ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3115 SCOMM 143: SENATE SPEC.COMM.ON NATURAL GAS DEV. 2005-2006

Fiscal Structure

Gross with Tax credits: "Shelf life"

Alaska has already a fiscal feature that is based on gross: the royalty.

Royalties provide about half of the State's oil and gas income.

To design a tax also largely based on gross in addition to the royalty is difficult economically.

In order to make the tax fit with the economic reality of the Alaska North Slope resources it is necessary to introduce sliding scales and formulas in order to make the widest possible range of investment opportunities economic. This resulted 1989 in the ELF formula.

Fiscal Structure

Gross with Tax Credits: "Shelf life"

The problem is that the "shelf life" of such formulas is relatively short. The ELF became outdated after about 10 years and it has now already taken more than five years to try to get a replacement of the ELF.

The reason for the short "shelf life" is that economic and technical conditions change rapidly and therefore the economic basis for the formula becomes rapidly outdated.

It is far simpler to base a system on net revenues. A system based on net revenues adjusts better to changing economic circumstances.

Fiscal Structure

Gross with Tax Credits: "Field" definition

In order to make a system based on "gross" work it is necessary to define a "field" or some type of area or unit to which the production tax formulas relate.

It is increasingly difficult to define such "fields". Most investments on the North Slope relate to deeper or shallower reservoirs, reservoir extensions, satellite fields, EOR in existing reservoirs, etc.

Fiscal Structure

Gross with Tax Credits: "Field" definition

Therefore, a system based on gross creates automatically inequities between different types of investments. If investments are made in the same "field", taxes may be high, if investments are made in new "fields" taxes may be low. These problems have already emerged.

A State or North Slope wide system based on net revenues avoids all these problems.

Fiscal Structure

Gross with Tax Credits: Heavy Oil

An important problem is that the future of the North Slope oil production will be largely based on heavy oil.

A system based on "gross" for light oil is not applicable to "heavy oil". Therefore special provisions need to be made.

Fiscal Structure

Gross with Tax Credits: Heavy Oil

Creating such special provisions for heavy oil is difficult with respect to the following:

- Definition of heavy oil
- Definition of economic difference between light oil and heavy oil. Rapid technological progress will change costs.
- Administration of special heavy oil provisions.

Fiscal Structure

Gross with Tax Credits: Conclusion

The North Slope developments are now at a mature stage in the traditional State lease areas. This creates a situation where it is no longer possible to define economics based on simple "field" or "unit" definitions and where it is important to kick off major developments in heavy and viscous oil.

This mature situation no longer lends itself to a gross production tax even if significant tax credits are introduced.

Fiscal Structure

Conclusion

A State wide system based on net revenues, such as the PPT, requiring a single tax return per company, is much easier to administer than a production tax based on gross revenues.

A PPT is also more durable. This is important.

However, what about cost control?

Fiscal Structure

PPT and cost control

The fact that so many nations have successfully worked with profit based systems during the last three decades indicates that these systems “work”.

Cost control is an important issue, but it should not be overblown.

Fiscal Structure

PPT and Cost Control

For instance, even if an company would illegally claim 30% more costs than actually are permitted as deductions, and Alaska auditors would not identify this, the effect on overall tax collection would be modest.

Assuming average costs of $ 6 per barrel (operating and capital). The tax and tax credit losses under the 20/20 PPT would be $ 0.54 per barrel. In an environment of $ 30 to $ 60 per barrel at the point of production, this is a relatively modest problem.

Fiscal Structure

PPT and Cost Control

Nevertheless, Section 25 of the PPT bill provides for a long list of non-deductible costs, including:

1. Depreciation, depletion, amortization
2. Financing charges and cost of raising equity
3. Acquisition costs of leases
4. Cost for arbitration, litigation
5. Partnership, JV, and other organizational costs
6. Any expenditures in excess of fair market value
7. Expenditures to purchase another company or business
8. Certain abandonment costs
9. Losses and damages of oil discharges.

7/13/06 **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
tax rate 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
tax rate 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	.001 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
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(j)--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 mo) for areas NOT ANS, NOT Cook Inlet *.170(a)--page28*	$6M credit ($500,000 per mo) for areas NOT ANS, NOT Cook Inlet *.170(a)--page28*	$6M credit ($500,000 per mo) for areas NOT ANS, NOT Cook Inlet *.170(a)--page27*
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 33-34*	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 335*

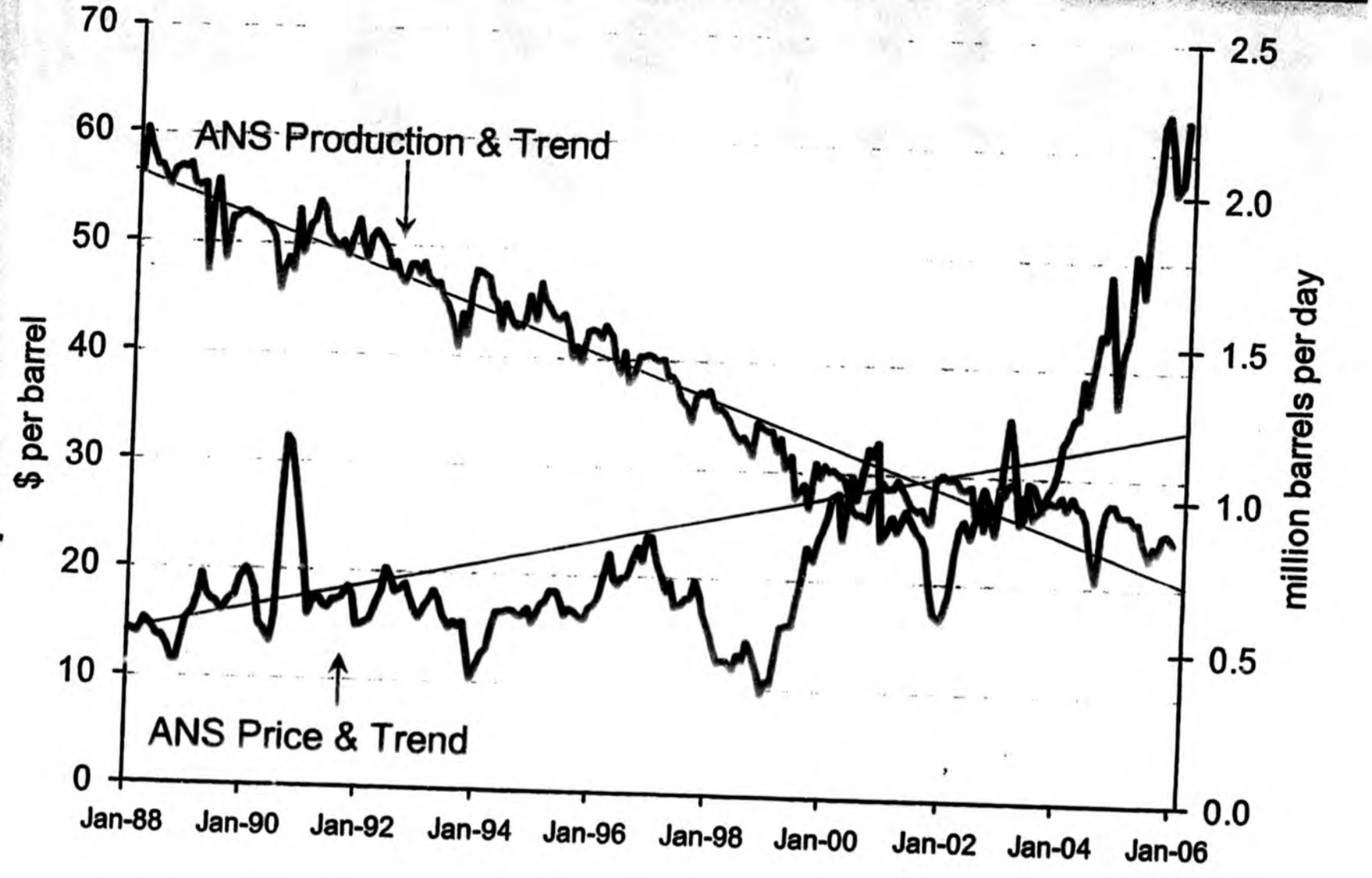
7/13 9:20am

	Light Oil	Heavy Oil
West Coast ANS Price	$30.00	$30.00
Shipping	$2.00	$2.00
Pipeline	$3.00	$3.00
GROSS	$25.00	$25.00
UPSTREAM COSTS	$7.50	$15.00
NET	$17.50	$10.00

SUPPOSE WE SIMPLY "SHELF THE ELF" AND TAX IS 15% OF GROSS:

Tax on Gross (15% X $25.00)	$3.75	$3.75
Tax as Percent of Net	21.4%	37.5%

ANS West Coast Price & Oil Production



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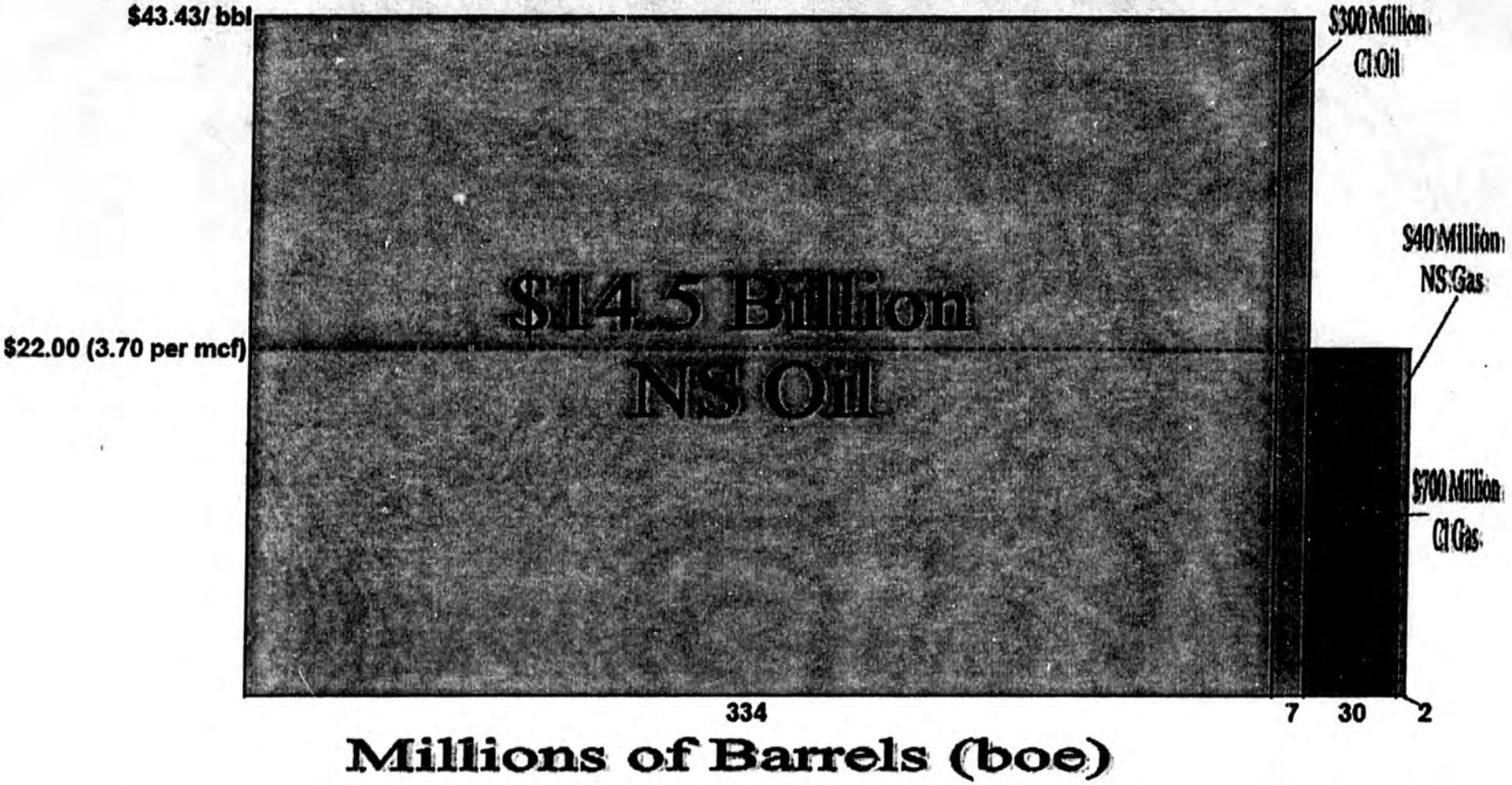
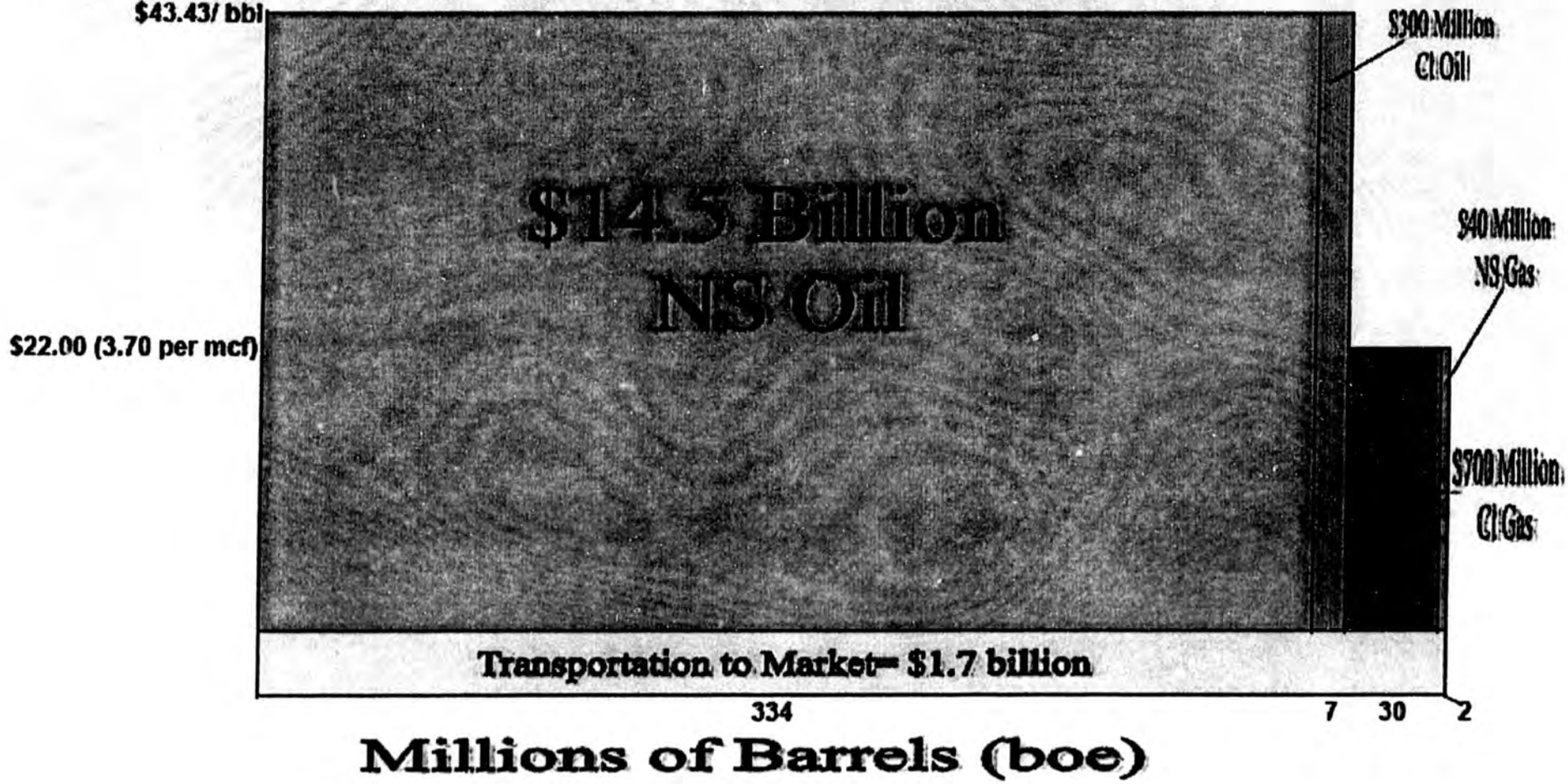
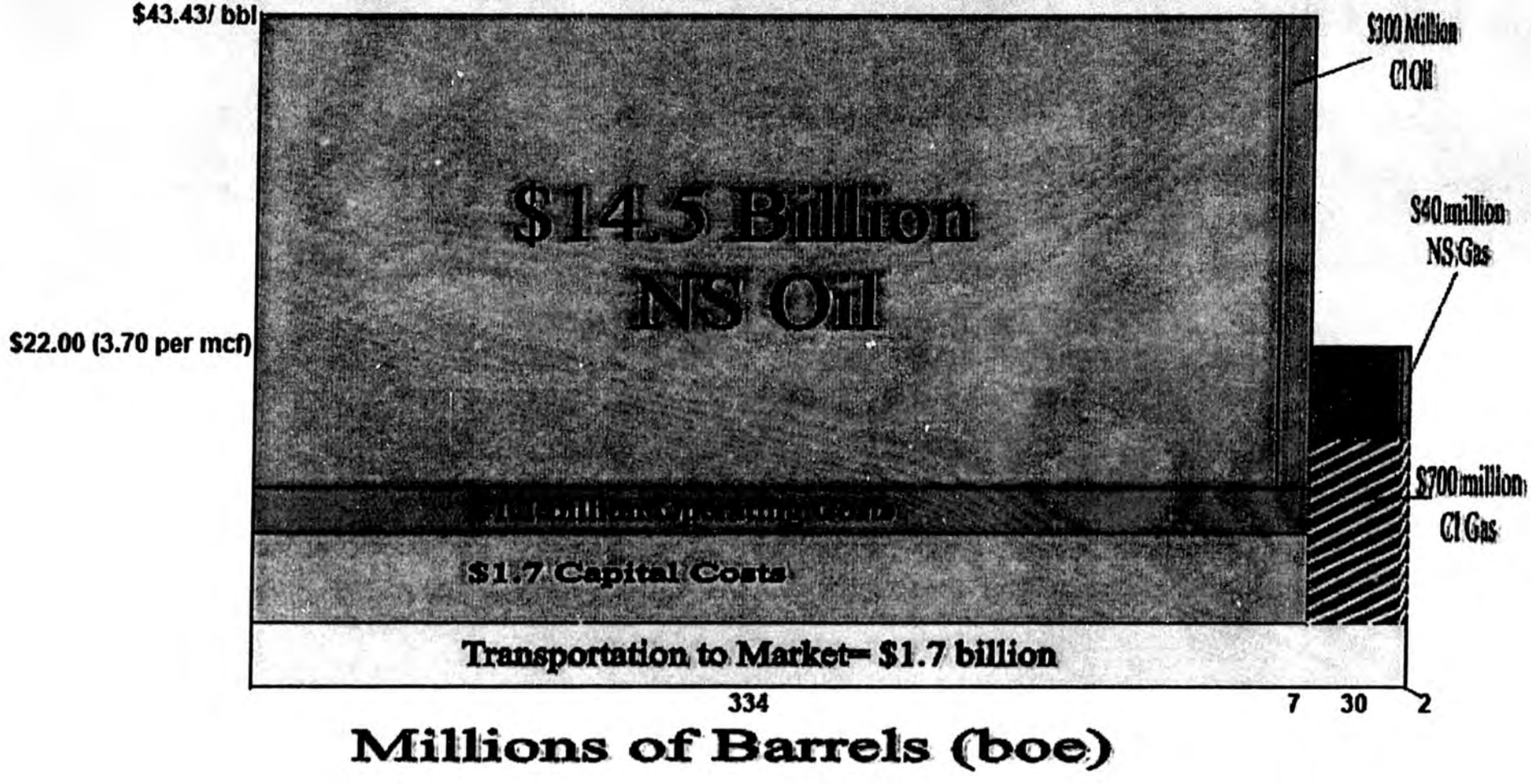
Sale at Market



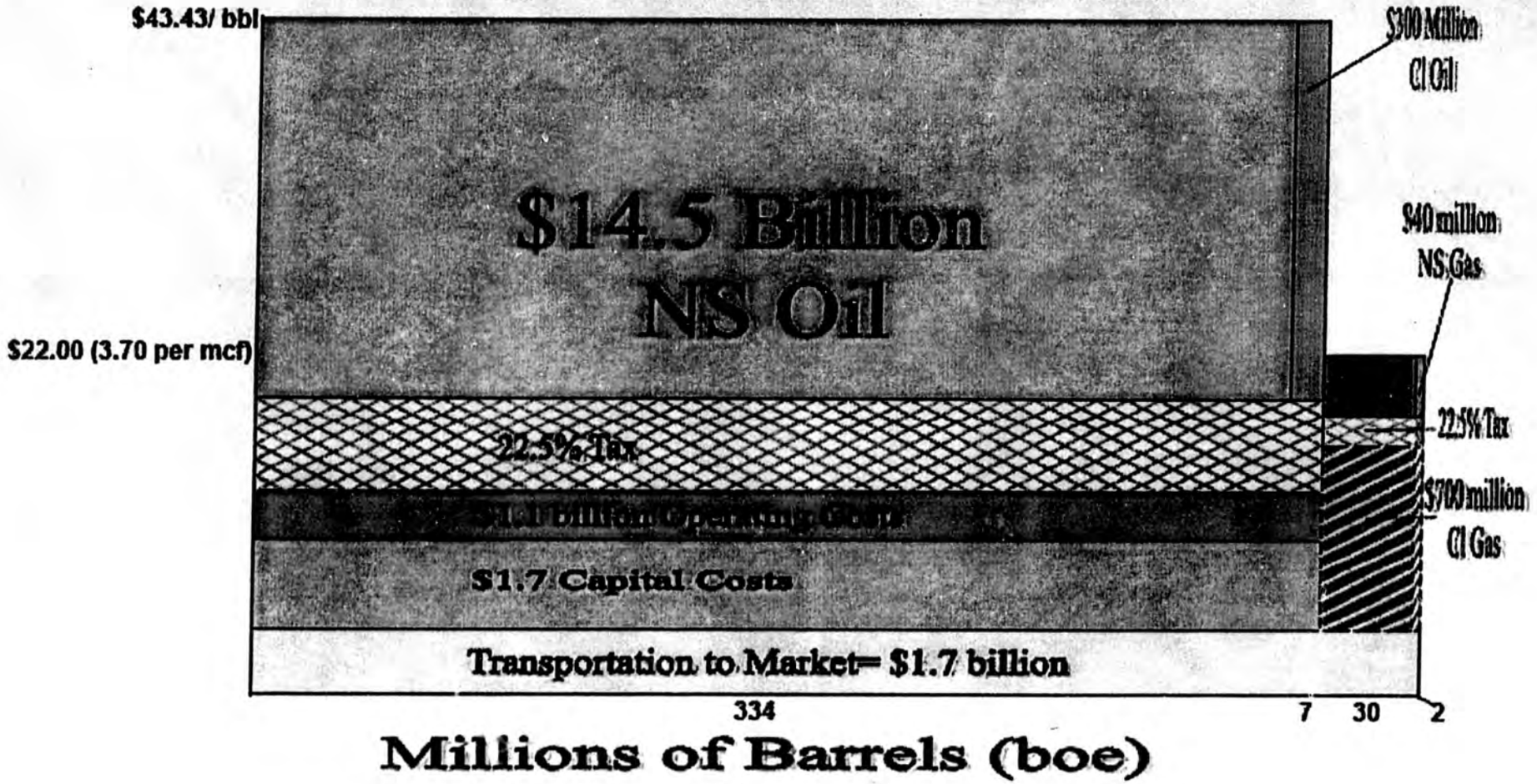
Gross Value at Point of Production



Net Value or Production Tax Value



Net Value or Production Tax Value



Tax Before Credits

Tax After Credits

Tax After Credits 1.7 billion

[redacted]

1.7b x .25= 425 million Qualified Capital Expenditure Credits

Tax After Credits

Tax After Credits 1.7 billion

5,000,551 equivalent credits users at max of 14 million= 112 million

1.7b x .25= 425 million Qualified Capital Expenditure Credits

Tax Under Status Quo ~ .9 billion