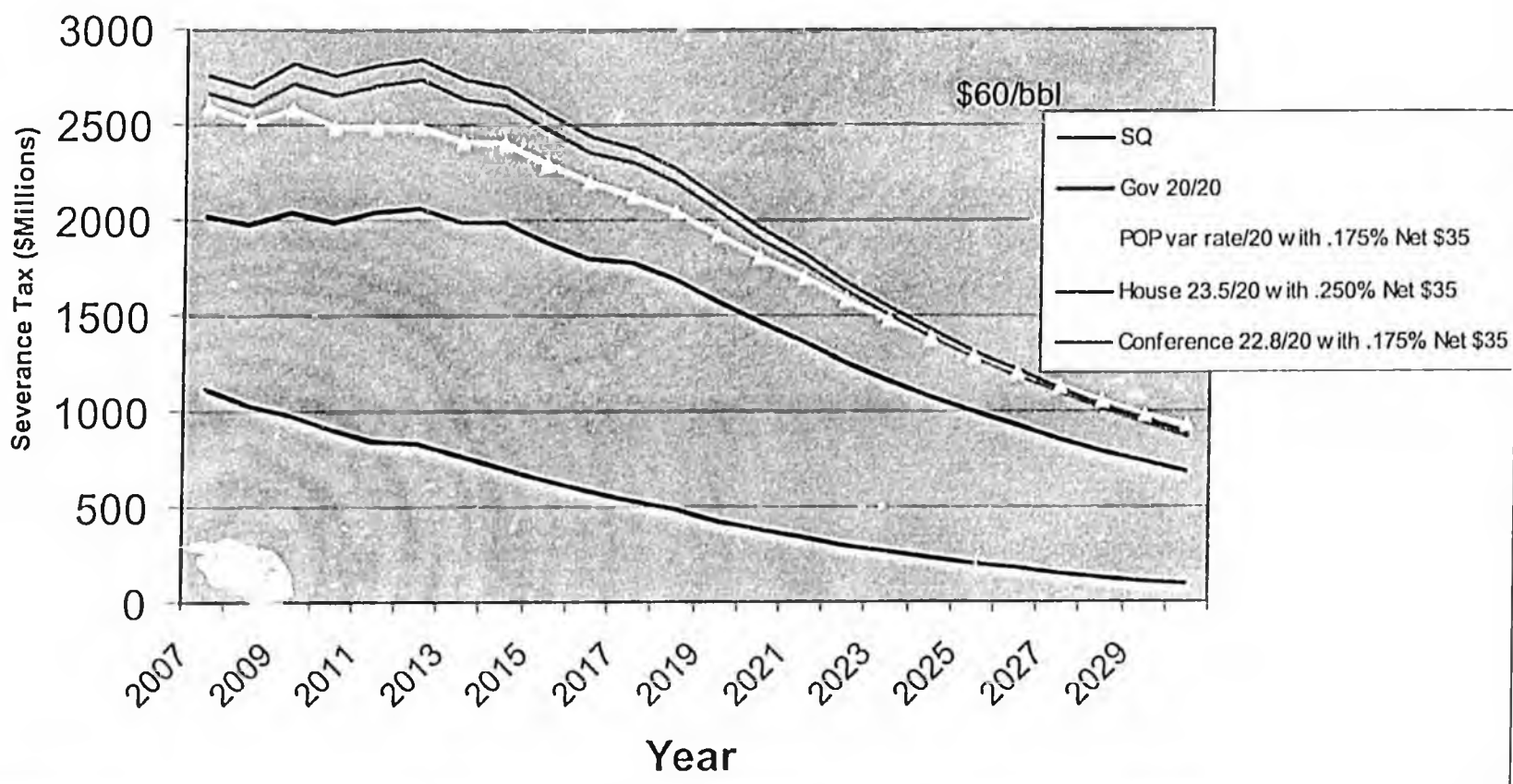
Companies which double production would have a blended rate as low as 18.5% for a number of years. Companies that are harvesters would rapidly pay 25%.

Effect on Incremental Investment

An incremental rate starting at 15% with a 20% tax credit is a more attractive tax package than a rate of 20% with a 20% tax credit for future investors.

Therefore, investments can be expected to be higher under this proposal than under the 20/20 concept.

**Severance Tax under the
Produce or Pay Plan (POP) and Various PPT Proposals at \$60/bbl**

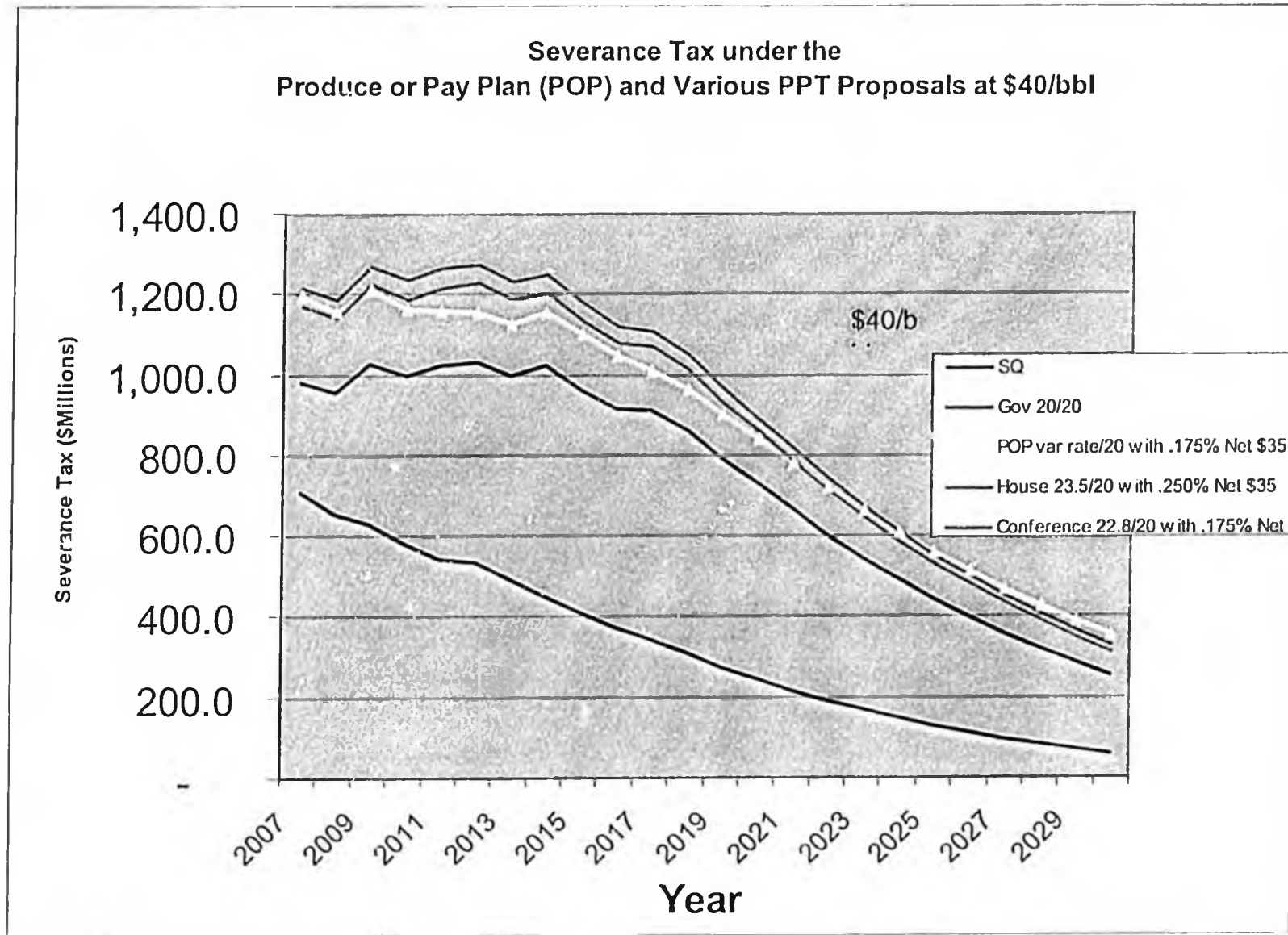


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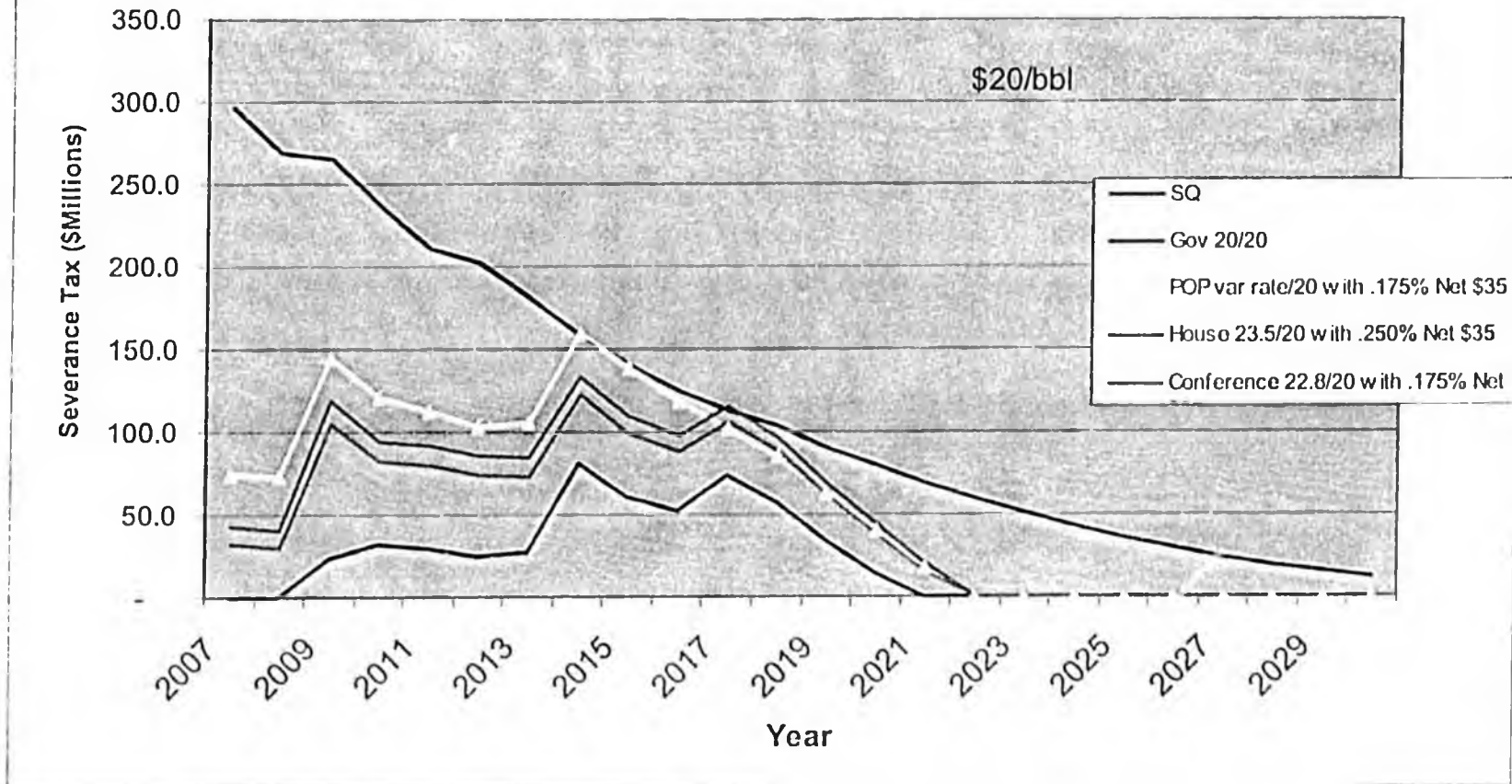
Source: AK DOR

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Severance Tax under the Produce or Pay Plan (POP) and Various PPT Proposals at \$40/bbl



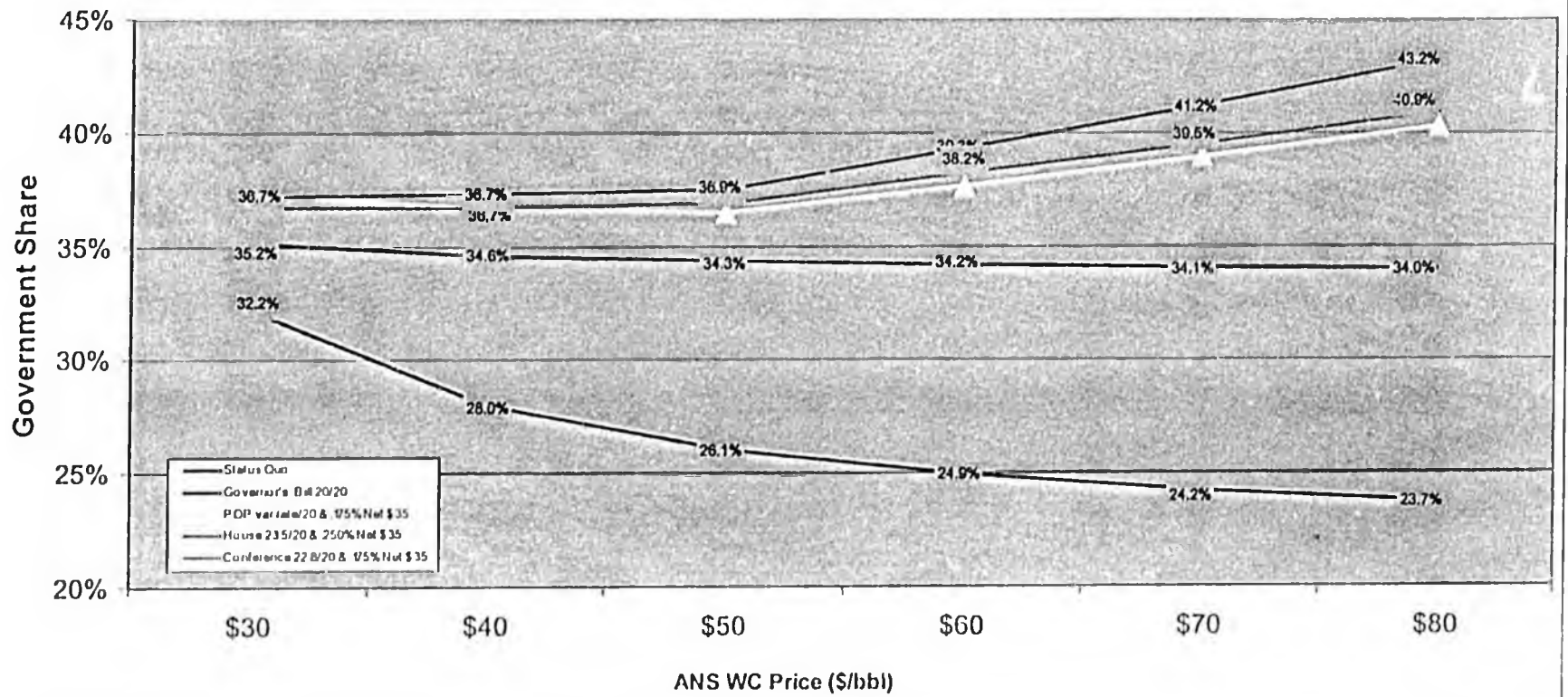
**Severance Tax under the
Produce or Pay Plan (POP) and Various PPT Proposals at \$20/bbl**



7/31/06

Source: AK DOR

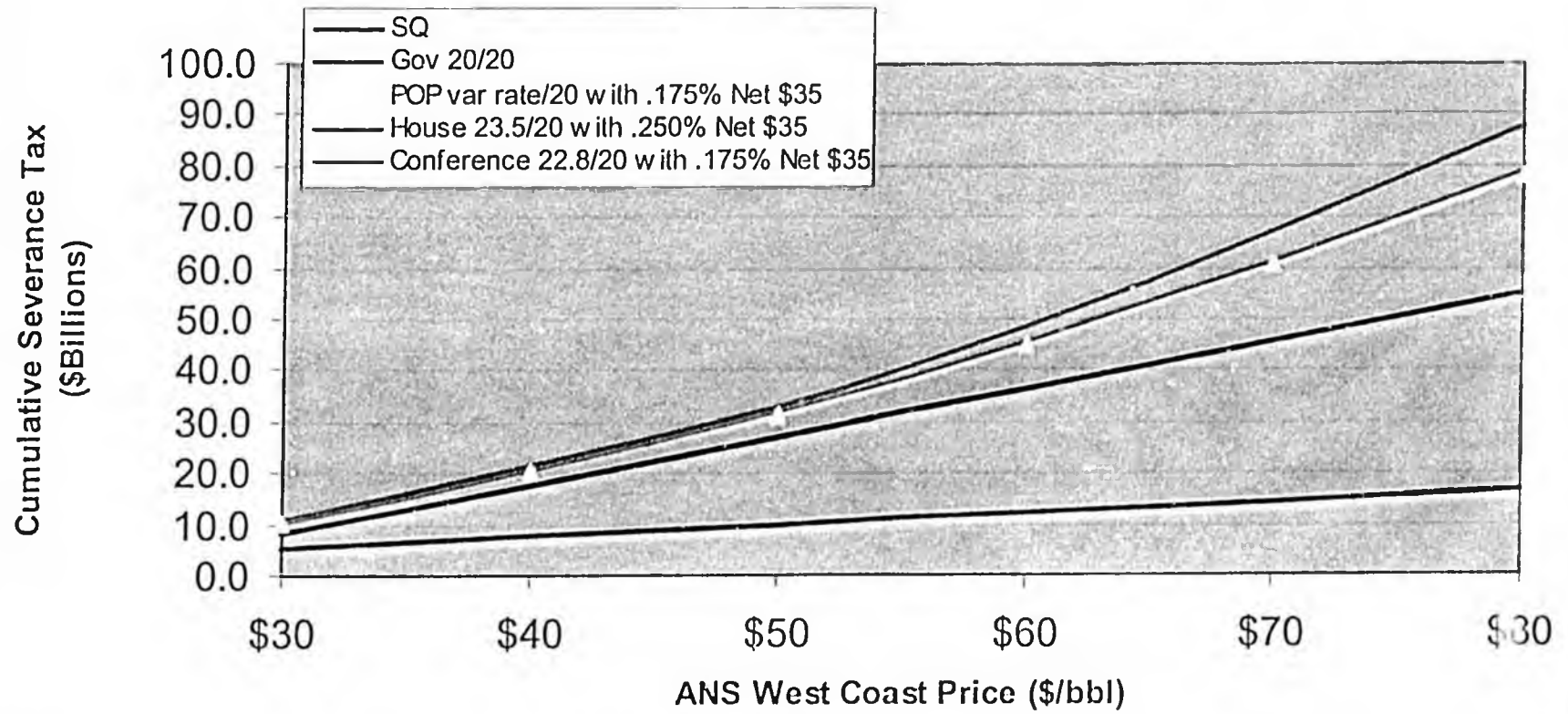
STATE TAKE: Distribution of Future Cash Flows Under SQ, Gov's Bill, POP, and Various PPT Proposals, FY 2007-2030



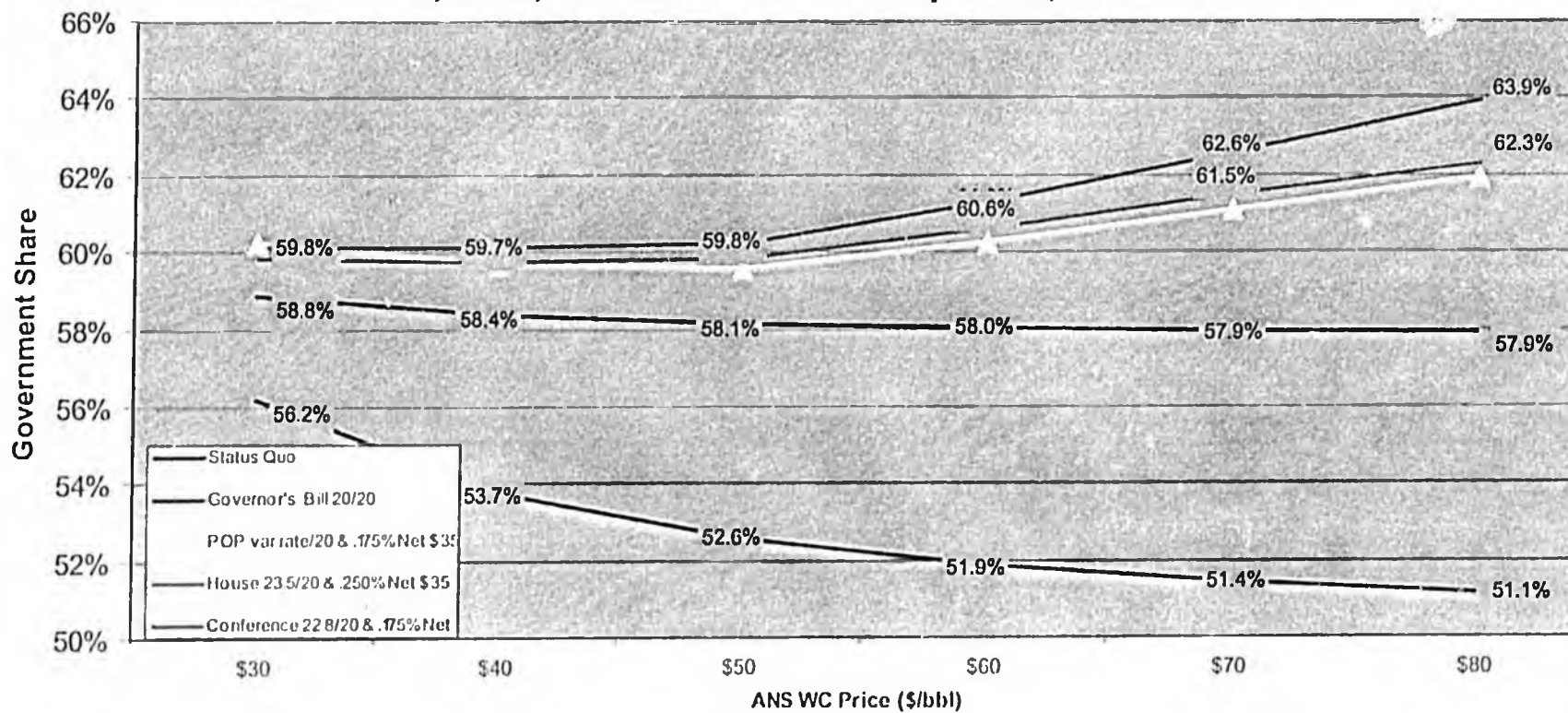
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Source: AK DOR

**Cumulative Severance Tax, 2007-2030,
Produce or Pay Plan (POP) and Various PPT Proposals**



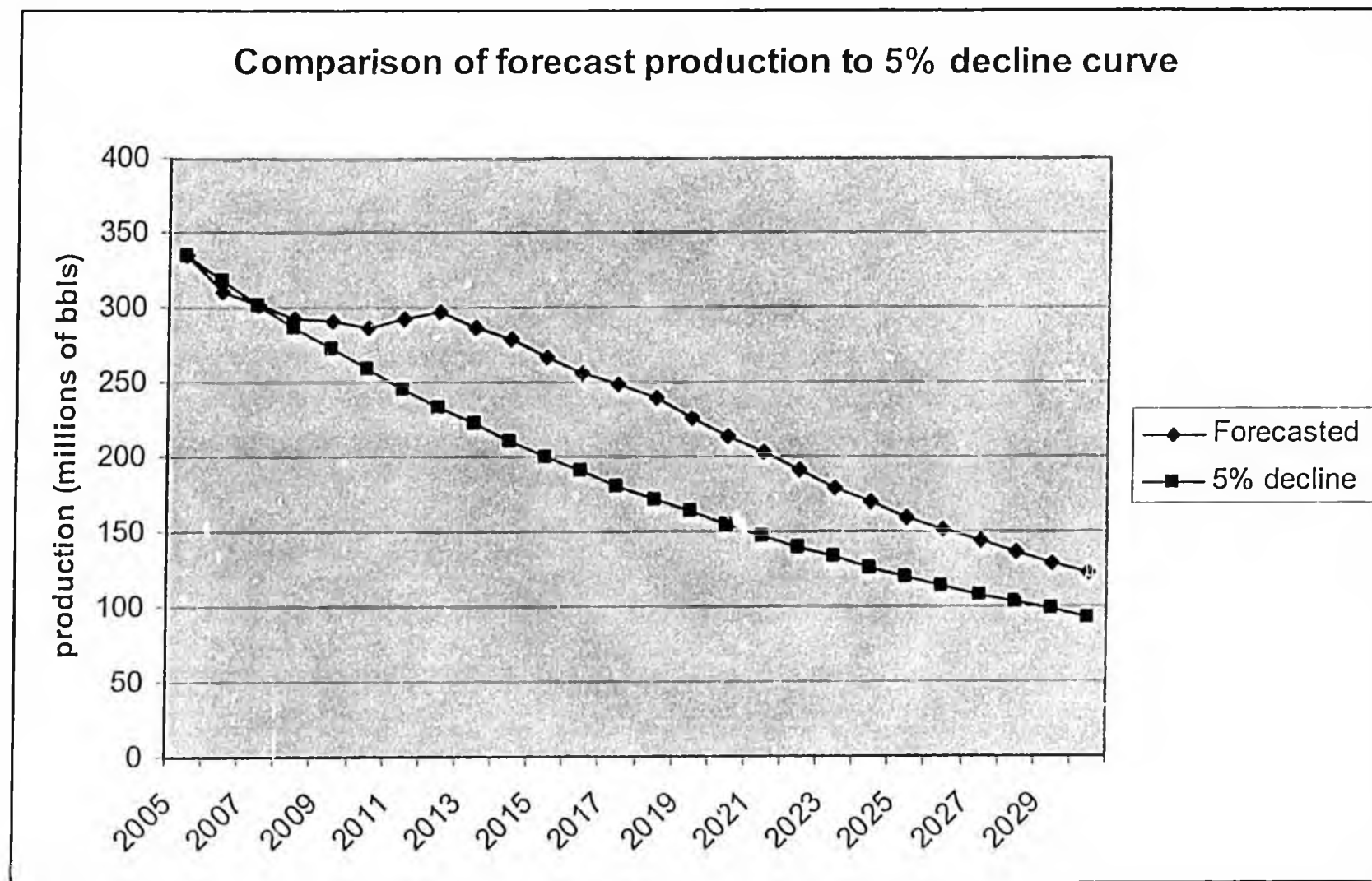
GOVERNMENT SHARE: Distribution of Future Cash Flows Under SQ, Gov's Bill, POP, and Various PPT Proposals, FY 2007-2030



7/31/06

Source: AK DOR

Comparison of forecast production to 5% decline curve



Fiscal Year	Forecasted Production (in mmbbls/yr)	Production Decline* per Forecast	Production Schedule per Allowed 5% Decline (in mmbbls/yr)	Blended Tax Rate per Forecast
2005	334.70	0.0%	334.71	n/a
2006	310.43	7.3%	317.97	n/a
2007	301.17	3.0%	302.07	22.5%
2008	293.06	2.7%	286.97	22.3%
2009	291.57	0.5%	272.62	22.0%
2010	286.77	1.6%	258.99	21.8%
2011	292.86	-2.1%	246.04	21.3%
2012	296.74	-1.3%	233.74	21.1%
2013	286.57	3.4%	222.05	21.2%
2014	278.26	2.9%	210.95	21.3%
2015	267.02	4.0%	200.40	21.5%
2016	256.23	4.0%	190.38	21.7%
2017	248.85	2.9%	180.86	21.8%
2018	239.47	3.8%	171.82	22.0%
2019	226.24	5.5%	163.23	22.2%
2020	214.13	5.4%	155.07	22.5%
2021	202.52	5.4%	147.31	22.7%
2022	190.32	6.0%	139.95	23.0%
2023	179.26	5.8%	132.95	23.2%
2024	169.09	5.7%	126.30	23.5%
2025	159.77	5.5%	119.99	23.7%
2026	151.25	5.3%	113.99	23.9%
2027	143.48	5.1%	108.29	24.1%
2028	136.23	5.1%	102.87	24.3%
2029	129.52	4.9%	97.73	24.6%
2030	123.45	4.7%	92.84	24.8%

*A negative decline rate is an increase in production

Volume weighted average blended tax rate, 2007 - 2030 = 22.35%

7/31/06

Source: AK DOR

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Gross vs. Net: Two Aspects
Heavy Oil
Exploration Economics

Alaska Department of Revenue
July 25, 2006

GROSS VS. NET - HEAVY OIL

	Light Oil	Heavy Oil
West Coast ANS Price	\$40.00	\$40.00
Shipping	\$2.00	\$2.00
Pipeline	\$3.00	\$3.00
GROSS	\$35.00	\$35.00
Royalty	\$4.38	\$4.38
UPSTREAM COSTS	\$7.50	\$15.00
NET	\$23.13	\$15.63

SUPPOSE THE TAX IS 15% OF GROSS:

Tax on Gross (15% X \$35.00)	\$5.25	\$5.25
Tax as Percent of Net	22.7%	33.6%

GROSS VS. NET - EXPLORATION ECONOMICS

field target size (barrels)	40,000,000
net price	\$10.00
total value	\$400,000,000
discount factor	0.4
net present value	\$160,000,000

probability of finding oil	15%
expected value	\$24,000,000
exploration cost	\$20,000,000

TAX ON GROSS

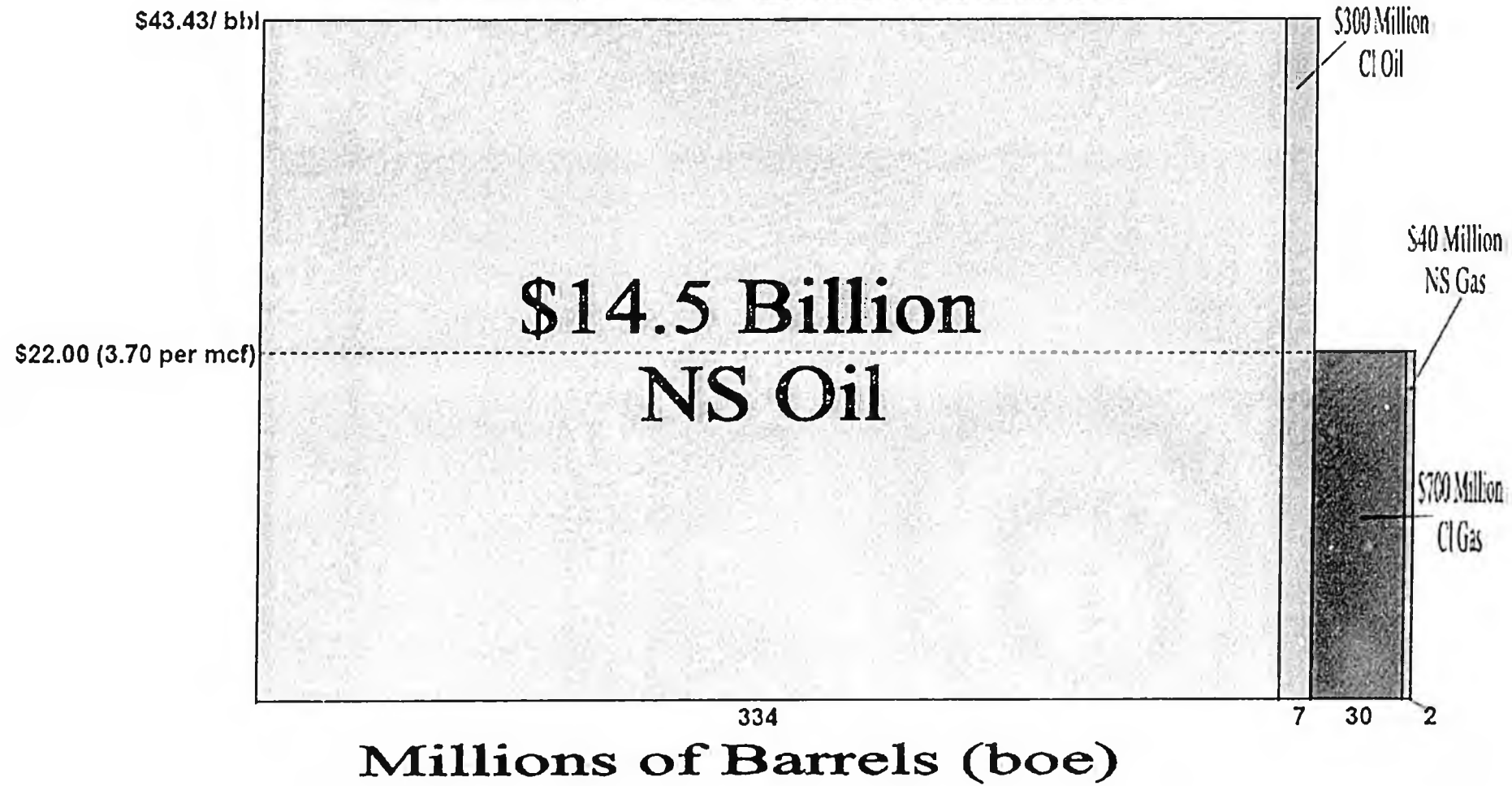
expected value	\$24,000,000
exploration cost	(\$20,000,000)
full cycle expected value	\$4,000,000

TAX ON NET

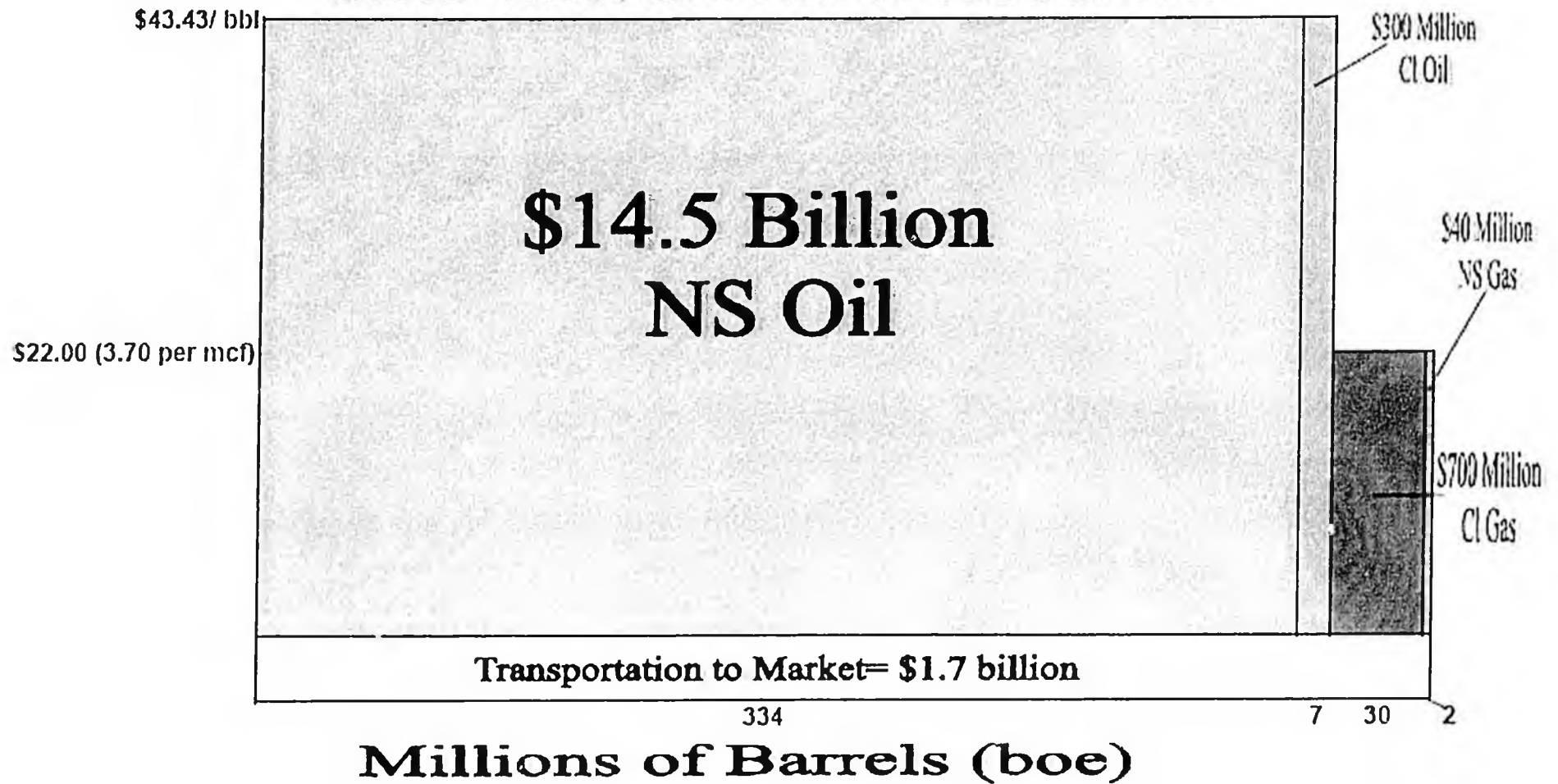
expected value	\$24,000,000
exploration cost	(\$20,000,000)
credit (20% of exploration cost)	\$4,000,000
deduction (20% of exploration cost)	\$4,000,000
full cycle expected value	\$12,000,000

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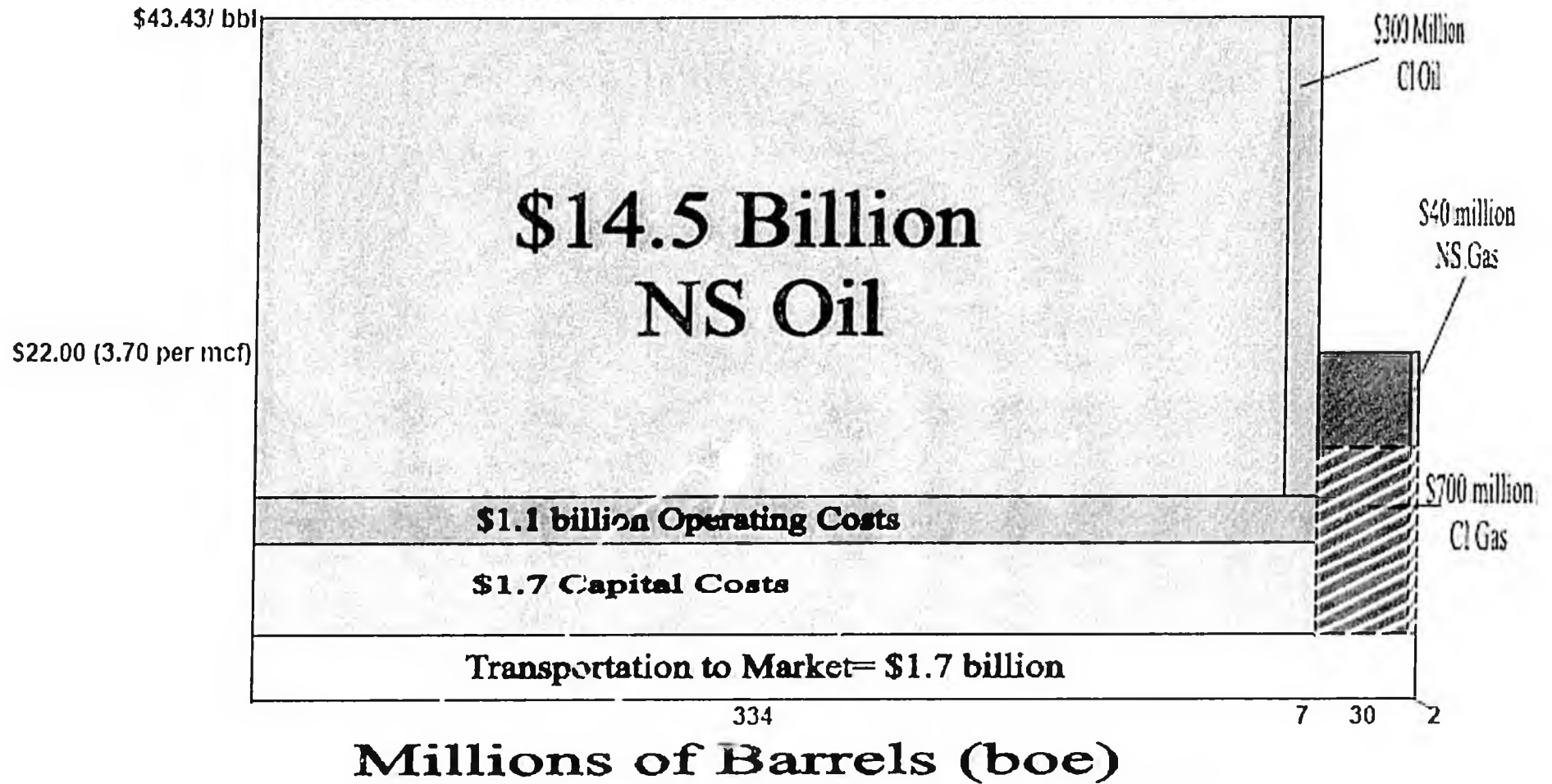
Sale at Market



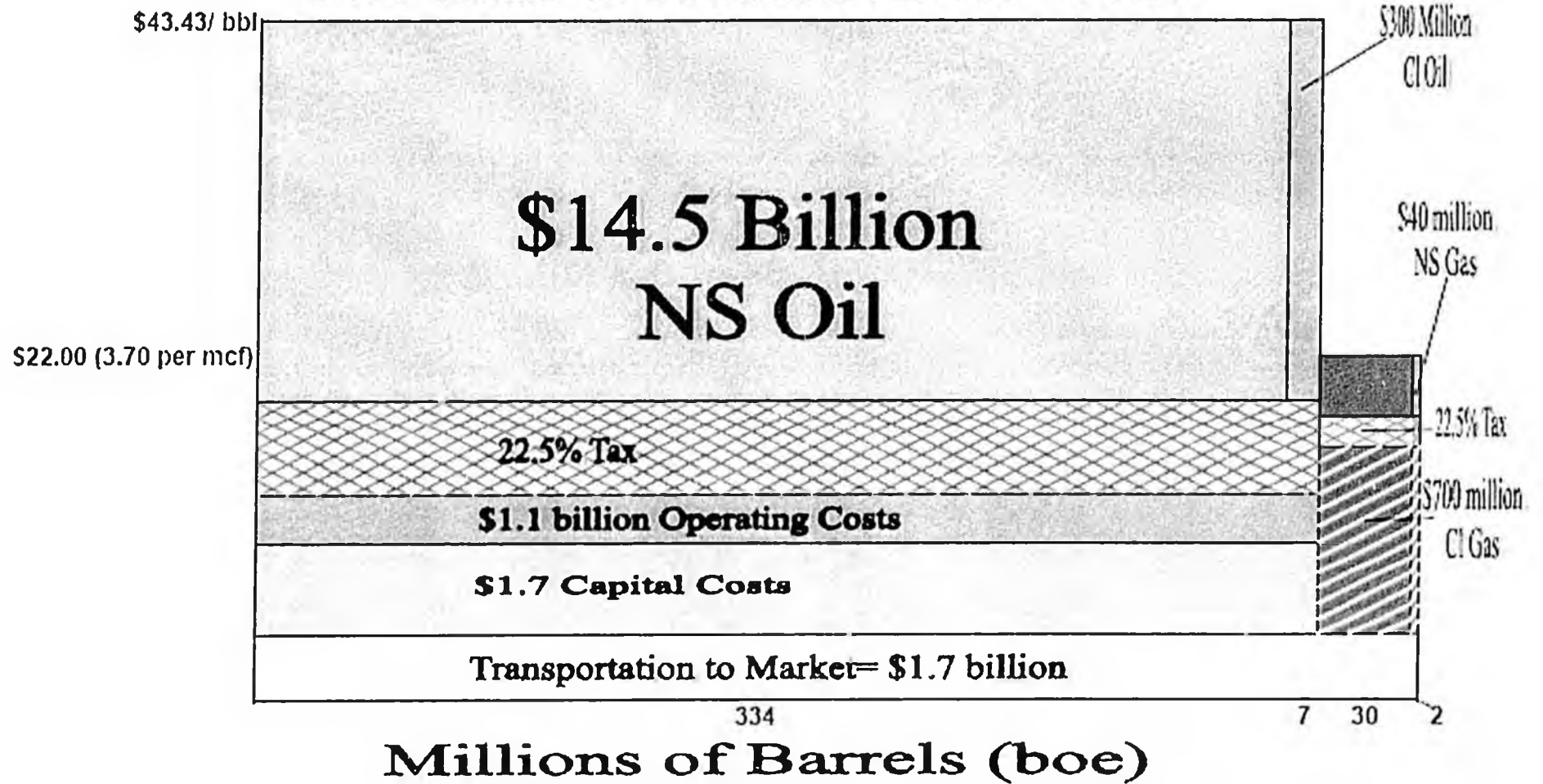
Gross Value at Point of Production



Net Value or Production Tax Value



Net Value or Production Tax Value



Tax Before Credits

2.4 billion

Tax After Credits

Tax After Credits 1.7 billion

3,000bbl equivalent credit 8 users at max of 14 million = 112 million

TIE credit $1.7 \times .5 \times .2 = 170$ million

$1.7b \times .25 = 425$ million Qualified Capital Expenditure Credits

Tax After Credits

Tax After Credits 1.7 billion

5,000bbl equivalent credit 8 users at max of 14 million = 112 million

TIE credit $1.7 \times .5 \times .2 = 170$ million

$1.7b \times .25 = 425$ million Qualified Capital Expenditure Credits

Tax Under Status Quo ~ .9 billion

Five Step Calculation of Tax Rate Under Amendment 2A

Step Three: Higher of, between 20% and 25%

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	25%	25%	25%	25%	25%	25%	25%	25%
\$ 0.50	25%	25%	25%	25%	25%	25%	25%	25%
\$ 1.00	25%	25%	25%	25%	25%	25%	25%	25%
\$ 1.50	25%	25%	25%	25%	25%	25%	25%	25%
\$ 2.00	24%	24%	24%	24%	24%	24%	24%	25%
\$ 2.50	24%	24%	24%	24%	24%	24%	24%	24%
\$ 3.00				24%	24%	24%	24%	24%
\$ 3.50					24%	24%	24%	24%
\$ 4.00						24%	24%	24%
\$ 4.50						24%	24%	24%
\$ 5.00	21%	21%					24%	24%
\$ 5.50	21%	21%	21%					24%
\$ 6.00	20%	20%	20%					
\$ 6.50	20%	20%	20%	21%				
\$ 7.00	20%	20%	20%	21%				

Five Step Calculation of Tax Rate Under Amendment 2A

Step four: Prop Version (prior to credits) with variable rate
 Progressivity slope: 0.0025 insert:

35

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	0.0%	0.0%	0.8%	3.3%	5.8%	8.3%	10.8%	13.3%
\$ 0.50	0.0%	0.0%	0.6%	3.1%	5.6%	8.1%	10.6%	13.1%
\$ 1.00	0.0%	0.0%	0.5%	3.0%	5.5%	8.0%	10.5%	13.0%
\$ 1.50	0.0%	0.0%	0.4%	2.9%	5.4%	7.9%	10.4%	12.9%
\$ 2.00	0.0%	0.0%	0.3%	2.8%	5.3%	7.8%	10.3%	12.8%
\$ 2.50	0.0%	0.0%	0.1%	2.6%	5.1%	7.6%	10.1%	12.6%
\$ 3.00	0.0%	0.0%	0.0%	2.5%	5.0%	7.5%	10.0%	12.5%
\$ 3.50	0.0%	0.0%	0.0%	2.4%	4.9%	7.4%	9.9%	12.4%
\$ 4.00	0.0%	0.0%	0.0%	2.3%	4.8%	7.3%	9.8%	12.3%
\$ 4.50	0.0%	0.0%	0.0%	2.1%	4.6%	7.1%	9.6%	12.1%
\$ 5.00	0.0%	0.0%	0.0%	2.0%	4.5%	7.0%	9.5%	12.0%
\$ 5.50	0.0%	0.0%	0.0%	1.9%	4.4%	6.9%	9.4%	11.9%
\$ 6.00	0.0%	0.0%	0.0%	1.8%	4.3%	6.8%	9.3%	11.8%
\$ 6.50	0.0%	0.0%	0.0%	1.6%	4.1%	6.6%	9.1%	11.6%
\$ 7.00	0.0%	0.0%	0.0%	1.5%	4.0%	6.5%	9.0%	11.5%

Five Step Calculation of Tax Rate Under Amendment 2A

Step Five: Net Tax Rate Plus Progressivity

	\$	30.00	\$	40.00	\$	50.00	\$	60.00	\$	70.00	\$	80.00	\$	90.00	\$	100.00
\$	-	25.0%		25.0%		25.8%		28.3%		30.8%		33.3%		35.8%		38.3%
\$	0.50	25.0%		25.0%		25.6%		28.1%		30.6%		33.1%		35.6%		38.1%
\$	1.00	25.0%		25.0%		25.5%		28.0%		30.5%		33.0%		35.5%		38.0%
\$	1.50	24.5%		24.5%		24.9%		27.4%		29.9%		32.4%		35.0%		37.5%
\$	2.00	24.0%		24.0%		24.3%		26.9%		29.5%		32.2%		34.7%		37.3%
\$	2.50	23.5%		23.5%		23.7%		26.5%		29.2%		31.9%		34.5%		37.1%
\$	3.00	23.0%		23.0%		23.2%		26.1%		28.9%		31.6%		34.2%		36.8%
\$	3.50	22.5%		22.5%		22.8%		25.7%		28.6%		31.3%		33.9%		36.6%
\$	4.00	22.0%		22.0%		22.4%		25.3%		28.2%		31.0%		33.7%		36.3%
\$	4.50	21.5%		21.5%		22.0%		24.9%		27.9%		30.7%		33.4%		36.0%
\$	5.00	21.0%		21.0%		21.5%		24.5%		27.5%		30.4%		33.1%		35.8%
\$	5.50	20.5%		20.5%		21.0%		24.0%		27.1%		30.0%		32.8%		35.5%
\$	6.00	20.0%		20.0%		20.5%		23.5%		26.7%		29.7%		32.5%		35.2%
\$	6.50	20.0%		20.0%		20.0%		23.0%		26.3%		29.4%		32.2%		35.0%
\$	7.00	20.0%		20.0%		20.0%		22.5%		25.9%		29.0%		31.9%		34.7%

Five Step Calculation of Tax Rate Under Amendment 2A

Net "Production Tax Value"/per bbl

Destination	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00	
Opex	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	
result	\$ 18.00	\$ 28.00	\$ 38.00	\$ 48.00	\$ 58.00	\$ 68.00	\$ 78.00	\$ 88.00	
Capex:	\$ -	18.00	28.00	38.00	48.00	58.00	68.00	78.00	88.00
\$ 0.50	17.50	27.50	37.50	47.50	57.50	67.50	77.50	87.50	
\$ 1.00	17.00	27.00	37.00	47.00	57.00	67.00	77.00	87.00	
\$ 1.50	16.50	26.50	36.50	46.50	56.50	66.50	76.50	86.50	
\$ 2.00	16.00	26.00	36.00	46.00	56.00	66.00	76.00	86.00	
\$ 2.50	15.50	25.50	35.50	45.50	55.50	65.50	75.50	85.50	
\$ 3.00	15.00	25.00	35.00	45.00	55.00	65.00	75.00	85.00	
\$ 3.50	14.50	24.50	34.50	44.50	54.50	64.50	74.50	84.50	
\$ 4.00	14.00	24.00	34.00	44.00	54.00	64.00	74.00	84.00	
\$ 4.50	13.50	23.50	33.50	43.50	53.50	63.50	73.50	83.50	
\$ 5.00	13.00	23.00	33.00	43.00	53.00	63.00	73.00	83.00	
\$ 5.50	12.50	22.50	32.50	42.50	52.50	62.50	72.50	82.50	
\$ 6.00	12.00	22.00	32.00	42.00	52.00	62.00	72.00	82.00	
\$ 6.50	11.50	21.50	31.50	41.50	51.50	61.50	71.50	81.50	
\$ 7.00	11.00	21.00	31.00	41.00	51.00	61.00	71.00	81.00	

Five Step Calculation of Tax Rate Under Amendment 2A

Step One: "Invest Down" of Tax Rate (independent of price)

		\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 0.50	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 1.00	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 1.50	0.500%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%
\$ 2.00	1.000%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
\$ 2.50	1.500%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%
\$ 3.00	2.000%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%
\$ 3.50	2.500%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%
\$ 4.00	3.000%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
\$ 4.50	3.500%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%
\$ 5.00	4.000%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
\$ 5.50	4.500%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%
\$ 6.00	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
\$ 6.50	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
\$ 7.00	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%

Five Step Calculation of Tax Rate Under Amendment 2A

Step Two: Calculation of "R"

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	25%	25%	25%	25%	25%	25%	25%	25%
\$ 0.50	24%	25%	25%	25%	25%	25%	25%	25%
\$ 1.00	24%	24%	24%	25%	25%	25%	25%	25%
\$ 1.50	23%	24%	24%	24%	24%	25%	25%	25%
\$ 2.00	22%	23%	24%	24%	24%	24%	24%	25%
\$ 2.50	21%	23%	24%	24%	24%	24%	24%	24%
\$ 3.00	20%	22%	23%	24%	24%	24%	24%	24%
\$ 3.50	19%	22%	23%	23%	24%	24%	24%	24%
\$ 4.00	17%	21%	22%	23%	23%	24%	24%	24%
\$ 4.50	15%	20%	22%	23%	23%	24%	24%	24%
\$ 5.00	12%	20%	22%	22%	23%	23%	24%	24%
\$ 5.50	8%	19%	21%	22%	23%	23%	23%	24%
\$ 6.00	3%	18%	20%	22%	22%	23%	23%	23%
\$ 6.50	-5%	16%	20%	21%	22%	23%	23%	23%
\$ 7.00	-19%	15%	19%	21%	22%	23%	23%	23%

API gravity

From Wikipedia, the free encyclopedia

API Gravity is a specific gravity scale developed by the American Petroleum Institute (API) for measuring the relative density of various petroleum liquids. API gravity is graduated in degrees on a hydrometer instrument and was designed so that most values would fall between 10 and 70 API gravity degrees.

The U.S. National Bureau of Standards established the Baumé scale (see degrees Baumé) as the standard for measuring specific gravity of liquids less dense than water in 1916. Investigation by the U.S. National Academy of Sciences found major errors in salinity and temperature controls that had caused serious variations in published values. Hydrometers in the U.S. had been manufactured and distributed widely with a modulus of 141.5 instead of the Baumé scale modulus of 140. The scale was so firmly established that by 1921 the remedy implemented by the American Petroleum Institute was to create the API Gravity scale recognizing the scale that was actually being used.

The formula used to obtain the API gravity of petroleum liquids is thus:

$$\text{API gravity} = (141.5/\text{SG at } 60\text{ }^{\circ}\text{F}) - 131.5$$

Conversely, the specific gravity of petroleum liquids can be derived from the API gravity value as

$$\text{SG at } 60\text{ }^{\circ}\text{F} = 141.5/(\text{API gravity} + 131.5)$$

60°F (or 15 5/9 °C) is used as the normal value for measurements and further tables give adjustments for temperature.

(See ASTM D1298)

Thus, a heavy oil with a specific gravity of 1.0 (i.e., with the same density as pure water at 60°F) would have an API gravity of:

$$(141.5/1.0) - 131.5 = 10.0 \text{ degrees API.}$$

Generally speaking higher API gravity degree oil values have a greater commercial value and lower degree values have lower commercial value. This general rule only holds up to 45 degrees API gravity as beyond this value the molecular chains become shorter and less valuable to a refinery.

Crude oil is classified as light, medium or heavy, according to its measured API gravity.

Light crude oil is defined as having an API gravity higher than 31.1 °API

Medium oil is defined as having an API gravity between 22.3 °API and 31.1 °API

Heavy oil is defined as having an API gravity below 22.3 °API.

Oil which will not flow at normal temperatures or without dilution is named bitumen and the API gravity is generally less than 10 °API. Bitumen derived from the oil sands deposits in the Alberta, Canada area has an API gravity of around 8 °API. It is 'upgraded' to an API gravity of 31 °API to 33 °API and the upgraded oil is known as synthetic oil.

External links

- link to hydrometer (<http://www.koehlerinstrument.com/products/hydrometer.html>)
- Conoco price adjustment by API gravity (<http://www.conocophillips.com/products/buy/gravity/index.htm>)
- comments on API gravity adjustment scale (http://dnr.louisiana.gov/sec/execdiv/tehasmt/oil_gas/crude_oil_gravity/comments_1989.htm)
- instructions for using a glass hydrometer measured in API gravity (<http://www.globalsecurity.org/military/library/policy/army/fm/10-67-1/APPI.HTML>)
- API Degree history (http://www.sizes.com/units/hydrometer_api.htm)

Retrieved from "http://en.wikipedia.org/wiki/API_gravity"

Category: Physical quantity

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7-2-06

Dollar Per barrel investment will determine tax rate between 20% and 25%
for year of investment

Per Bbl Investment	Amount below 25%	Tax Rate
\$ -	0.00%	25.00%
\$ 0.50	0.00%	25.00%
\$ 1.00	0.00%	25.00%
\$ 1.50	0.50%	24.50%
\$ 2.00	1.00%	24.00%
\$ 2.50	1.50%	23.50%
\$ 3.00	2.00%	23.00%
\$ 3.50	2.50%	22.50%
\$ 4.00	3.00%	22.00%
\$ 4.50	3.50%	21.50%
\$ 5.00	4.00%	21.00%
\$ 5.50	4.50%	20.50%
\$ 6.00	5.00%	20.00%
\$ 6.50	5.00%	20.00%
\$ 7.00	5.00%	20.00%

Capital Spending on the North Slope, 2001 - 2006

BP			
Year	Volume	Investment	\$/bbl
2001	122 2048	\$612	\$5 008
2002	125 8920	\$358	\$2 844
2003	129 9084	\$257	\$1 978
2004	126 1286	\$264	\$2 093
2005	114 7406	\$284	\$2 475
2006 est	106 9320	\$326	\$3 049
Averages		\$350	\$2 908

ConocoPhillips			
Year	Volume	Investment	\$/bbl
2001	144 2077	\$603	\$4 181
2002	145 0393	\$460	\$3 172
2003	140 6935	\$365	\$2 594
2004	135 4255	\$484	\$3 574
2005	129 2072	\$561	\$4 342
2006 est	120 4140	\$608	\$5 049
Averages		\$514	\$3 819

Exxon/Mobil			
Year	Volume	Investment	\$/bbl
2001	84 3135	\$175	\$2 076
2002	77 8699	\$162	\$2 080
2003	74 0578	\$142	\$1 917
2004	69 6960	\$173	\$2 482
2005	62 7572	\$150	\$2 390
2006 est	58 4860	\$175	\$2 992
Averages		\$163	\$2 323

Others			
Year	Volume	Investment	\$/bbl
2001	13 3438	\$120	\$8 993
2002	15 2663	\$120	\$7 860
2003	15 1419	\$86	\$5 680
2004	14 9356	\$89	\$5 959
2005	15 2026	\$110	\$7 236
2006 est	14 1580	\$251	\$19 833
Averages		\$134	\$9 260

Capital Spending on the North Slope, 2001 - 2006

ALL COMPANIES			
Year	Volume	Investment	\$/bbl
2001	364 6998	\$1 510	\$4 146
2002	364 0675	\$1 100	\$3 021
2003	359 8016	\$850	\$2 362
2004	346 1857	\$1 010	\$2 916
2005	321 9076	\$1 105	\$3 433
2006 est	300 0000	\$1 390	\$4 633
Averages		\$1 160 83	\$3 419

Source: Volumes - DOR; Investment - ConocoPhillips estimates

Millions of Dollar of Annual Investment

Million Bbls daily production	Million Bbls Annual production	\$ 400	\$500	\$600	\$700	\$ 800	\$ 900	\$1,000	\$ 1,100	\$ 1,200	\$1,300	\$1,400	\$1,500	\$1,600	\$1,700	\$1,800	\$1,900	\$2,000
0.900	328,500	1.22	1.52	1.83	2.13	2.44	2.74	3.04	3.35	3.65	3.96	4.26	4.57	4.87	5.18	5.48	5.78	6.09
0.850	310,250	1.29	1.61	1.93	2.26	2.58	2.90	3.22	3.55	3.87	4.19	4.51	4.83	5.16	5.48	5.80	6.12	6.45
0.800	292,000	1.37	1.71	2.05	2.40	2.74	3.08	3.42	3.77	4.11	4.45	4.79	5.14	5.48	5.82	6.16	6.51	6.85
0.750	273,750	1.46	1.82	2.19	2.56	2.92	3.29	3.65	4.02	4.38	4.75	5.11	5.48	5.84	6.21	6.58	6.94	7.31
0.700	255,500	1.57	1.96	2.35	2.74	3.13	3.52	3.91	4.31	4.70	5.09	5.48	5.87	6.26	6.65	7.05	7.44	7.83
0.650	237,250	1.69	2.11	2.53	2.95	3.37	3.79	4.21	4.64	5.06	5.48	5.90	6.32	6.74	7.17	7.59	8.01	8.43
0.600	219,000	1.83	2.28	2.74	3.20	3.65	4.11	4.57	5.02	5.48	5.94	6.39	6.85	7.31	7.76	8.22	8.68	9.13
0.550	200,750	1.99	2.49	2.99	3.49	3.99	4.48	4.98	5.48	5.98	6.48	6.97	7.47	7.97	8.47	8.97	9.46	9.96
0.500	182,500	2.19	2.74	3.29	3.84	4.38	4.93	5.48	6.03	6.58	7.12	7.67	8.22	8.77	9.32	9.86	10.41	10.96
0.450	164,250	2.44	3.04	3.65	4.25	4.87	5.48	6.09	6.70	7.31	7.91	8.52	9.13	9.74	10.35	10.96	11.57	12.18
0.400	146,000	2.74	3.42	4.11	4.79	5.48	6.16	6.85	7.53	8.22	8.90	9.59	10.27	10.96	11.64	12.33	13.01	13.70
0.350	127,750	3.13	3.91	4.70	5.48	6.26	7.05	7.83	8.61	9.39	10.18	10.96	11.74	12.52	13.31	14.09	14.87	15.66
0.300	109,500	3.65	4.57	5.48	6.39	7.31	8.22	9.13	10.05	10.96	11.87	12.79	13.70	14.61	15.53	16.44	17.35	18.25
0.250	91,250	4.27	5.48	6.58	7.67	8.77	9.86	10.96	12.05	13.15	14.25	15.34	16.44	17.53	18.63	19.73	20.82	21.92
0.200	73,000	5.13	6.45	7.77	9.09	10.41	11.73	13.05	14.37	15.69	17.01	18.33	19.65	20.97	22.29	23.61	24.93	26.25

Shaded areas would result in sub-optimal pricing

Comments Related To Heavy Oil in Proposed Legislation

There are four issues related to heavy oil in proposed legislation that need to be recognized as critical to the collection of production taxes. These items are the following:

- Definition of Heavy Oil
- Measurement
- Time and Changes Over Time
- Technology and Time

As currently proposed in legislation, the four items listed above would make the collection of taxes challenging and problematic. It is assumed that heavy oil is omitted from tax liability in HB 3003 due to the difficulty and high cost of developing it. As this discussion will show, just because a crude oil is classified as heavy [according to HB 3003] does not mean it will be difficult or expensive to develop and oil not classified as heavy may be very difficult and expensive to develop. What is now classified as expensive to develop, may not be in the future. Each topic is now reviewed.

Definition of Heavy Oil

HB 3003 defines heavy oil as that with an American Petroleum Institute [API] gravity of 18° or less. While this appears to be a "clean" definition, it omits the fact that crude oils with an API of 18° or less are not necessarily difficult to produce. Other factors may be more important. Some basics:

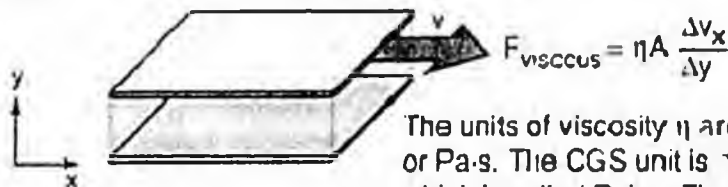
Heavy Oil is a type of crude oil which is very *viscous* and does not flow easily. The common characteristic properties are the following:

- High specific gravity
- Low hydrogen to carbon ratios
- High carbon residues, and
- High contents of asphaltenes, heavy metal, sulphur and nitrogen

It is not just the gravity that makes the heavy oil difficult to deal with – it is the presence of other factors. There is no one definition of heavy oil, but it refers to oil with a high density and low API gravity due to the presence of a high proportion of heavy hydrocarbon fractions. All these definitions refer to the crude oil at the surface. In terms of the ability of the oil to flow within the formation – the key issue in Alaska – is that heavy oils are generally those with a viscosity greater than 100 centiPoise [cP] at reservoir conditions (although on occasions the term heavy oil has been applied to *in situ* viscosity as low as 4 cP).

Viscosity is the measure of the internal friction of a fluid. This friction becomes apparent when a layer of fluid is made to move in relation to another layer. The greater the friction, the greater the amount of force required to cause this movement,

which is called "shear." Shearing occurs whenever the fluid is physically moved or distributed, as in pouring, spreading, spraying, mixing, etc. *Highly viscous fluids, therefore, require more*



The units of viscosity η are then N s/m^2 or $\text{Pa}\cdot\text{s}$. The CGS unit is dyne sec/cm^2 which is called Poise. The viscosity of water at 20° C is 0.01 Poise. The viscosity of blood at body temperature is about 0.03 Poise. The $\text{Pa}\cdot\text{s}$ is called a *Poiseuille* and is equal to 10 Poise.

force to move than less viscous materials.

Temperature also plays a key role in viscosity. Higher temperatures imply lower viscosity with the fluid flowing more easily. In oil formations, the deeper in the ground the oil formation, the warmer the temperature, the lower the viscosity, the easier the flow. In Alaska, the viscous oils tend to be in shallower depths, which mean the oil is cooler, more viscous, and does not flow as easily. Also, the Alaska oil is found in less consolidated formations which produce a lot of sand as the oil is produced.

The combination of temperature, viscosity, and additional components in the oil [carbon residues, heavy metals, sulphur, nitrogen and sand] make for difficulty in developing of heavy oil – not necessarily API gravity.

Figure 1

Measurement

To accurately interpret HB 3003, all oil coming from the North Slope would have to be examined and evaluated to determine if it is heavy. This would imply measuring all oil produced from each well. A well may be multi-lateral with different bores going to different levels [see Figure 1]. Oil produced at one level may be classified as heavy [less than 18° API] while crude produced from a different formation [same well, same field, different depth] may not be classified as heavy. Measurement could be a nightmare.

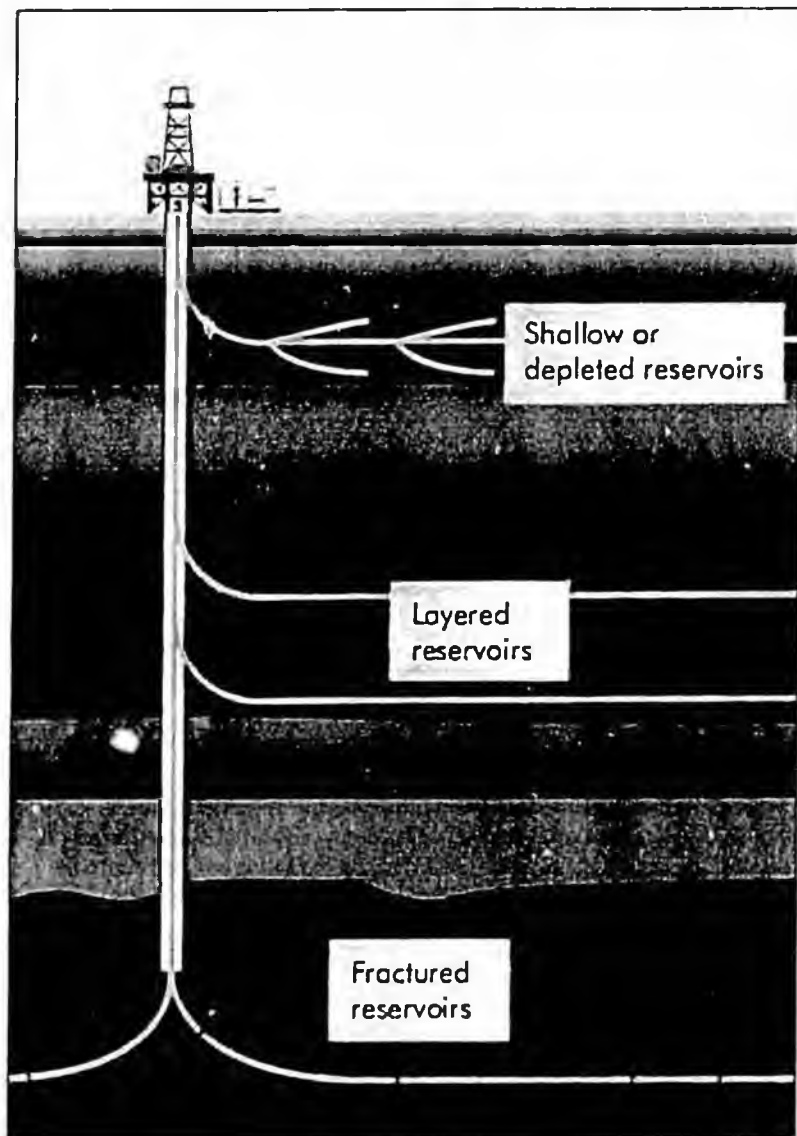
Time and Changes Over Time

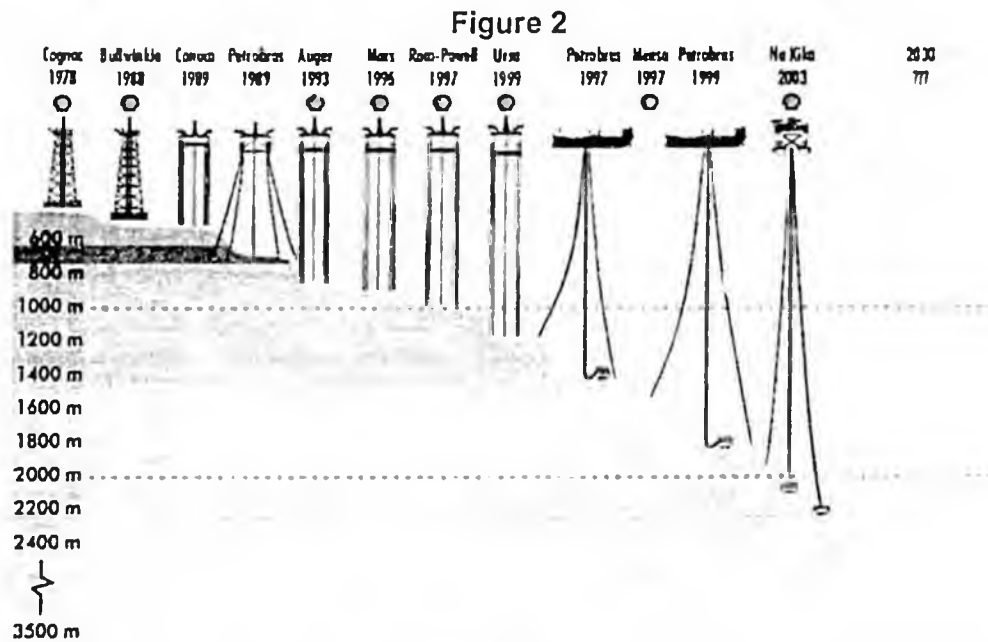
The production would have to be measured and monitored on a monthly basis. Changes in field operations occur all the time. A well may be producing oil classified as heavy today, and that classification could change in a day, a week, a month, or a year as new bores are drilled into different layers. Thus, the measurement aspect would have to be an on-going monthly event.

Technology and Time

What may be difficult and expensive to produce today, may well be commonplace and cheaper to

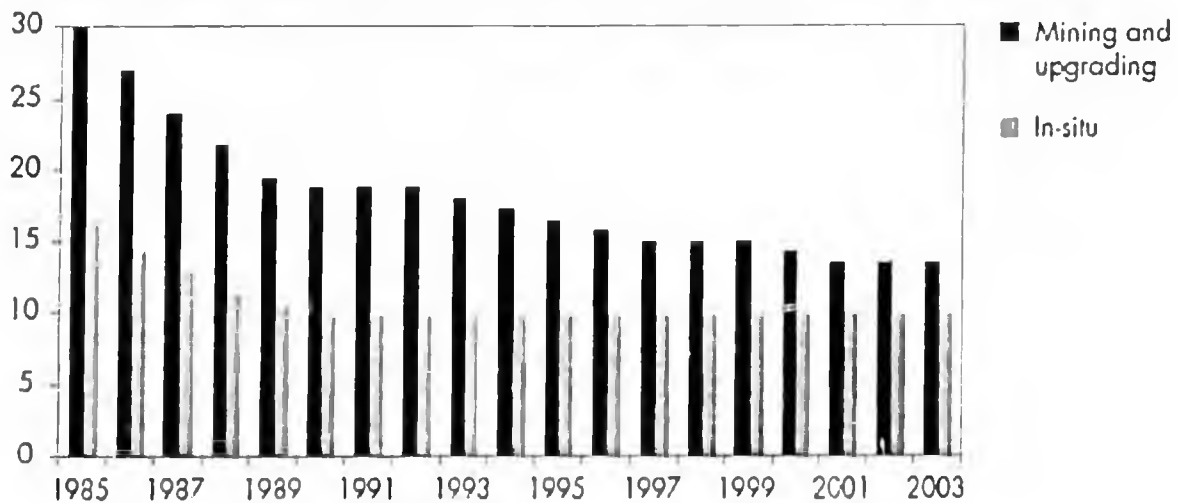
produce in the future. The oil industry has shown tremendous ingenuity in developing techniques to find and develop oil. For example, in the case of deepwater offshore oil development, it was impossible to produce oil from depths greater than 600 meters in the early 1970s. By 2003, oil companies were regularly producing oil at depths below 1,500 meters. New systems and techniques were developed to access the oil deeper and deeper under the ocean [see Figure 2 following page].





In North America, similar results can be found in Canada where new techniques have been introduced to develop heavy oil. As the new techniques were developed, the per barrel costs of developing heavy oil decreased [see Figure 3].

Figure 3
Oil Production Costs from Canadian Tar Sands, 2004 Dollars per Barrel



In summary, oil that is difficult and expensive to produce today may well be less expensive to produce in the future. Any legislation that assumes heavy oil will always be expensive to develop does not take into account the dynamic nature of the oil industry and its ability to develop new methods and techniques to produce hydrocarbons, and reduce costs in the process.

Conclusions

Legislation that seeks to tax oil production using API gravity as a means to determine tax liability has a high likelihood of being difficult to administer while offering real challenges to measure and enforce. Changes in methods and technology over time will likely allow heavy oil to be recovered and often developed at a lower per barrel cost as time marches on. This means the very rationale for using heavy oil as a discriminating factor will lose its basis over time. It is recommended that another option be used for tax legislation purposes.

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July 12, 2006

The Honorable John Harris
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Harris:

Under the authority of article III, section 18, of the Alaska Constitution, I am transmitting a bill relating to the oil and gas production tax.

This bill is similar to previous versions of oil and gas production tax legislation that the Legislature has considered during both the regular and special sessions this year. I appreciate that legislators have devoted sustained and serious attention and concern to this subject, and there is therefore no need for me to repeat in detail here the reasons why this legislation is urgently needed or how the new tax system set out in this legislation would work. Legislators well understand that the existing production tax law is not adequately serving the interests of Alaskans and that the approach taken by this bill would provide the state with a fairer share of the value of oil and gas production while encouraging vital investment in future production.

I also appreciate that the legislative process this year has led to numerous improvements in the bills that were originally submitted, resulting in increased clarity, predictability, and ease of administration. The bill I am transmitting takes advantage of these improvements by using as its model the most recent versions that were passed by the House and Senate, HCS CSSB 2001(FIN) am H and CCS SB 2001. The following two changes from those versions are reflected in the bill:

1. Because I still believe that a 20 percent tax rate on net value represents a more appropriate balance than either of the higher rates contained in HCS CSSB 2001(FIN) am H or CCS SB 2001, my bill returns to a 20 percent rate.

2. For the same reason, my bill eliminates the additional "progressivity" tax provisions that were in the other versions.

HB 3001

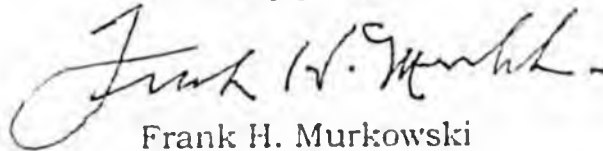
The Honorable John Harris
July 12, 2006
Page 2

3. Similarly, because I believe that the four percent of gross value tax floor on North Slope production that was added by HCS CSSB 2001(FIN) am H and the similar three percent floor that was contained in CCS SB 2001 are inconsistent with the concept of a progressive net value tax system, my bill eliminates that tax floor provision.

As explained more fully in my transmittal letter accompanying the original administration bills, this bill will greatly improve Alaska's oil and gas tax system, encouraging investment in the state making tax administration more predictable, and better reflecting the variable economics of oil and gas development. This bill will provide Alaskans with a fairer share of the value of the oil and gas taken out of the ground in our state and provide fiscal certainty for future generations of Alaskans.

I urge your prompt and favorable action on the bill.

Sincerely yours,

A handwritten signature in cursive script, reading "Frank H. Murkowski".

Frank H. Murkowski
Governor

Enclosure

7/26/06 Wilson

7/26/06 LIMITED COMPARISON OF PPT BILL VERSIONS-

source: DOR	CSSB 2001 (FIN) Version F	House CS for SB 2001(FIN) Version X.A	Conference CS for SB 2001 Version C.A.	Governor's Bill Version A
general	22.5% .011(e) - page 3	23.5% .011(e) - page 3	22.8% .011(e) - page 3	20.0% .011(e) - page 3
tax rate				
Cook Inlet Oil	3/4 rev. excl for Cook Inlet oil 160(a) - page 19	ELF tax ceiling on Cook Inlet oil .011(j) - page 5	ELF tax ceiling on Cook Inlet oil .011(j) - page 5	ELF tax ceiling on Cook Inlet oil .011(h) - page 4
Cook Inlet Gas	ELF tax ceiling on Cook Inlet gas .011(i) - page 4	ELF tax ceiling on Cook Inlet gas .011(i) - page 4	ELF tax ceiling on Cook Inlet gas .011(i) - page 4	ELF tax ceiling on Cook Inlet gas .011(g) - page 4
progressivity surcharge	over \$35/bbl (net value/boe) x .001 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(q) & (h) - page 4	over \$35/bbl (net value/boe) x .0025 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(q) & (h) - page 4	over \$35/bbl (net value/boe) x .00175 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(q) & (h) - page 4	none n/a
credits for annual loss	yes, at 22.5% .024(b) - page 8	yes, at 23.5% .024(b) - page 10	yes, at 22.8% .024(b) - page 10	yes, at 20% .024(b) - page 9
credit usage floor	n/a	.024 credits cannot be used to reduce PPT tax to below 4% of gross for ANS region .024(c) - page 10	.024 credits cannot be used to reduce PPT tax to below 3% of gross for ANS region .024(c) - page 10	none
Gas (GRE)	ANS gas 2/3 included (1/3 excl.); CI gas 1/3 included; new gas 1/2 included .160(a) pages 19-20	n/a	n/a	n/a
transition (TIE) credit	5 yrs lookback capex 2 for 1 recoupment .024(i) - pages 11-12	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 13	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 13	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 12
base allowance credit	\$12M credit (\$1M per month) (equates to \$53.3M ded.) NOT based on production .170(a) - page 26	\$12M credit (\$1M per month) (equates to \$51M ded.) based on production .170(c) - page 29	\$12M credit (\$1M per month) (equates to \$52.6M ded.) based on production .170(c) - page 29	\$12M credit (\$1M per month) (equates to \$60M ded.) based on production .170(c) - page 27
new area development credit	n/a	\$6M credit (\$500,000 per mc) for areas NOT ANS, NOT Cook Inlet .170(a) - page 28	\$6M credit (\$500,000 per mc) for areas NOT ANS, NOT Cook Inlet .170(a) - page 28	\$6M credit (\$500,000 per mc) for areas NOT ANS, NOT Cook Inlet .170(a) - page 27
sunset of new area development credit	n/a	10 yr rolling .170(b) - page 28	10 yr rolling .170(b) - page 28	10 yr rolling .170(b) - page 28
oil spill	any oil spill cleanup costs not ded (exception for gravel pad) .160(d)(17) - page 24	any oil spill cleanup costs not ded (improved pad language) .160(d)(17) - page 25	any oil spill cleanup costs not ded (improved pad language) .160(d)(17) - page 25	any oil spill cleanup costs not ded (improved pad language) .160(d)(17) - page 24
transition payment	10 mos. pymt on old system; true- up in 11th mo Sec. 37(f)(g) - pages 37-34	10 mos. pymt on old system; true-up in 10th mo (clarification) Sec. 36(g)(h) - pages 36-37	10 mos. pymt on old system; true-up in 10th mo (clarification) Sec. 36(g)(h) - pages 36-37	10 mos. pymt on old system; true-up in 10th mo (clarification) Sec. 36(g)(h) - pages 35

LIMITED COMPARISON OF PPT BILL VERSIONS and POP draft CS

7-31-06
R. Wilson

source: DOR		House CS for SB 2001(FIN) Version X	House CS for SB 2001(FIN) Version X A	Conferece CS for SB 2001 Version C A	Governor's Bill Version A	POP Plan Draft CS
tax rate	general flat rate	20.0% .011(e) - page 3	23.5% .011(e) - page 3	22.8% .011(e) - page 3	20.0% .011(e) - page 3	n/a blended rate see below; blended rate not to exceed 22.5% in first 3 years .011(f)(1) - page 3
	blended, variable rate	base rate				25.0% .011(f)(2) - page 3
		incremental rate				15% increasing starting 2012, maximum 25% .011(f)(3) - page 3
		Cook Inlet Oil	ELF tax ceiling on Cook Inlet oil .011(j) - page 5	ELF tax ceiling on Cook Inlet oil .011(j) - page 5	ELF tax ceiling on Cook Inlet oil .011(j) - page 5	ELF tax ceiling on Cook Inlet oil .011(h) - page 4
	Cook Inlet Gas	ELF tax ceiling on Cook Inlet gas .011(i) - pages 4-5	ELF tax ceiling on Cook Inlet gas .011(i) - page 4	ELF tax ceiling on Cook Inlet gas .011(i) - page 4	ELF tax ceiling on Cook Inlet gas .011(g) - page 4	ELF tax ceiling on Cook Inlet gas .011(i) - pages 5-6
capex credit rate	20% .024(a) - page 9	20% .024(a) - page 9	20% .024(a) - page 9	20% .024(a)(1)(A) - page 8	20% .023(a)(1) - page 12	
progressivity surcharge	over \$45/bbl (net value/boe) x .00175 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(g) & (h) - page 4	over \$35/bbl (net value/boe) x .0025 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(g) & (h) - page 4	over \$35/bbl (net value/boe) x .00175 x net value with new boe rules PPT rate + prog rate not to exceed 50% .011(g) & (h) - page 4	none n/a	yes - particulars in discussion cap under discussion .011(g), (h) - pages 4-5	
credits for annual loss	yes, at 20% .024(b) - page 10	yes, at 23.5% .024(b) - page 10	yes, at 22.8% .024(b) - page 10	yes, at 20% .024(b) - page 9	yes, at 20% .023(b) - page 13	
credit usage floor	n/a	.024 credits cannot be used to reduce PPT tax to below 4% of gross for ANS region .024(c) - page 10	.024 credits cannot be used to reduce PPT tax to below 3% of gross for ANS region .024(c) - page 10	none	none	
transition (TIE) credit	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 12-14	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 13	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 13	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .024(j) - page 13	5 yrs lookback capex 2 for 1 recoupment (CORRECTED) .023(d) - pages 15-16	
base allowance credit	\$12M credit (\$1M per month) (equates to \$60M ded.) based on production .170(c) - pages 28-29	\$12M credit (\$1M per month) (equates to \$51M ded.) based on production .170(c) - page 29	\$12M credit (\$1M per month) (equates to \$52.6M ded.) based on production .170(c) - page 29	\$12M credit (\$1M per month) (equates to \$60M ded.) based on production .170(c) - page 27	none	
new area development credit	\$6M credit (\$500,000 per mo) for areas NOT ANS, NOT Cook Inlet .170(a) - page 28	\$6M credit (\$500,000 per mo) for areas NOT ANS, NOT Cook Inlet .170(a) - page 28	\$6M credit (\$500,000 per mo) for areas NOT ANS, NOT Cook Inlet .170(a) - page 28	\$6M credit (\$500,000 per mo) for areas NOT ANS, NOT Cook Inlet .170(a) - page 27	\$6M credit (\$500,000 per mo) for areas NOT ANS, NOT Cook Inlet .024(a) - page 17	

LIMITED COMPARISON OF PPT BILL VERSIONS and POP draft CS

source: DOR	House CS for SB 2001(FIN) Version X	House CS for SB 2001(FIN) Version X.A	Conference CS for SB 2001 Version C.A	Governor's Bill Version A	POP Plan Draft CS
lease expenditures: authority of Industry practices	the department shall give "substantial weight" .160(c)(1)(A)--page 22	the department shall give "substantial weight" .160(c)(1)(A)--page 22	the department shall give "substantial weight" .160(c)(1)(A)--page 22	the department shall give "substantial weight" .160(c)(1)(A)--page 21	the department shall "consider" .165(a)--page 27
lease expenditures: authorized	.160(c)--pages	.160(c)--pages 22-23	.160(c)--pages 22-23	.160(c)--pages 21-22	improved language .165(c)--pages 28-29
DOR reports to the legislature	private royalty rates--2013, certain credits--2015 .180--pages 30-31	private royalty rates--2013, certain credits--2015 .180--pages 30-31	private royalty rates--2013, certain credits--2015 .180--pages 30-31	private royalty rates--2013, certain credits--2015 .180--page 29	all provisions esp. tax rates, all credits, and lease exps.--2011 .180--page 34
ADMINISTRATIVE PROVISIONS					
effective date	4/1/2006 Sec. 39--page 35	4/1/2006 Sec. 39--page 38	4/1/2006 Sec. 39--page 35	4/1/2006 Sec. 39--page 35	4/1/2006 Sec. 39--page 41
tax returns due	monthly--due end of month following month of production; annual true up return due 3/30 .030(a)	monthly--due end of month following month of production; annual true up return due 3/31 .030(a)--page 18	monthly--due end of month following month of production; annual true up return due 3/32 .030(a)--page 18	monthly--due end of month following month of production; annual true up return due 3/33 .030(a)--page 17	annual return due 3/31 .030(a)--page 22
safe harbor for payments due	95%, annual true-up, no interest .020(a)--page 7	95%, annual true-up, no interest .020(a)--page 7	95%, annual true-up, no interest .020(a)--page 7	95%, annual true-up, no interest .020(a)--page 7	none
installment payments (estimated tax payments)	n/a	n/a	n/a	n/a	monthly pmts due end of following month based on monthly gross value less 1/12 lease exps; 1/12 credits .020(a)--pages 8-9
pmt < required payment	interest only .020(a)--page 7	interest only .020(a)--page 7	interest only .020(a)--page 7	interest only .020(a)--page 7	interest at fed. rate .020(g)--page 11
pmt > required payment	no provision	no provision	no provision	no provision	interest at fed. rate .020(h)--pages 11-12
transillon payment	10 mos. pymt on old system; true up in 10th mo. (clarification) Sec. 36(h)(g)--page 36	10 mos. pymt on old system; true up in 10th mo. (clarification) Sec. 36(g)(h)--pages 36-37	10 mos. pymt on old system; true-up in 10th mo. (clarification) Sec. 36(g)(h)--pages 36-37	10 mos. pymt on old system; true-up in 10th mo. (clarification) Sec. 36(n)(h)--pages 35	pymt on old system through Jan. 07 true up on 3/31/07 Sec. 36(d)--page 39

Roadmap of modified sections

Comparison of Samuels/Hawker POP proposal
to Conference CS for S. Bill No. 2001 version CA

source: AK DOR

7/31/2006

	Conf. Com. Ver. CA	POP Plan Draft CS
PPT/POP rate	.011(e)	.011(f)(1)
base rate		.011(f)(2)
incremental rate		.011(f)(3)
base production		.011(f)(4)
incremental production		.011(f)(5)
transfers of working interests		.011(f)(6)
progressivity feature	.011(g), (h)	.011(g), (h)
private royalty rates	.011(f)	.011(i)
Cook Inlet gas ELF ceiling	.011(i)	.011(j)
Cook Inlet oil ELF ceiling	.011(j)	.011(k)
clarification of Cook Inlet tax reduction application		.011(L)
application of credits for Cook Inlet	.011(k)	.011(m)
regulations for allocation of credits	.011(L)	.011(n)
regulations for testing heating value	.011(m)	.011(o)
BTU equivalent barrel definition		.900(18)
95% safe harbor	.020(a)	n/a
monthly installment payments		.020(a)
monthly installment rules for private royalties		.020(d)
interest rules for monthly installment payments		.020(g), (h)
capex credits	.024	.023(a)(1)
losses converted to credits	.024(b)	.023(b)
transitional investment credits (TIE)	.024(j)	.023(i)
anti-churning rules	.024(i)	.023(k)(2)(B)
additional non transferable tax credits	.170	.024
New Area Development credit	.170(a), (b)	.024(a)-(e)
Base Allowance credit	.170(c), (d)	n/a
non-arms length (re: IRC §482)	.160(i)	.165(i)
production tax value calculation	.160(a)-(b)	.160
lease expenditures--allowed	.160(c)	.165(c)
lease expenditures--disallowed	.160(d)	.165(e)
adjustments to lease expenditures	.160(e)	.170
election to utilize 1/2 lease expenditures rather than actual	.160(f)	n/a

EFFECT OF A "DO NOTHING" SCENARIO UNDER PRODUCE OR PAY

August 1, 2006

Pedro van Meurs

The following graph illustrates why under a "do nothing" scenario the producers would be quickly faced with a 25% PPI rate.

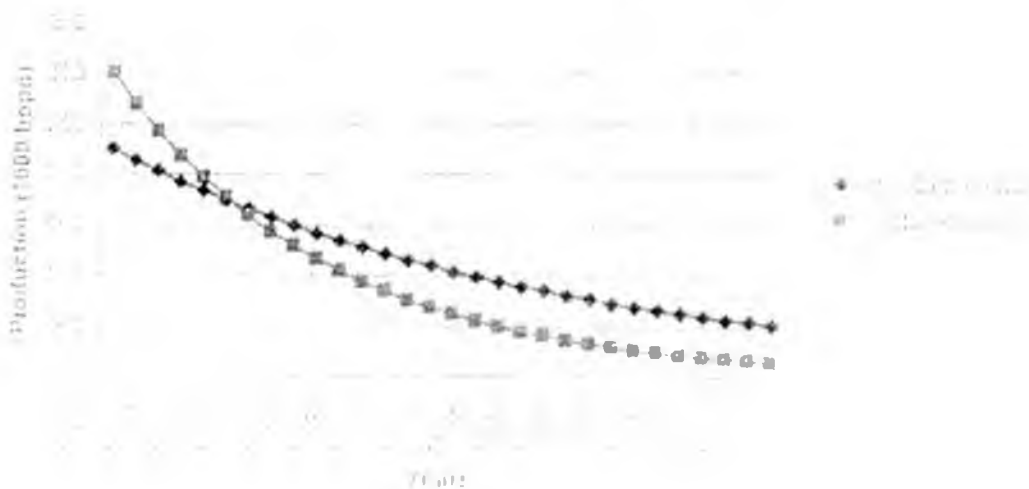
Under a "do nothing" scenario the production of a mature reservoir would typically decline as much as 10% per year or more.

In 2005 the actual production starts at 300,000 bopd and the base production is 225,000 bopd, so the producer would start out with 75,000 bopd.

However, already in 2010 the two amounts are equal at about 175,000 bopd and the producer would have lost all its incremental production and the rate becomes 25%.

After 2010 the actual production would be less than the base production and therefore the producer would pay 25%.

Comparison of Actual Production under a "do nothing" scenario
with a 10% decline and the 5% decline curve



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Code, Regulations, Committee Reports & Tax Treaties

Internal Revenue Code

Current Code

Subtitle F Procedure and Administration §§6001-7874

Chapter 67 INTEREST §§6601-6631

Subchapter C Determination of Interest Rate; Compounding of Interest §§6621-6622

§6621 Determination of rate of interest.

Internal Revenue Code

§ 6621 Determination of rate of interest.**(a) General rule.****(1) Overpayment rate.**

The overpayment rate established under this section shall be the sum of—

- (A) the Federal short-term rate determined under subsection (b) , plus
- (B) 3 percentage points (2 percentage points in the case of a corporation).

To the extent that an overpayment of tax by a corporation for any taxable period (as defined in subsection (c)(3) , applied by substituting "overpayment" for "underpayment") exceeds \$10,000, subparagraph (B) shall be applied by substituting "0.5 percentage point" for "2 percentage points".

(2) Underpayment rate.

The underpayment rate established under this section shall be the sum of—

- (A) the Federal short-term rate determined under subsection (b) , plus
- (B) 3 percentage points.

(b) Federal short-term rate.

For purposes of this section —

(1) General rule.

The Secretary shall determine the Federal short-term rate for the first month in each calendar quarter.

(2) Period during which rate applies.

(A) In general. Except as provided in subparagraph (B) , the Federal short-term rate determined under paragraph (1) for any month shall apply during the first calendar quarter beginning after such month.

(B) Special rule for individual estimated tax. In determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the Federal short-

term rate which applies during the 3rd month following such taxable year shall also apply during the first 15 days of the 4th month following such taxable year.

(3) Federal short-term rate.

The federal short-term rate for any month shall be the Federal short-term rate determined during such month by the Secretary in accordance with section 1274(d). Any such rate shall be rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, such rate shall be increased to the next highest full percent).

(c) Increase in underpayment rate for large corporate underpayments.

(1) In general.

For purposes of determining the amount of interest payable under section 6601 on any large corporate underpayment for periods after the applicable date, paragraph (2) of subsection (a) shall be applied by substituting "5 percentage points" for "3 percentage points".

(2) Applicable date.

For purposes of this subsection —

(A) In general. The applicable date is the 30th day after the earlier of —

(i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or

(ii) the date on which the deficiency notice under section 6212 is sent.

The preceding sentence shall be applied without regard to any such letter or notice which is withdrawn by the Secretary.

(B) Special rules.

(i) Nondeficiency procedures. In the case of any underpayment of any tax imposed by this title to which the deficiency procedures do not apply, subparagraph (A) shall be applied by taking into account any letter or notice provided by the Secretary which notifies the taxpayer of the assessment or proposed assessment of the tax.

(ii) Exception where amounts paid in full. For purposes of subparagraph (A), a letter or notice shall be disregarded if, during the 30-day period beginning on the day on which it was sent, the taxpayer makes a payment equal to the amount shown as due in such letter or notice, as the case may be.

(iii) Exception for letters or notices involving small amounts. For purposes of this paragraph, any letter or notice shall be disregarded if the amount of the deficiency or proposed deficiency (or the assessment or proposed assessment) set forth in such letter or notice is not greater than \$100,000 (determined by not taking into account any interest, penalties, or additions to tax).

(3) Large corporate underpayment.

For purposes of this subsection —

(A) In general. The term "large corporate underpayment" means any underpayment of a tax by a C corporation for any taxable period if the amount of such

underpayment for such period exceeds \$100,000.

(B) Taxable period. For purposes of subparagraph (A) , the term "taxable period" means—

(i) in the case of any tax imposed by subtitle A, the taxable year, or

(ii) in the case of any other tax, the period to which the underpayment relates.

(d) Elimination of interest on overlapping periods of tax overpayments and underpayments.

To the extent that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period.

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Subtitle F Procedure and Administration §§6001-7874

Chapter 67 INTEREST §§6601-6631

Subchapter C Determination of Interest Rate; Compounding of Interest §§6621-6622
§6622 Interest compounded daily.

Internal Revenue Code

§ 6622 Interest compounded daily.

(a) General rule.

In computing the amount of any interest required to be paid under this title or sections 1961(c) (1) or 2411 of title 28, United States Code , by the Secretary or by the taxpayer, or any other amount determined by reference to such amount of interest, such interest and such amount shall be compounded daily.

(b) Exception for penalty for failure to file estimated tax.

Subsection (a) shall not apply for purposes of computing the amount of any addition to tax under section 6654 or 6655 .

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7/25/06



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My turn: Playing fast, loose with rules

Legislators with conflicts of interest should abstain

Legislators who play fast and loose with their rules are likely to do the same with your rights and resources. Reps. Mike Hawker, Kevin Meyer and Mike Chenault have played fast and loose with the governing rules of the Legislature.

Mason's Manual of Legislative Procedure states: "It is a general rule that no one can vote on a question in which he has a direct personal or pecuniary (financial) interest. In recognition of this maxim, Rule 34(b) of the Alaska Legislature's Uniform Rules advises legislators to declare any conflicts of interest they may have and ask to be allowed to abstain from voting on those issues."

The exception to this rule is that "a member may not be permitted to abstain except upon the unanimous consent of the membership," and, in the Alaska Legislature, members routinely object to these abstentions. When a direct financial conflict exists, however, the abstention request must be agreed to if public trust is to be maintained. That is why the rule exists.

On March 27, Hawker, Meyer and Chenault turned this exception into a loophole just as the House Finance Committee was beginning debate over Gov. Murkowski's ill-fated oil tax revision plan. Go to www.ktoo.org/gavel/schedule.cfm.

The succession of events went as follows:

Rep. Meyer, co-chairman of the House Finance Committee, who has worked for the oil industry since 1979 and is employed directly by ConocoPhillips, declared a conflict and asked to be excused from voting. Rep. Chenault, the other co-chairman of the committee, objected to that request and thereby freed Meyer to vote on the issue.

Next, Rep. Hawker declared a conflict. Hawker's wife is employed by ConocoPhillips, and, according to the Alaska Public Offices Commission, earns a yearly salary of more than \$100,000. Rep. Hawker's wife also holds an unspecified number of shares of fully salable and transferable ConocoPhillips stock. Hawker himself is a freelance accountant who has performed contract work for companies directly and indirectly associated

with the oil industry.

Rep. Hawker asked to be excused from participation and voting but, again, co-chairman Chenault objected to the request and thereby freed Hawker to do both.

Only after clearing his conflicted colleagues did Chenault reveal that he too has a conflict: His family-owned business, Qwick Construction, is an oil field maintenance company based in Nikiski. In Chenault's own words, he has worked for the majority of Alaska's oil production companies and presently deals with oil and gas issues on the Kenai.

Like a well choreographed Marx Brothers routine, two men with conflicts were pardoned by a man with a conflict - a man who then quipped that he'd pardon himself if no one else would.

This episode might have been funny had it not occurred in arguably the most powerful committee in the Legislature, including the three most influential members of that committee and involving an issue titanic in its potential ramifications to the future of Alaska. Seen in this light, the shenanigans of Hawker, Meyer and Chenault on March 27 were unconscionable.

By turning the conflict declaration process into a farce, Reps. Hawker, Meyer and Chenault removed any assurance that they have the commitment necessary to place the public good above their private interests. In doing so, they undermined the trust that is vital if the public is to believe the prospective oil tax and natural gas pipeline contract are being pursued in a manner consistent with Alaska's laws and constitution, or will produce results that are in the public's best interest.

Speaker John Harris should be mindful of this situation. He is the leader of the Alaska State House of Representatives - the People's House. With this special session being devoted entirely to oil and gas, he should call upon members with clear conflicts of interest to abstain from voting on these issues and request that other members not object.

- Jim Whitaker is the mayor of the Fairbanks North Star Borough, chairman of the Alaska Gasline Port Authority, a three-term representative, a member of the House Finance Committee and the chairman of the House Oil and Gas Committee.

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Anchorage Daily News

Kelly mentioned on pg. 2

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Murkowski oil consultant offers 'produce or pay' plan**UNVEILING: Proposal uses volumes contained in new discoveries to set tax rate.**By MATT VOLZ
The Associated Press*(Published: August 1, 2006)*

JUNEAU -- A new attempt to break the Legislature's stalemate over a revised oil production tax was introduced Monday.

It's dubbed the "produce or pay" plan, and it would raise or lower oil companies' production tax rates depending on the amount of new oil they develop.

The plan would separate existing oil production from new production, with a 25 percent tax on the profits on the former and a 15 percent profits tax on the latter.

That 15 percent rate on new production would start to rise 0.5 percent a year starting in 2012 until it matched the "base production" tax rate of 25 percent.

In the beginning, the combined, or "blended" tax rate, would be 22.5 percent of oil companies' Alaska profits.

Individual companies' production tax rates would rise or fall each year, depending on whether their oil production is below or above the expected rate of decline, which is now set in the bill at 5 percent.

So, if companies produce enough new oil to slow that 5 percent production decline, they would be rewarded with a lower tax rate. However, if a company invests little or nothing in new production, its tax rate will rise.

The concept was introduced in the House Finance Committee by Pedro van Meurs, an international petroleum consultant working for Gov. Frank Murkowski. Van Meurs said the concept is familiar to worldwide oil companies, and it is "technically, economically and structurally a sound system."

The plan is the product of attempts by Reps. Ralph Samuels and Mike Hawker to find a compromise that will keep the Legislature from rejecting the oil tax rewrite for the third time this year. The concern, as the Anchorage Republicans saw it, was finding a fair rate at which to tax oil companies that would not squash new exploration and production.

The new bill is to be formally introduced today, once the Legislature's legal division has looked it over, said House Finance co-chairman Mike Chenault, R-Nikiski.

"Maybe this is the program that will get us over that hurdle, give us some agreement," Chenault said.

The special legislative session is required to adjourn by Aug. 10. The new tax plan is to be included in Murkowski's gas pipeline contract with the state's three largest companies, with the governor hoping for legislative approval of the contract before the end of the session.

Until now, Murkowski has supported a flat 20 percent tax on oil companies' Alaska profits, which he negotiated with BP, Conoco Phillips and Exxon Mobil. The House and Senate have rejected that tax rate as too low but have failed to come up with a compromise.

On Monday, Revenue Commissioner Bill Corbus signaled that the Murkowski administration may be willing to accept this new plan.

"We are interested in seeing this process go forward," Corbus told the committee.

Legislators seeing it for the first time pointed out what they saw as possible shortcomings. Rep. Mike Kelly, R-Fairbanks, said a lot depended on where the rate of production decline was set. If that 5 percent decline rate was wrong, it would be much harder to tax companies at the full 25 percent of their profits, he said.

House Minority Leader Ethan Berkowitz, D-Anchorage, said the proposal was more complicated than the other plans out there: Either a flat tax on net profits that rises at high oil prices, or else a tax on gross oil production.

"Complexity with 10 days to go is a complication," Berkowitz said. "I think we're in a time bind."

Rep. Berta Gardner, D-Anchorage, questioned van Meurs on why this plan wasn't introduced earlier this year.

Van Meurs said the flat tax on profits was a simpler version of the bill, and while he believes the new plan is sound, it is more complex.

"There is virtue in simplicity," he said.

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Five Step Calculation of Tax Rate Under Amendment 2A

8-3-06

Net "Production Tax Value"/per bbl

Destination	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
Opex	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00
result	\$ 18.00	\$ 28.00	\$ 38.00	\$ 48.00	\$ 58.00	\$ 68.00	\$ 78.00	\$ 88.00
Capex:	\$ -	18.00	28.00	38.00	48.00	58.00	68.00	78.00
\$ 0.50	17.50	27.50	37.50	47.50	57.50	67.50	77.50	87.50
\$ 1.00	17.00	27.00	37.00	47.00	57.00	67.00	77.00	87.00
\$ 1.50	16.50	26.50	36.50	46.50	56.50	66.50	76.50	86.50
\$ 2.00	16.00	26.00	36.00	46.00	56.00	66.00	76.00	86.00
\$ 2.50	15.50	25.50	35.50	45.50	55.50	65.50	75.50	85.50
\$ 3.00	15.00	25.00	35.00	45.00	55.00	65.00	75.00	85.00
\$ 3.50	14.50	24.50	34.50	44.50	54.50	64.50	74.50	84.50
\$ 4.00	14.00	24.00	34.00	44.00	54.00	64.00	74.00	84.00
\$ 4.50	13.50	23.50	33.50	43.50	53.50	63.50	73.50	83.50
\$ 5.00	13.00	23.00	33.00	43.00	53.00	63.00	73.00	83.00
\$ 5.50	12.50	22.50	32.50	42.50	52.50	62.50	72.50	82.50
\$ 6.00	12.00	22.00	32.00	42.00	52.00	62.00	72.00	82.00
\$ 6.50	11.50	21.50	31.50	41.50	51.50	61.50	71.50	81.50
\$ 7.00	11.00	21.00	31.00	41.00	51.00	61.00	71.00	81.00

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Five Step Calculation of Tax Rate Under Amendment 2A

Step One: "Invest Down" of Tax Rate (independent of price)

		\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 0.50	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 1.00	0.000%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
\$ 1.50	0.500%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%
\$ 2.00	1.000%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
\$ 2.50	1.500%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%
\$ 3.00	2.000%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%
\$ 3.50	2.500%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%
\$ 4.00	3.000%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
\$ 4.50	3.500%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%	21.5%
\$ 5.00	4.000%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
\$ 5.50	4.500%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%	20.5%
\$ 6.00	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
\$ 6.50	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
\$ 7.00	5.000%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%

Five Step Calculation of Tax Rate Under Amendment 2A

Step Two. Calculation of "R"

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	25%	25%	25%	25%	25%	25%	25%	25%
\$ 0.50	24%	25%	25%	25%	25%	25%	25%	25%
\$ 1.00	24%	24%	24%	25%	25%	25%	25%	25%
\$ 1.50	23%	24%	24%	24%	24%	25%	25%	25%
\$ 2.00	22%	23%	24%	24%	24%	24%	24%	25%
\$ 2.50	21%	23%	24%	24%	24%	24%	24%	24%
\$ 3.00	20%	22%	23%	24%	24%	24%	24%	24%
\$ 3.50	19%	22%	23%	23%	24%	24%	24%	24%
\$ 4.00	17%	21%	22%	23%	23%	24%	24%	24%
\$ 4.50	15%	20%	22%	23%	23%	24%	24%	24%
\$ 5.00	12%	20%	22%	22%	23%	23%	24%	24%
\$ 5.50	8%	19%	21%	22%	23%	23%	23%	24%
\$ 6.00	3%	18%	20%	22%	22%	23%	23%	23%
\$ 6.50	-5%	16%	20%	21%	22%	23%	23%	23%
\$ 7.00	-19%	15%	19%	21%	22%	23%	23%	23%

Five Step Calculation of Tax Rate Under Amendment 2A

Step Three: Higher of, between 20% and 25%

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	25%	25%	25%	25%	25%	25%	25%	25%
\$ 0.50	25%	25%	25%	25%	25%	25%	25%	25%
\$ 1.00	25%	25%	25%	25%	25%	25%	25%	25%
\$ 1.50	25%	25%	25%	25%	25%	25%	25%	25%
\$ 2.00	24%	24%	24%	24%	24%	24%	24%	25%
\$ 2.50	24%	24%	24%	24%	24%	24%	24%	24%
\$ 3.00				24%	24%	24%	24%	24%
\$ 3.50					24%	24%	24%	24%
\$ 4.00						24%	24%	24%
\$ 4.50						24%	24%	24%
\$ 5.00	21%	21%					24%	24%
\$ 5.50	21%	21%	21%					24%
\$ 6.00	20%	20%	20%					
\$ 6.50	20%	20%	20%	21%				
\$ 7.00	20%	20%	20%	21%				

Five Step Calculation of Tax Rate Under Amendment 2A

Step four: Prop Version (prior to credits) with variable rate

Progressivity slope: 0.0025 insert: 35

	\$ 30.00	\$ 40.00	\$ 50.00	\$ 60.00	\$ 70.00	\$ 80.00	\$ 90.00	\$ 100.00
\$ -	0.0%	0.0%	0.8%	3.3%	5.8%	8.3%	10.8%	13.3%
\$ 0.50	0.0%	0.0%	0.6%	3.1%	5.6%	8.1%	10.6%	13.1%
\$ 1.00	0.0%	0.0%	0.5%	3.0%	5.5%	8.0%	10.5%	13.0%
\$ 1.50	0.0%	0.0%	0.4%	2.9%	5.4%	7.9%	10.4%	12.9%
\$ 2.00	0.0%	0.0%	0.3%	2.8%	5.3%	7.8%	10.3%	12.8%
\$ 2.50	0.0%	0.0%	0.1%	2.6%	5.1%	7.6%	10.1%	12.6%
\$ 3.00	0.0%	0.0%	0.0%	2.5%	5.0%	7.5%	10.0%	12.5%
\$ 3.50	0.0%	0.0%	0.0%	2.4%	4.9%	7.4%	9.9%	12.4%
\$ 4.00	0.0%	0.0%	0.0%	2.3%	4.8%	7.3%	9.8%	12.3%
\$ 4.50	0.0%	0.0%	0.0%	2.1%	4.6%	7.1%	9.6%	12.1%
\$ 5.00	0.0%	0.0%	0.0%	2.0%	4.5%	7.0%	9.5%	12.0%
\$ 5.50	0.0%	0.0%	0.0%	1.9%	4.4%	6.9%	9.4%	11.9%
\$ 6.00	0.0%	0.0%	0.0%	1.8%	4.3%	6.8%	9.3%	11.8%
\$ 6.50	0.0%	0.0%	0.0%	1.6%	4.1%	6.6%	9.1%	11.6%
\$ 7.00	0.0%	0.0%	0.0%	1.5%	4.0%	6.5%	9.0%	11.5%

Five Step Calculation of Tax Rate Under Amendment 2A

Step Five: Net Tax Rate Plus Progressivity

	\$	30.00	\$	40.00	\$	50.00	\$	60.00	\$	70.00	\$	80.00	\$	90.00	\$	100.00
\$	-	25.0%		25.0%		25.8%		28.3%		30.8%		33.3%		35.8%		38.3%
\$	0.50	25.0%		25.0%		25.6%		28.1%		30.6%		33.1%		35.6%		38.1%
\$	1.00	25.0%		25.0%		25.5%		28.0%		30.5%		33.0%		35.5%		38.0%
\$	1.50	24.5%		24.5%		24.9%		27.4%		29.9%		32.4%		35.0%		37.5%
\$	2.00	24.0%		24.0%		24.3%		26.9%		29.5%		32.2%		34.7%		37.3%
\$	2.50	23.5%		23.5%		23.7%		26.5%		29.2%		31.9%		34.5%		37.1%
\$	3.00	23.0%		23.0%		23.2%		26.1%		28.9%		31.6%		34.2%		36.8%
\$	3.50	22.5%		22.5%		22.8%		25.7%		28.6%		31.3%		33.9%		36.6%
\$	4.00	22.0%		22.0%		22.4%		25.3%		28.2%		31.0%		33.7%		36.3%
\$	4.50	21.5%		21.5%		22.0%		24.9%		27.9%		30.7%		33.4%		36.0%
\$	5.00	21.0%		21.0%		21.5%		24.5%		27.5%		30.4%		33.1%		35.8%
\$	5.50	20.5%		20.5%		21.0%		24.0%		27.1%		30.0%		32.8%		35.5%
\$	6.00	20.0%		20.0%		20.5%		23.5%		26.7%		29.7%		32.5%		35.2%
\$	6.50	20.0%		20.0%		20.0%		23.0%		26.3%		29.4%		32.2%		35.0%
\$	7.00	20.0%		20.0%		20.0%		22.5%		25.9%		29.0%		31.9%		34.7%

7/31
_____**BILL NO.**_____

IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - THIRD SPECIAL SESSION

BY

Offered:

Sponsor(s):

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the production tax on oil and gas and to conservation surcharges on
2 oil; relating to criminal penalties for violating conditions governing access to and use of
3 confidential information relating to the production tax; amending the definition of 'gas'
4 as that definition applies in the Alaska Stranded Gas Development Act; making
5 conforming amendments; and providing for an effective date."

6 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

7 * **Section 1.** The uncodified law of the State of Alaska is amended by adding a new section
8 to read:

9 **LEGISLATIVE INTENT.** (a) It is the intent of the legislature through sec. 11 of this
10 Act to confirm by clarification the long-standing interpretation of AS 43.55.020(f) by the
11 Department of Revenue.

12 (b) It is the intent of the legislature that the division or other unit of the Department of
13 Environmental Conservation assigned responsibility for administration of the programs under

1 AS 46.08 that are principally supported by the conservation surcharges on oil levied under
2 AS 43.55.201 - 43.55.299 and 43.55.300 - 43.55.310

3 (1) reduce program costs, including personnel costs, as necessary to operate
4 within the revenue anticipated to be generated by those surcharges, in the amounts of those
5 surcharges as amended by secs. 26 and 28 of this Act; and

6 (2) request appropriations for exceptional program needs and expansions
7 beyond what can be provided from the estimated amounts collected from those surcharges
8 from alternative funding sources.

9 * Sec. 2. AS 43.05.230(f) is amended to read:

10 (f) A wilful violation of the provisions of this section or of a condition
11 imposed under AS 43.55.040(1)(B) is punishable by a fine of not more than \$5,000,
12 or by imprisonment for not more than two years, or by both.

13 * Sec. 3. AS 43.20.031(c) is amended to read:

14 (c) In computing the tax under this chapter, the taxpayer is not entitled to
15 deduct any taxes based on or measured by net income. The taxpayer may deduct the
16 tax levied and paid under AS 43.55.

17 * Sec. 4. AS 43.20.072(b) is amended to read:

18 (b) A taxpayer's business income to be apportioned under this section to the
19 state shall be the federal taxable income of the taxpayer's consolidated business for the
20 tax period, except that

21 (1) taxes based on or measured by net income that are deducted in the
22 determination of the federal taxable income shall be added back; the tax levied and
23 paid under AS 43.55 may not be added back;

24 (2) intangible drilling and development costs that are deducted as
25 expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the
26 federal taxable income shall be capitalized and depreciated as if the option to treat
27 them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been
28 exercised;

29 (3) depletion deducted on the percentage depletion basis under 26
30 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income
31 shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612

1 (Internal Revenue Code); and

2 (4) depreciation shall be computed on the basis of 26 U.S.C. 167
3 (Internal Revenue Code) as that section read on June 30, 1981.

4 * **Sec. 5.** AS 43.55.011 is amended by adding new subsections to read:

5 (e) There is levied on the producer of oil or gas a tax for all oil and gas
6 produced each calendar year from each lease or property in the state, less any oil and
7 gas the ownership or right to which is exempt from taxation or constitutes a
8 landowner's royalty interest. Except as otherwise provided under (j) and (k) of this
9 section, the tax is equal to the annual production tax value of the taxable oil and gas as
10 calculated under AS 43.55.160 multiplied by the tax rate determined under (f) of this
11 section.

12 (f) For the purposes of (e) of this section,

13 (1) the tax rate for a calendar year under (e) of this section is the
14 weighted average of the percentage rate under (2) of this subsection applicable to the
15 producer's base production, if any, for the calendar year and the percentage rate under
16 (3) of this subsection applicable to the producer's incremental production, if any, for
17 the calendar year, with each percentage rate weighted proportionally to the amount of
18 the production to which it applies; however, the tax rate for 2006, 2007, and 2008 may
19 not exceed 22 1/2 percent;

20 (2) the percentage rate for each year applicable to a producer's base
21 production is 25 percent;

22 (3) the percentage rate applicable to a producer's incremental
23 production is

24 (A) for 2006 through and including 2011, 15 percent;

25 (B) for 2012 through and including 2030, one-half percentage
26 point greater than the percentage rate for the immediately preceding year;

27 (C) for 2031 and later years, 25 percent;

28 (4) except as otherwise provided under (6) of this subsection, a
29 producer's base production

30 (A) for a calendar year earlier than 2031 is

31 $.75 \times TP \times (.95)^{\exp(m)}$

1 where: TP = the total amount of taxable and nontaxable oil and gas, in BTU
2 equivalent barrels, produced by the producer from leases or
3 properties in the state during 2005; and

4 n = the number that represents the calendar year subsequent to 2005 for
5 which the tax is being computed, with the number that represents
6 calendar year 2006 being 1, the number that represents calendar year
7 2007 being 2, and so on:

8 (B) for 2031 and later years, is zero:

9 (5) a producer's incremental production for a calendar year is the total
10 amount of taxable and nontaxable oil and gas, in BTU equivalent barrels, produced by
11 the producer from leases or properties in the state during the calendar year, less the
12 producer's base production for the calendar year, but the incremental production may
13 not be less than zero:

14 (6) if a working interest in a lease or property from which oil or gas
15 was produced during 2005 is transferred after 2005, the amount of 2005 oil and gas
16 production attributable to that interest is considered, from the date of the transfer, to
17 have been produced by the producer acquiring the working interest, for the purposes
18 of computing the term TP under (4) of this subsection.

19 (g) In addition to the tax levied under (e) of this section, during each calendar
20 year for which the price index determined under (h) of this section is greater than zero
21 for one or more months, there is levied on the producer of oil or gas a tax for all oil
22 and gas produced during that calendar year from each lease or property in the state,
23 less any oil and gas the ownership or right to which is exempt from taxation or
24 constitutes a landowner's royalty interest. Except as otherwise provided under (j) and
25 (k) of this section, the tax levied under this subsection is equal to the sum, over all
26 months in the calendar year, of the amounts calculated for each month as follows:
27 _____ percent of the monthly production tax value of the taxable oil and gas as
28 calculated under AS 43.55.160, multiplied by the price index determined under (h) of
29 this section. However, the amount calculated under this subsection for any month may
30 not exceed _____ percent of the monthly production tax value of the taxable oil and
31 gas as calculated under AS 43.55.160.

1 (h) For purposes of (g) of this section, the price index for a month is calculated
2 by subtracting _____ from the number that is equal to the quotient of the total monthly
3 production tax value of the taxable oil and gas produced by the producer during that
4 month, as calculated under AS 43.55.160, divided by the total amount of the taxable
5 oil and gas produced by the producer during that month in BTU equivalent barrels.
6 However, a price index may not be less than zero.

7 (i) There is levied on the producer of oil or gas a tax for all oil and gas
8 produced each calendar year from each lease or property in the state the ownership or
9 right to which constitutes a landowner's royalty interest, except for oil and gas the
10 ownership or right to which is exempt from taxation. The provisions of this subsection
11 apply to a landowner's royalty interest as follows:

12 (1) the tax levied for oil is equal to five percent of the gross value at
13 the point of production of the oil:

14 (2) the tax levied for gas is equal to 1.667 percent of the gross value at
15 the point of production of the gas:

16 (3) if the department determines that, for purposes of reducing the
17 producer's tax liability under (1) or (2) of this subsection, the producer has received or
18 will receive consideration from the royalty owner offsetting all or a part of the
19 producer's royalty obligation, other than a deduction under AS 43.55.020(d) of the
20 amount of a tax paid, then notwithstanding (1) and (2) of this subsection, the tax is
21 equal to 25 percent of the gross value at the point of production of the oil and gas.

22 (j) For a calendar year earlier than 2022, the total tax levied by (e) and (g) of
23 this section on gas produced from a lease or property in the Cook Inlet sedimentary
24 basin may not exceed

25 (1) for a lease or property that first commenced commercial production
26 of gas before April 1, 2006, the product obtained by multiplying (A) the amount of
27 taxable gas produced during the calendar year from the lease or property, times (B) the
28 average rate of tax that was imposed under this chapter on taxable gas produced from
29 the lease or property for the 12-month period ending on March 31, 2006, times (C) the
30 quotient of the total gross value at the point of production of the taxable gas produced
31 from the lease or property during the 12-month period ending March 31, 2006, divided

1 by the total amount of that gas:

2 (2) for a lease or property that first commences commercial production
3 of gas after March 31, 2006, the product obtained by multiplying (A) the amount of
4 taxable gas produced during the calendar year from the lease or property, times (B) the
5 average rate of tax that was imposed under this chapter on taxable gas produced from
6 all leases or properties in the Cook Inlet sedimentary basin for the 12-month period
7 ending on March 31, 2006, times (C) the average prevailing value for gas delivered in
8 the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by
9 the department under AS 43.55.020(f).

10 (k) For a calendar year earlier than 2022, the total tax levied by (e) and (g) of
11 this section on oil produced from a lease or property in the Cook Inlet sedimentary
12 basin may not exceed

13 (1) for a lease or property that first commenced commercial production
14 of oil before April 1, 2006, the product obtained by multiplying (A) the amount of
15 taxable oil produced during the calendar year from the lease or property, times (B) the
16 average rate of tax that was imposed under this chapter on taxable oil produced from
17 the lease or property for the 12-month period ending on March 31, 2006, times (C) the
18 quotient of the total gross value at the point of production of the taxable oil produced
19 from the lease or property during the 12-month period ending March 31, 2006, divided
20 by the total amount of that oil;

21 (2) for a lease or property that first commences commercial production
22 of oil after March 31, 2006, the product obtained by multiplying (A) the amount of
23 taxable oil produced during the calendar year from the lease or property, times (B) the
24 average rate of tax that was imposed under this chapter on taxable oil produced from
25 all leases or properties in the Cook Inlet sedimentary basin for the 12-month period
26 ending on March 31, 2006, times (C) the average prevailing value for oil delivered in
27 the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by
28 the department under AS 43.55.020(f).

29 (l) When a limitation under (j) or (k) of this section on the tax levied by (e)
30 and (g) of this section has the effect of reducing the producer's tax on gas or oil
31 produced from a lease or property below the amount of tax that would be levied in the

1 absence of that limitation, the amount of the reduction is applied first against the tax
2 levied by (g) of this section, but that tax may not be reduced below zero.

3 (m) Notwithstanding any contrary provision of AS 38.05.180(i),
4 AS 41.09.010, AS 43.20.043, or 43.55.025, tax credits under AS 38.05.180(i),
5 AS 41.09.010, AS 43.20.043, and 43.55.025 that are allocated to gas produced from
6 leases or properties in the Cook Inlet sedimentary basin and that are available to be
7 applied against a tax levied by (e) of this section on gas produced from leases or
8 properties in the Cook Inlet sedimentary basin during a calendar year may be applied
9 only against the tax levied by (e) of this section on that gas. The amount by which the
10 amount of tax credits that are allocated to gas produced from leases or properties in the
11 Cook Inlet sedimentary basin and that the producer would otherwise be allowed to use
12 for a later calendar year or transfer to another person exceeds the amount of tax credits
13 whose application would reduce the tax levied by (e) of this section on that gas to
14 zero, if any, is considered the amount of excess tax credits and the excess tax credits
15 are subject to the following:

16 (1) for each lease or property for which a limitation under (j) or (k) of
17 this section on the tax levied by (e) and (g) of this section has the effect of reducing
18 the producer's tax below the amount of tax that would be levied in the absence of that
19 limitation, the producer shall calculate the amount of that reduction:

20 (2) the producer shall calculate the total of the reductions calculated
21 under (1) of this subsection for all affected leases or properties;

22 (3) the producer shall reduce the amount of excess tax credits by the
23 total calculated under (2) of this subsection, but not to less than zero;

24 (4) any amount of excess tax credits remaining after reduction under
25 (3) of this subsection may be used for a later calendar year, transferred to another
26 person, or applied against a tax levied on oil or gas produced from a lease or property
27 located anywhere in the state to the extent otherwise allowed under applicable law
28 governing the tax credits.

29 (n) Allocation of credits under (m) of this section shall be made under
30 regulations adopted by the department that provide for reasonable methods of
31 allocating tax credits to gas produced from leases or properties in the Cook Inlet

1 sedimentary basin.

2 (o) The department shall by regulation establish sampling, testing, and
3 averaging methods for determining the heating value of a producer's gas. In the
4 absence of sufficient sampling and testing of gas produced during 2005 or 2006, the
5 department may provide for the heating value of the gas to be estimated based on
6 sampling and testing of later-produced gas or on other information.

7 * **Sec. 6.** AS 43.55.017(a) is amended to read:

8 (a) Except as provided in this chapter, the taxes imposed by this chapter are in
9 place of all taxes now imposed by the state or any of its municipalities, and neither the
10 state nor a municipality may impose a tax on [UPON]

11 (1) producing oil or gas leases;

12 (2) oil or gas produced or extracted in the state;

13 (3) the value of intangible drilling and development costs, as
14 described in 26 U.S.C. 263(c) (Internal Revenue Code), as amended through
15 January 1, 1974 [EXPLORATION EXPENSES].

16 * **Sec. 7.** AS 43.55.020(a) is repealed and reenacted to read:

17 (a) The tax levied on a producer for a calendar year by AS 43.55.011(e), (g),
18 and (i) must be paid as follows:

19 (1) an installment payment of the estimated tax levied by
20 AS 43.55.011(e) and (g), net of any tax credits applied as allowed by law, is due for
21 each month of the calendar year on the last day of the following month; the amount of
22 the installment payment is the sum of the amounts calculated under (2) and (3) of this
23 subsection, but not less than zero;

24 (2) the first of the two amounts used to calculate the installment
25 payment for a month under (1) of this subsection is equal to the remainder obtained by
26 subtracting

27 (A) 1/12 of the tax credits that are allowed by law to be applied
28 against the tax levied by AS 43.55.011(e) for the calendar year, from

29 (B) the total of the monthly production values calculated under
30 AS 43.55.100(a)(2) of all oil and gas taxable under AS 43.55.011(e) and
31 produced by the producer from leases or properties in the state during the

1 month, multiplied by the tax rate determined under AS 43.55.011(f) for the
2 calendar year assuming that the producer's incremental production for the
3 calendar year is the amount calculated according to the following formula but
4 not less than zero:

$$5 \quad IP = 12 X (MP - 1/12 X BP)$$

6 where: IP = the producer's assumed incremental production for the calendar
7 year;

8 MP = the total amount of taxable and nontaxable oil and gas, in BTU
9 equivalent barrels, produced by the producer from leases or
10 properties in the state during the month; and

11 BP = the producer's base production for the calendar year;

12 (3) the second of the two amounts used to calculate the installment
13 payment for a month under (1) of this subsection is the amount calculated for the
14 month under AS 43.55.011(g):

15 (4) an installment payment of the estimated tax levied by
16 AS 43.55.011(i) for each lease or property is due for each month of the calendar year
17 on the last day of the following month; the amount of the installment payment is the
18 sum of

19 (A) the applicable percentage rate for oil provided under
20 AS 43.55.011(i) multiplied times the gross value at the point of production of
21 the oil taxable under AS 43.55.011(i) and produced from the lease or property
22 during the month; plus

23 (B) the applicable percentage rate for gas provided under
24 AS 43.55.011(i) multiplied times the gross value at the point of production of
25 the gas taxable under AS 43.55.011(i) and produced from the lease or property
26 during the month;

27 (5) any amount of tax levied by AS 43.55.011(e), (g), and (i), net of
28 any credits applied as allowed by law, that exceeds the total of the amounts due as
29 installment payments of estimated tax is due on March 31 of the year following the
30 calendar year of production.

31 * Sec. 8. AS 43.55.020(b) is amended to read:

1 (b) The production tax on oil and [OR] gas shall be paid to the department
2 by or on behalf of the producer.

3 * Sec. 9, AS 43.55.020(d) is amended to read:

4 (d) In making settlement with the royalty owner for oil and gas that is
5 taxable under AS 43.55.011, the producer may deduct the amount of the tax paid on
6 taxable royalty oil and [OR] gas, or may deduct taxable royalty oil or gas equivalent
7 in value at the time the tax becomes due to the amount of the tax paid. If the total
8 deductions of installment payments of estimated tax for a calendar year exceed
9 the actual tax for that calendar year, the producer shall, no later than March 31
10 of the following year, refund the excess to the royalty owner. Unless otherwise
11 agreed between the producer and the royalty owner, the amount of the tax paid
12 under AS 43.55.011(e) and (g) on taxable royalty oil and gas for a calendar year,
13 other than oil and gas the ownership or right to which constitutes a landowner's
14 royalty interest, is considered to be the gross value at the point of production of
15 the taxable royalty oil and gas produced during the calendar year multiplied by a
16 figure that is a quotient, in which

17 (1) the numerator is the producer's total tax liability under
18 AS 43.55.011(e) and (g) for the calendar year of production; and

19 (2) the denominator is the total gross value at the point of
20 production of the oil and gas taxable under AS 43.55.011(e) and (g) produced by
21 the producer from all leases and properties in the state during the calendar year.

22 * Sec. 10, AS 43.55.020(e) is repealed and reenacted to read:

23 (e) Gas flared, released, or allowed to escape in excess of the amount
24 authorized by the Alaska Oil and Gas Conservation Commission is considered, for the
25 purpose of AS 43.55.011 - 43.55.180, as gas produced from a lease or property. Oil or
26 gas used in the operation of a lease or property in the state in drilling for or producing
27 oil or gas, or for repressuring, except to the extent determined by the Alaska Oil and
28 Gas Conservation Commission to be waste, is not considered, for the purpose of
29 AS 43.55.011 - 43.55.180, as oil or gas produced from a lease or property.

30 * Sec. 11, AS 43.55.020(f) is amended to read:

31 (f) If oil or gas is produced but not sold, or if oil or gas is produced and