

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3091

Safe Harbor

CSHB 488(RES)

SB 305

Due: 100%

Due: 95%

True-up: not needed
because interest
accrues on 100%

True-up: 3/31 annual

Effective Date

CSHB 488(RES): **4/1/06** (Sec. 45)

SB 305: **4/1/06** (Sec. 40)

Both bills provide for transition rule that payments are made under old (ELF) system for 6 mo., with pay-up in 7th month

Spill Surcharge (split nickel)

CSHB 488(RES)

1/4

Total: no change (5¢)

Collected: increases 1¢
to 4¢

Treatment: no credit
no deduction

SB 305

1/5

Total: increases 1¢ to

6¢

Collected: increases 2¢
to 5¢

Treatment: no credit
no deduction

Use of DNR Royalty Values

CSHB 488(RES): DOR may allow the use of
DNR royalty values

SB 305: no provision for DOR to allow the
use of DNR royalty values

Use of DNR Values (SB 305 language)

AS 43.55.150(d)

Under regulations adopted by the
department, if the department determines
that an election under this subsection
would
of tax administration and would

and are

, the department may allow

Other differences

Abandonment:

CSHB 488(RES): no credit for any abandonment

SB 305: no credit or deduction for abandonment
of old production

allocation of expense based on
production before and after effective date

Other provisions included in SB 305

- For exploration credits, requires data to DNR
- DOR permitted to utilize principles of IRC Sec. 482 (transfer-pricing)
- Clarifying language in AS 43.55.160(c)(1)(B)
- Producer must support FERC's consideration of credits granted to producer on FERC-regulated facilities

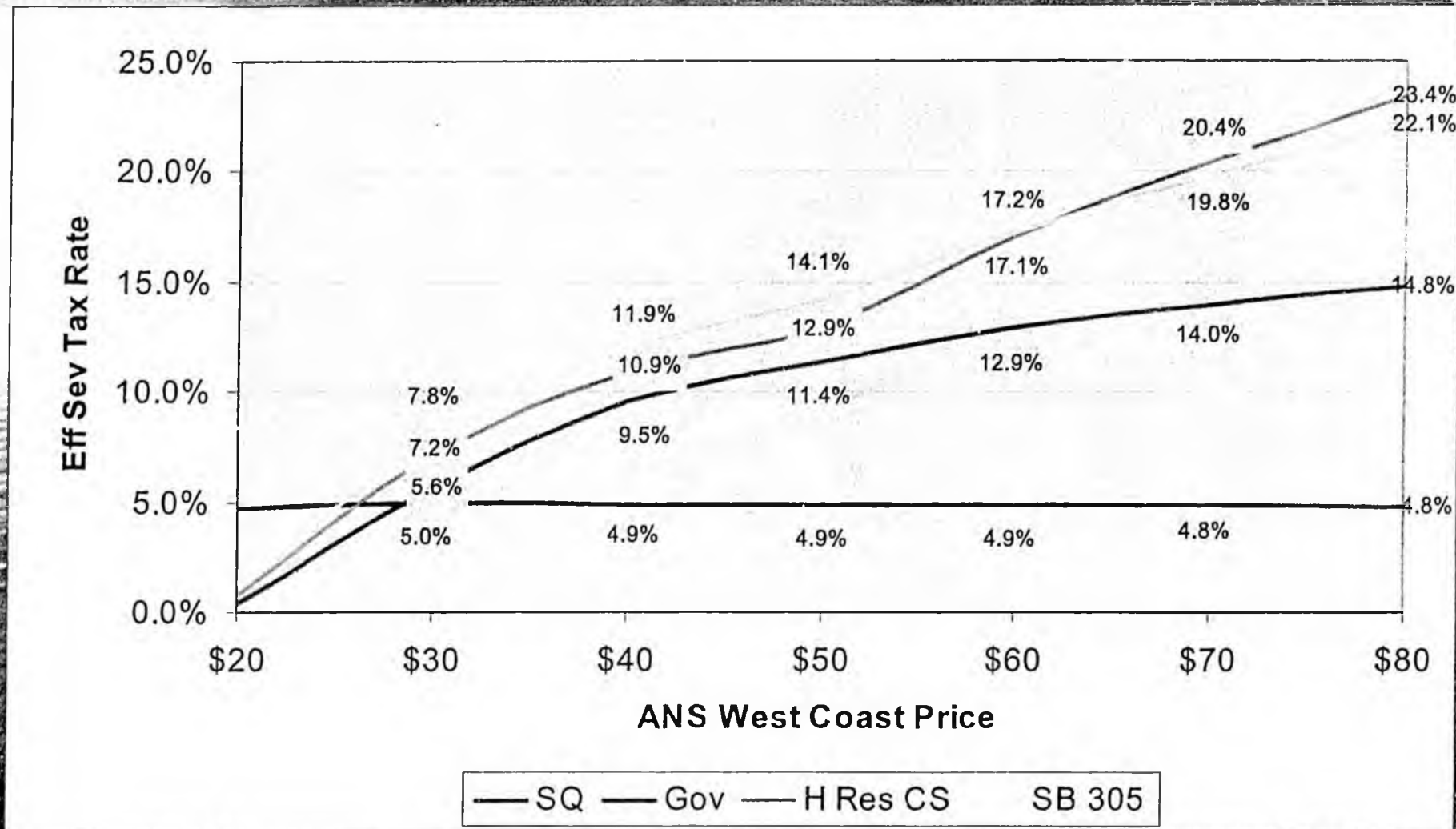
Catastrophic Oil Spill expenditures to clean up

CSHB 488(RES): not deductible

SB 305: may be deductible if on lease

AS 46.04.900: "catastrophic oil discharge" means
an oil discharge in excess of 100,000 barrels, or
any other discharge which the governor
determines presents a grave and substantial
threat to the economy or environment of the
state"

Effective Severance Tax Rate Sev Tax / Wellhead (less royalty) Low Volume Scenario



**Navigating CSHB 488 (RES)
(With the Differences from
HB 488 Highlighted)**

**Before the House Finance
Committee**

March 28, 2006

**Robert E. Mintz, Department of Law
Dan E. Dickinson, C.P.A.**

handout 3-28-06

HB 488, Section 35
CSHB 488, Section 38

New production tax provisions apply to oil
and gas produced on or after:

(HB 488)

April 1, 2006 (CSHB 488)

HB 488, Section 5

AS 43.55.011(a)

There is levied upon the producer . . . a tax
for all produced . . .

The tax is equal to of the
. . . under AS 43.55.160.

CSHB 488, Section 5

AS 43.55.011(a)

There is levied upon the producer . . . a tax
for all produced . . .
[except for] a lessor's royalty interest. . . .
The tax is equal to of the
production tax . . . under AS ~~43~~.55.160.

CSHB 488, Section 6

AS 43.55.011(e)

There is levied upon the producer . . . a tax for all oil and gas produced each month . . . the ownership or right to which constitutes a lessor's royalty interest The tax is equal to five percent of the gross value at the point of production

CSHB 488, Section 6

AS 43.55.011(f) – (k)

[Above specified price thresholds] There is levied upon the producer

. . . a tax for all oil . . . equal to .30 percent of the gross value at the point of production . . . multiplied by the oil price index

. . . a tax for all gas . . . equal to two percent of the gross value at the point of production . . . multiplied by the gas price index

So . . .

The has a production tax: 20 %
of net value.

The CS has four production tax components:

- (1) 20% of net value (now called "production tax value") *except* for lessor royalty share
- (2) 5% of gross value for lessor royalty share
- (3) A progressive-rate oil tax on gross value, including lessor royalty share
- (4) A progressive-rate gas tax on gross value, including lessor royalty share

HB 488, Section 21

AS 43.55.160(a)

... is the total of the
of ... oil and gas ...
from in the state, less
... as ... and
... 1/72 of ...

CSHB 488, Section 28

AS 43.55.160(a)

production tax . . . is the total of the
of . . .

oil and gas . . . from
in the state,

less [progressivity taxes on gross value] . . .

and . . . less as

HB 488, Section 31
CSHB 488, Section 34

AS 43.55.900(7) ↘

“gross value at the point of production”
means

for , the value . . . at the . . . meter . . . in .

..

for . . . the value . . . where . . . metered

[

]

HB 488, Section 19
CSHB 488, Section 26

AS 43.55.150(a)

... gross value at the point of production is
calculated using the reasonable

HB 488, Section 20
CSHB 488, Section 28

AS 43.55.150(d)

... the department ... gross value
[to be calculated based upon] ... a
... [or]
a formula ... that uses ... [
] royalty ... valuation [or]
another
a value

HB 488, Section 21

AS 43.55.160(c)

... lease expenditures ... are the ... costs
of the point of production ... on
or after ... that are the
costs of
oil or gas
deposits located ... in the state.

CSHB 488, Section 28

AS 43.55.160(c)

... lease expenditures ... are the costs
of the point of production ... on
or after January 1, 2006 ... that are the
costs of
oil
or gas deposits located ... in the state.

Section 21/28

AS 43.55.160(c) (continued)

In determining . . . [. . .] costs . . . the department shall give substantial weight . . . to typical . . . as to [billable] costs . . . under . . . and [. . .].

CSHB 488, Section 28

AS 43.55.160(j)(2)

CS adds a definition of “ordinary and necessary” to make clear that Internal Revenue Code meaning is adopted.

CSHB 488, Section 28

AS 43.55.160(c) (continued)

lease expenditures . . . do not include . . .
catastrophic oil discharge . . . expenses . . .
or damages

HB 488, Section 21

CSHB 488, Section 28

AS 43.55.160(d) provides specific examples of, and exclusions from, “direct costs”

CSHB 488 has several improvements recommended by the Administration: e.g.,

- (d)(1)(A) and (d)(2)(A), clarifying treatment of capitalized expenditures
- (d)(2)(L), ensuring that conservation surcharges are not deductible

HB 488, Section 21
CSHB 488, Section 28

AS 43.55.160(e)

[Lease expenditures must be by the producer for (1) another's use of a production facility; (2) reimbursement, e.g. field costs paid by state, that offset lease expenditures; and (3) sale of assets acquired through lease expenditures or of non-taxable oil or gas used in lease operations.]

CSHB 488, Section 28

AS 43.55.160(a), (b)(2), and (e)

At the Administration's recommendation, the CS addresses potential timing mismatches between lease expenditures and adjustments, ensuring that the tax effect of an adjustment will be recognized even if a producer or explorer has no production, or has low lease expenditures, when an adjustment payment is received.

HB 488, Section 21

AS 43.55.160(g)

... transitional investment expenditures are ...
[incurred
] ... less ... [proceeds from] the
... acquired ... as a result of [those] capital
expenditures

[This provision is *not* in the CS; instead CS defines
“lease expenditures” to include expenditures back
to January 1, 2006]

HB 488, Section 21

AS 43.55.160(i)

... a producer that is ... may reduce the
net value by ... [T]he
total of the allowances ... during the calendar year
does . An unused
allowance ... may

[This provision is *not* in the CS; instead CS provides for additional credit of up to \$12 million per year]

HB 488, Section 7
CSHB 488, Section 8

AS 43.55.020(a)

... the tax levied under AS 43.55.011,
applied under this chapter, is due

... The tax levied under AS 43.55.011(a)
applied under this chapter, is
due :

HB 488, Section 12
CSHB 488, Section 14

AS 43.55.024(a)

... a producer ... that incurs a ...
... may ... elect ... to
take a ... in the amount of 20 percent
of that expenditure.

CSHB 488, Section 14

AS 43.55.024(i)(2)

“qualified capital expenditure” does not include

an expenditure incurred . . . for . . . an extended period of disuse, dismantlement, removal . . . or abandonment . . . or for the restoration of a lease, field, [etc.]

Section 12/14 (cont.)

AS 43.55.024(b)

A producer may elect to take a
... of ... of a carried-forward
[which is the amount of a previous year's
that were
because they would have reduced the net value
of the oil and gas below zero].

Section 12/14 (cont.)

AS 43.55.024(d) – (e), (g)

[AS 43.55.024(d) – (f) in original bill]

A producer entitled to a tax credit may apply to the Dep't of Revenue for a

. Once issued, a certificate may be used for its face value, but a transferee may not apply a certificate to reduce its tax liability by more than during a calendar year.

CSHB 488, Section 14 (cont.)

AS 43.55.024(f)

[D]epartment [of Revenue] . . . shall issue a cash refund . . . for a [transferable tax credit] certificate* if . . .

- [producer's total refunds in calendar year do not exceed \$10 million]
- [producer invests or buys an oil and gas lease for at least the amount of the refund]
- [producer owes no delinquent taxes]

CSHB 488, Section 28

AS 43.55.170 – Additional nontransferable credit

Up to \$12 million in a calendar year may be taken as a tax credit for qualified capital expenditures – even if a credit is taken under AS 43.55.024 or 43.55.025 for the same expenditure

-- unused credit may not be carried forward or transferred

-- the provision expires April 1, 2016

CSHB 488, Section 28

AS 43.55.170(b) – producer's qualification for the additional nontransferable credit

This is an anti-splitting provision to prevent abuse of the \$12 million *per producer* credit.

It is essentially the same anti-splitting provision that is in sec. 21 of the original bill, for the \$73 million *per producer* allowance.

HB 488, Sections 22-29
CSHB 488, Sections 29-32

Original bill allowed a to be taken for conservation surcharge payments; CS does not.

CS reduces sec. 201 surcharge from \$.02 to \$.01 per barrel and increases sec. 300 surcharge from \$.03 to \$.04 per barrel.

CSHB 488, Sections 15-19

Extends existing exploration credits under AS 43.55.025 through 2016 and conforms sec. 025 to new production tax provisions by specifying that the credits may be taken only against tax under AS 43.55.011(a) – i.e., against the 20 percent tax on production tax value, *not* against lessor royalty tax or additional progressive taxes on gross value

HB 488, Section 7

of production tax, net of
credits, is due

The remainder is due of the next
calendar year.

CSHB 488, Sections 8, 13

100 percent of total production tax (total of all four components), net of credits, is due each month.

Payment of less than 90 percent of total tax due triggers an automatic five percent penalty on the deficiency.

HB 488, Section 9

CSHB 488, Section 10

[P]roducer may deduct [from royalty] the amount of the tax paid on taxable royalty oil and gas . . .

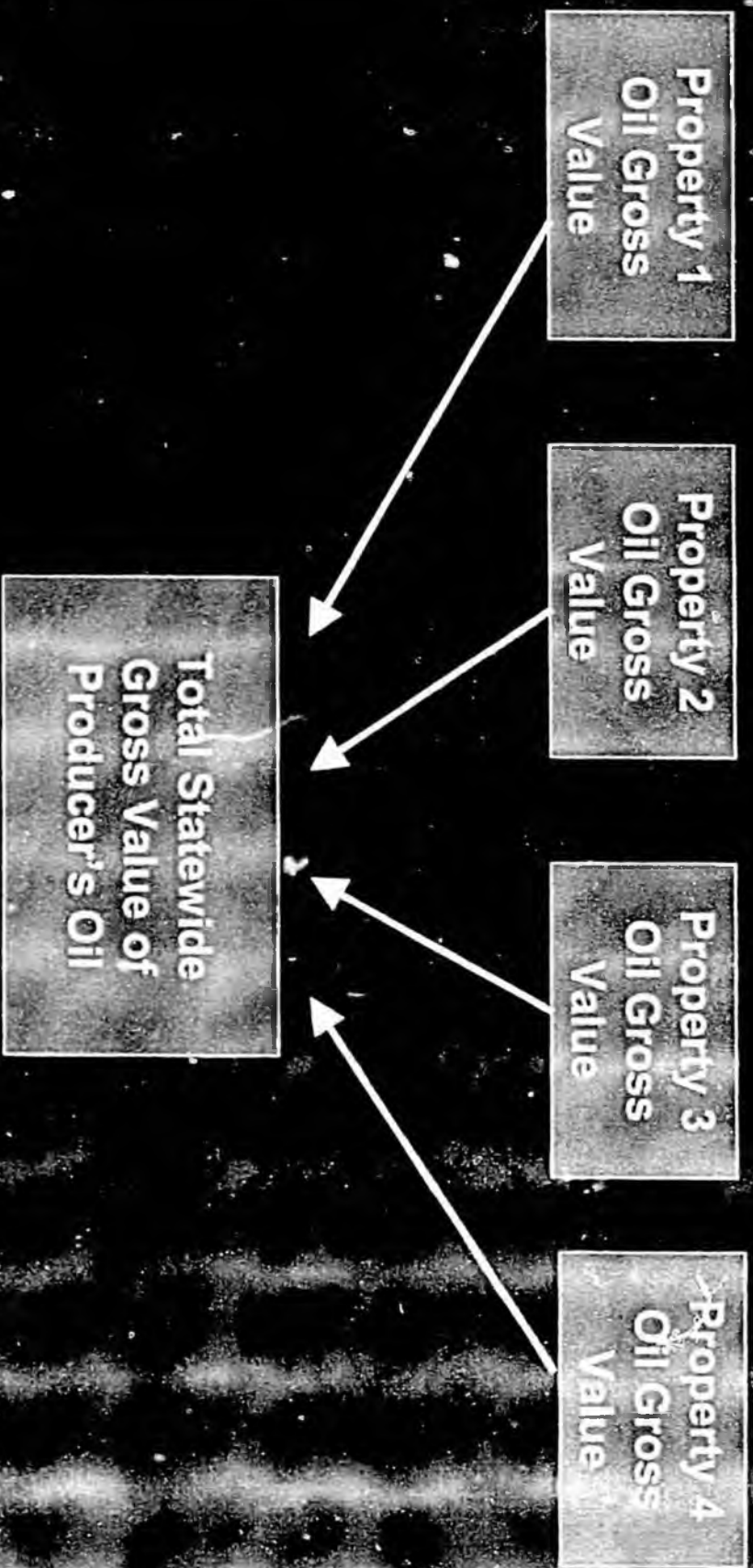
- Original bill provides a default formula for allocating the 20% tax on net value to royalty share.
- CS provides a slightly different formula for allocating the 20% tax on net value (“production tax value”) to *non-lessor* royalty share.

STEPS IN TAX CALCULATION

Under CSHB 488 (RES)

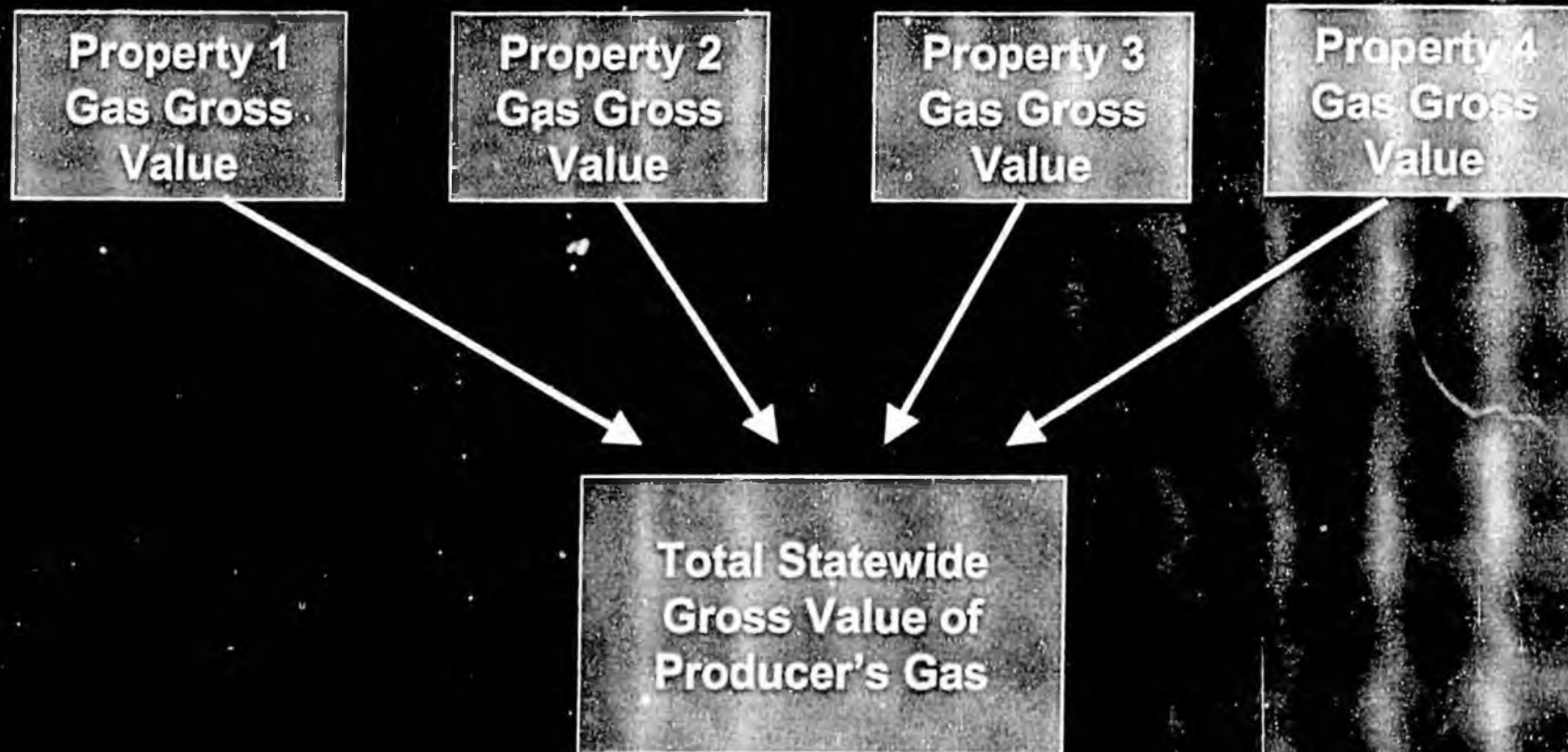
GROSS VALUE OF OIL

AS 43.55.150, AS 43.55.900



GROSS VALUE OF GAS

AS 43.55.150, AS 43.55.900



GROSS VALUE OF OIL AND GAS

AS 43.55.150, AS 43.55.900

Total Statewide
Gross Value of
Producer's Oil

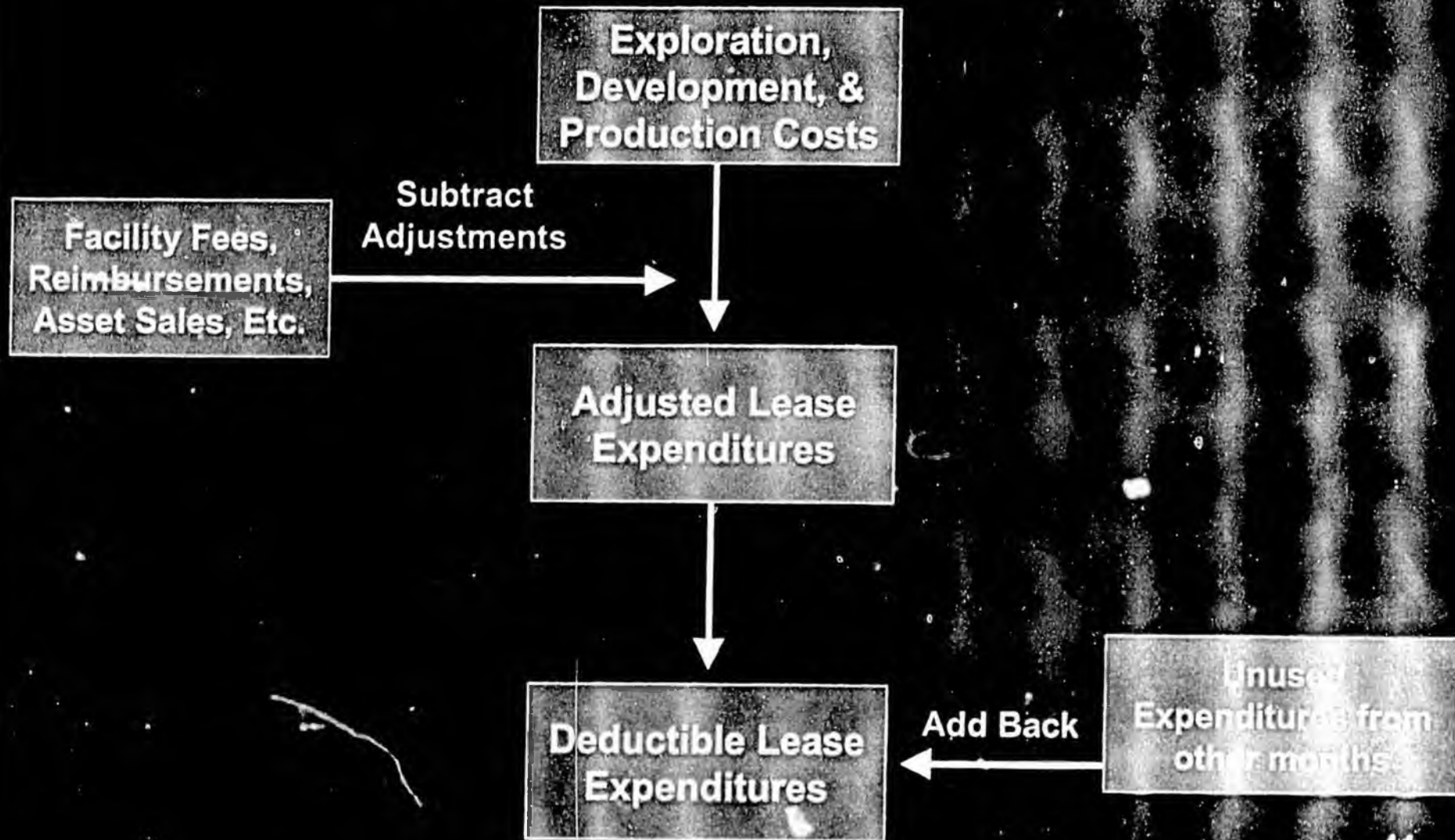
Total Statewide
Gross Value of
Producer's Gas



Total Statewide
Gross Value of
Producer's Oil and
Gas

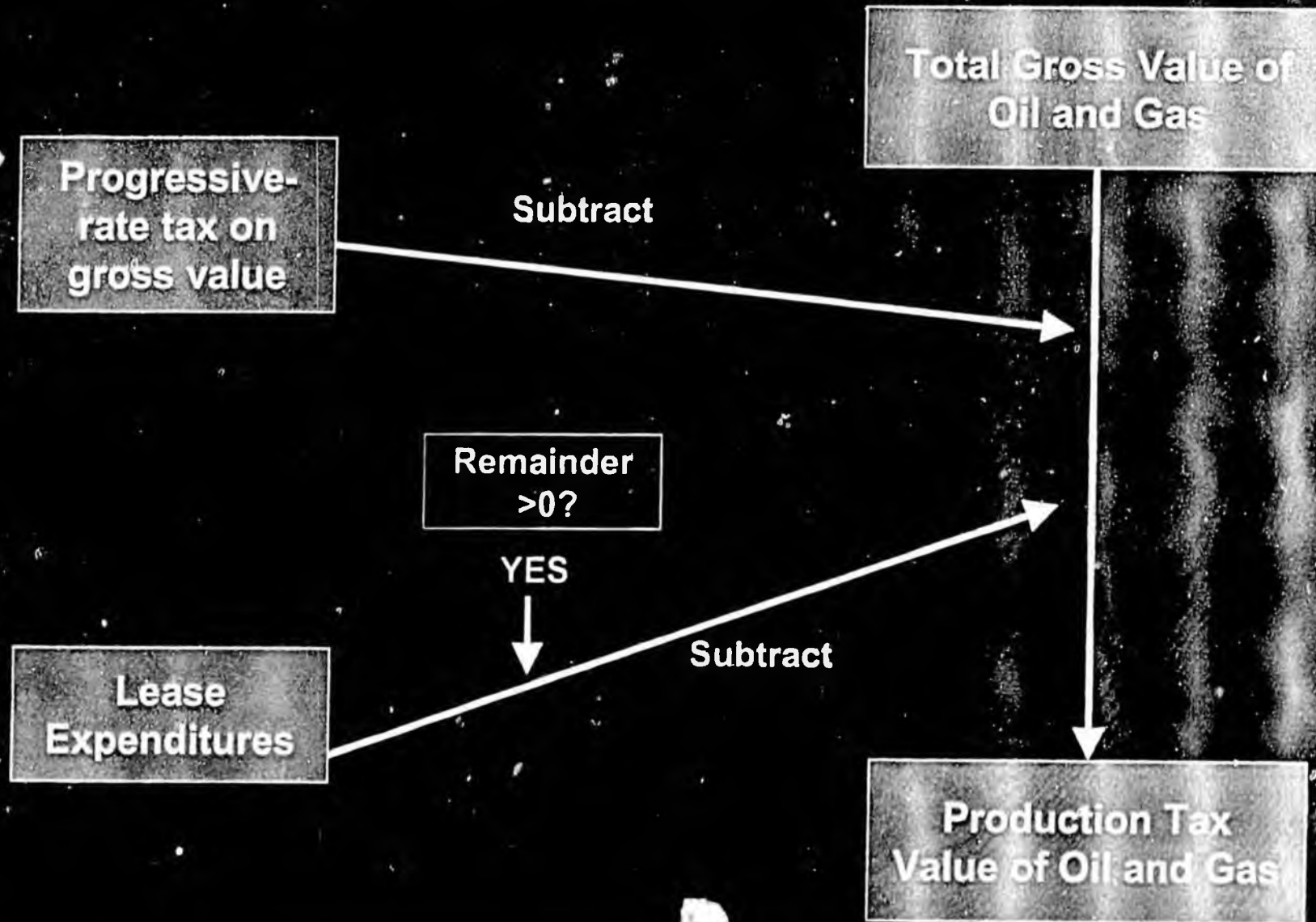
LEASE EXPENDITURES

AS 43.55.160(b) – (f)



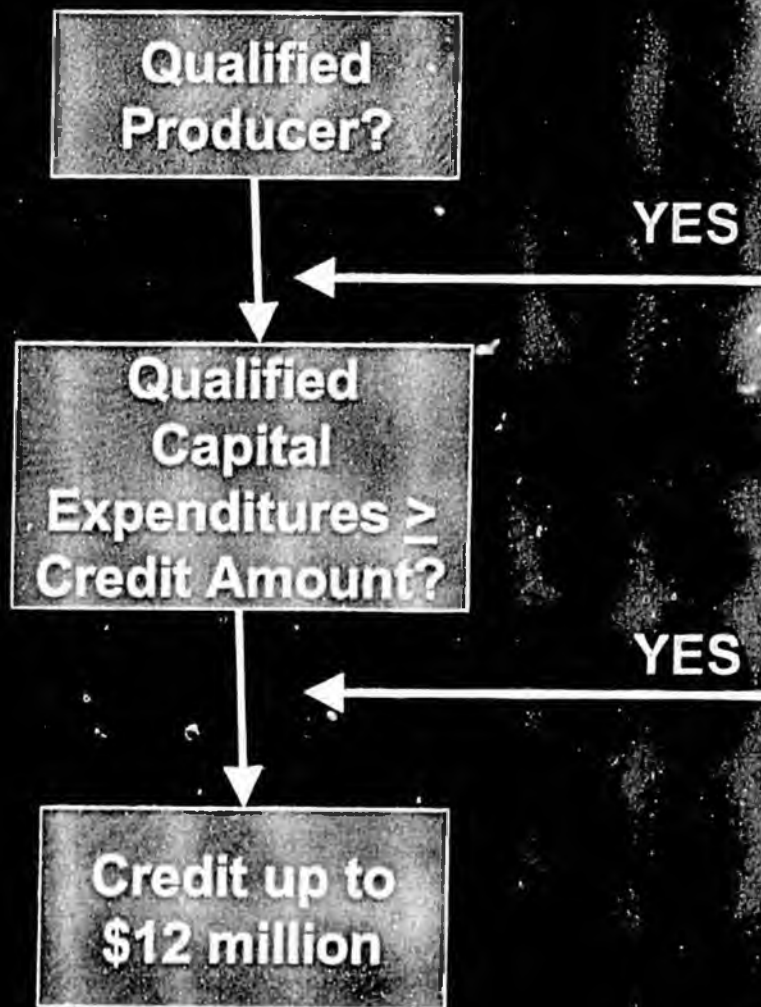
PRODUCTION TAX VALUE

AS 43.55.160 (a)



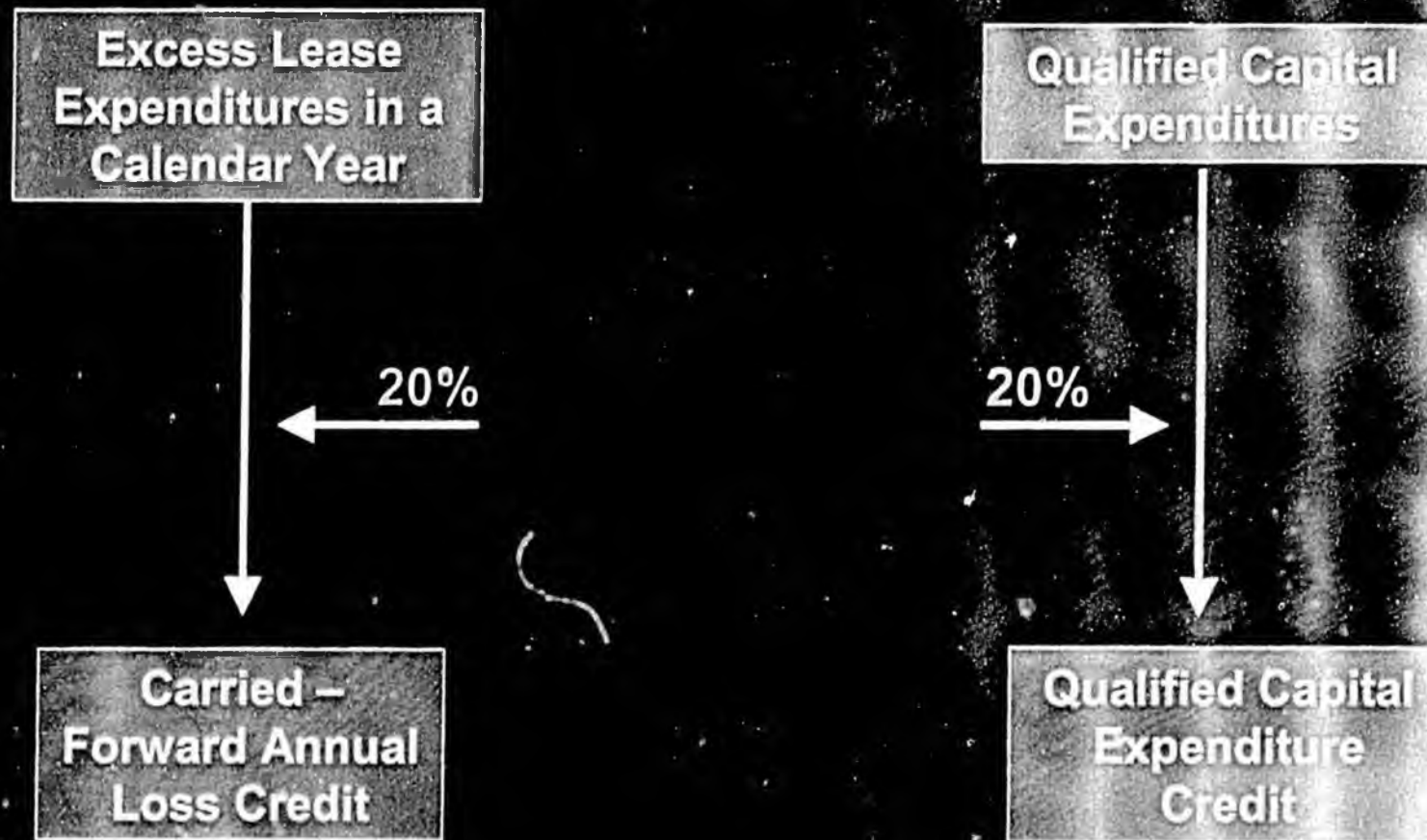
NONTRANSFERABLE CREDIT

43.55.170

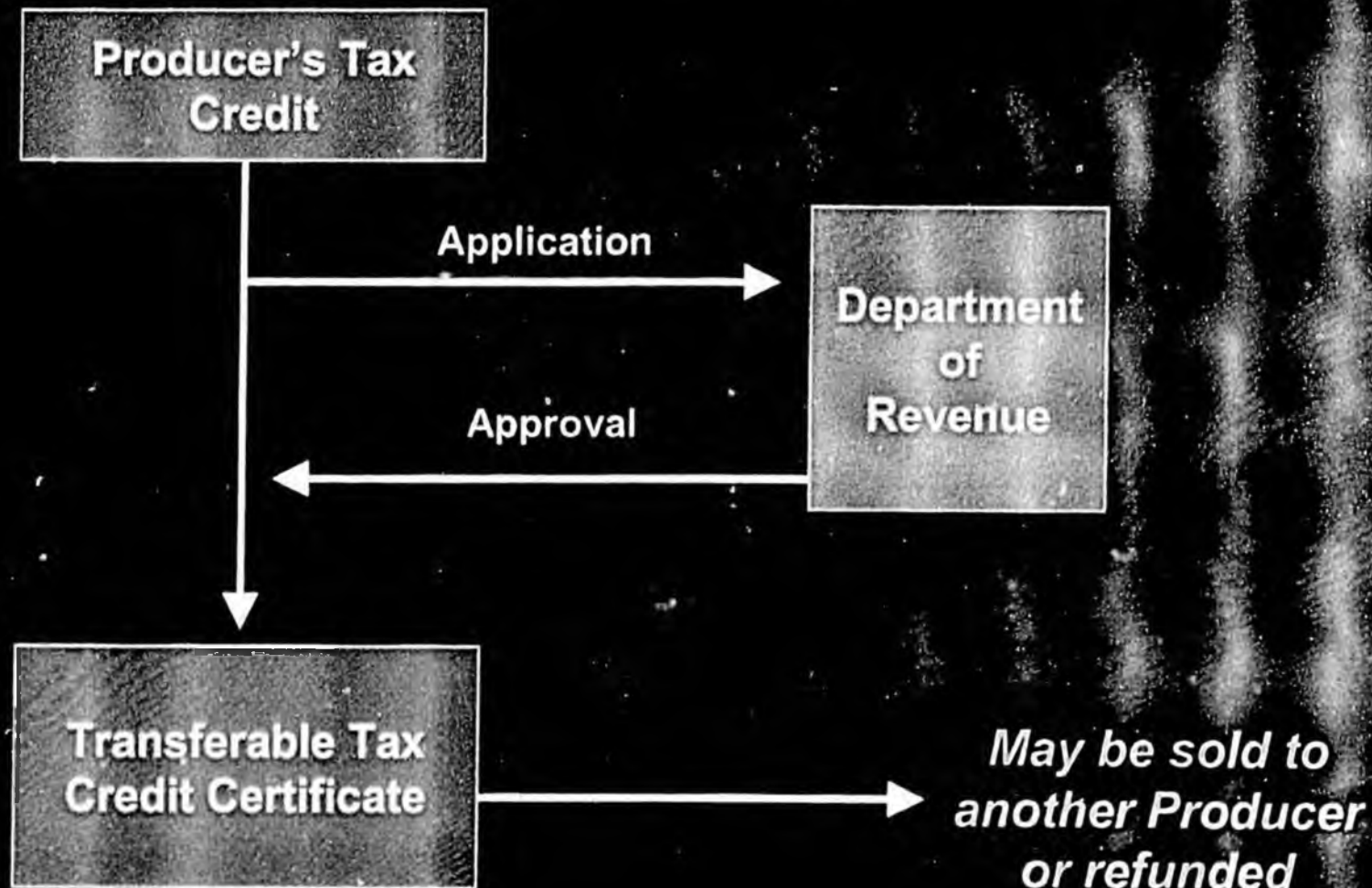


SEC. 024 TAX CREDITS

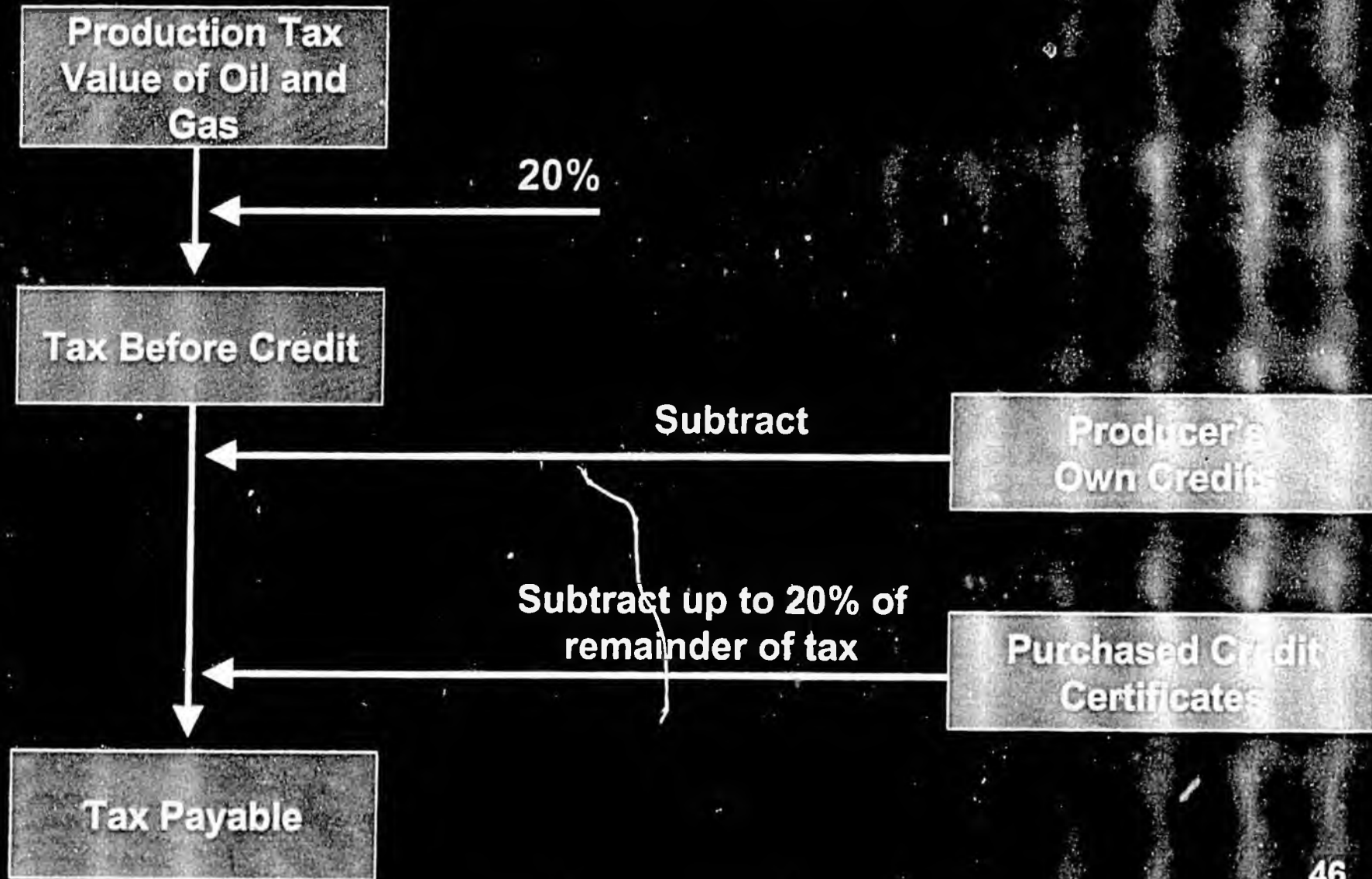
AS 43.55.024 (a) and (b)



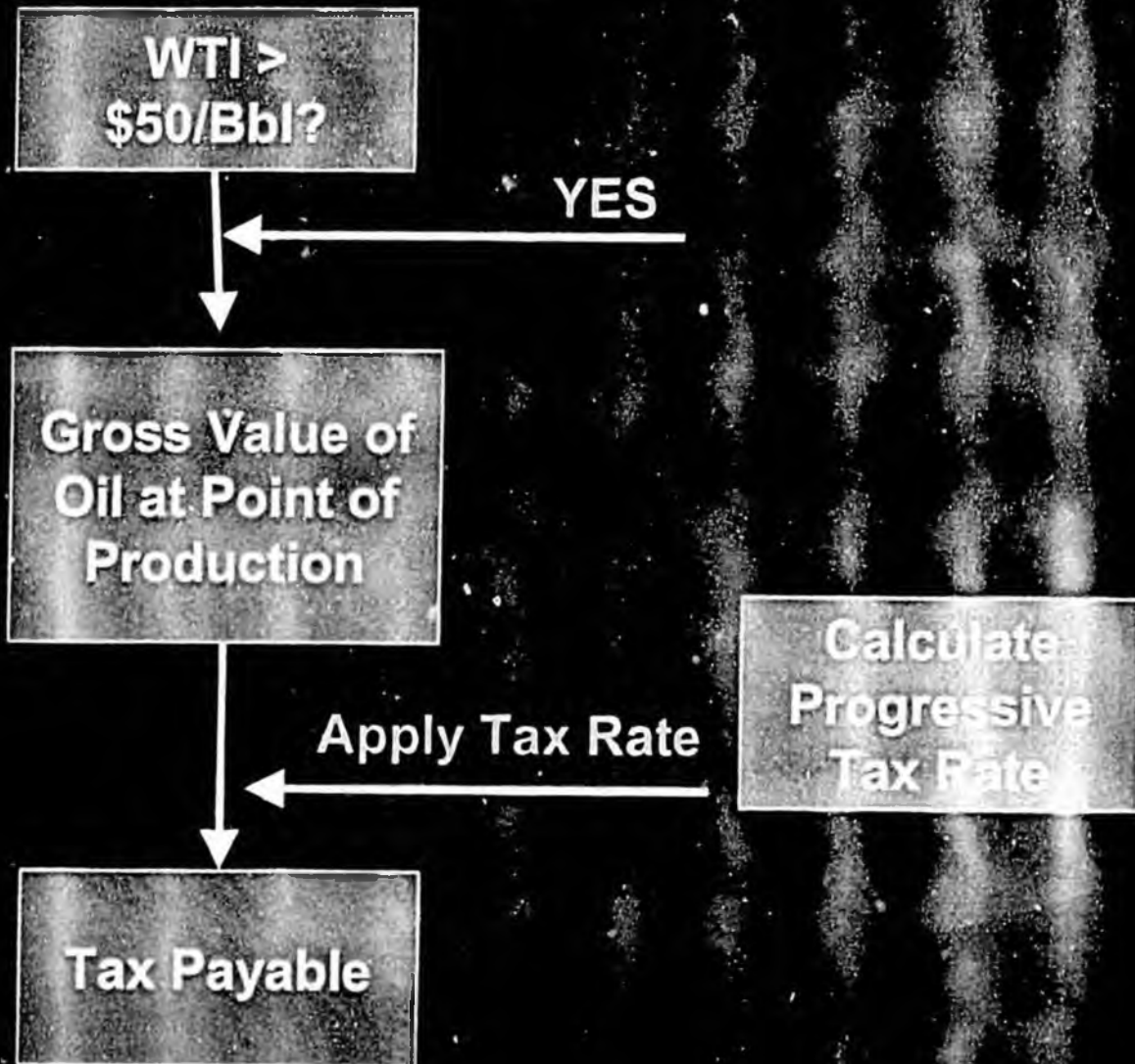
TRANSFERABLE TAX CREDIT CERTIFICATES - AS 43.55.024 (d)-(g)



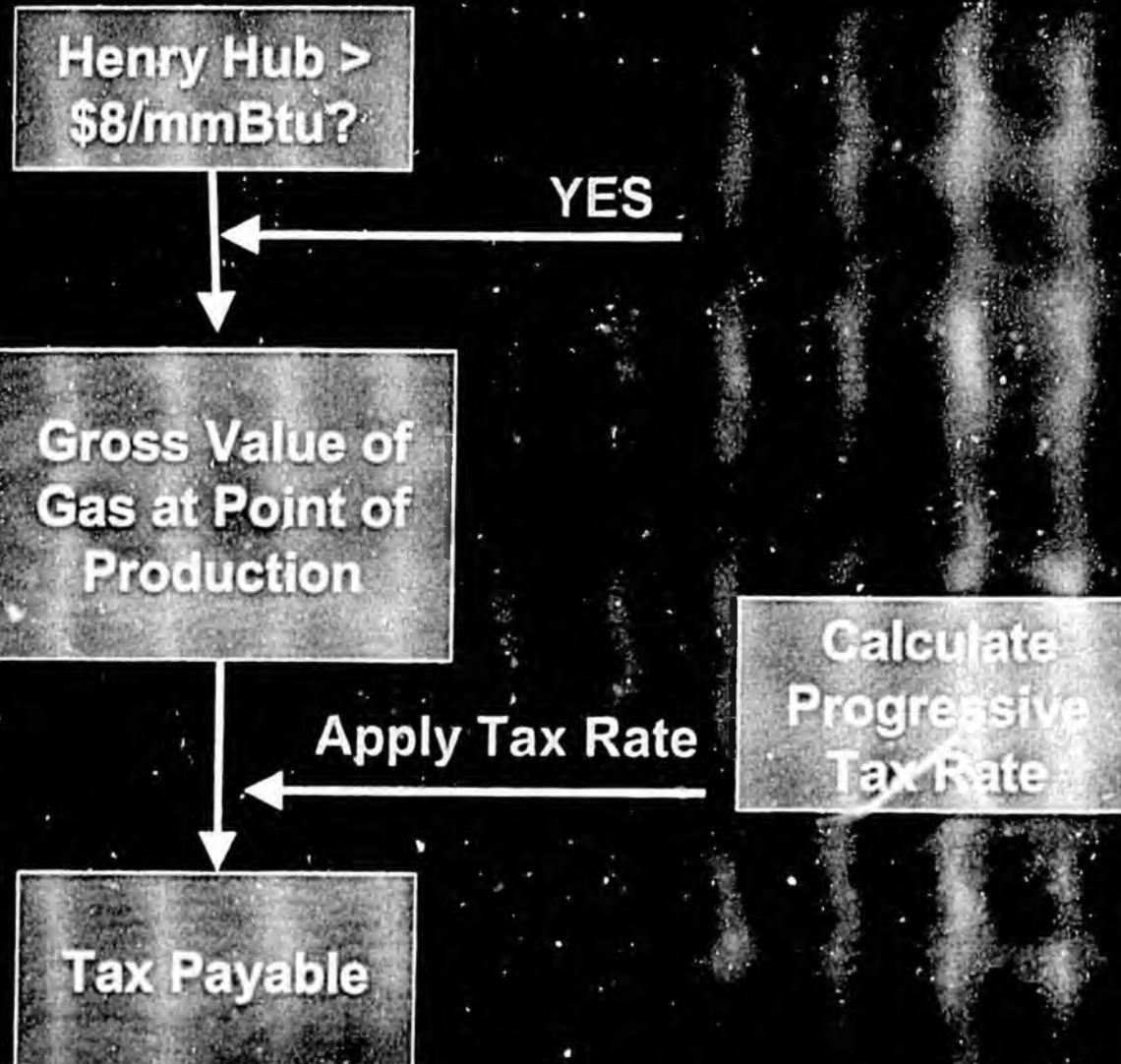
TAX CALCULATION: AS 43.55.011(a), 43.55.024, 43.55.025, 43.55.170



TAX CALCULATION: AS 43.55.011(f) – (h)



TAX CALCULATION: AS 43.55.011(i) –(k)



TAX CALCULATION: AS 43.55.011(e)

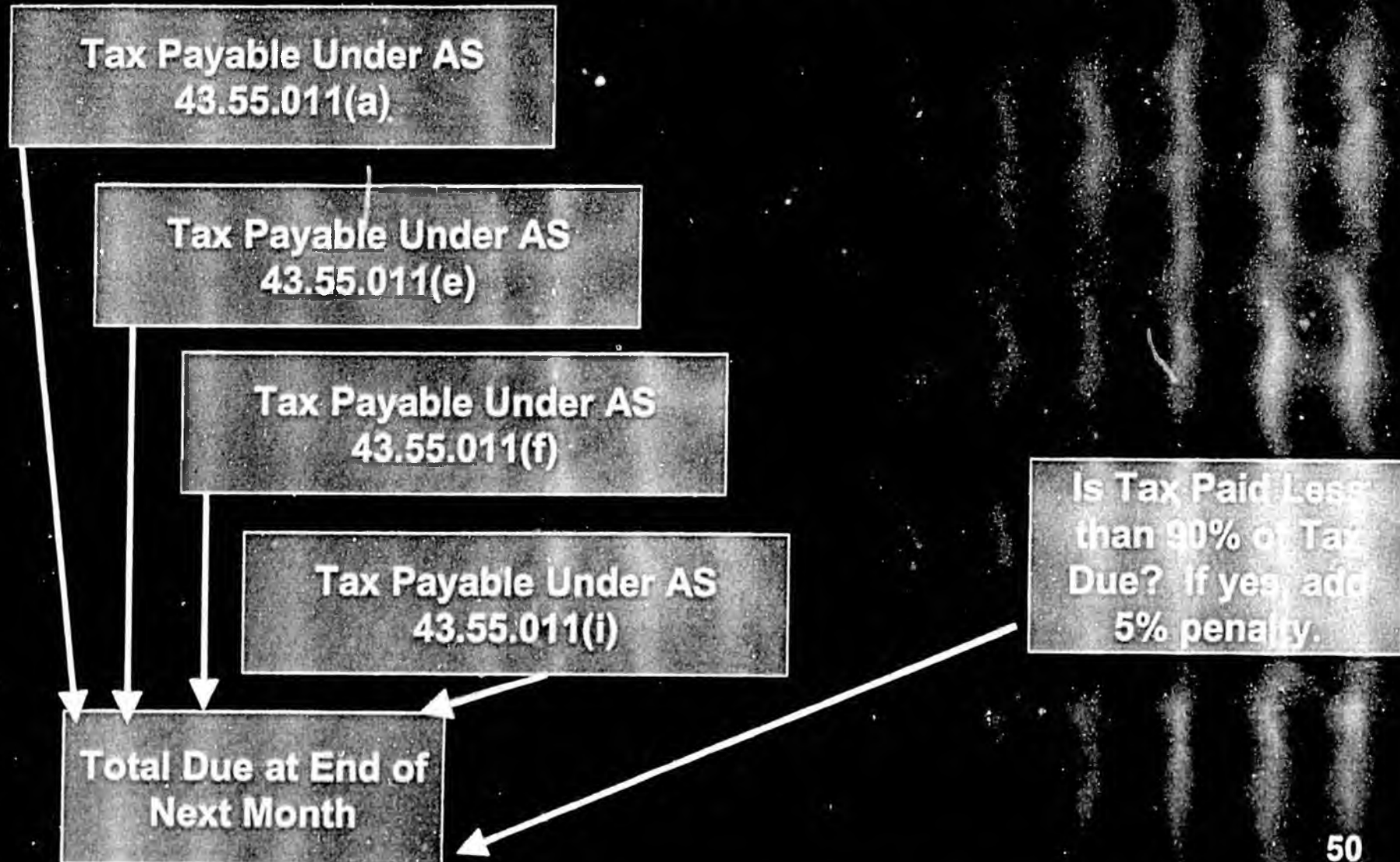
Gross Value at Point of
Production of Lessor's
Royalty Share of Oil and
Gas

Multiply by 5%

Tax Payable

TAX PAYMENT

AS 43.55.020(a), (g), and (h)



Petroleum Profits Tax (PPT)

CS for HB 488 (RES) Overview

Alaska Department of Revenue
Before the House Finance Committee

March 27, 2006

Robynn J. Wilson, Director, TAX Division, DOR

Dan E. Dickinson, CPA

3-27-06

The Governor's 3 Big Ideas

- The current Production Tax system is broken.
- We need to use the tax system to encourage investment
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low

The Governor's 3 Big Ideas

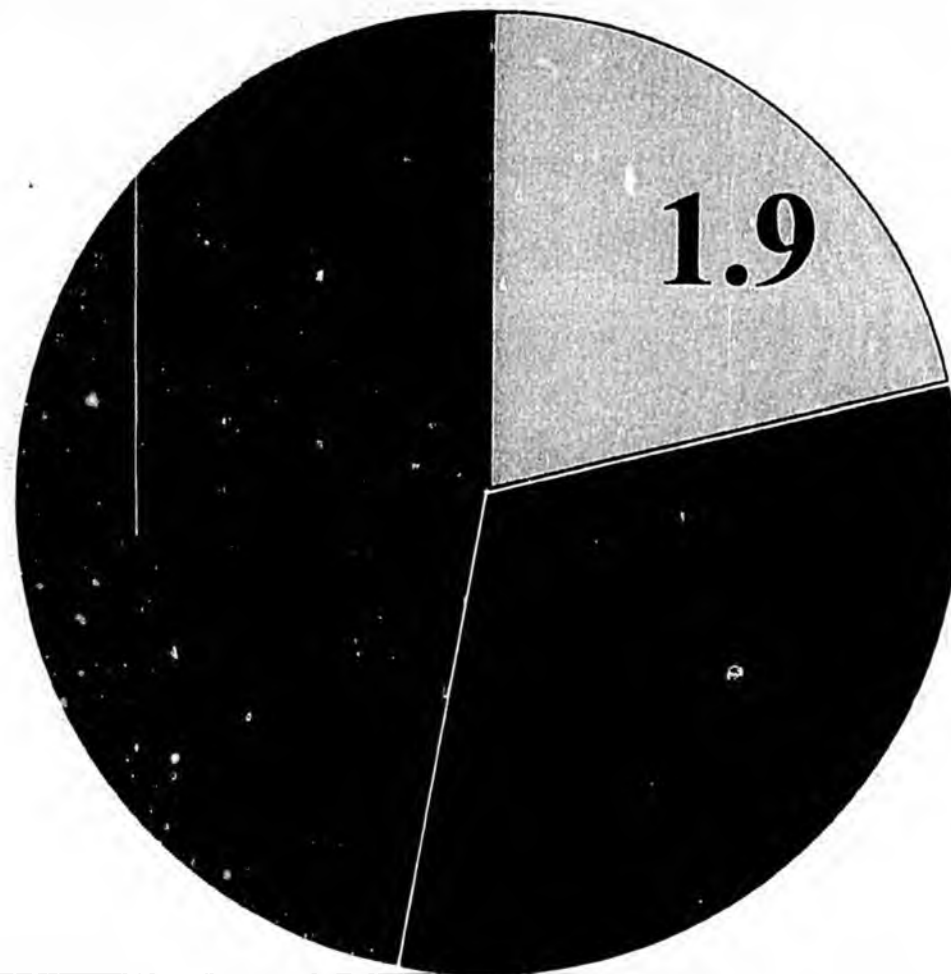
- The current Production Tax system is broken. *The CS also replaces it.*
- We need to use the tax system to encourage investment. *The CS has incentives for investment*
- We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low. The CS preserves the Governor's 20/20 structure

The Governor's 3 Big Ideas

- Idea one: The Production Current Tax System is broken
 - We are not getting the investment we need – could the structure of the Production Tax be to blame
 - We are not getting a fair share of revenues when Prices are high and investment is low

Unrestricted & Restricted Revenue

\$ Billion

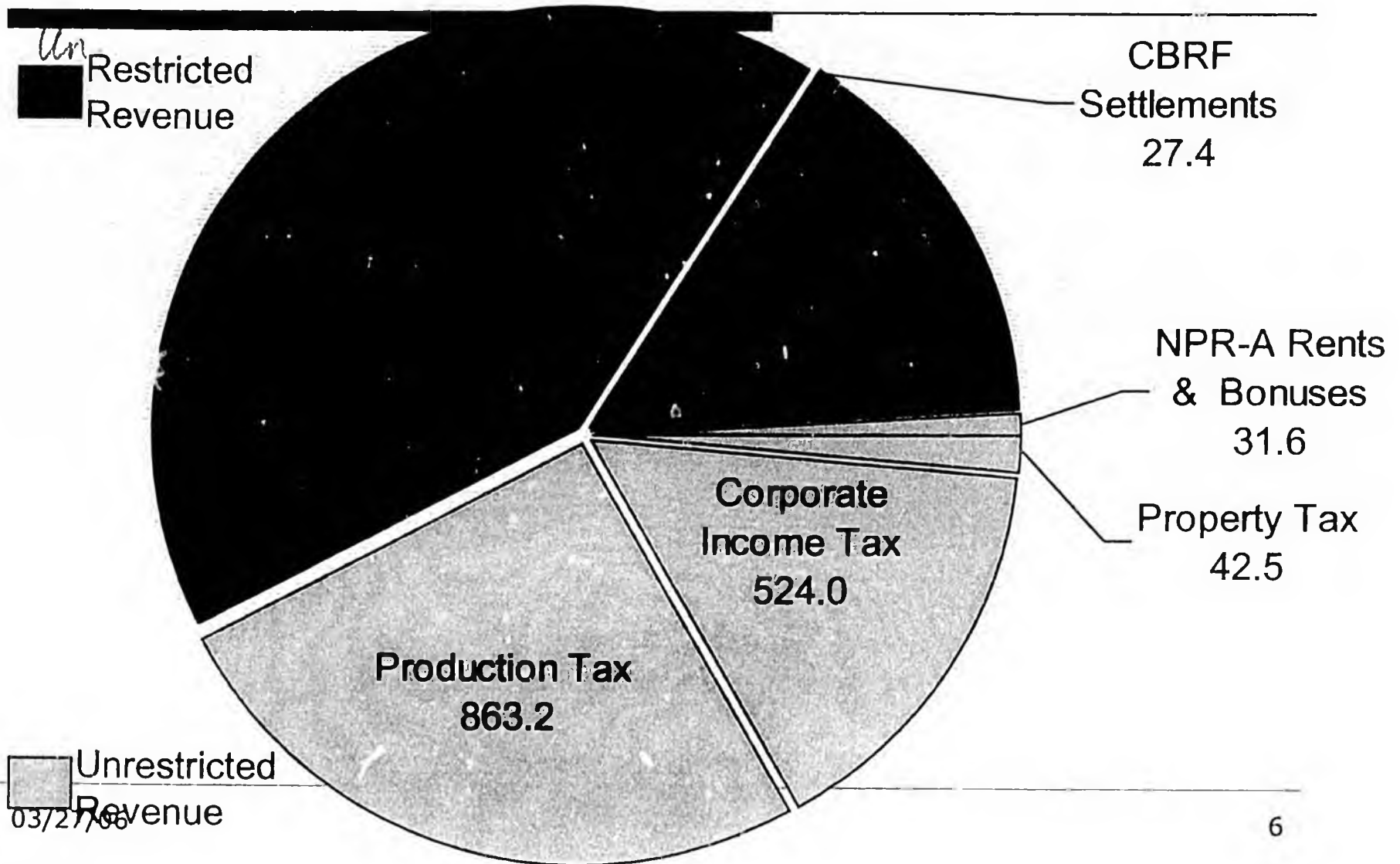


FY 2005

- Federal
- Investment
- Oil
- Other

FY 2005 Petroleum Revenue

\$ Million



1. Destination Value at Market (2005)

	Volume Millions barrels	\$ per barrel	\$ Million
Destination Value at Market	330	\$43.43	\$14,332
Less Tankering & Pipelines	330	\$ 4.51	(\$1,488)
Gross Value at Point of Production	330	\$38.92	\$12,844
Less Upstream Costs			
Operating:		\$ 3.33	
Capital:		\$ 3.18	
Total	330	\$ 9 6.52	(\$2,150)
Net Value at Point of Production	330	\$32.40	\$ 10,694

08/17/06

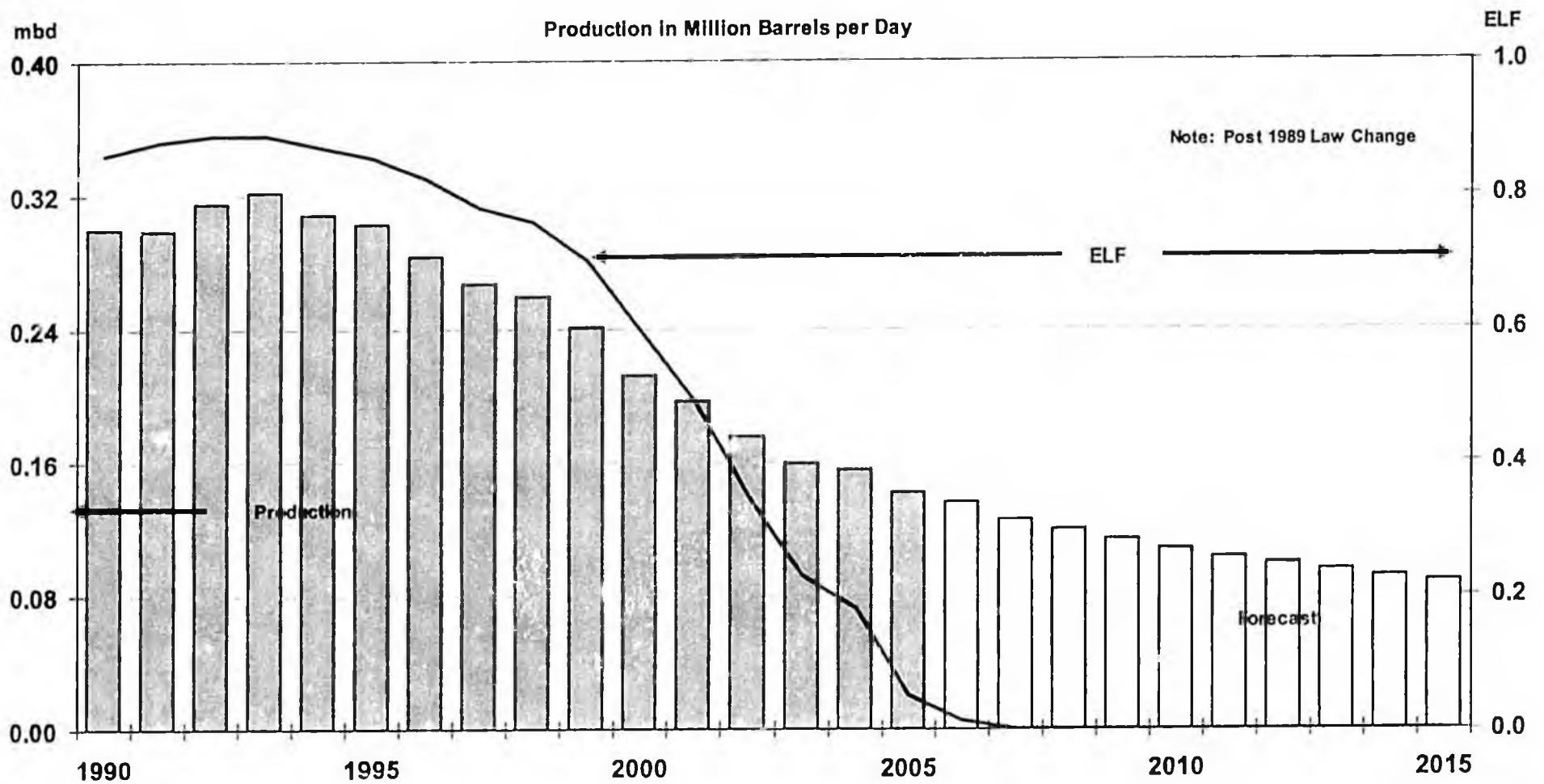
2. Current Production Tax

	\$ in Billion
Gross Value at Point of Production	\$12,844
1- Royalty Rate	0.875
Value Net of Royalty	<u>\$11,238</u>
Tax Rate	0.15
ELF Rate	0.55
Tax	\$ 927

Implicit Cost

	\$ in Billion
Production Tax Net of Royalty	\$11,238
Less Implicit Cost from Proxy	<u>(\$ 5,057)</u>
	\$ 6,181
Tax Rate	0.15
Proposed Production Tax	\$ 927

Kuparuk Crude Oil Production & ELF



Economic Limit Factor, FY 1995-2005 and FY 2006-2016

