

AK LEGISLATURE FINANCE COMMITTEES FILES 2007-2008 3285

167

- **Entered Alaska in late 2002**
- **Ooguruk Unit Operator**
- **Cosmopolitan Unit Operator**
- **~1.5 million acre leasehold**
- **11 NS exploration wells**
- **35 local Alaska staff**

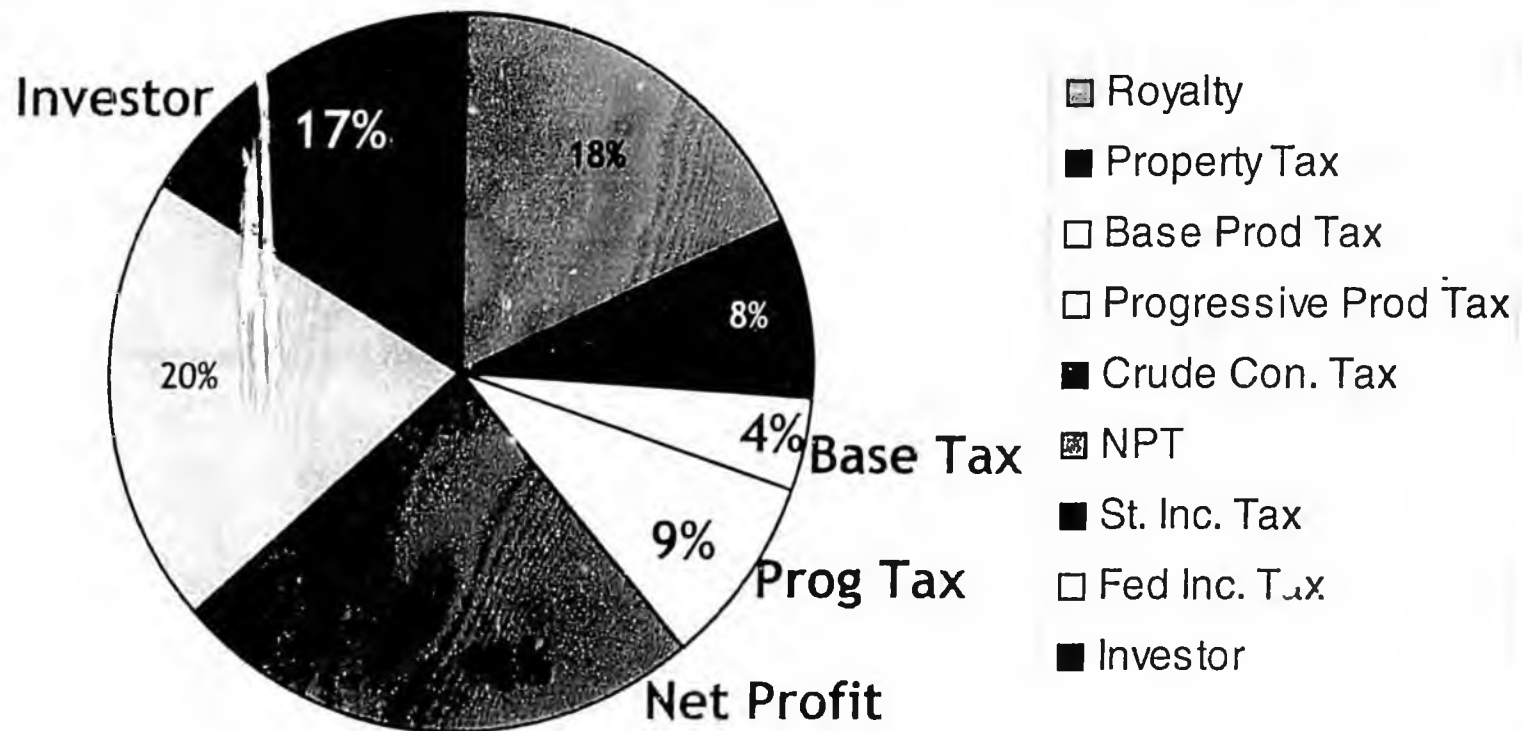
- **First independent NS oil producer**
- **First third party facility access**
- **Trailblazer for other investors**
- **Royalty + 30% net profits to SOA**
- **State income tax**
- **Property taxes to NSB**
- **Construction & Operating jobs**
- **Contractor profits**

<b>Future Operating Statistics</b>	
<b>Gross Reserve Potential</b>	<b>70 - 90 MMBO</b>
<b>First Production</b>	<b>2008</b>
<b>Gross Peak Flow Rates</b>	<b>15 - 20 MBOPD</b>
<b>Productive Life</b>	<b>25+ Years</b>

- **Satisfaction with the state of the local Industry?**
  - Legacy fields 6% annual production decline
  - Limited activity from new players
- **Is AK attractive to independents for investment?**
  - Investment competition for Independents is L-48 resource plays:
    - Lower cost - Shorter cycle time - Greater flexibility
    - Lower take - No progressivity – Price upside retained by investor
- **Will current bill improve this situation?**

- **Progressivity is an attempt to capture price windfall**
- **NPSL obligation is over and above Production Tax**

**Ooquruk Estimated Lifecycle Take Split (mm\$ - Discounted - @\$70)**



- **Net Profit Payments already capture 30+% of all profits**

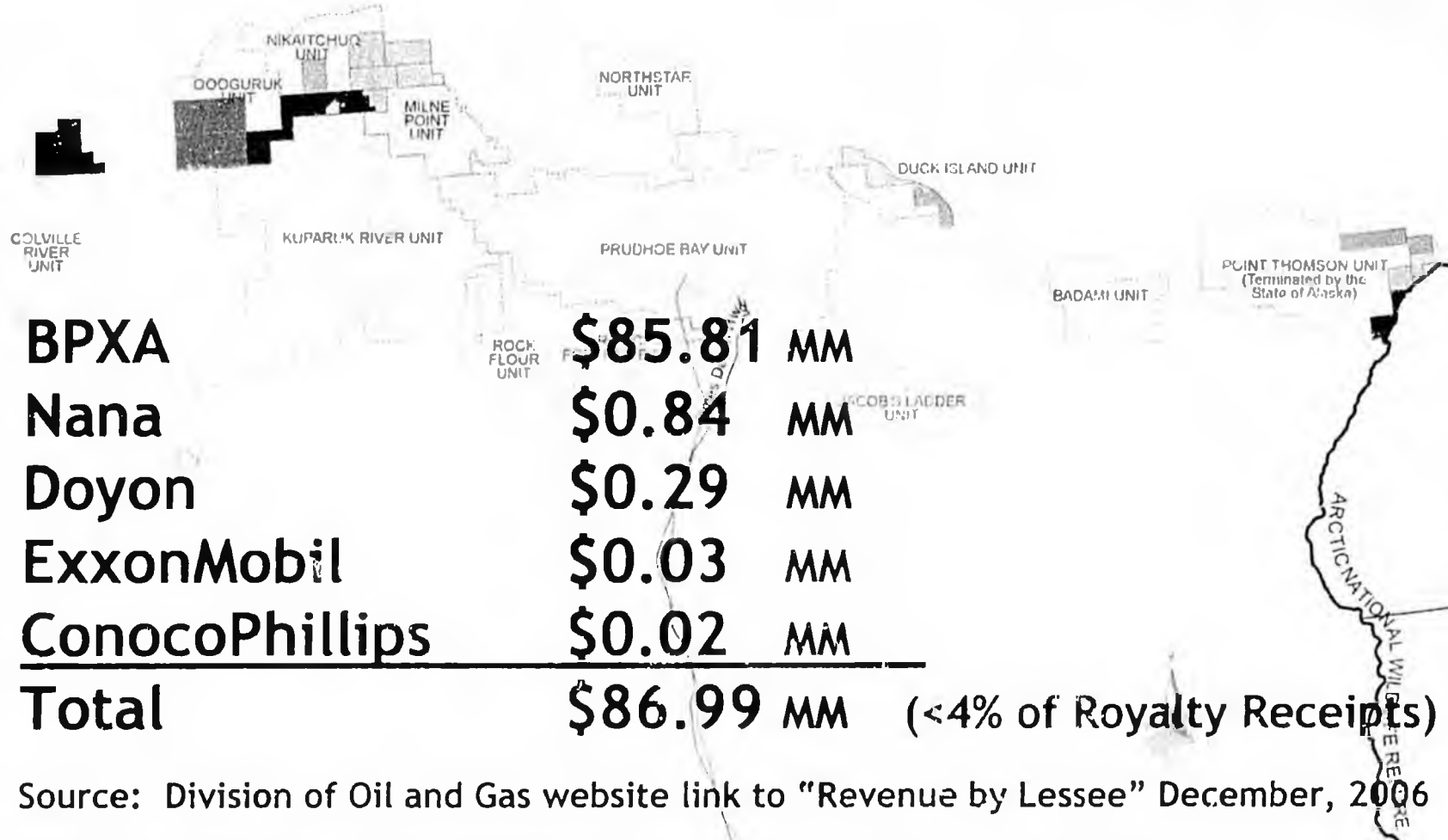
**Equitable Solution: Credit NPSL payments against Progressivity**

**CURRENT NET PROFIT LEASES**  
ARCTIC SLOPE & BEAUFORT SEA, ALASKA



CURRENT NET PROFIT LEASES BY OPERATOR

-  BPXA
-  CHEVRON
-  CPAI
-  ENI US
-  EXXON MOBIL
-  PIONEER NR
-  CURRENT LEASES



Source: Division of Oil and Gas website link to "Revenue by Lessee" December, 2006

- **Current Program Incentives Exploration**
  
- **Proposed Program Cumbersome & Reduces Incentives**
  1. Explorers must prove well tests separate new trap
  2. Wells must be pre-approved by the DNR Commissioner
  3. DNR must determine geologic objective was achieved
  4. Well data now includes All derivative work products
  5. Well data goes public 24 months after delivery, no extensions
  
- **A Program without certainty does not affect investment**

- **Pioneer has been an aggressive investor to date**
- **Proposed changes makes all N S projects less competitive**
  - Vast majority of Pioneer's investment opportunities are not burdened by Progressivity – Price upside is retained
  - At higher prices AK Opportunities are even less competitive
- **Raising taxes will push marginal projects off the table**
- **Unfunded projects create zero royalty, tax or jobs**
- **State already captures price upside on NPSL Leases**
  - Credit of NPSL payments against progressive tax is fair & equitable
- **Full protection of TIE credits remains important to Pioneer**
  
- **Does current bill motivate the desired behavior?**

bp



BP Presentation on HB 2001CS  
House Finance Committee

Claire Fitzpatrick and Bernard Hajny  
November 7, 2007

Is the bill true to the stated Guiding Principles for the New Production Tax System?



- Fair Revenue to the State (Higher)
  - Share upside benefit and downside risk
- Attractive Investment Climate – new exploration and reinvestment in existing fields (including heavy oil)
- Transparency – reduce the risk to the state
  - Clear to both state and taxpayer

Does the current bill accomplish these objectives relative to PPT?



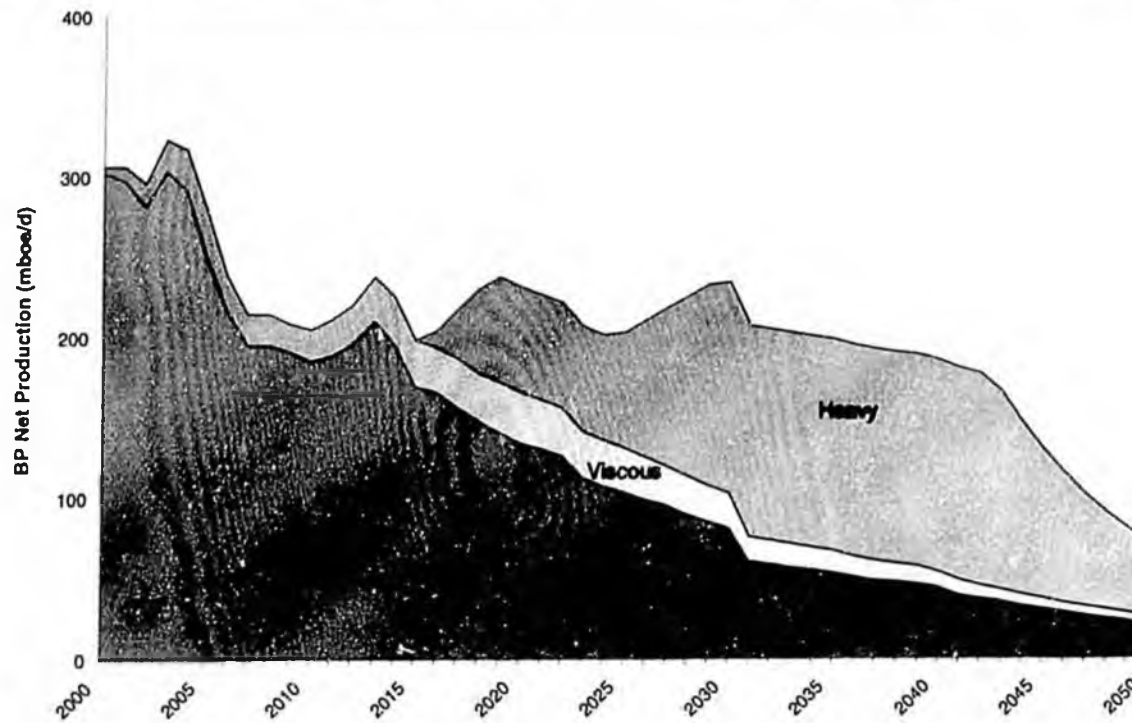
Proposed Measures	Fair? (HIGHER) Revenue	Attractive Investment Climate	Clear and Transparent
Tax Rate of 25% vs. 22.5%	✓	✗	NA
Gross Progressivity	✓	✗	✗
Capital Credits	Neutral	Neutral	Neutral
TIE Credits 3 years vs 5	✓	✗	NA
Takes away JIB use as basis for deductible costs	?	✗	✗
DR&R Non Deductible	?	NA	NA
Excludes ULSD Plant	?	✗	✗

Does the current bill accomplish these objectives relative to PPT?



<b>Proposed Measures</b>	<b>Fair? (HIGHER) Revenue</b>	<b>Attractive Investment Climate</b>	<b>Clear and Transparent</b>
Costs must be physically on lease	✓	✗	✗
Transportation deductions limited to those ruled by RCA	✓	✗	✗
\$1000 per day penalty to provide information	?	Neutral	?
Retroactivity	✗	✗	✗
6 year statute of limitations for Audits	?	✗	✓
Publication of aggregated tax information for 3 or more taxpayers	NA	?	?

# Impact of Investment Climate to Heavy Oil



## Heavy Oil Benefits for Alaska

- ❖ Multi-billion spend in the market
- ❖ 50 years of production
- ❖ 2+ Billion new barrels of oil
- ❖ Many new jobs
- ❖ Alaska becomes recognized among industry leader in "Arctic Heavy Oil"
- ❖ Huge ripple effect on the Alaska economy

## PPT or Better



Economic prize is big enough to try to unlock HO.

## ACES



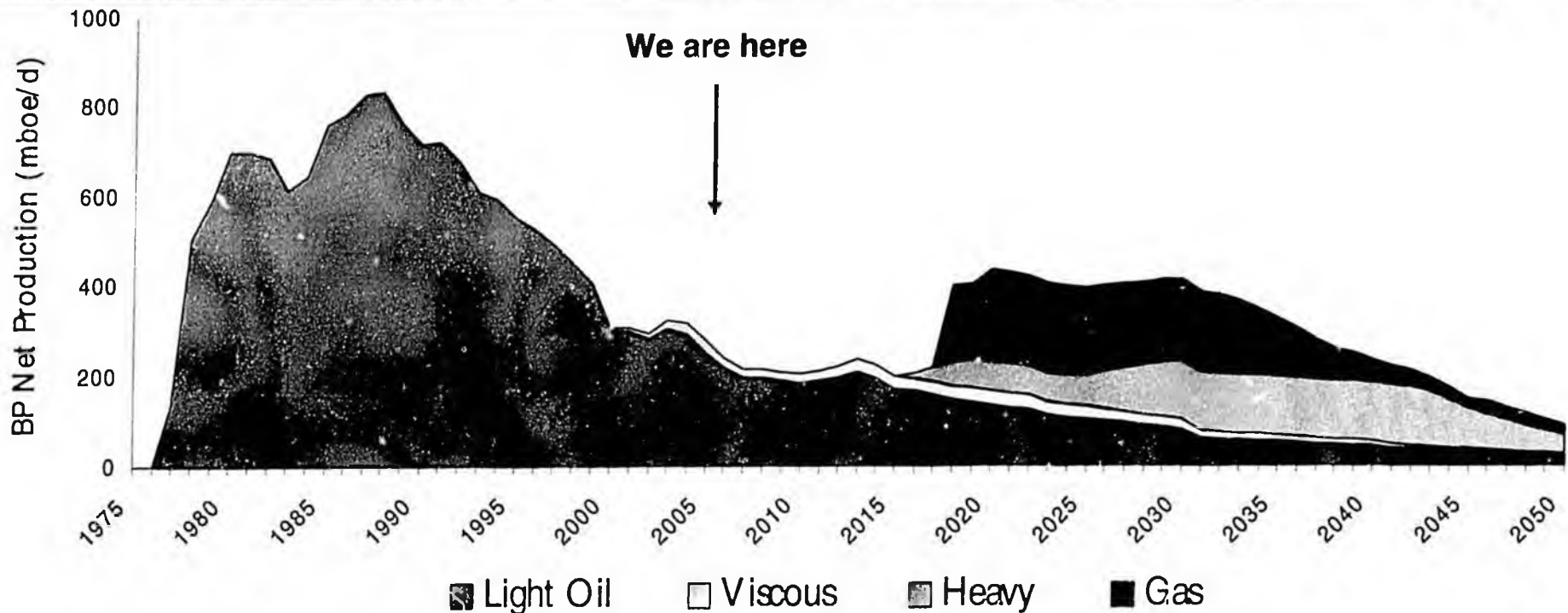
Economic prize is more marginal – may not be adequate to balance the risk.

## Latest CS's



Unfavorable relationship between risk and reward.

# BP Alaska – Building for the Future



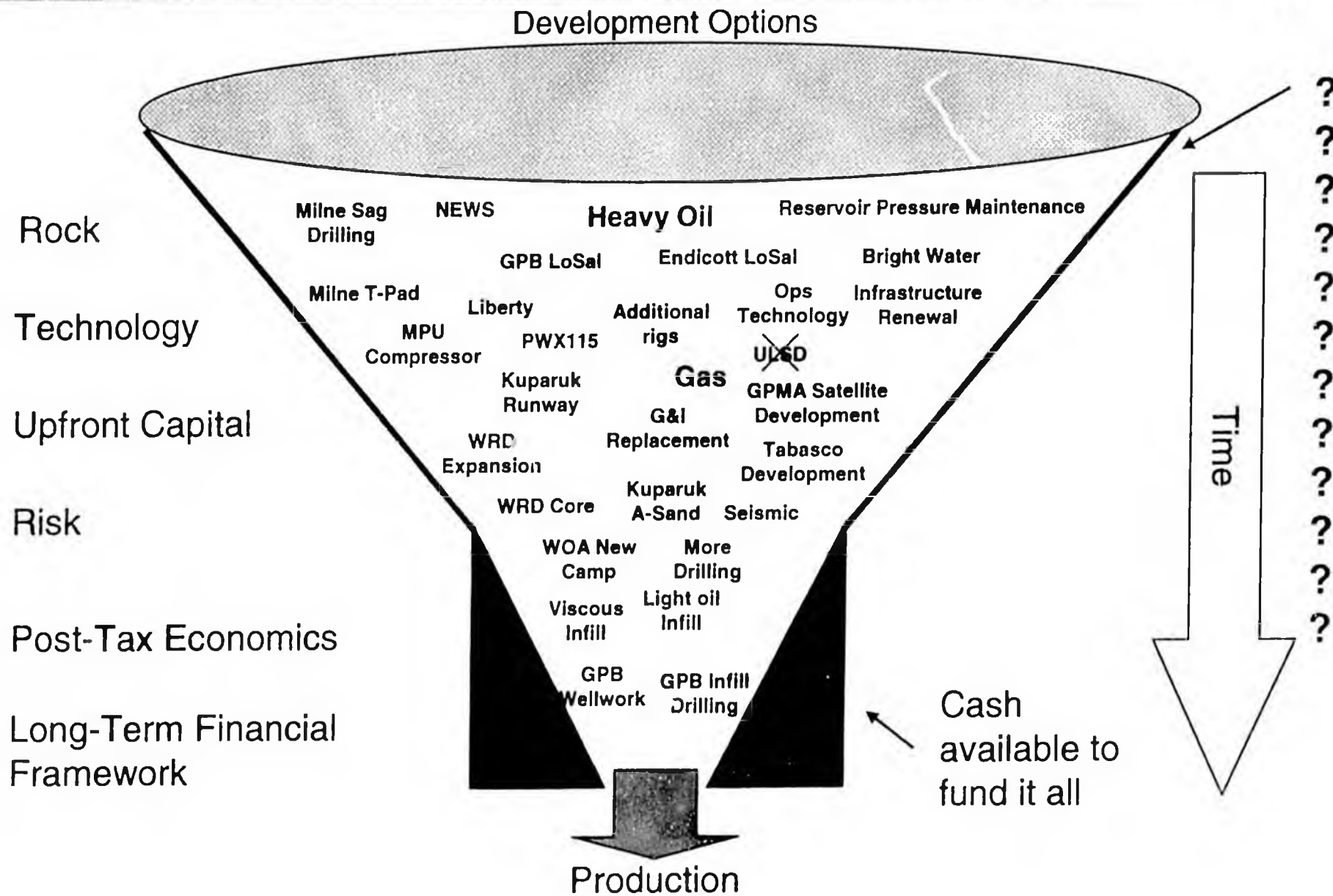
## Strategy

- **FOCUS** on the known Resource Base
  - Manage decline for Light Oil
  - Unlock Heavy Oil
- **ACCELERATE RENEWAL** of facilities, infrastructure and people
- **BRIDGE** to Gas

## Enabling Themes

- Fiscal stability
- Facility & Infrastructure Renewal
- Organizational Renewal
- Technology Pull-through
- Reserves Progression
- Government & Regulatory Relationships

# The Investment Hopper Squeeze



**Rep. Les Gara**

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**From:** Tremaine, Richard (DOR) [richard.tremaine@alaska.gov]  
**Sent:** Wednesday, October 31, 2007 4:21 PM  
**To:** Rep. Les Gara  
**Cc:** Williams, Michael D (DOR)  
**Subject:** Review of estimates of BP and ConocoPhillips profit margins for 2006

Rep. Gara,

You provided estimated profit margins for 2006 ConocoPhillips and BP in the range of 36% to 37%.

I have preliminarily reviewed unaudited PPT filings for these two companies for 2006. I have had to estimate federal and state corporate income tax. My preliminary review suggests that your profit margins underestimate actual profit margins these two companies enjoyed for ANS operations in 2006 after PPT and income tax calculations.

I hope this answers your question.

Dick Tremaine  
Economist  
Alaska Department of Revenue

*Distributed by  
Rep. Gara*



# Alaska State Legislature

Senator Bill Wielechowski

Representative Les Gara

716 W. 4<sup>th</sup> Avenue, Anchorage, Alaska 99501

October 22, 2007

James Bowles  
President of ConocoPhillips Alaska  
700 G St.  
Anchorage, AK 99501

Doug Suttles  
President of BP Exploration (Alaska) Inc.  
900 E. Benson Blvd.  
Anchorage, AK 99508

Dear Sirs:

We are writing to ask that you confirm your companies' Alaska profit margins which, by our calculations from your 2006 annual reports, seem much higher than your companies earn elsewhere around the world. While your companies are presenting the public with selective information stating that costs in Alaska are high, we have not heard your companies mention to the public that under the current Alaska tax system, your companies are left with higher profit margins in Alaska than almost anywhere else in the world. We would appreciate confirmation that we are not missing any information when looking at your annual reports.

According to Conoco's 2006 Annual Report, that company earned \$2.3 billion in clear Alaska profit on 6.5 billion in total Alaska revenues. That leaves Conoco with a profit margin (profits earned as a percent of total revenue) of roughly 36%. That is the second highest profit margin Conoco reports of any other region where it does business around the world, and is a far higher margin than Conoco earns on average worldwide. According to Conoco's 2006 report, it's world profit margins are as follows:

<i>Region</i>	<i>Profit Margin</i>
Alaska	36%
Middle East/Africa	7%
Russia	Negative
Europe	22%
Lower 48	27%

Canada	30%
Pacific/Asia	42% (but \$1.5 billion in profit compared to \$2.3 billion in Alaska)
Worldwide Average	28%

According to BP's 2006 Annual Report, it earned \$2.2 billion in profits on \$6 billion in revenue in Alaska in 2006. That is more than triple the profit margin BP earns worldwide. While BP does not appear to report its profits in other areas by region, its Annual Report shows a roughly 36.5% profit margin in Alaska. According to BP's 2006 Annual Report, worldwide BP earned less than a 10% profit margin (\$22 billion in profit on \$274 billion in revenue).

In April, 2007, both companies completed their 2006 tax payments, and it is not clear whether those final payments are reflected in your 2006 annual reports, and we ask that you confirm whether or not that is the case.

Assuming the 2007 payments need to be subtracted from your companies' 2006 profit numbers, those numbers change very little. In April all Alaska oil producers paid, in total, supplemental "true up" tax payments of roughly \$1 billion. Companies only pay 65% of this amount (\$677 million), since 35% of this amount gets deducted from your Federal tax payments. Roughly 42% of Alaska's North Slope oil is produced by Conoco, and 35% by BP. The Department of Revenue will be asked to confirm these numbers, but our best estimate is that Conoco's profit would be reduced by \$285 million (42% of \$677 million), and that BP's profit would be reduced by \$237 million (35% of \$677 million).

Using these estimates, even assuming the true up payments were not reflected in your companies' 2006 profit reports, those profit numbers would be adjusted as follows: Conoco's profit margins and profits would be reduced from 36% to 31.4%, and \$2.3 billion to \$2.05 billion respectively. That would still leave Alaska as Conoco's second highest profit margin region in the world. BP's margins and profits would be reduced from 36.5% to 32.6%, and \$2.2 billion to \$1.96 billion respectively.

We would appreciate it if you would advise us whether your companies' 2006 annual reports reflected the 2006 true up payments made in 2007, and, if not, how much your companies paid in 2006 taxes, after the 35% federal tax deduction you receive.

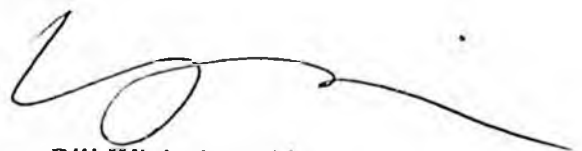
As we proceed with discussions on an appropriate oil tax, the public is entitled to know the profits your companies are making from holdings on the highly profitable Prudhoe Bay, Kuparuk and Alpine fields (Conoco has shares in all three).

Thank you.

Sincerely,



Rep. Les Gara



Sen. Bill Wielechowski

## ConocoPhillips 2006 Alaska Profits

### • Results of Operations

Year Ended	Millions of Dollars										
December 31	Consolidated Operations										
	Alaska	Lower 48	Total U.S.	Canada	Europe	Asia Pacific	Middle East and Africa	Russia and Caspian	Other Areas	Total	Equity Affiliates
<b>2006</b>											
Sales	\$ 6,304	3,408	9,712	2,951	5,950	3,755	1,965	—	140	24,473	5,161
Transfers	210	4,023	4,233	—	2,954	9	542	—	—	7,738	2,821
Other revenues	2	56	58	145	14	(8)	127	—	4	340	108
<b>Total revenues</b>	<b>6,516</b>	<b>7,487</b>	<b>14,003</b>	<b>3,096</b>	<b>8,918</b>	<b>3,756</b>	<b>2,634</b>	<b>—</b>	<b>144</b>	<b>32,551</b>	<b>8,090</b>
Production costs excluding taxes	708	893	1,601	706	814	324	215	—	27	3,687	739
Taxes other than income taxes	914	554	1,468	52	37	91	10	1	30	1,689	3,444
Exploration expenses	105	222	327	246	73	121	44	32	17	860	46
Depreciation, depletion and amortization	460	2,272	2,732	1,155	1,200	512	220	1	21	5,841	461
Property impairment	—	15	15	131	—	10	—	—	19	175	—
Transportation costs	610	555	1,165	104	316	89	18	—	10	1,702	420
Other related expenses	11	44	55	15	87	18	38	43	28	284	52
Accretion	34	36	70	39	97	8	2	—	—	216	6
<b>Provision for income taxes</b>	<b>3,674</b>	<b>2,896</b>	<b>6,570</b>	<b>648</b>	<b>6,294</b>	<b>2,583</b>	<b>2,087</b>	<b>(77)</b>	<b>(8)</b>	<b>18,097</b>	<b>2,922</b>
	1,409	1,064	2,473	(193)	4,578	1,061	1,931	(13)	(7)	9,830	891
<b>Results of operations for producing activities</b>	<b>2,265</b>	<b>1,832</b>	<b>4,097</b>	<b>841</b>	<b>1,716</b>	<b>1,522</b>	<b>156</b>	<b>(64)</b>	<b>(1)</b>	<b>8,267</b>	<b>2,031</b>
Other earnings	68	183	251	191	335	62	32	(4)	(25)	842	133
<b>Net income (loss)</b>	<b>2,333</b>	<b>2,015</b>	<b>4,348</b>	<b>1,032</b>	<b>2,051</b>	<b>1,584</b>	<b>188</b>	<b>(68)</b>	<b>(26)</b>	<b>9,109</b>	<b>2,164</b>
Results of operations for producing activities of equity affiliates	—	—	—	—	—	—	(6)	1,229	808	—	2,031

**BP (Alaska) Inc. 2006 Profits**

Income statement

\$ million

For the year  
ended 31  
December

2006

	Issued	Guarantor	Other subsidiaries	Eliminations and reclassifications	BP group
	BP Exploration (Alaska) Inc.	BP p.l.c.			
Sales and other operating revenues	4,812	-	265,906	(4,812)	265,906
Earnings from jointly controlled entities - after interest and tax	-	-	3,553	-	3,553
Earnings from associates - after interest and tax	-	-	442	-	442
Equity accounted income of subsidiaries after interest and tax	570	23,119	-	(23,689)	-
Interest and other revenues	627	187	881	(994)	701
<b>Total revenues</b>	<b>6,009</b>	<b>23,306</b>	<b>270,782</b>	<b>(29,495)</b>	<b>270,602</b>
Gains on sale of businesses and fixed assets	-	105	3,714	(105)	3,714
<b>Total revenues and other income</b>	<b>6,009</b>	<b>23,411</b>	<b>274,496</b>	<b>(29,600)</b>	<b>274,316</b>

Purchases	506	-	191,429	(4,812)	187,183
Production and manufacturing expenses	814	-	22,479	-	23,293
Production and similar taxes	605	-	2,956	-	3,621
Depreciation, depletion and amortization	374	-	8,754	-	9,128
Impairment and losses on sale of businesses and fixed assets	109	-	440	-	549
Exploration expense	14	-	1,031	-	1,045
Distribution and administration expenses	20	278	14,264	(115)	14,447
Fair value (gain) loss on embedded derivatives	-	-	(608)	-	(608)
<hr/>					
Profit before interest and taxation from continuing operations	3,447	23,133	33,751	(24,673)	35,658
Finance costs	--	702	895	(879)	718
Other finance expense (income)	11	(675)	462	-	(202)
<hr/>					
Profit before taxation from continuing operations	3,436	23,106	32,394	(23,794)	35,142
Taxation	1,243	686	10,587	-	12,516
<hr/>					
Profit from continuing	2,193	22,420	21,807	(23,794)	22,626

operations Profit (loss) from Innovene operations	-	-	(25)	-	(25)
Profit for the year	2,193	22,420	21,782	(23,794)	22,601
Attributable to BP shareholders	2,193	22,420	21,496	(23,794)	22,315
Minority interest	-	-	286	-	286
	2,193	22,420	21,782	(23,794)	22,601

The following is a summary of the adjustments to the profit for the year attributable to BP shareholders which would be required if US GAAP had been applied instead of IFRS.

		\$ million			
		2006			
	Issuer	Guarantor		Eliminations and reclassifications	BP group
	BP Exploration (Alaska) Inc.	BP p.l.c.	Other subsidiaries		
Profit as reported	2,193	22,420	21,496	(23,794)	22,315

Source: Figures from BP PLC SEC Filings for 2006; pg.185

Available at: <http://www.sec.gov/Archives/edgar/data/313807/000115697307000346/b848881-20f.htm>

**CS HB 2001 Testimony  
November 8, 2007**

**ConocoPhillips Alaska**

**Kevin Mitchell**

Vice President, Finance & Administration

**Jim Taylor**

Vice President, Commercial Assets

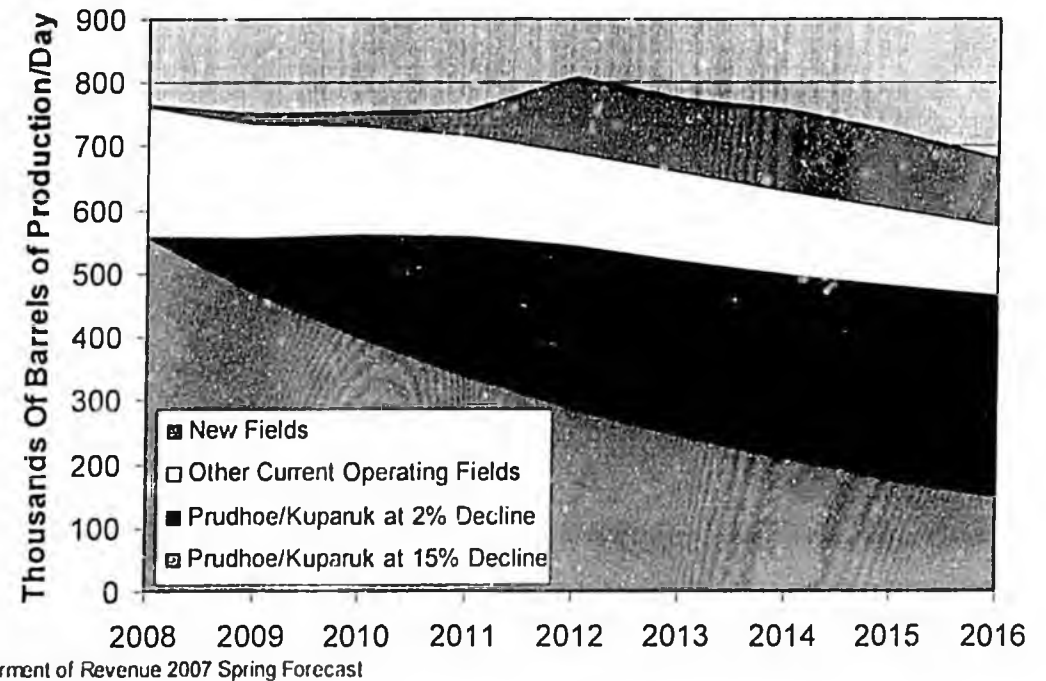
**ConocoPhillips**

# Summary of CS Bill

- Less attractive climate for investors:
  - Increased base rate
  - Increased progressivity
  - Multiple changes to deductions and other provisions
- Will have an impact on decisions
- Will result in less investment

# Tax System and Investments

- Base rate increase
- Progressivity increase
- Gross elements
- Reduced TIE credits



*A tax system formulated on the most economic projects will deter investment on more marginal projects, including Heavy Oil*

# Other Provisions

- Out of state exclusion
- Topping plant exclusion
- DR&R exclusion
- “Reasonable” transportation costs
- Exploration confidentiality
- 6 year statute of limitations
- Retroactive implementation

# Impact on Investment Climate

- Enhanced EICs – Positive
- Base rate increase to 25% – Negative
- Increased progressivity – Negative
- Progressivity on gross – Negative
- Reduce TIE credits – Negative
- Exclude out of state costs – Negative
- Exclude topping plant – Negative
- “Reasonable” transportation costs – Negative
- Exclude DR&R – Negative
- Exploration data confidentiality – Negative
- Retroactive implementation – Negative

ADMINISTRATION

**State of Alaska**  
Department of Revenue  
*Commissioner's Office*



**SARAH PALIN, GOVERNOR**  
333 Willoughby Avenue, 11<sup>th</sup> Floor  
P.O. Box 110400  
Juneau, Alaska 99811-0405  
Phone: (907) 465-2300  
Fax: (907) 465-2394

November 7, 2007

The Honorable Mike Chenault  
Co-Chair, House Finance Committee  
State Capitol, Room 505  
Juneau, AK 99801-3100

Cc: All Members, House Resources Committee

Re: Request for Outline of Department of Revenue Penalty Provisions

Dear Representative Chenault:

Attached is a short description of the penalty provisions applicable to taxpayers under Alaska's current oil and gas production tax laws and proposed changes, as requested today by Representative Hawker.

Sincerely,

Marcia Davis, Deputy Commissioner  
Department of Revenue

# **Tax Penalties Under Current Law and Proposed under CSHB2001(RES) and CSSB 2001(JUD)**

Distributed by the Department of Revenue

November 6, 2007

## **I. CURENT LAW**

### 1. Penalties applicable to all state tax types.

Under AS 43.05.220, the state may levy three types of civil penalties for failure to file a return or report or pay the full amount of tax:

- basic penalty for underpayment or failure to file
- penalty for negligence
- penalty for fraud

All three are general provisions applying to all state taxes, including the oil and gas production tax. Penalties are calculated as a percentage of the tax deficiency and are cumulative, so that a fraudulent taxpayer, for example, could be assessed the fraud penalty, in addition to the negligence penalty and the basic failure to file or pay penalty.

### 2. Federal IRS Penalties Incorporated into State Law

Additional penalties are levied under the Internal Revenue Service code, for which the state has no equivalent. The state has incorporated these penalties in its corporate income tax structure by reference in AS 43.20.021. These include penalties for deficient estimated taxes, substantial understatement, Gross Value Misstatement, and others that are less significant for state purposes.

### 3. Penalties unique to oil and gas production taxes (AS 43.55).

HB 2001 did not propose any change to the applicability of the general penalties and their application to the oil and gas production tax. Currently, there are no penalties specific to the failure to file or the underpayment of taxes due under AS 43.55.

## **II. PROPOSED CHANGES TO LAW**

### 1. Penalties Associated with Reporting Requirements.

SB/HB 2001, CSHB2001(RES) and CSHB2001(JUD) propose to add penalties for failure to comply with the proposed information reporting

requirements. (See Sec. 43 and Sec. 45 of CS House Bill 2001(Res)). The penalty provisions allow the department to assess not more than \$1000 per day for each day a taxpayer fails to make the required report. These additional penalty provisions are necessary because the existing penalties are structured as a percentage of a tax deficiency and the reporting requirements do not have associated tax deficiencies. These penalties will ensure that the Department receives timely and complete reporting of costs, potential tax credits, etc., from explorers and producers to enable it to fulfill its revenue forecasting duties for the Governor and the Legislature.

### 2. House Penalty for Improper Monthly Installment Payments.

Section 25 of CSHB2001 (RES) also proposes a 5% civil penalty for failure to file timely the monthly installment payments due under AS43.55.020(a)(1)-(4). This provision is necessary because under the House bill, production tax is owed annually, and the monthly estimated payments would not give rise to tax deficiencies. Therefore current penalties structures would not function with this monthly reporting structure.

### 3. Senate Penalty for substantial and gross understatement of tax.

Section 49 of CSSB 2001 (JUD) provides for a 20% and 40% penalty for substantial and gross understatement of tax, in a manner similar to the federal IRS rules. A substantial understatement is greater than 10% of the tax requirement or at least \$10 million. A gross understatement is greater than 20% of the tax requirement or at least \$20 million.

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The following is more detailed information about the penalties identified above:

## Failure to File (Basic) Penalty

### State of Alaska / Federal, IRS

The basic failure to file penalty arises when the taxpayer fails to file a return or report when required or pay the full amount due. The penalty levied by the state in this case, is generally the same as would be issued by the Internal Revenue Service (IRS). Five percent of the unpaid balance of the tax liability is added to a tax for each 30 day period, or fraction of the period of noncompliance. This penalty may not exceed a total of 25% of the unpaid

balance. The penalty may be forgiven if the taxpayer shows that the failure to file or pay is due to reasonable cause and not willful neglect.<sup>1</sup>

Reasonable cause is not easy to show and the burden of proof lies with the taxpayer. The taxpayer must demonstrate in writing, and under penalty of perjury, that they acted in good faith to take all reasonable steps to ensure timeliness of the filing or payment. In determining whether the taxpayer has shown that the failure was due to reasonable cause and not willful neglect, the department considers the standards imposed by the Internal Revenue Code. Circumstances that may constitute reasonable cause include acts of God, war, other disaster that made filing or delay unavoidable, or acts by another person beyond the control of the person required to file.<sup>2</sup>

## Fraudulent Failure to File

### Federal, IRS

Fifteen percent of the unpaid balance of the tax liability is added to a tax for each 30 day period, or fraction of the period of noncompliance. This penalty may not exceed a total of 75% of the unpaid balance.

## Negligence Penalty

### State of Alaska

In addition to the basic penalty, if a deficiency is due to negligence or intentional disregard of a law or regulation, the department will, in its discretion, assess a penalty of 5% of the total amount of the deficiency. The penalty is calculated based on the total deficiency, even if only a part of the deficiency is due to negligence or intentional disregard. Negligence or intentional disregard may be shown by any relevant evidence including that the taxpayer has substantially deviated from the statutes or regulations, failed to keep adequate records, exaggerated deductions, or understated income without justification.<sup>3</sup>

### Federal, IRS

Federal accuracy-related penalties are generally set at 20% of the portion of the underpayment. This applies to:

<sup>1</sup> AS 43.05.220(a). For more detail on failure to file and failure to pay penalties, see 15 AAC 05.210.

<sup>2</sup> 15 AAC 05.200.

<sup>3</sup> AS 43.05.220(b); 15 AAC 05.210(g). For more detail on the additional penalty for negligence or intentional disregard, see 15 AAC 05.220.

- Negligence
- Substantial Understatements: An understatement of the greater of \$5000 or 10% of the due tax
- Substantial Valuation Misstatements: Valuation is off by 200% or more

## Gross Valuation Misstatement

This penalty is similar to other negligence penalties under the IRS code, for Substantial Valuation Misstatement, but applies when valuation is off by more than 400%. Under this circumstance, the penalty is increased from 20% to 40% of the portion of the underpayment.

## Fraud Penalty

### State of Alaska

If a deficiency is due to fraud, the department shall add a penalty equal to 50% of the tax due or \$500, whichever is greater. The penalty is calculated based on the total deficiency, even if only a part of the deficiency is due to fraud. To establish fraud, the department must show by clear and convincing evidence that the taxpayer understated a tax liability with the intent to evade tax. The intent to evade the tax may be shown by any relevant evidence including evidence of false explanations regarding income, false source documents, unjustified omissions or significant understatements of income, or substantial overstatement of a deduction.<sup>4</sup>

In addition to the three civil penalties discussed above, AS 43.05.290 provides for a number of criminal penalties for tax evasion and willful failure to comply with payment, filing, truthful accounting and information requirements, and for perjury. Along with several misdemeanors, penalties include felonies for willfully attempting to evade a tax, willfully failing to truthfully account for and pay a tax, and willfully and knowingly assisting in preparing or presenting a false return.

### Federal, IRS

The IRS generally levies a penalty of 75% of the underpayment amount attributable to fraud.

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<sup>4</sup> AS 43.05.220(c); 15 AAC 05.230.

Proposed Changes to Current Law

1. Penalties Associated with Reporting Requirements.  
SB/HB 2001, CSHB2001(RES) and CSHB2001(JUD)

AS.43.55.030(d)—Failure to file annual and monthly reports

(d) Reports **required under this section** [BY OR ON BEHALF OF THE PRODUCER] are delinquent the first day following the day the report is due. **The person required to file the report is liable for a penalty, as determined by the department under standards adopted in regulation by the department, of not more than \$1,000 for each day the person fails to file the report at the time required. The penalty is in addition to the penalties in AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title. In this subsection, "report" includes a statement.**

AS.43.55.040(6)—Failure to provide reports needed for state revenue forecasts

(6) assess against a person required under this section to file a report, statement, or other document a penalty, as determined by the department under standards adopted in regulation by the department, of not more than \$1,000 for each day the person fails to file the report, statement, or other document at the time required; the penalty is in addition to the penalties in AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title.

2. House Penalty for Improper Monthly Installment Payments.  
Section 25 of CSHB2001 (RES)

Sec. 25. AS 43.55.020 is amended by adding a new subsection to read:

(i) A civil penalty shall be added to the amount of an installment payment required under (a)(1) - (4) of this section if the full amount of the payment is not paid by the date the payment is due. The penalty is equal to five percent of the difference between the amount of the installment payment that was made timely and the amount of the installment payment required under (a)(1) - (4) of this section. If no part of the required installment payment was made timely, the penalty is equal to five percent of the installment payment

required under (a)(1) - (4) of this section. The penalty is in addition to the interest imposed under (g) of this section and a penalty added under AS 43.05.220, if any.

3. Senate Penalty for substantial and gross understatement of tax.  
Section 49 of CSSB 2001 (JUD)

**Sec. 49.** AS 43.55. is amended by adding a new section to read:

**Sec. 43.55.055. Penalty for understatement of tax.** (a) In addition to other penalties prescribed by law, if there is a substantial understatement of tax required to be shown on a return under this chapter, there shall be added to the tax an amount equal to 20 percent of the substantial understatement of tax.

(b) In addition to other penalties prescribed by law, if there is a gross understatement of tax required to be shown on a return under this chapter, there shall be added to the tax an amount equal to 40 percent of the gross understatement of tax.

(c) In addition to the penalties imposed under (a) or (b) of this section, a person who has made a substantial or gross underpayment of tax is liable to the state for the reasonable costs of the state's enforcement action, including auditing costs.

(d) For purposes of this section,

(1) a substantial understatement of tax for any taxable year exists if the amount of the understatement for the taxable year exceeds the lesser of 10 percent of the tax required to be shown on the return for the taxable year or \$10,000,000;

(2) a gross understatement of tax for any taxable year exists if the amount of the understatement for the taxable year exceeds the lesser of 20 percent of the tax required to be shown on the return for the taxable year or \$20,000,000;

(3) "understatement" means the amount by which the tax required to be shown on the return for the taxable year exceeds the amount of the tax reported as due by the taxpayer as shown on the return.

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# **Alaska's Equitable Share**

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**House Finance Committee**

**07 November 2007**



# Topics

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- GCA's understanding of the goals or drivers for Alaska's Petroleum Fiscal System?
- Description and comparison of the four fiscal structures under consideration
- Working from a portfolio of projects representative of the opportunities described by industry, show the impacts of each fiscal system
- Analysis of industry returns from the Prudhoe Bay drilling program

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# Goals

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# Goals 1, 2 & 4

## The Fiscal Design Challenge

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- **At the same time the State must address “The Take”**
  - (1) Capture the State’s equitable share when margins are very high (as they are today)
  - (4) Include a form of progressive structure to adapt to the inevitable changes in the three main variables of the business:
    - Price
    - Production
    - Cost
- **...as well as “The Give Back”**
  - (2) Encouragement to reinvest profits for more development inside legacy units



## Goal 3: Encourage New Investment

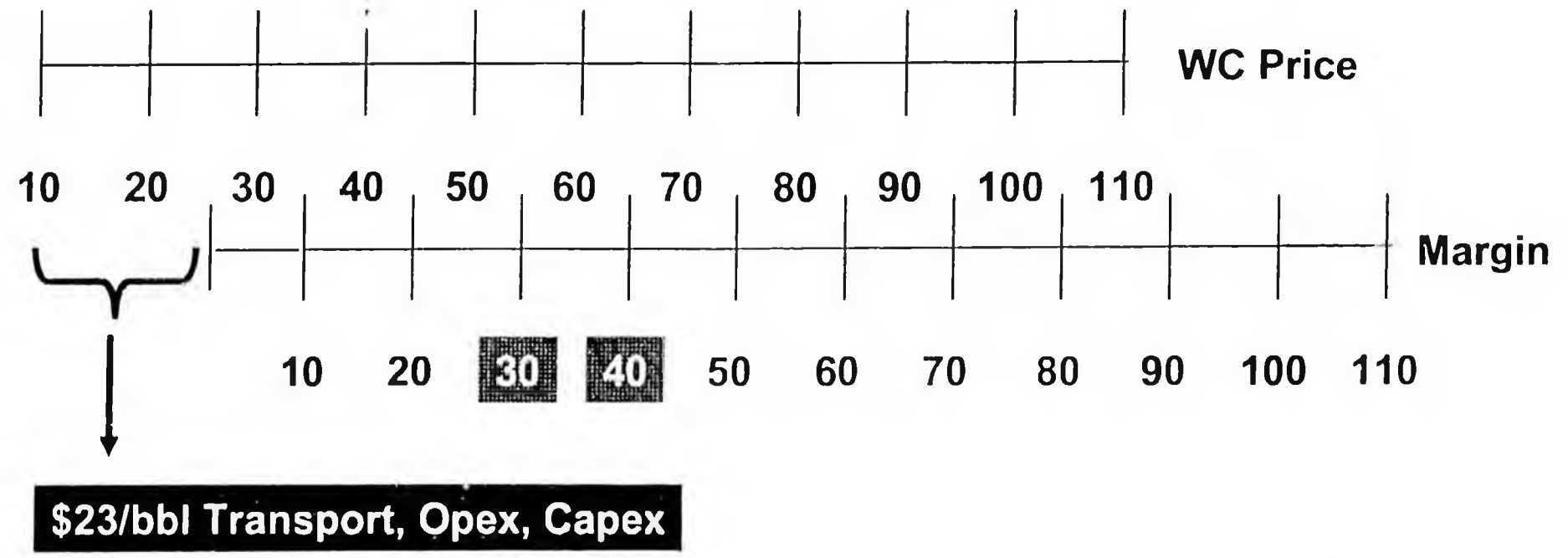
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- **The proposed legislation appears to provide the right incentives to encourage investment in new fields**
  - Investment credits
  - Net Operating Loss credits
    - Aid to new entrants with no existing tax base
  - The net based systems by design lower the applicable production tax rate for fields with higher cost structure
    - More distant from infrastructure
    - Heavy Oil
    - Gas
- **Beyond the individual project, the State and industry benefit from new developments as they provide additional barrels down TAPS thus extending the productive life of existing reservoirs**

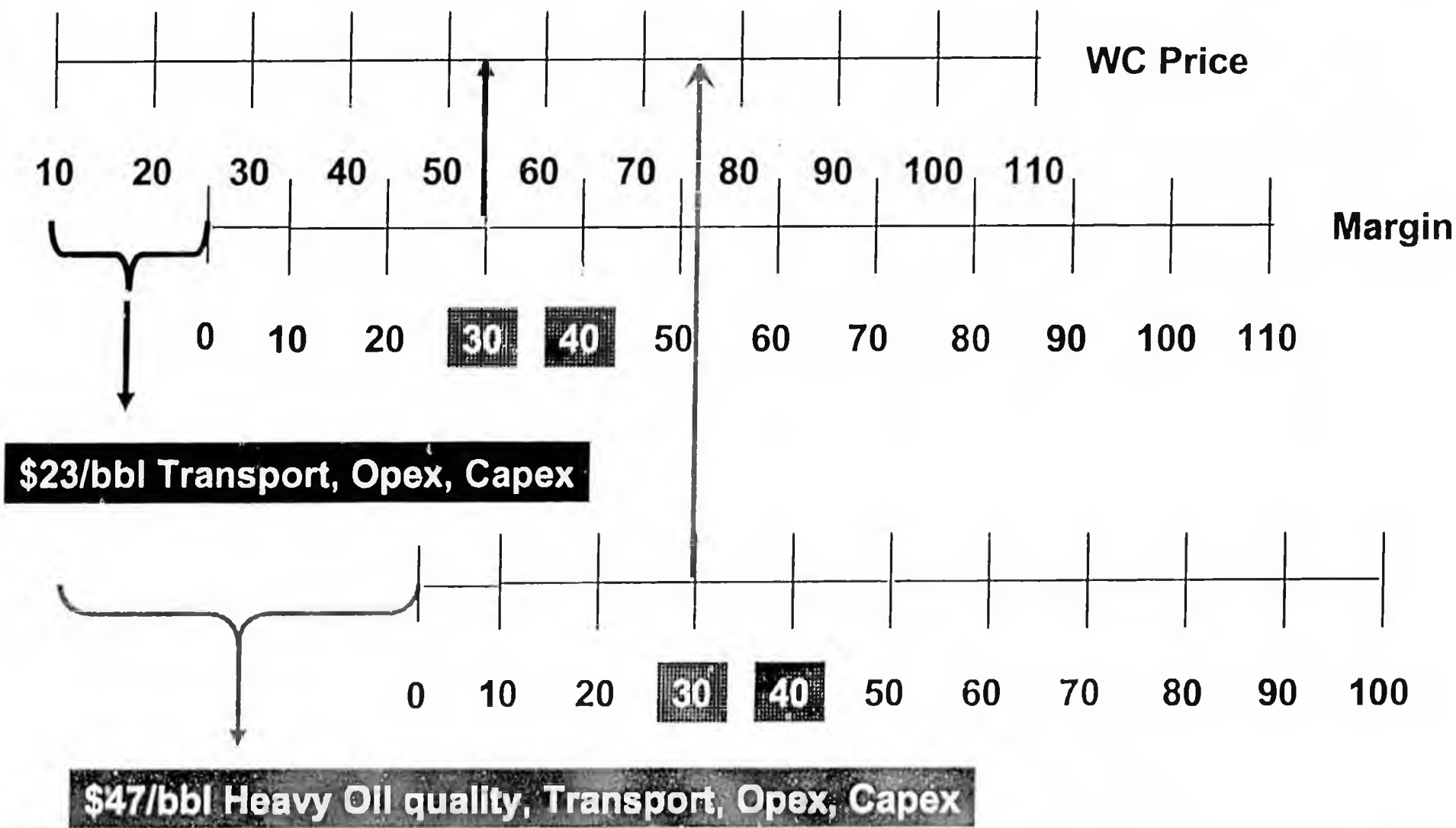


# Key Point Easily Misunderstood

# Price $\neq$ Margin



# Margin/Price relationship changes with time and with project addition



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# Regime Comparison

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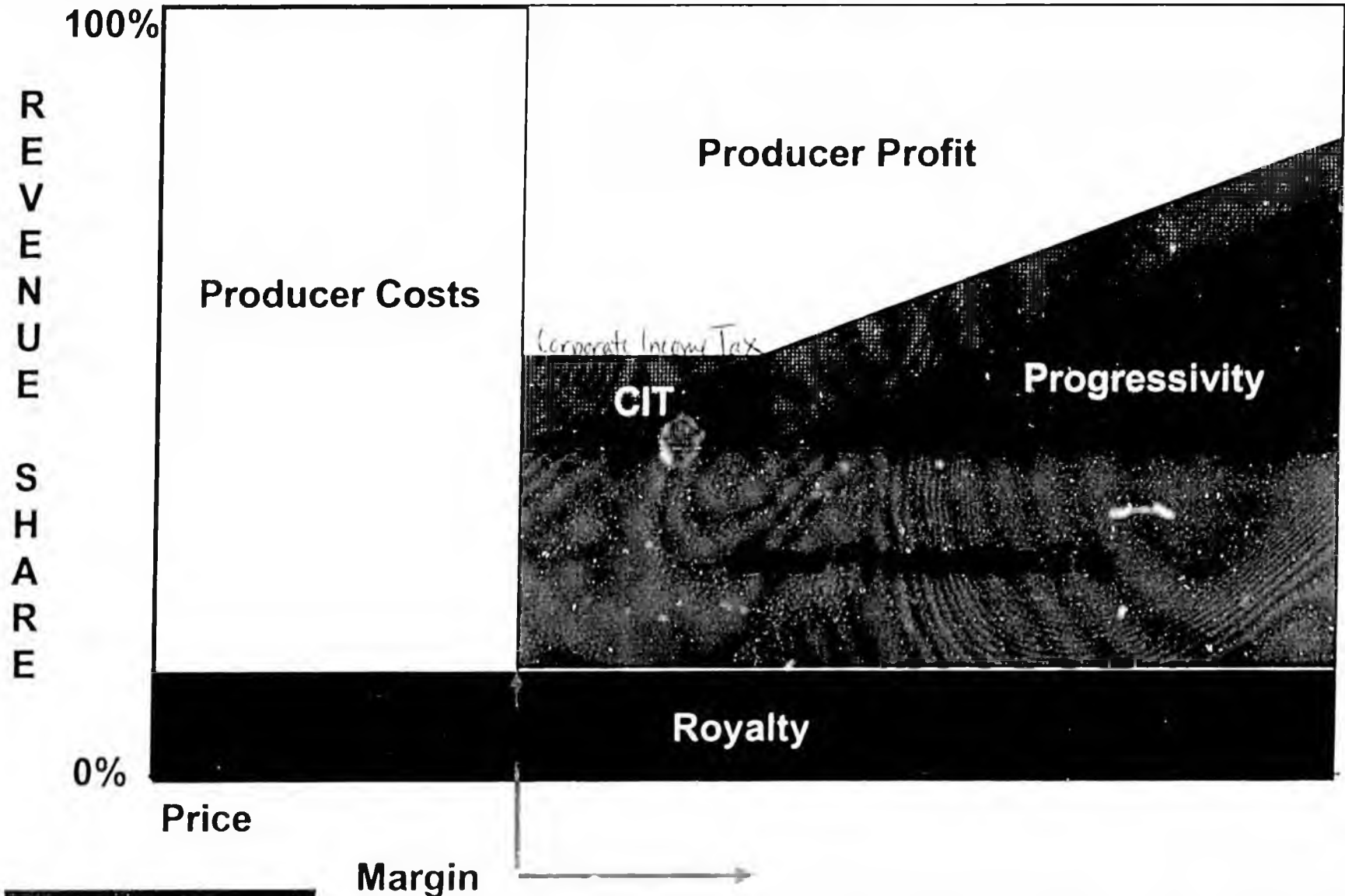
# Regime Review

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- **Four fiscal systems in discussion**
  - PPT
  - ACES
  - Senate CS
  - House CS



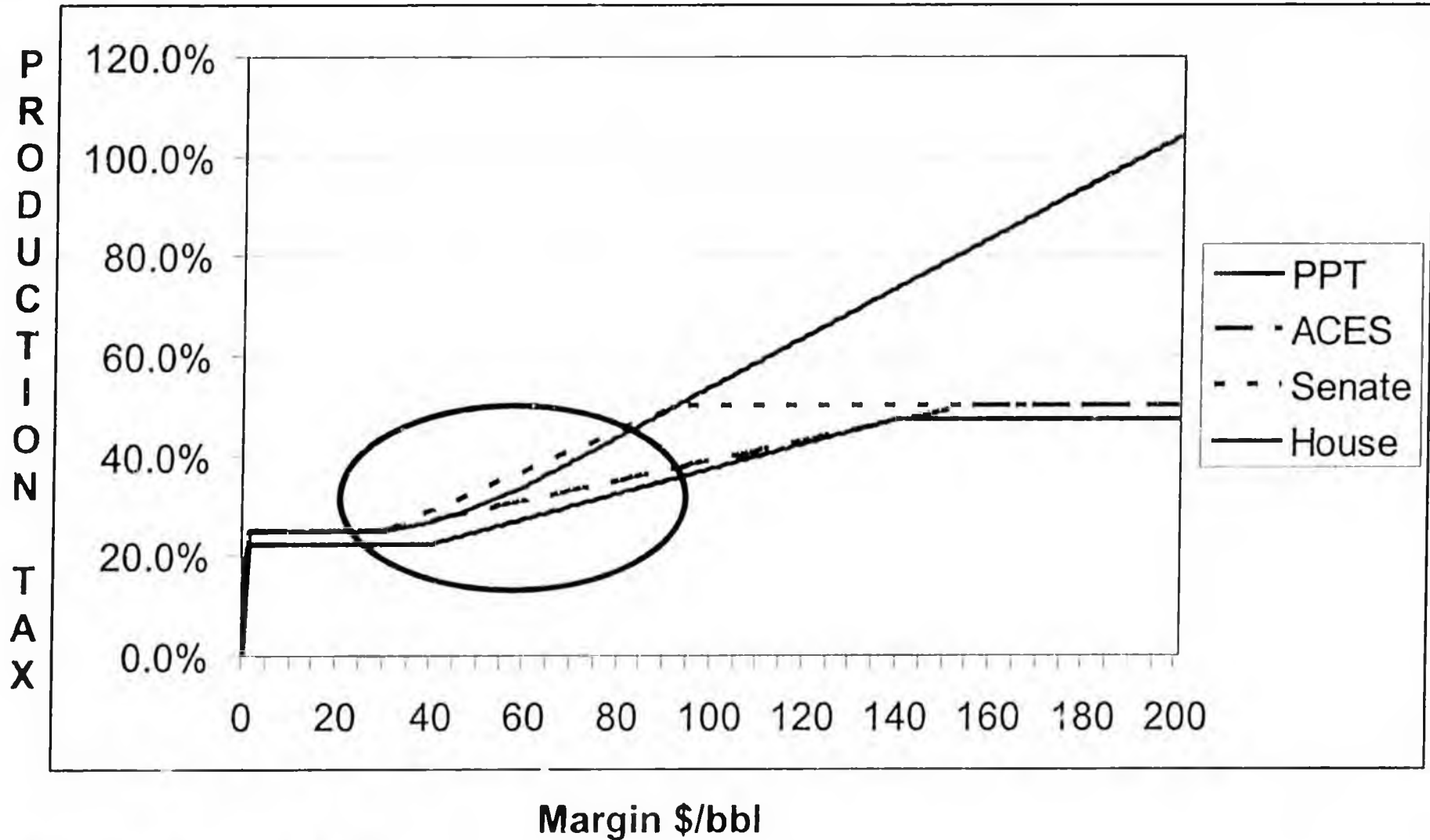
# For PPT, ACES and Senate CS





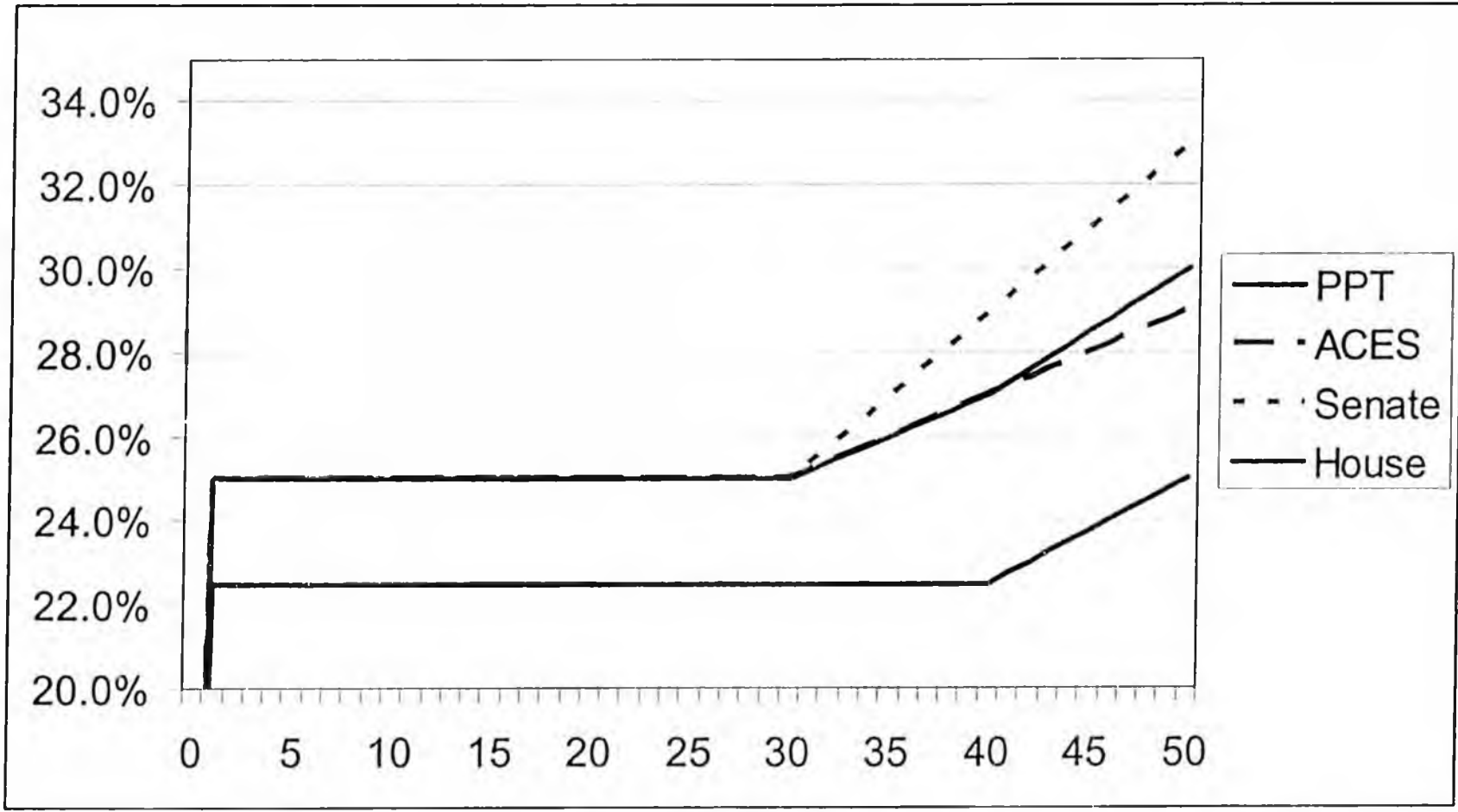


# Four fiscal systems





# Likely zone of operation





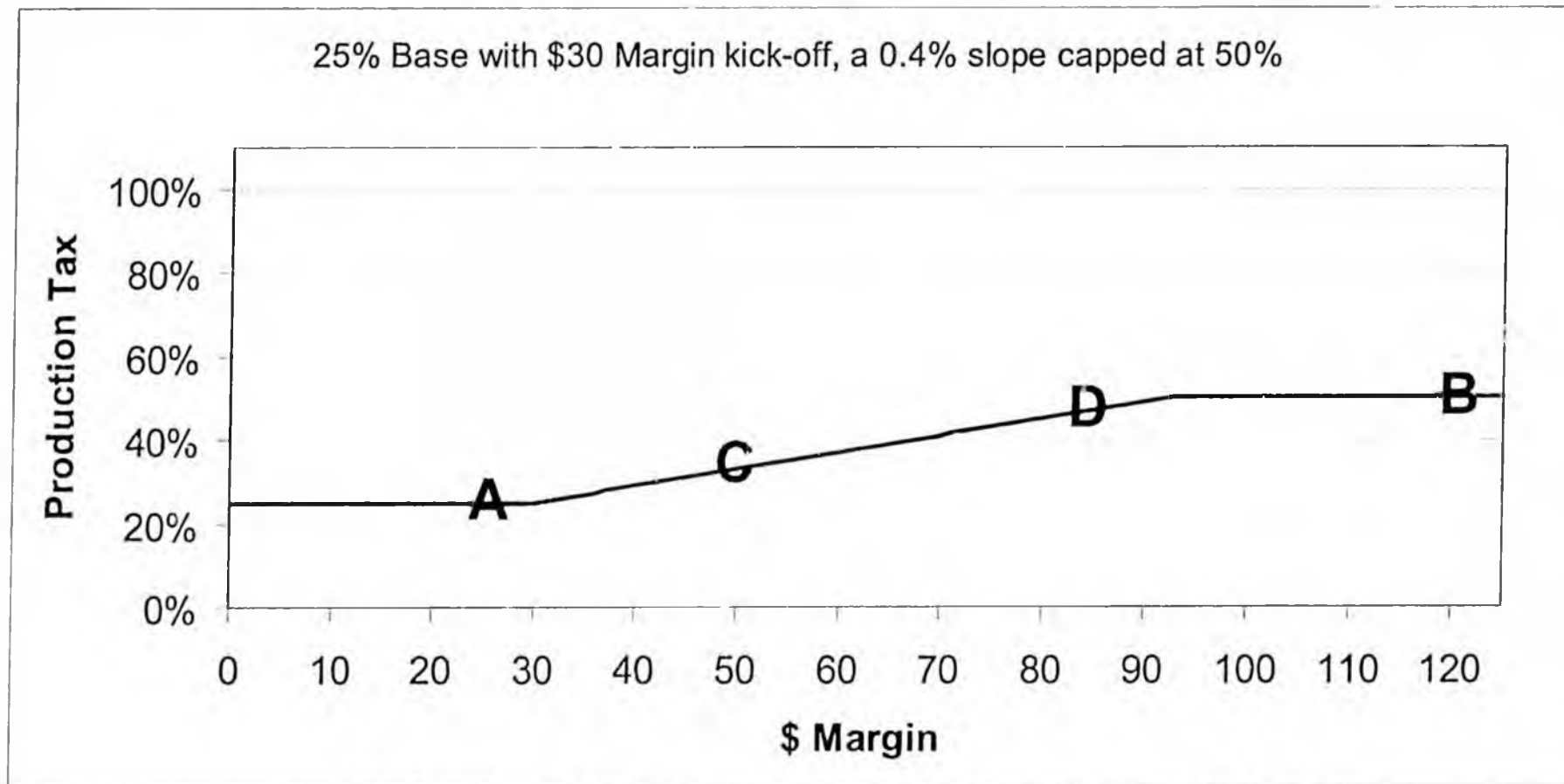
# Progressivity Impacts

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- **The use of progressivity creates a sizeable difference between the effective rate and the marginal rate of tax in relation to investment decisions**
  - This is present with the existing PPT language
  - The impact provides either:
    - A good sized “carrot” to invest; or
    - A good sized “stick” to not export after tax cash flow from Alaska



# Margin Cases



Federal and State Income tax impacts excluded



# An Example of Progressivity Impacts

- **Let's assume a company has \$1000 before tax cash flow and is deciding whether or not to make a \$100 investment (or roughly reinvest 10%)**
  - If the net margin before investment is under \$30/bbl
    - Production tax savings associated with the \$100 investment is 25%
  - If the net margin is greater than \$92.5/bbl
    - Production tax savings associated with the \$100 investment is 50%
  - If the net margin is between \$31/bbl and \$92.5/bbl
    - Production tax savings associated with the \$100 investment ranges from 25% to over 100%



## Taxpayer 'A' - Low Margin

- **\$1000 net revenue @ a margin of \$25/bbl**
  - Tax = \$1000 x 25%
  - Tax = \$250
- **Now we invest \$100- reduces net revenue to \$900 and our margin to \$22/bbl**
  - Tax = \$900 x 25%
  - Tax = \$225
- **Production Tax savings due to the investment**
  - Tax Savings =  $(\$250 - \$225)/\$100$
  - Tax Savings = 25/100
  - New Marginal Tax Rate = 25%



## Taxpayer 'B' - High Margin

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- **\$1000 net revenue @ a margin of \$125/bbl**
  - Tax = \$1000 x 50%
  - Tax = \$500
- **Now we invest \$100 that takes our net revenue to \$900 and our margin to \$110/bbl**
  - Tax = \$900 x 50%
  - Tax = \$450
- **Production Tax savings due to the investment**
  - Tax Savings =  $(\$500 - \$450)/\$100$
  - Tax Savings = 50/100
  - New Marginal Tax Rate = 50%



## Taxpayer 'C' – Low on the slope

- **\$1000 net revenue @ a margin of \$50/bbl**
  - Tax = \$1000 x 33%
  - Tax = \$330
- **Now we invest \$100 that takes our net revenue to \$900 and our margin to \$45/bbl**
  - Tax = \$900 x 31%
  - Tax = \$279
- **Production Tax savings due to the investment**
  - Tax Savings =  $(\$330 - \$279)/\$100$
  - Tax Savings = 51/100
  - New Marginal Tax Rate = 51%



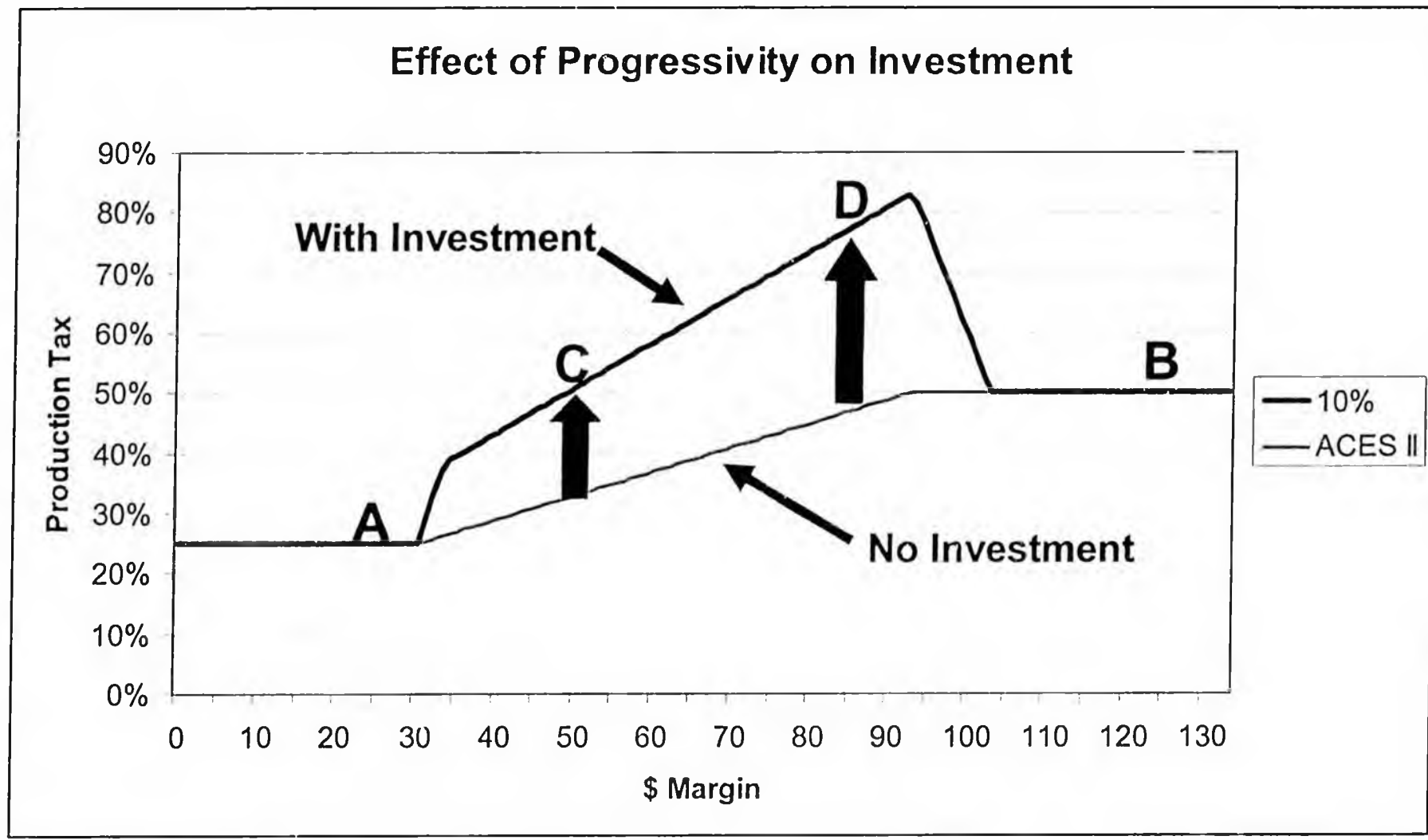
## Taxpayer 'D' – High on the slope

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- **\$1000 net revenue @ a margin of \$85/bbl**
  - Tax = \$1000 x 47%
  - Tax = \$470
- **Now we invest \$100 that takes our net revenue to \$900 and our margin to \$72/bbl**
  - Tax = \$900 x 43.6%
  - Tax = \$392
- **Production Tax savings due to the investment**
  - Tax Savings =  $(\$470 - \$392)/\$100$
  - Tax Savings = 78/100
  - New Marginal Tax Rate = 78%

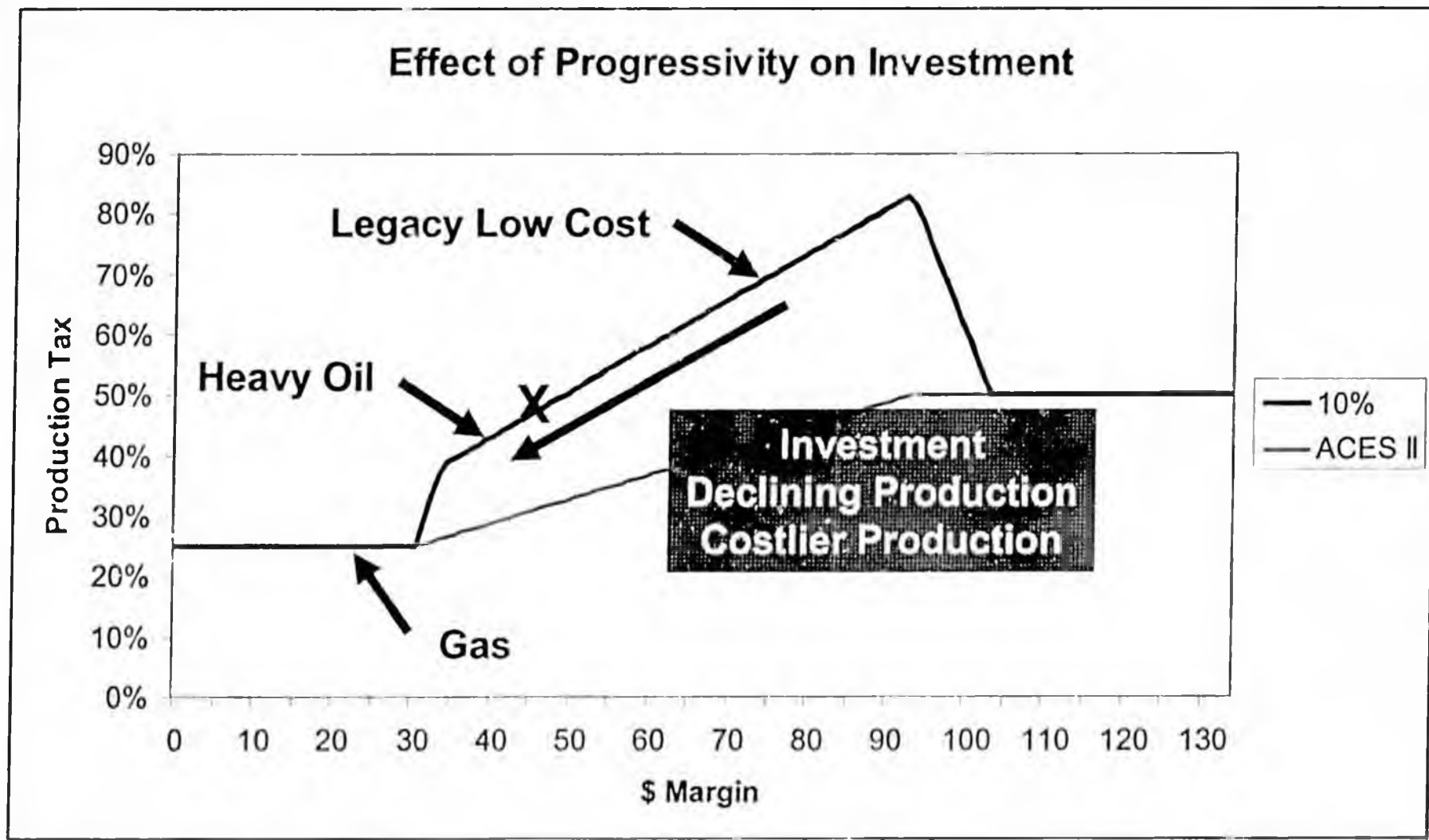


# 'C' & 'D' New Marginal tax rate higher





# Progressivity and Goals 1,2 & 3



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# The Net Tax Structure

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## Net Tax Structure – “Headlines”

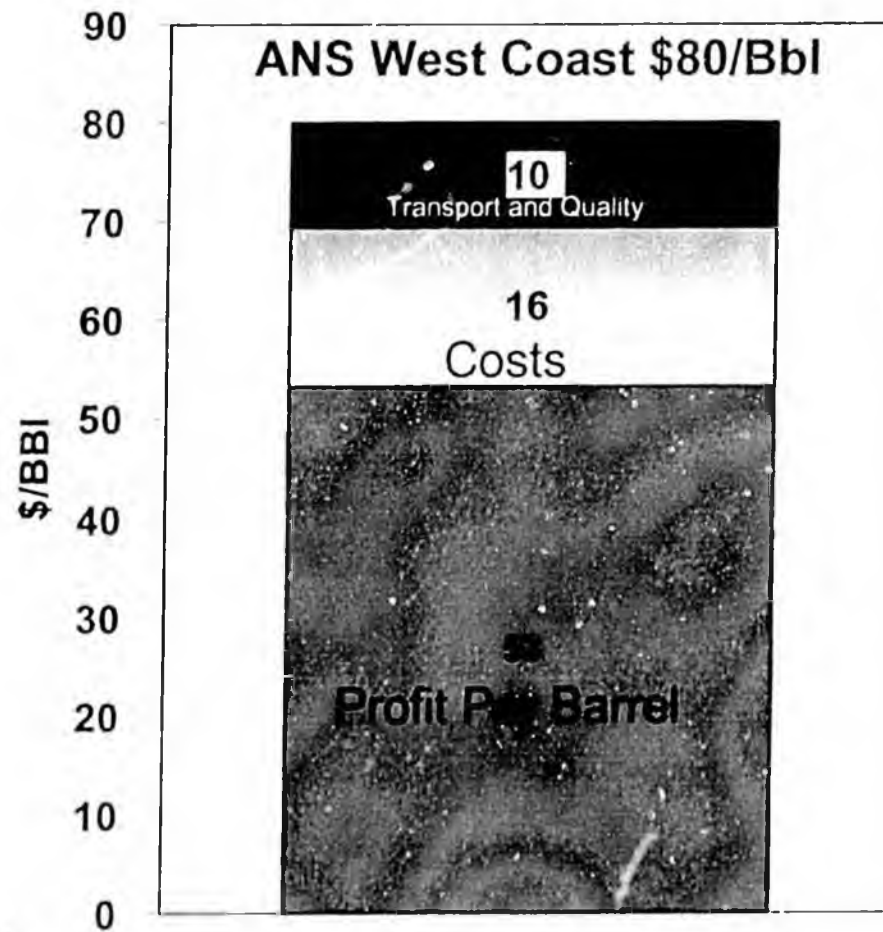
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- Tax on net profits
- Contains progressivity feature that increases tax rate with increasing profitability per barrel
- Ringfenced so that profit per barrel reflects a company’s entire portfolio



# Profitability As Typically Described

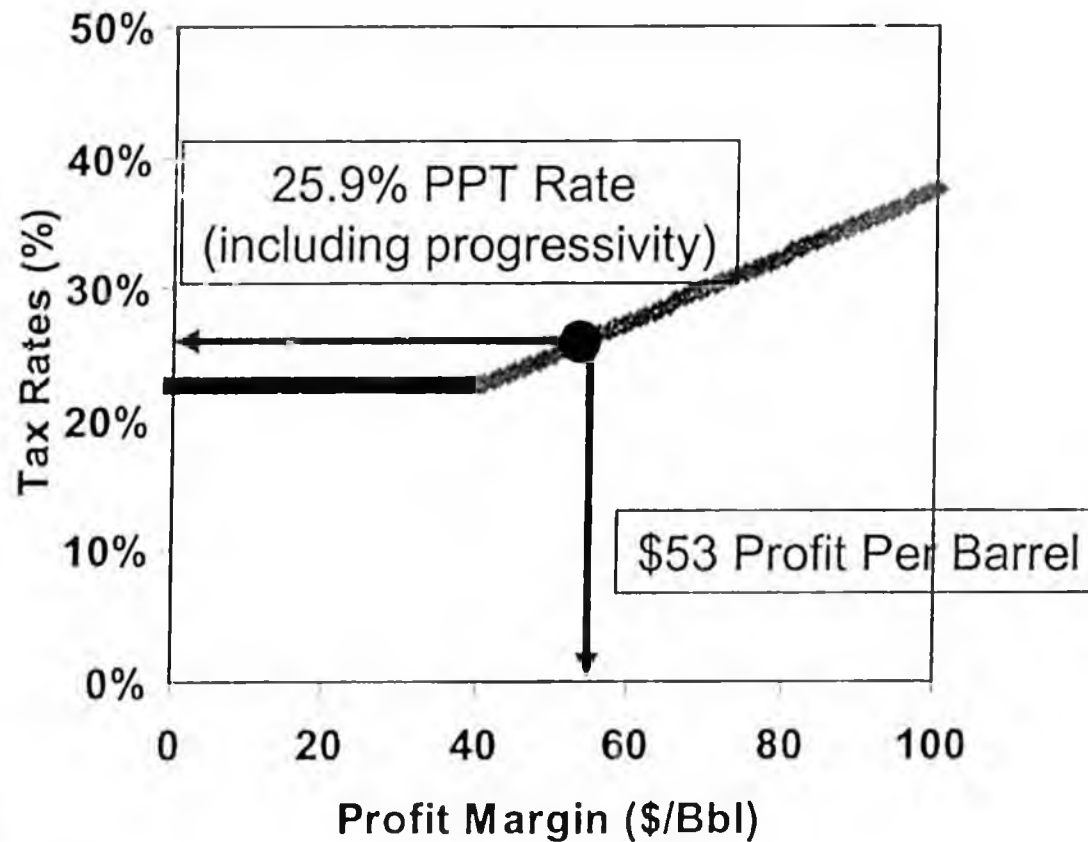
## Portfolio Profitability





# PPT - Based On \$53/Bbl Profit ...

Tax Rate Structure  
(Incorporating Progressivity)





# Misconception – Net Progressivity

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- **“Net” taxes all fields at a single rate**
  - If only looking at the “headline” net tax rate, this would be the perception
  - In reality, when looking at the marginal impact of different parts of the portfolio, it taxes different fields or reservoirs at different rates
    - Based upon their individual profitability

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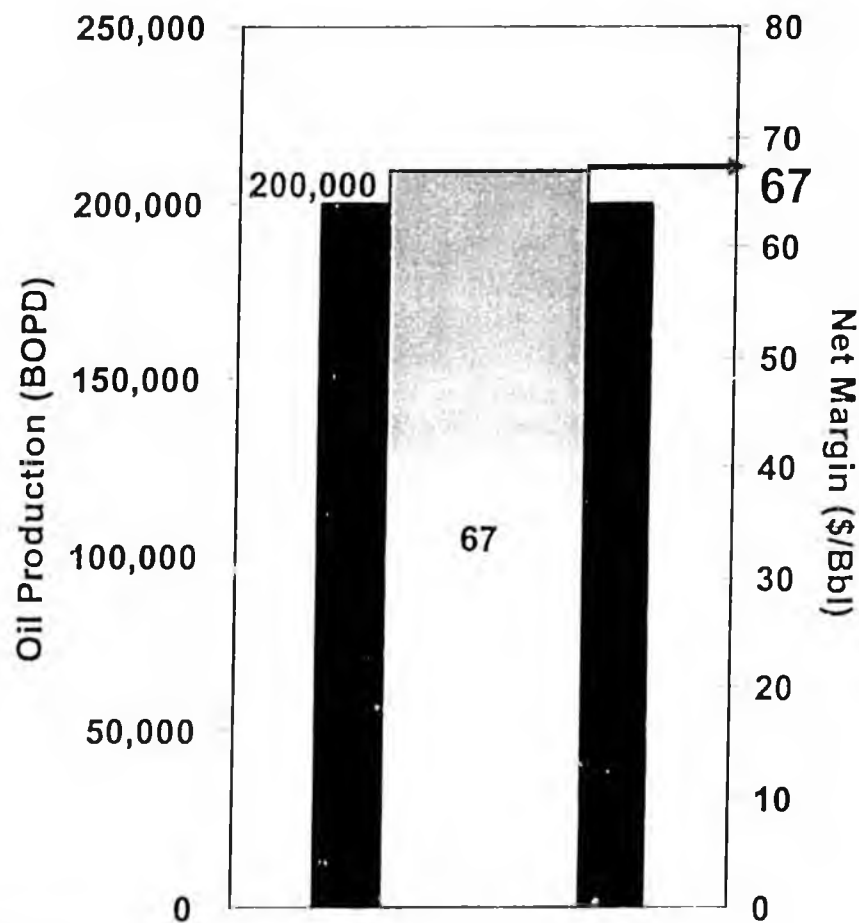
# Understanding How “Net” Works

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# Start With A Single Asset

Initial Portfolio

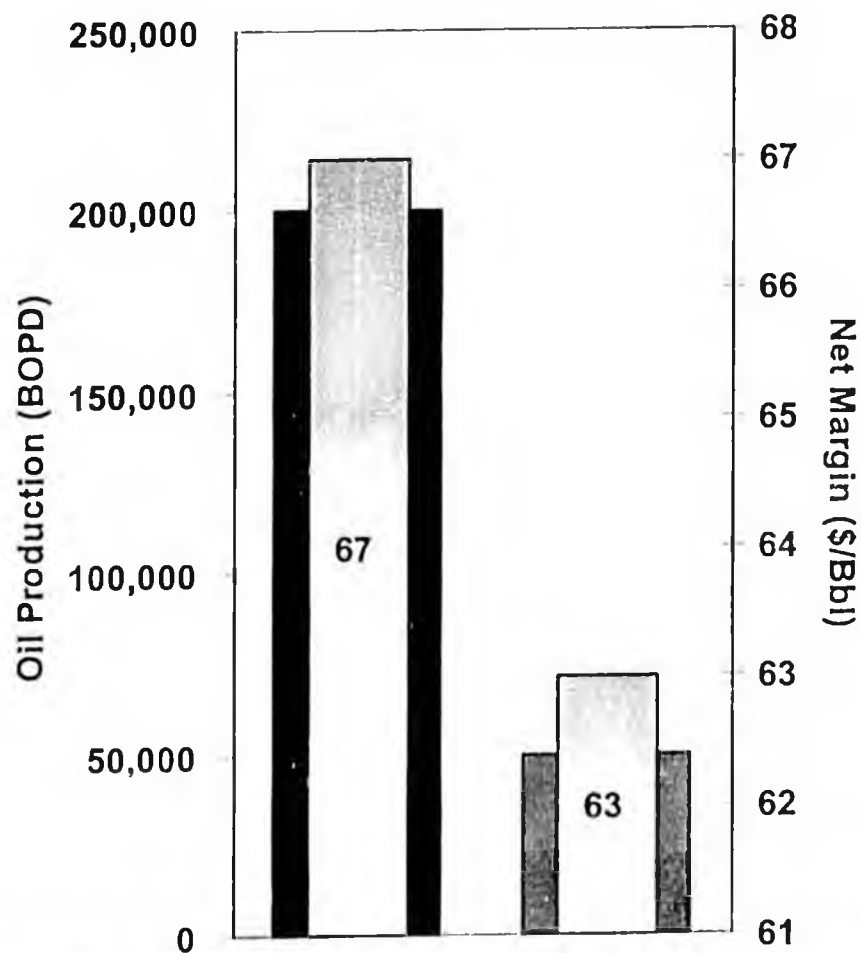


PPT Rate on this would be  
29.25%



# Now, Add Another Field

Expanded Portfolio



Average Net Margin on the expanded portfolio is \$66.20

PPT Rate on these fields Combined would be 29.1%

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**So, does this mean that I am  
paying 29.1% on each field ?**

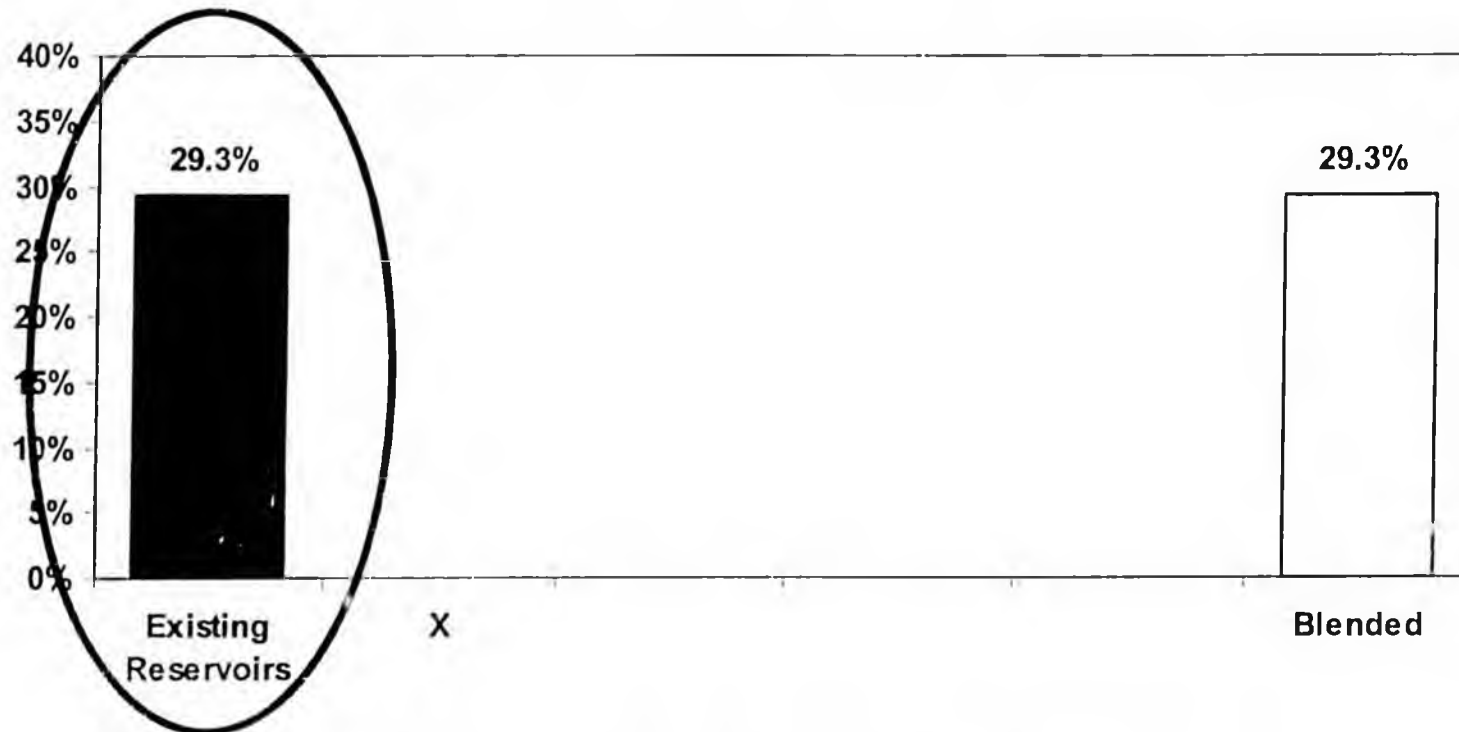
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No ....

# So, Does That Mean I Am Paying 29.1% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending



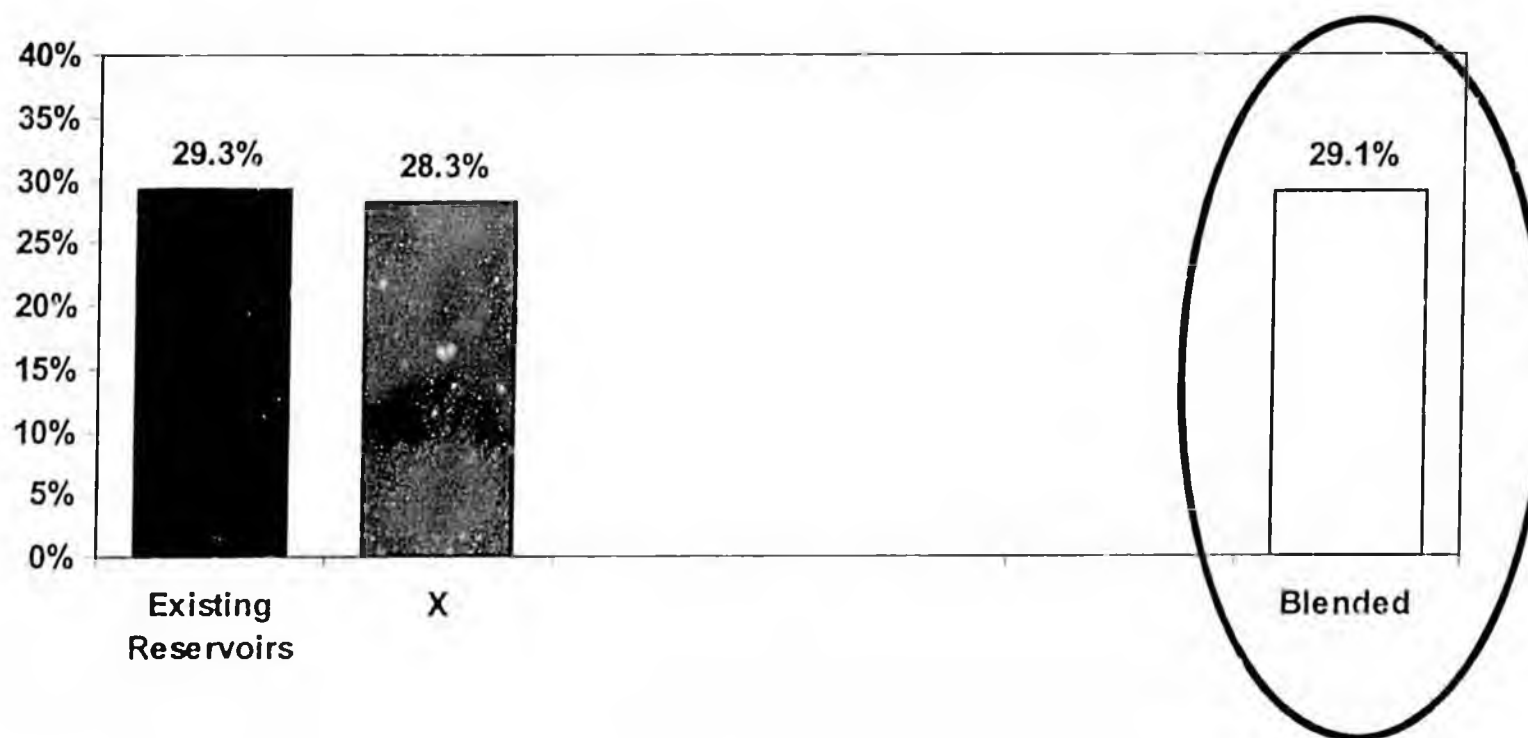
If I had just Existing Reservoirs, and did not develop anything new, I would pay tax on my profits at 29.3%



# So, Does That Mean I Am Paying 29.1% On Each Field ?



Tax Rate By Field Within A Company - As Affected By Portfolio Blending



Both fields together, the rate is 29.1%

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**However, this does not tell  
the whole story . . .**

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**The lower profitability field benefits from  
the progressivity structure**