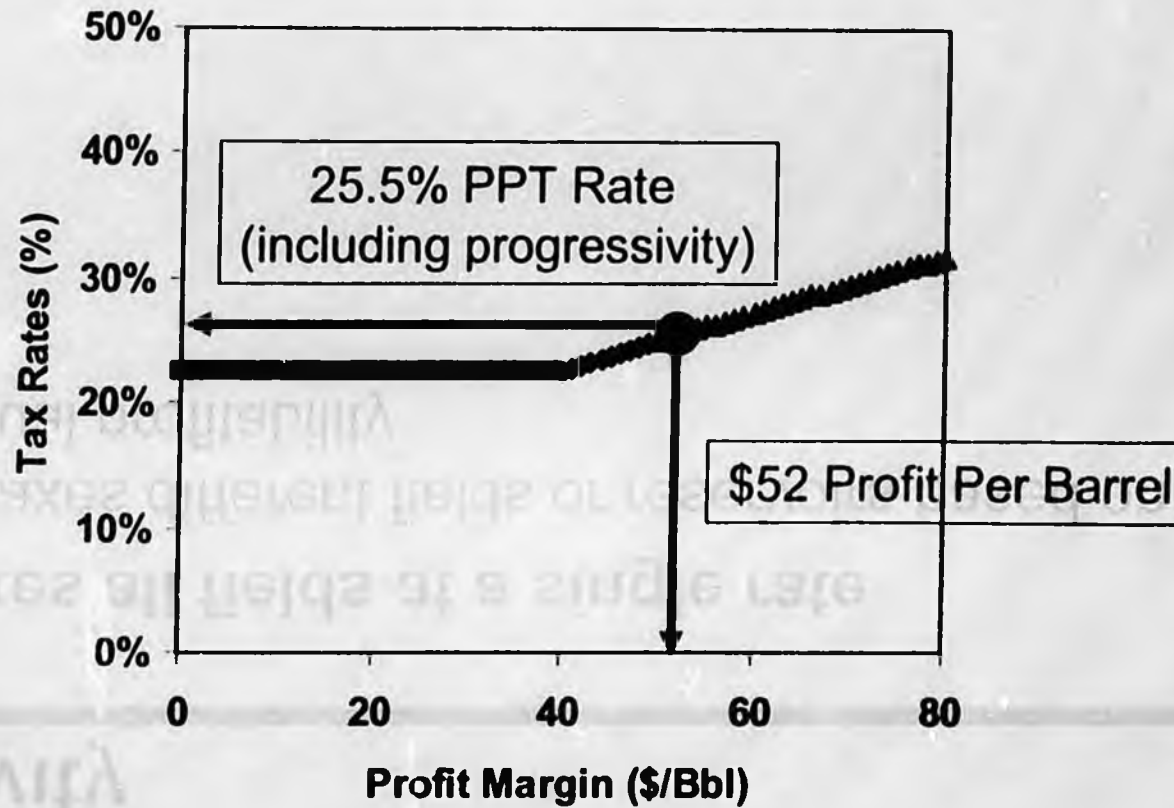


ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SJUD 12569



Based On \$52/Bbl Profit ...

Tax Rate Structure (Incorporating Progressivity)



Progressivity



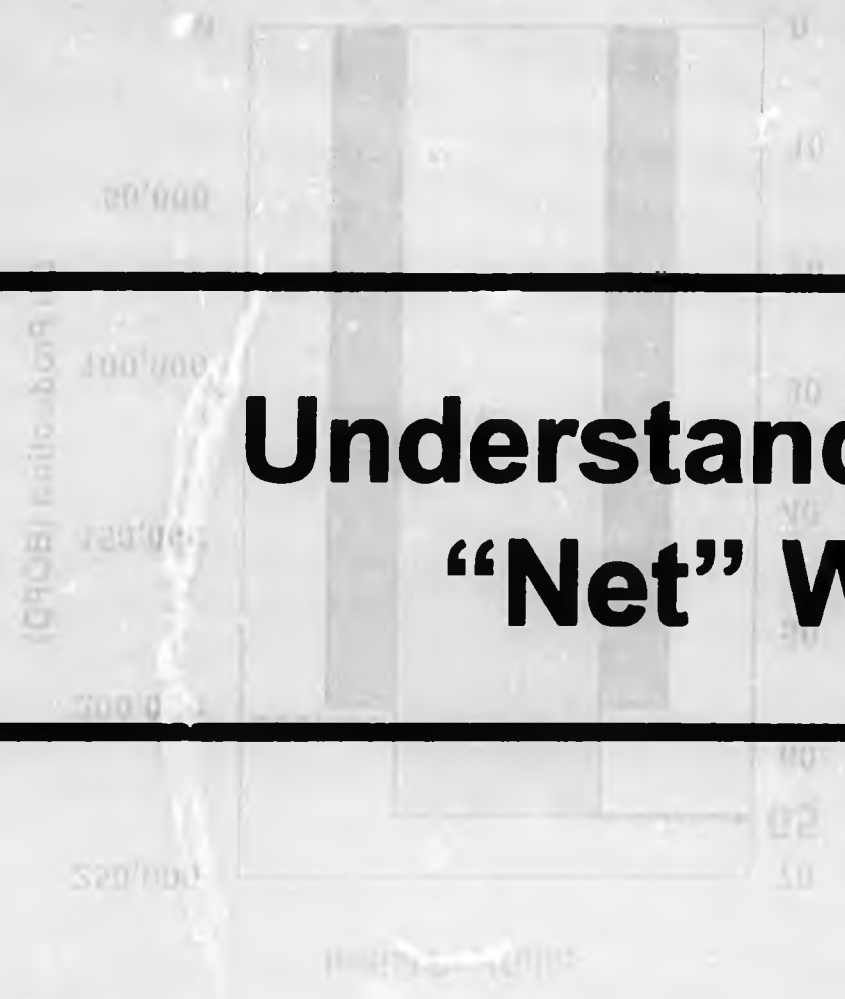
- **“Net” taxes all fields at a single rate**
 - No, it taxes different fields or reservoirs based on their individual profitability



(incorporating progressivity)
TAX RATE STRUCTURE

BASED ON \$25/BBL PROFIT ...

Understanding How "Net" Works



Understanding How "Net" Works

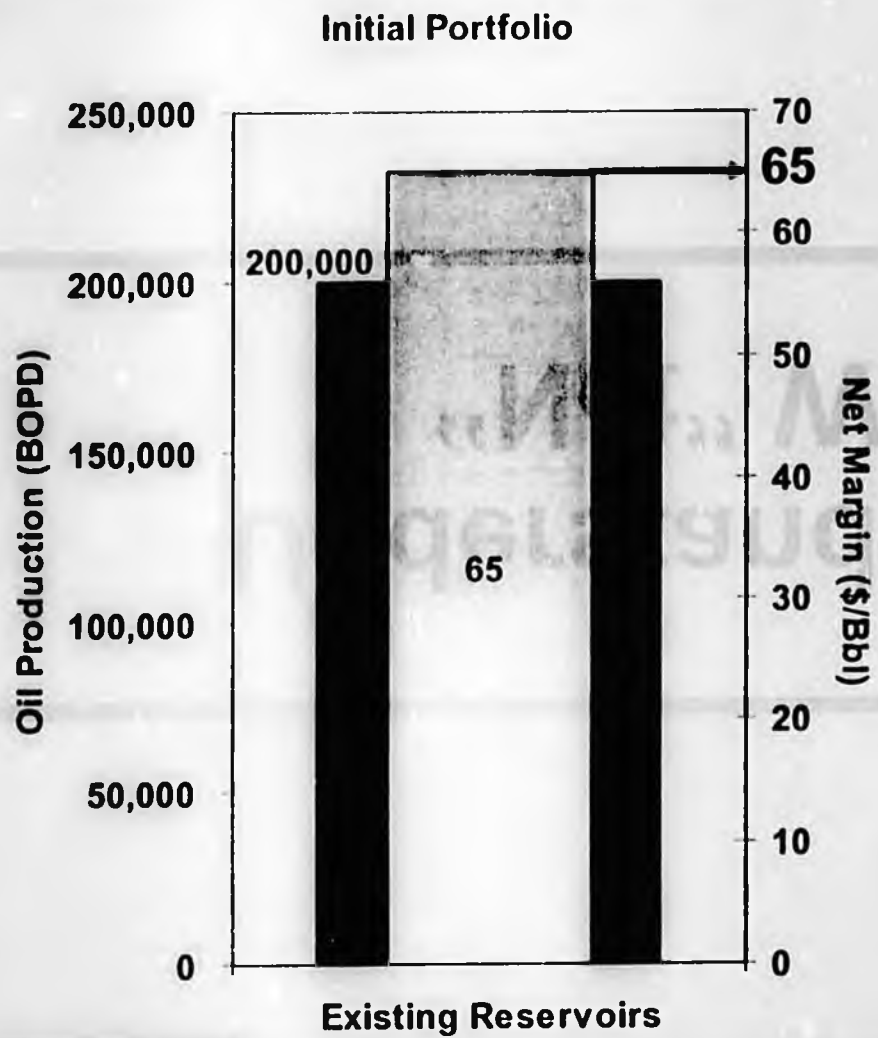
38.4%
but this is the world's

Start With A Portfolio Of One Investment





Start With A Portfolio Of One Investment

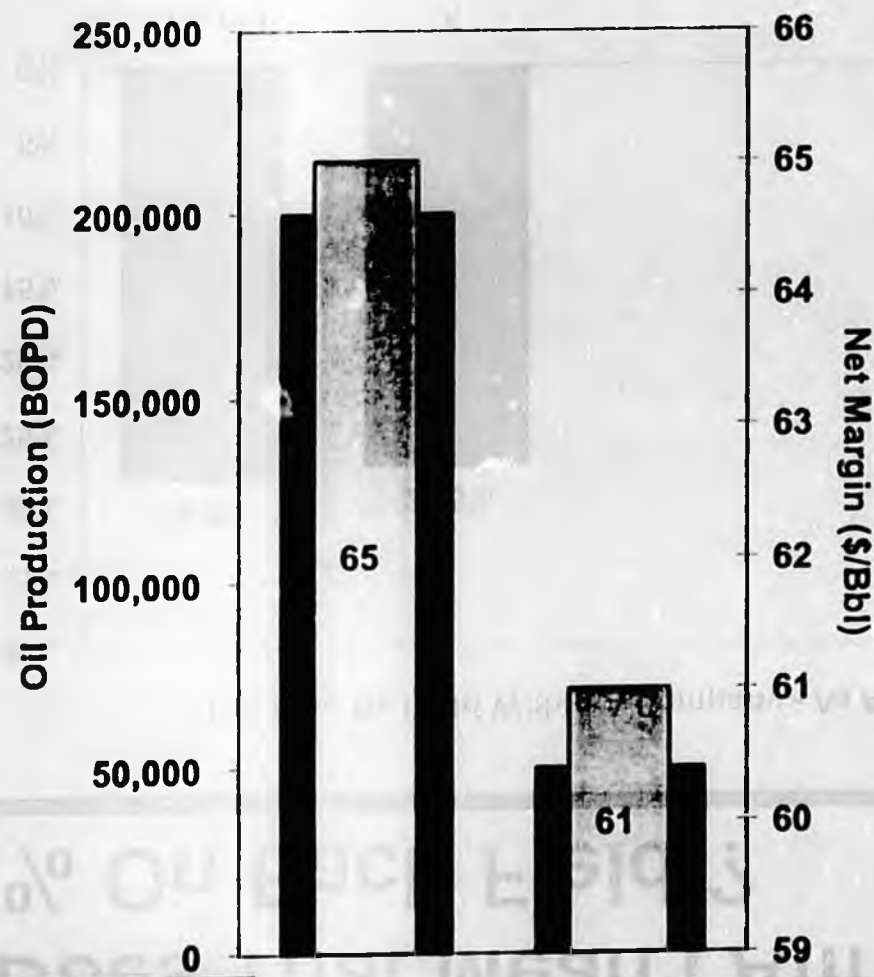


PPT Rate on this would be
28.4%



Now, Add Another Field

Expanded Portfolio



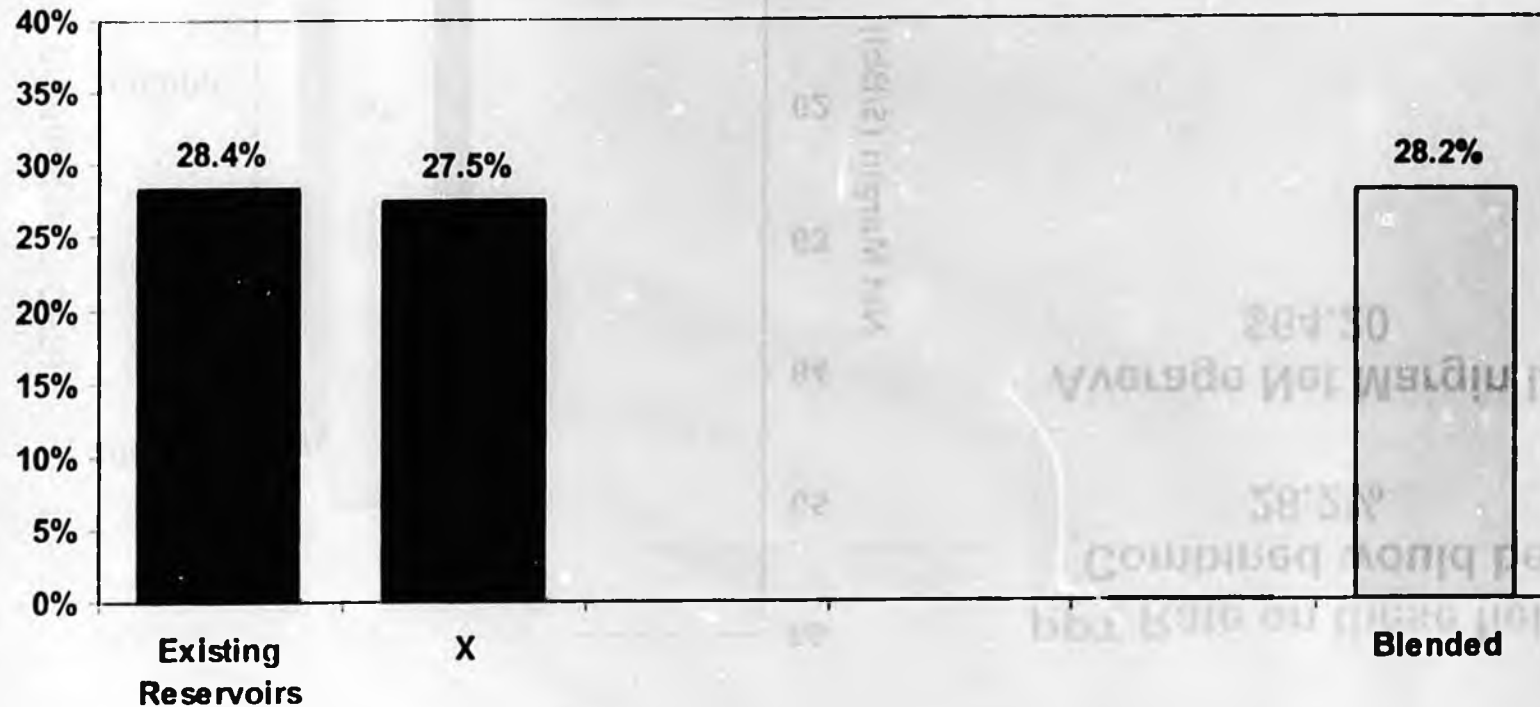
**PPT Rate on these fields
Combined would be
28.2%**

**Average Net Margin Is
\$64.20**

So, Does That Mean I Am Paying 28.2% On Each Field ?



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



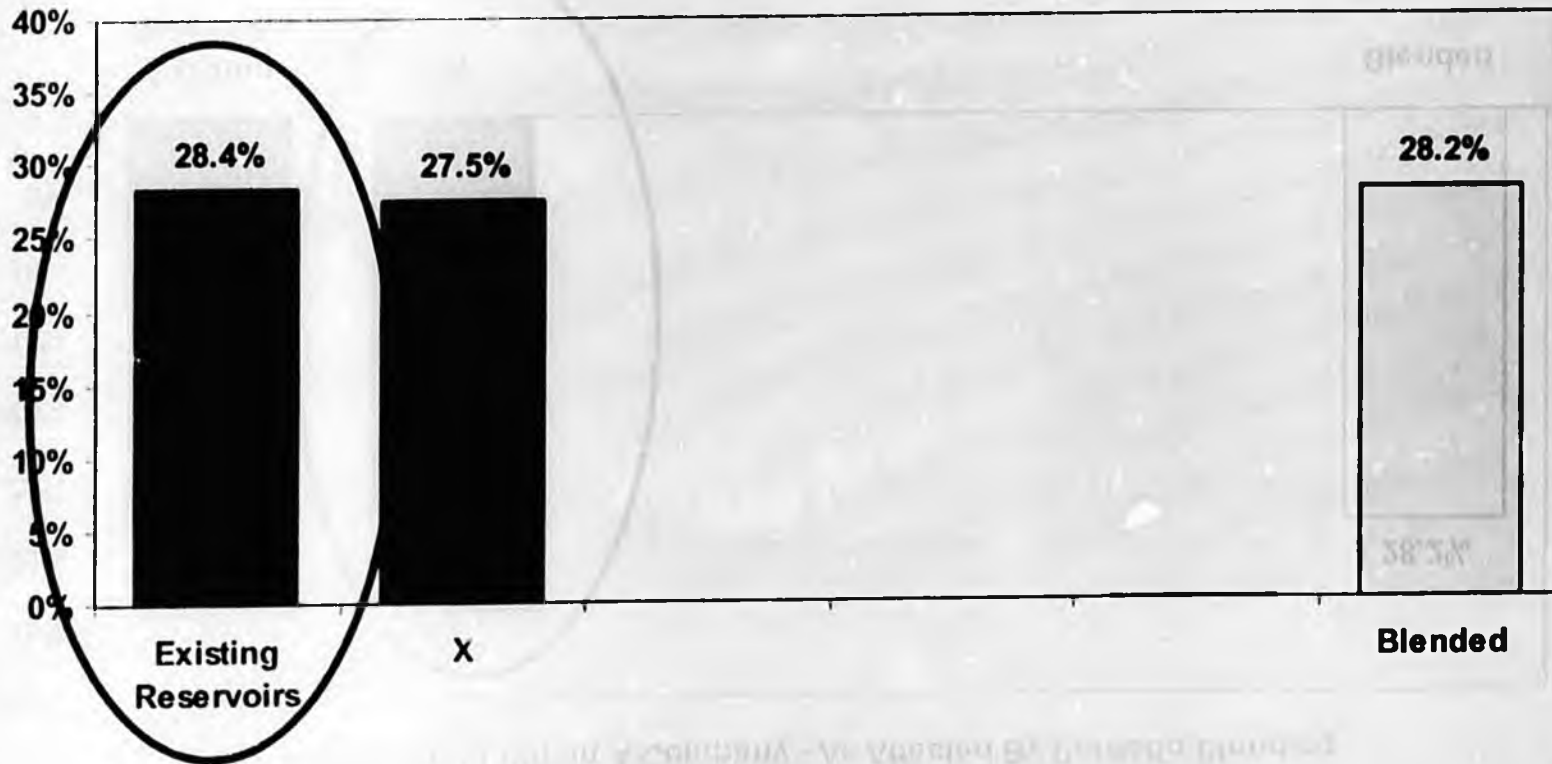
No

Look at this in the way that companies look at it when they make investment decisions

So, Does That Mean I Am Paying 28.2% On Each Field ?



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

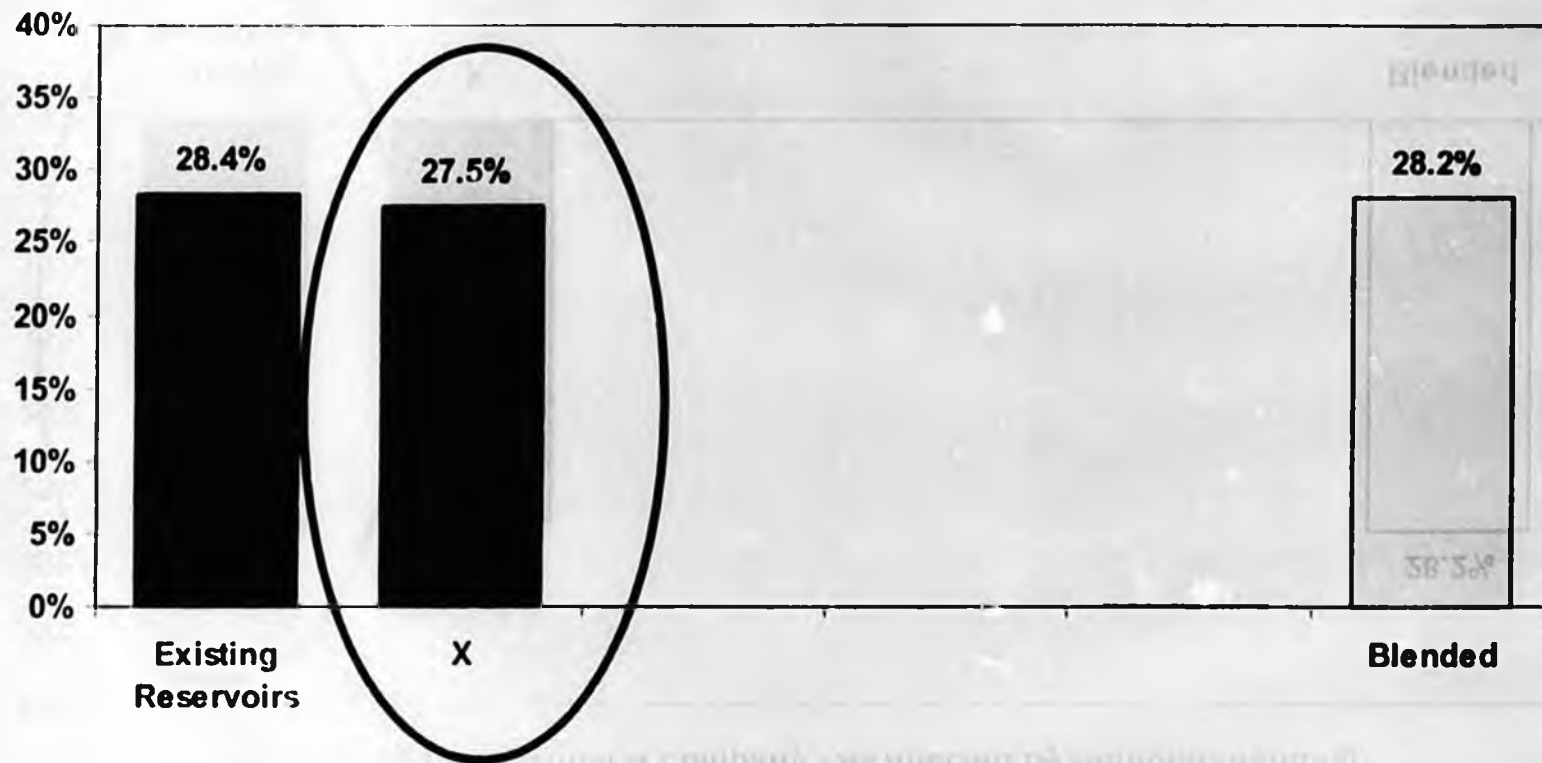


If I had just Existing Reservoirs, and did not develop anything new, I would pay tax on my profits at 28.4%

So, Does That Mean I Am Paying 28.2% On Each Field ?



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

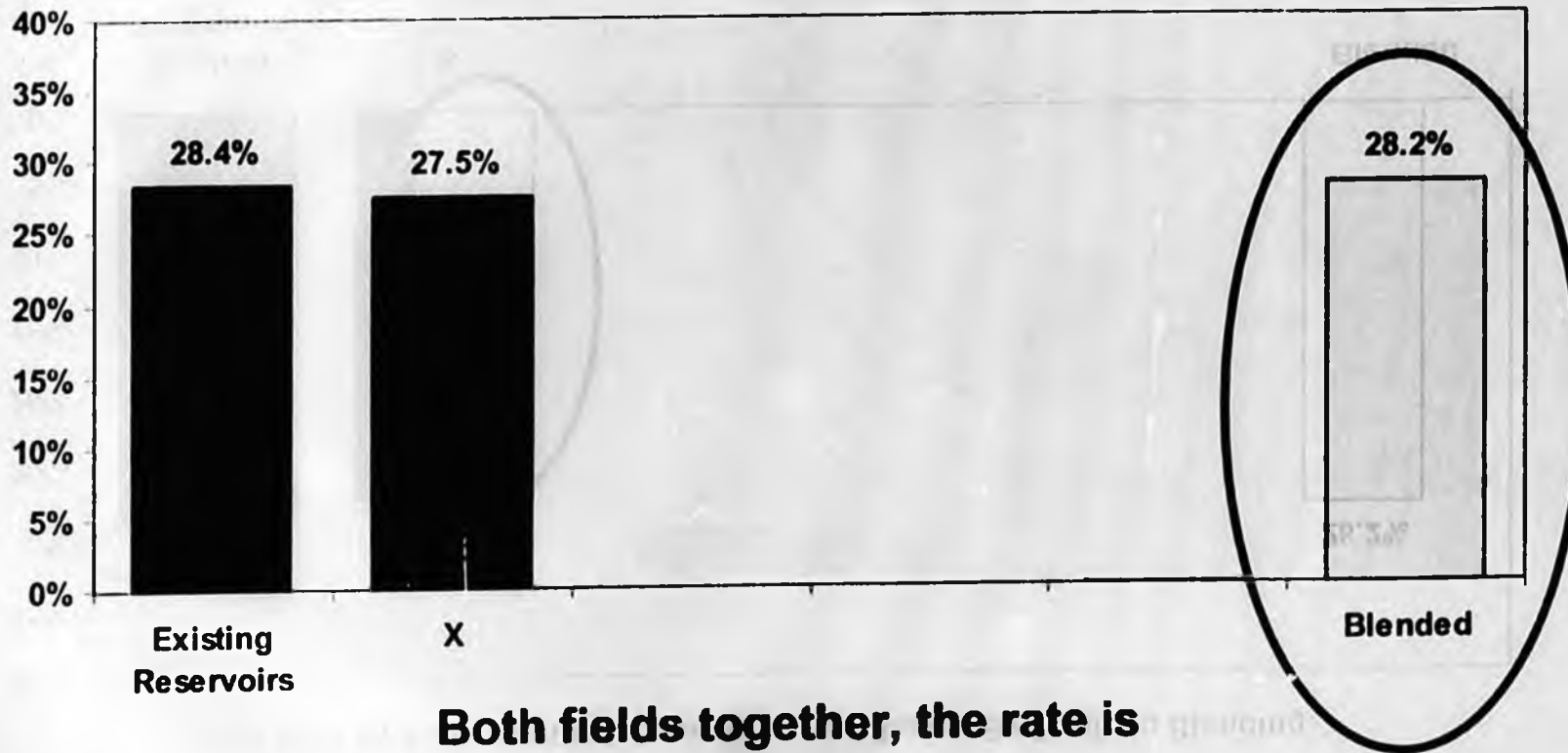


If I had just Field X, I would pay tax on my profits at 27.5% - its margin is slightly lower

So, Does That Mean I Am Paying 28.2% On Each Field ?



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



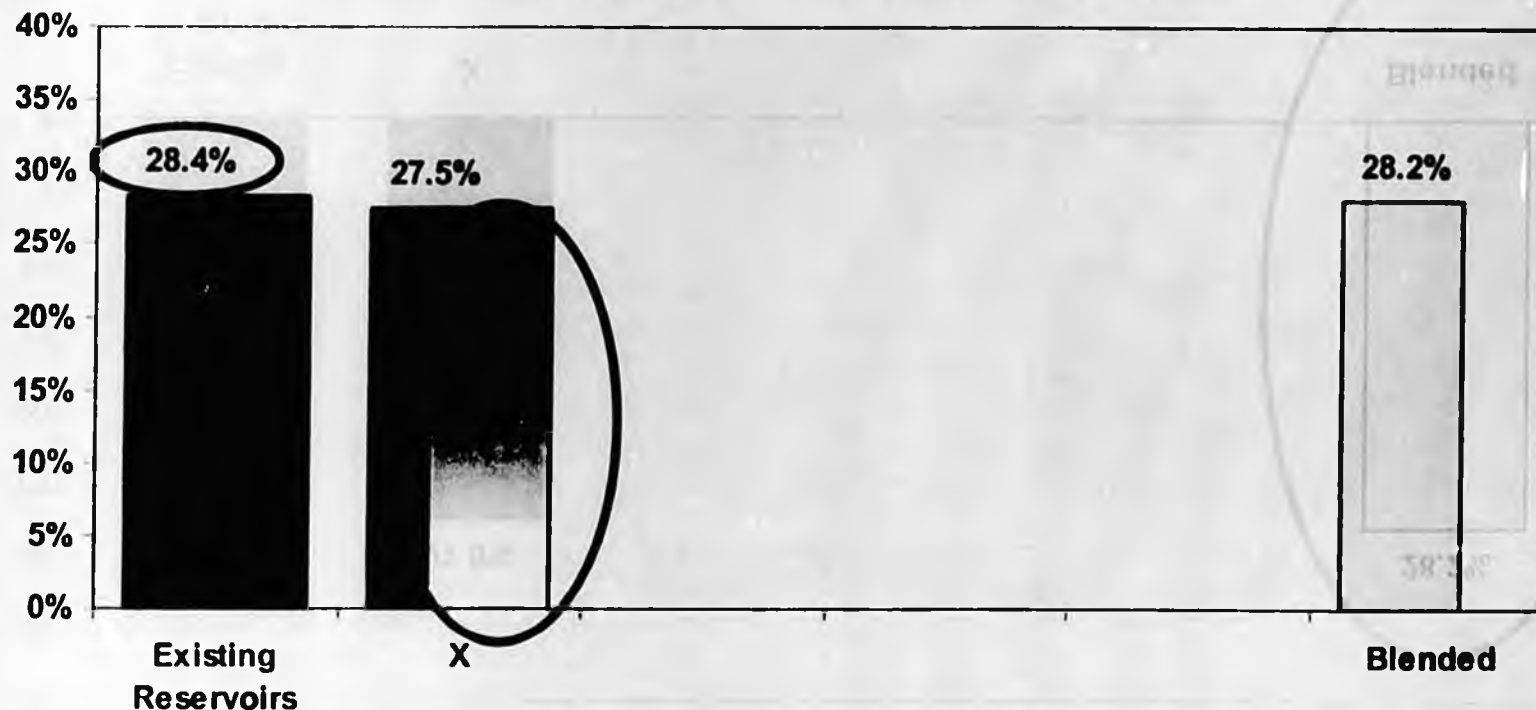
Both fields together, the rate is 28.2%

However, this is not all ...

So, Does That Mean I Am Paying 28.2% On Each Field ?



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

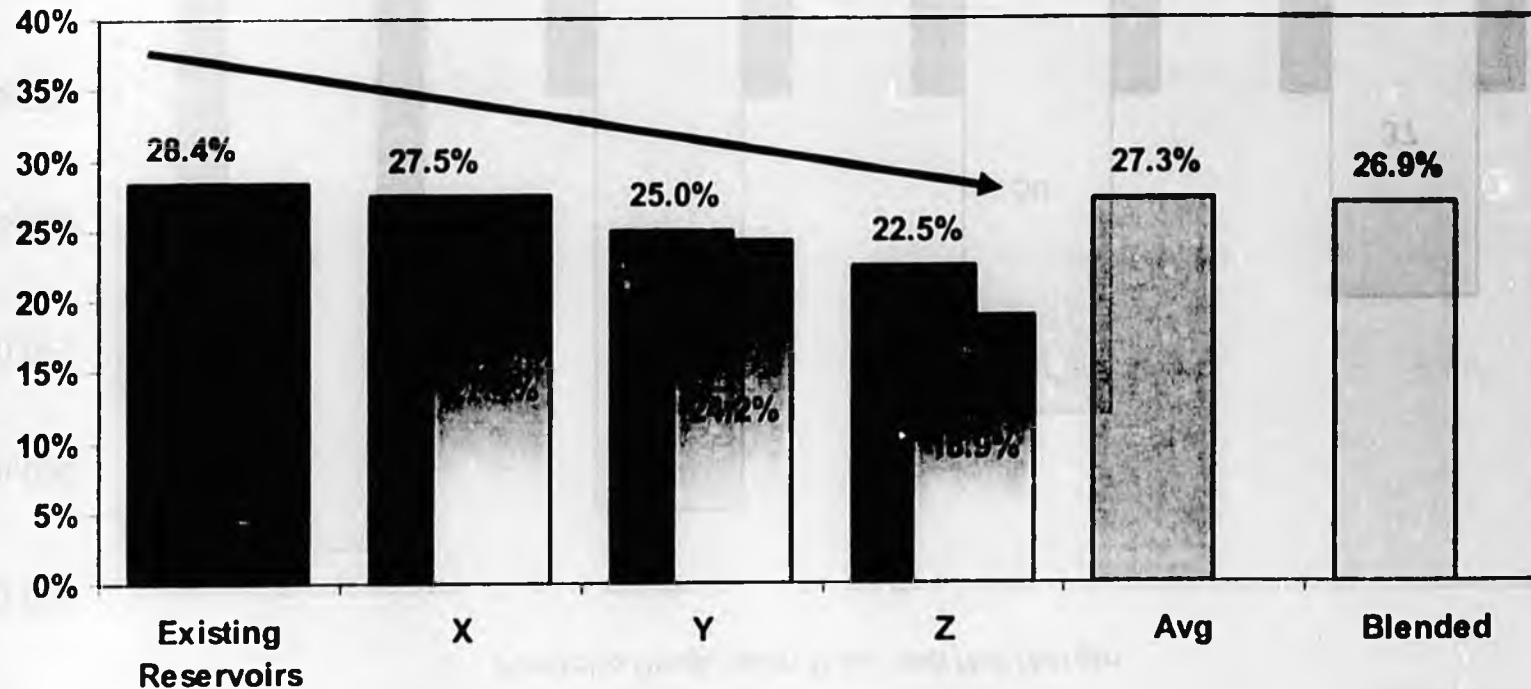


The mathematics of this reduction means that actually while Existing Reservoirs continue to pay tax at a rate of 28.4%, The effective rate on Field X is actually 27.4%
... less than it would be if it were developed stand-alone

The Impact On The Lower Margin Fields Is More Noticeable



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



The progressivity can be seen through the lower effective tax rate on lower margin fields

Weighted average rate
 This is maintained in the period after period (the
 lower than the base rate (55.2% in 1991)
 The effective rate on some lower-weighted rates may even be

1990-1991



Weighted average rate on some lower-weighted rates may even be

Fields is More Noticeable

the number of the lower weight





Cash Flow, Not Profit

- **PPT taxes all fields at a single rate**
 - No, it taxes different fields or reservoirs based on their individual profitability
- **Is based on profit per barrel**
 - Not exactly, it is based on net cash flow per barrel after capital investment (for future production)

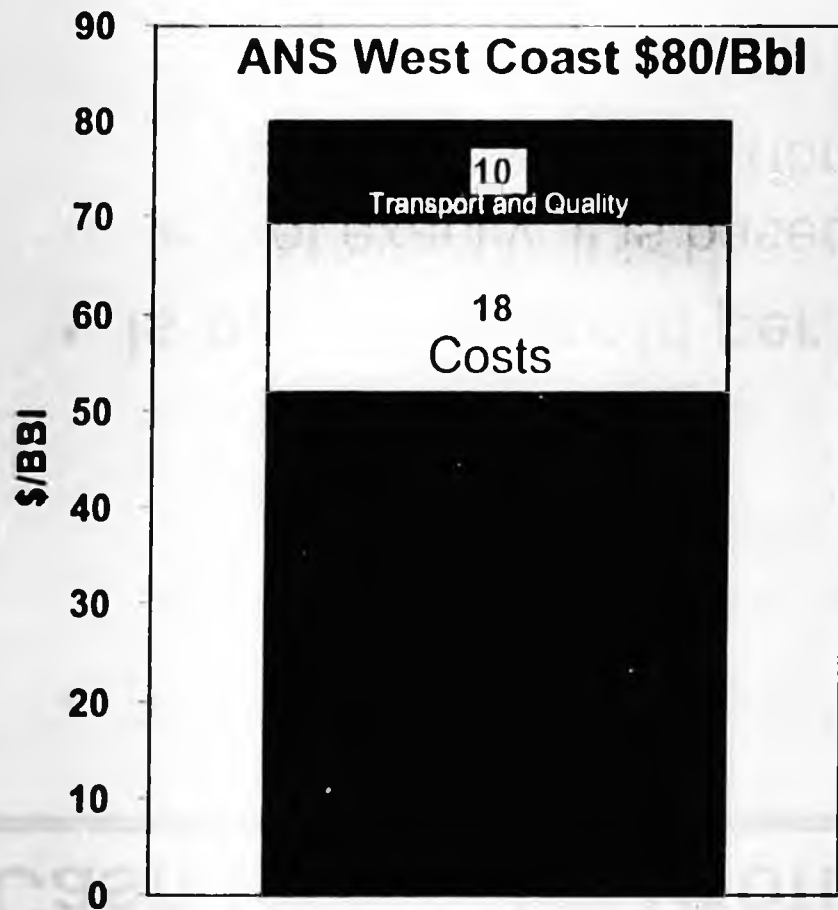
Remember These Slides ?



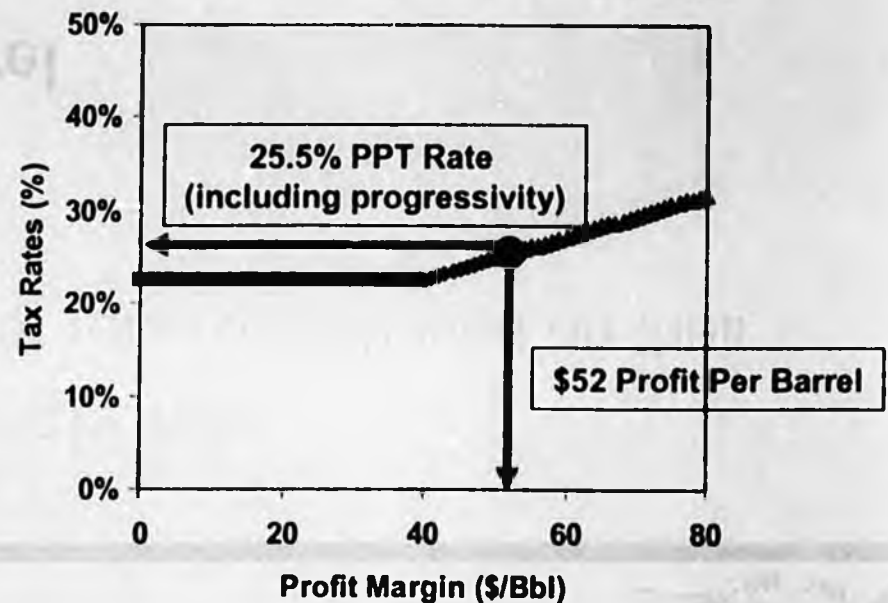
Remember These Slides ?

Portfolio Profitability

The portfolio on the previous slides had a blended rate of 26.9%, not 25.5%



Tax Rate Structure (Incorporating Progressivity)



How 3

This increases the rate balance to 26.9%

Assume that 26.9% is the rate that will be payable before further capital investment decisions are made ...

... in this example \$800 million

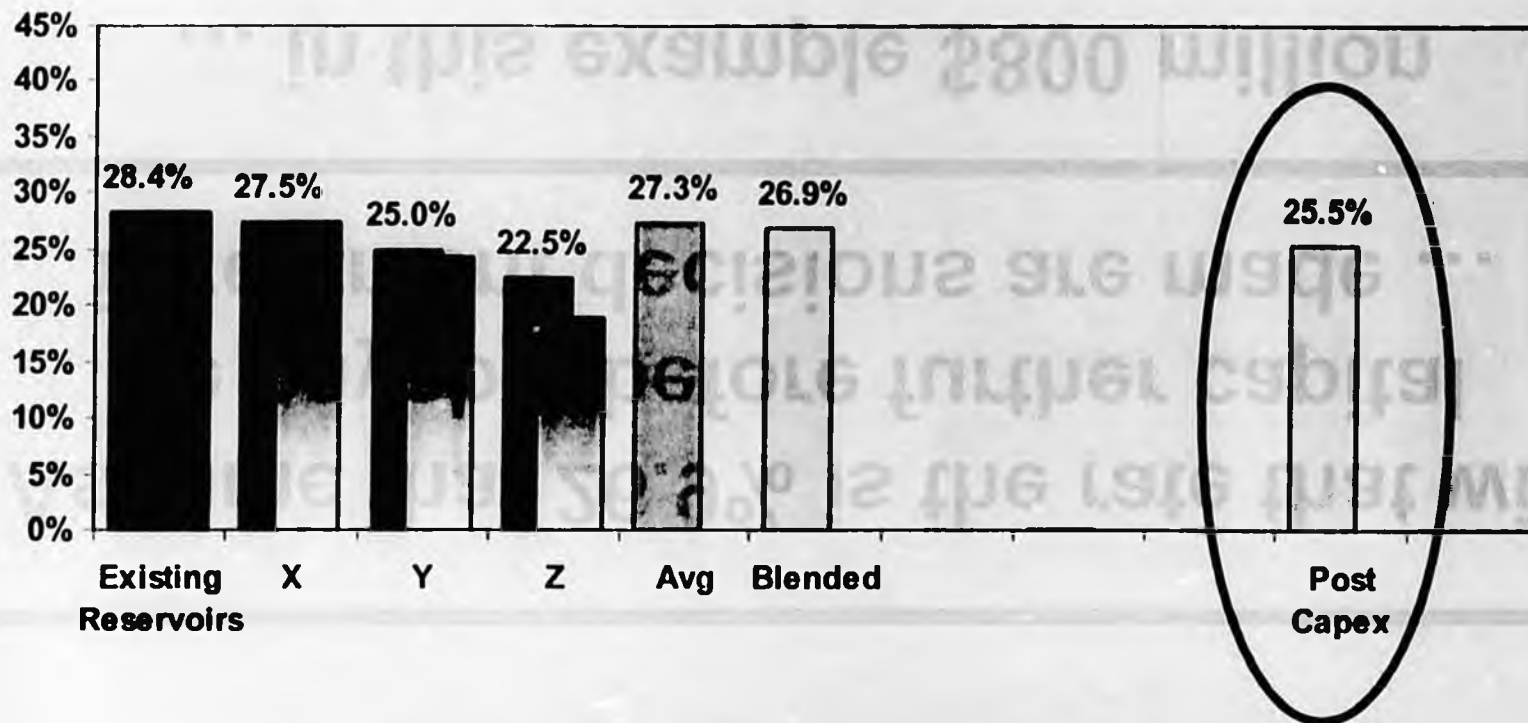
Rate 100 ...



Capital Spending Has An Impact On Rate, Too



Tax Rate By Field Within A Company - As Affected By Portfolio Blending,
Capex And Tax Credit



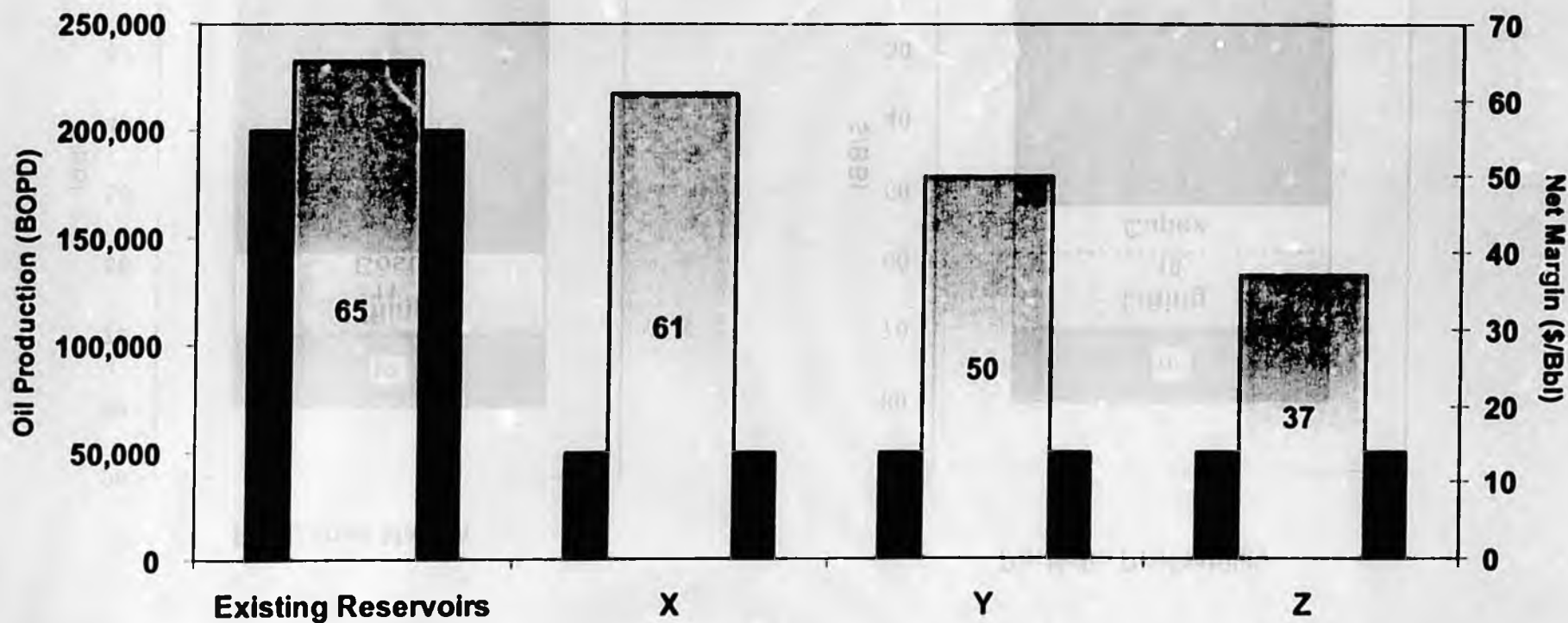
This reduces the rate payable to 25.5%

How ?

\$800 million amounts to \$6.26 Per Barrel Based On This Portfolio



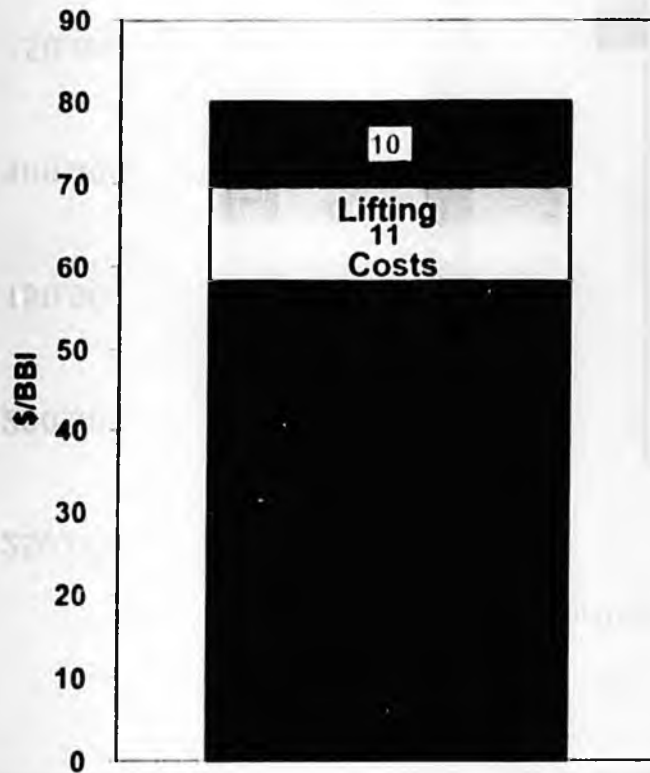
Portfolio Production Rate and Net Margin



The \$6.26 Per Barrel Capital Increases "Costs" And Lowers The Tax Rate

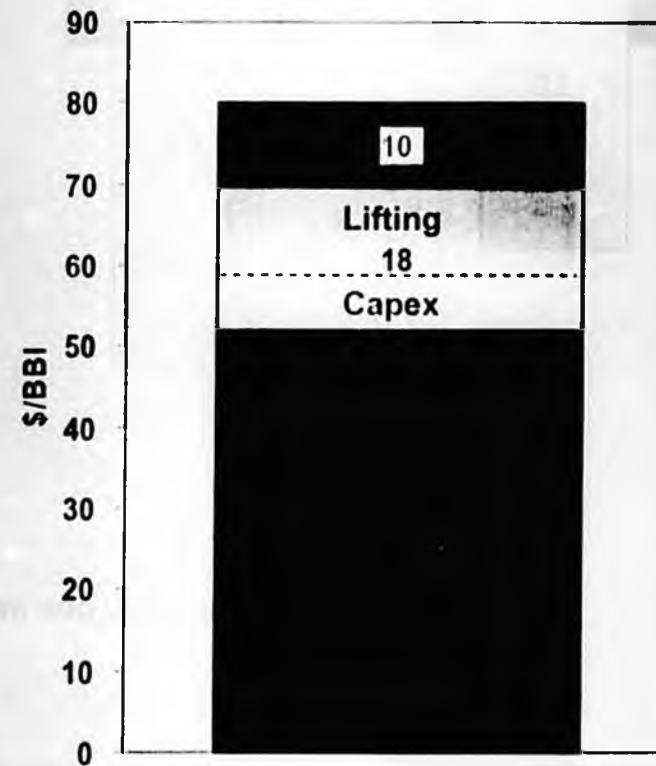


Pre-Capex Margin



**Tax Rate
26.9%**

Portfolio Profitability

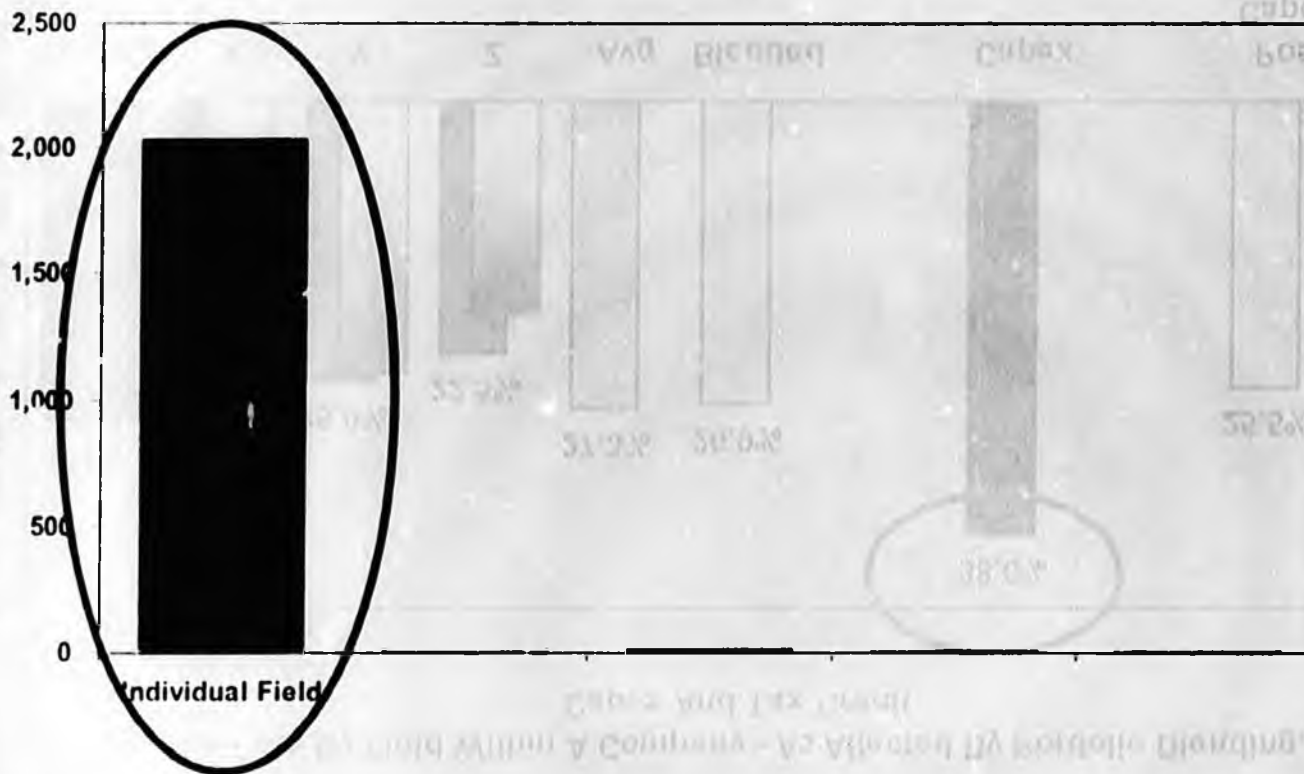


**Tax Rate
25.5%**

Look At The Tax System Through The Amount Of Tax Payable ...



Tax Allocable By Field Within Portfolio



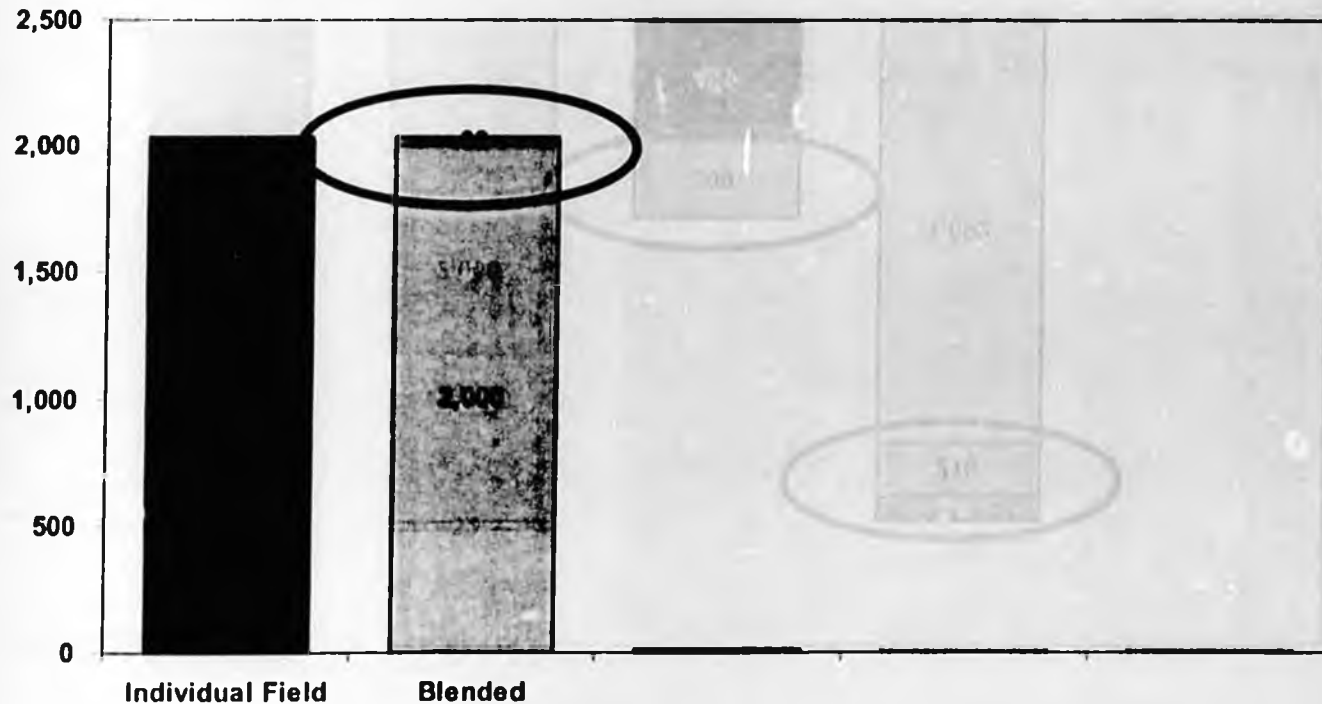
As individual fields, this portfolio would pay just over \$2,032 million in PPT

* from PPT only - does not include State and Federal tax effects



Portfolio Effects Lower Total Tax

Tax Allocable By Field Within Portfolio

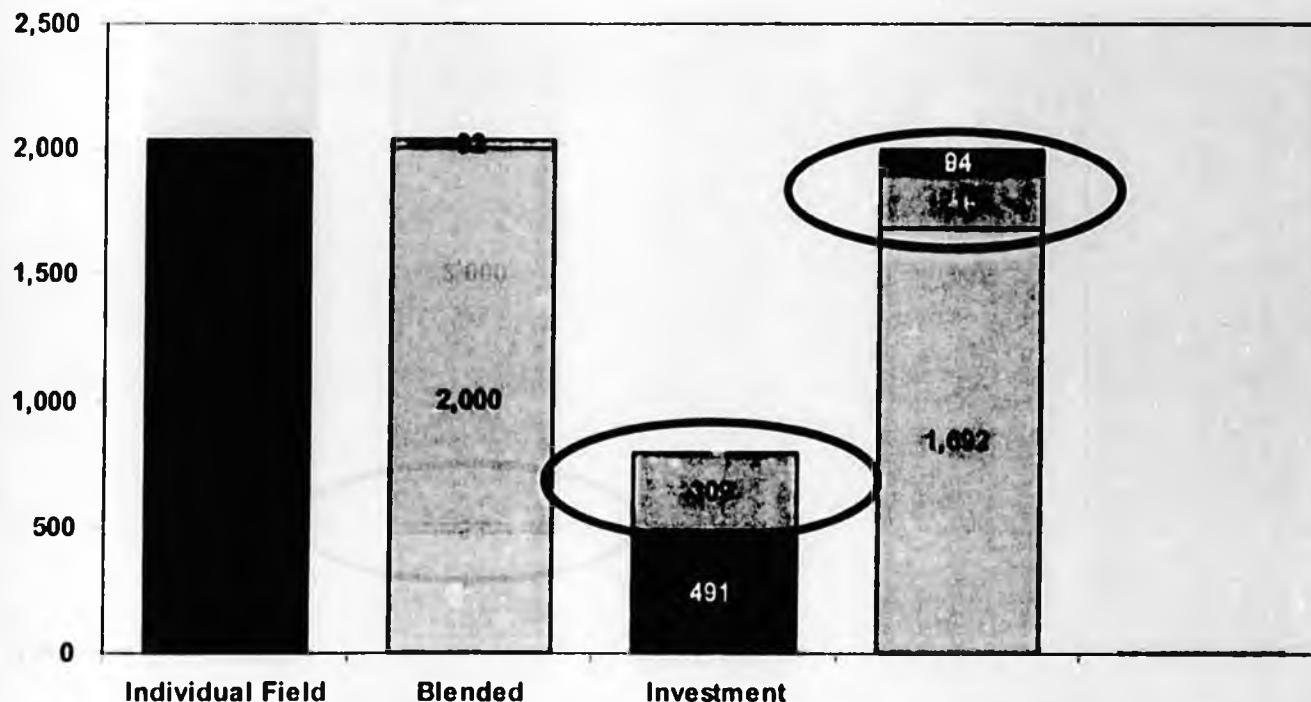


Putting all fields in one portfolio (company) lowers this to \$2Bn ...
... a saving of \$ 32 million



The Big Winner Though Is Capex

Tax Allocable By Field Within Portfolio

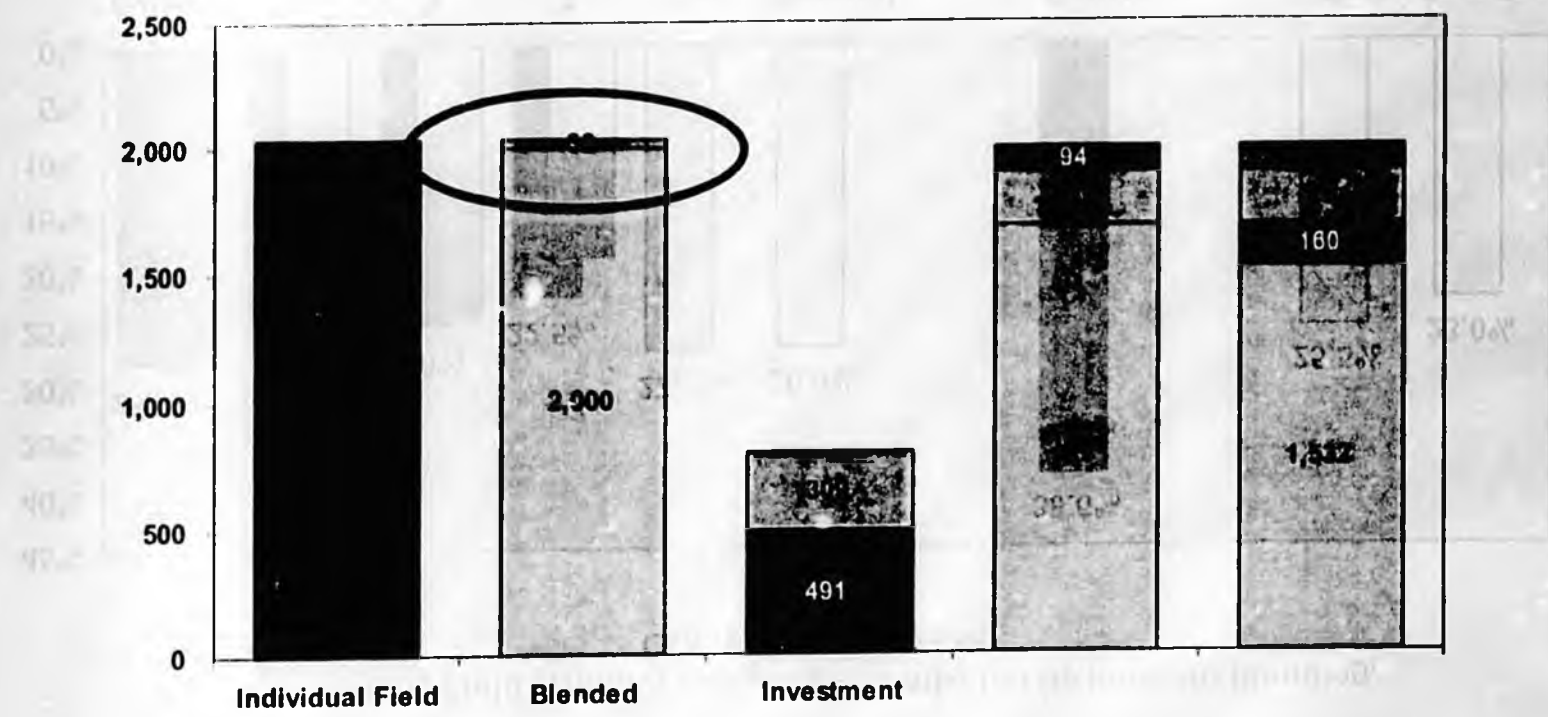


In this example the State pays \$309 million (38.6%) of the capital (the percentage will vary based on overall portfolio net margin per barrel)
The \$309 million can be allocated as \$215 million from reducing taxable income at 26.9% and \$94 million from lowering the rate from 26.9% to 25.5%



But Wait ! That Is Not All

Tax Allocable By Field Within Portfolio

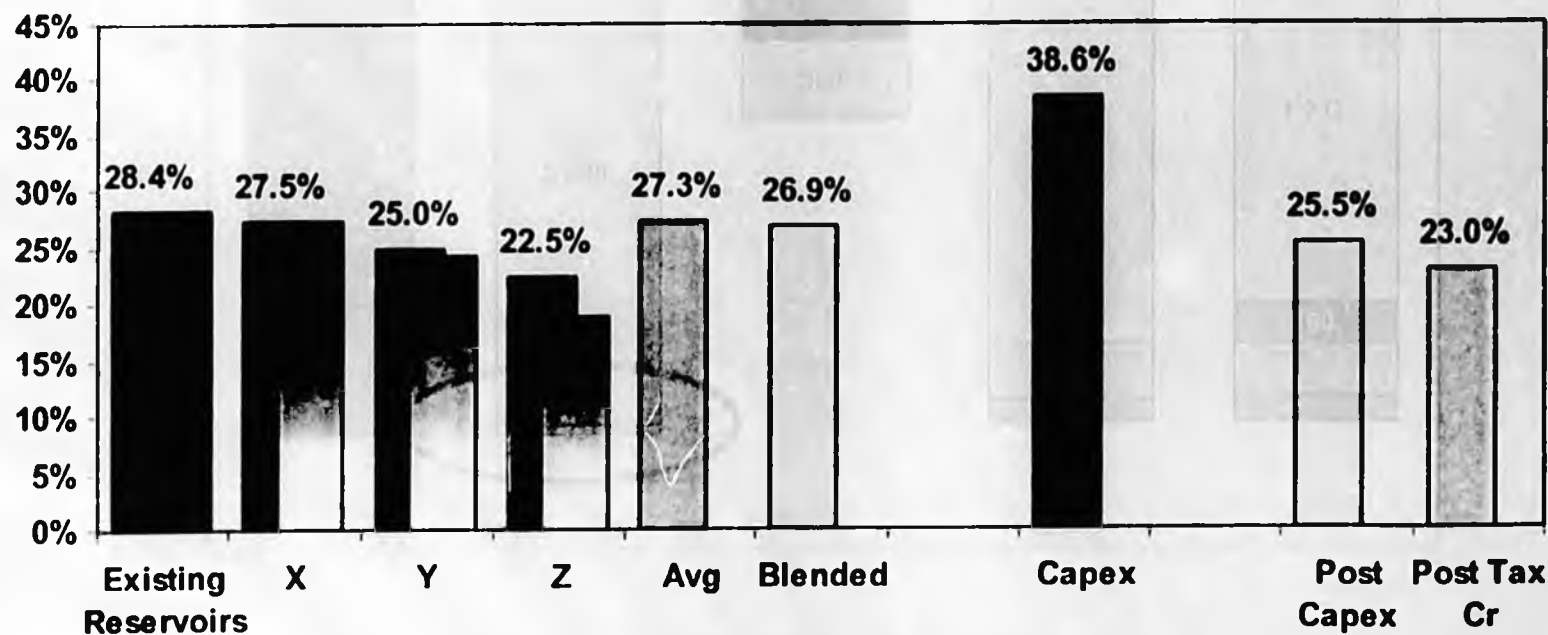


Investment Credits Take a further \$160 million (20% of \$800 million) from the tax payable



After Investment Credits ...

Tax Rate By Field Within A Company - As Affected By Portfolio Blending,
Capex And Tax Credit



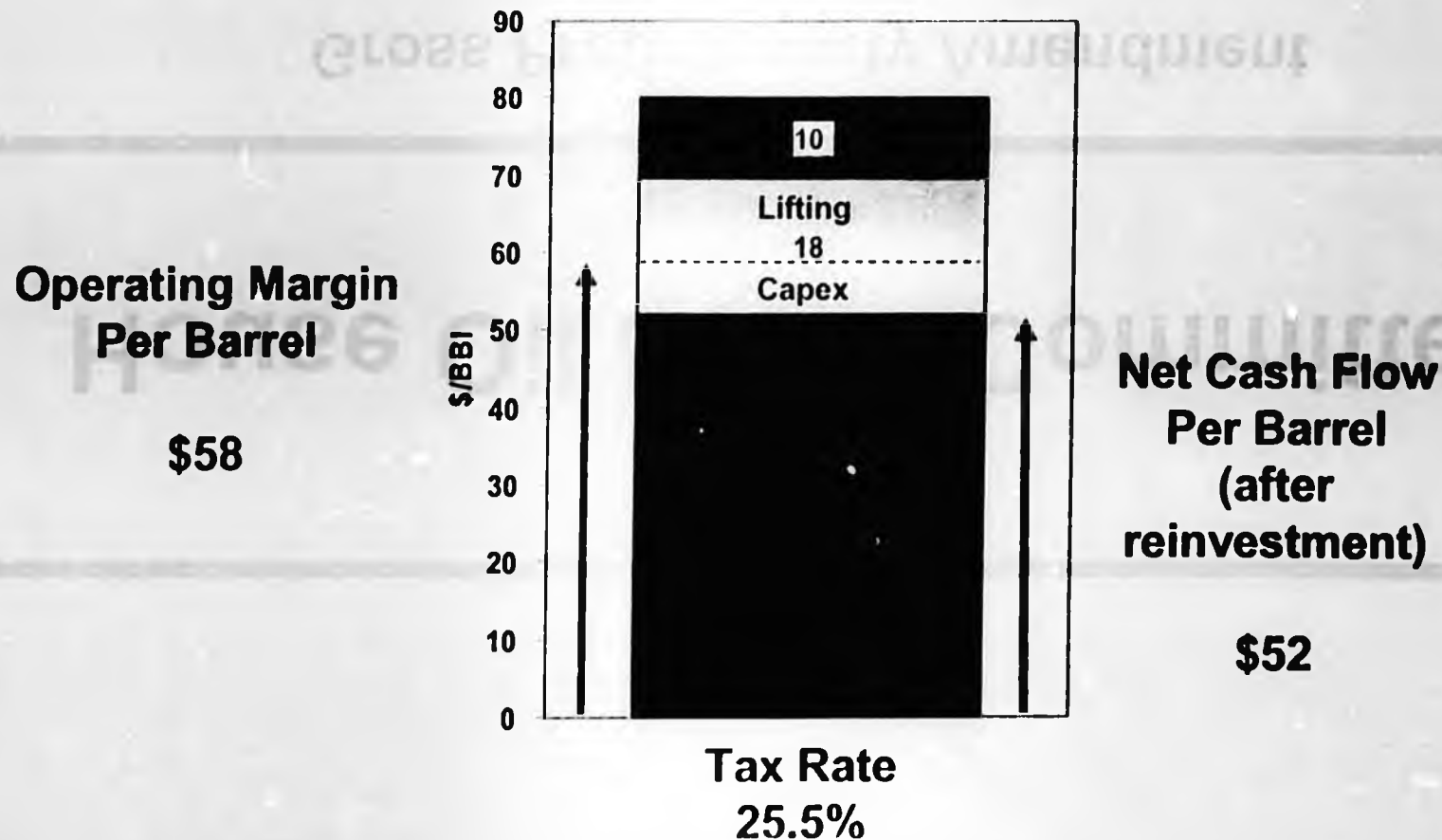
... the effective tax rate is lowered further to 23%*

* In this example

PPT Is Really A Tax On Net Cash Flow Per Barrel



... or, a tax on net revenues that are not reinvested ...



32-28
14x 18 1/2

225

16104631004
(3101
601 BULLC)

House Oil & Gas Committee

Gross Progressivity Amendment

NOTES TO THE COMMITTEE (SEE PAGE 10) ON THE PROGRESSIVITY AMENDMENT

FROM PER BULLC

PER BULLC A TAX ON NET COST

Energy, Commerce & Administration





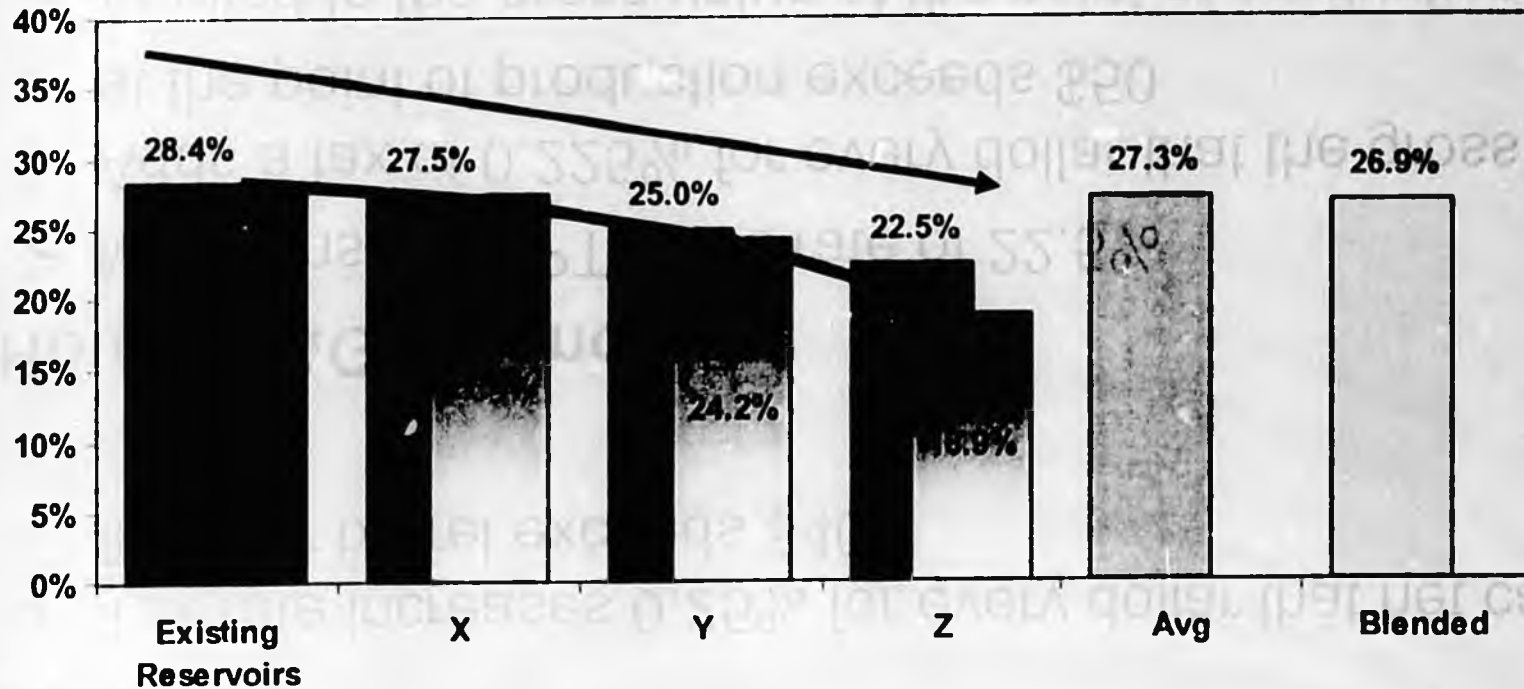
Progressivity

- **PPT**
 - Tax rate increases 0.25% for every dollar that net cash flow per barrel exceeds \$40
- **House O&G Amendment**
 - Maintains the PPT basic rate of 22.5%
 - Adds a tax of 0.225% for every dollar that the gross value at the point of production exceeds \$50
 - Applied to the gross value at the point of production



PPT Progressivity

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

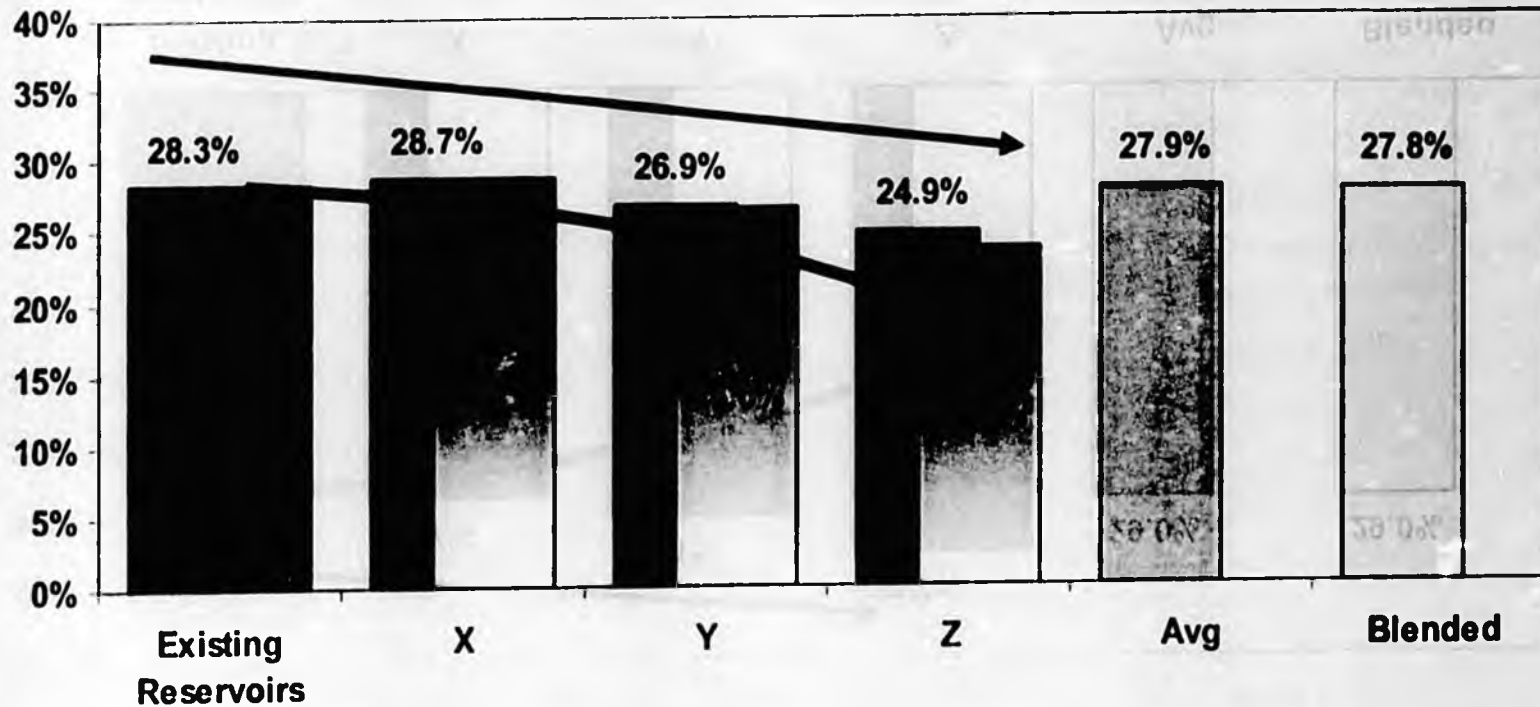


The progressivity can be seen through the lower effective tax rate on lower margin fields



House Oil & Gas Progressivity

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

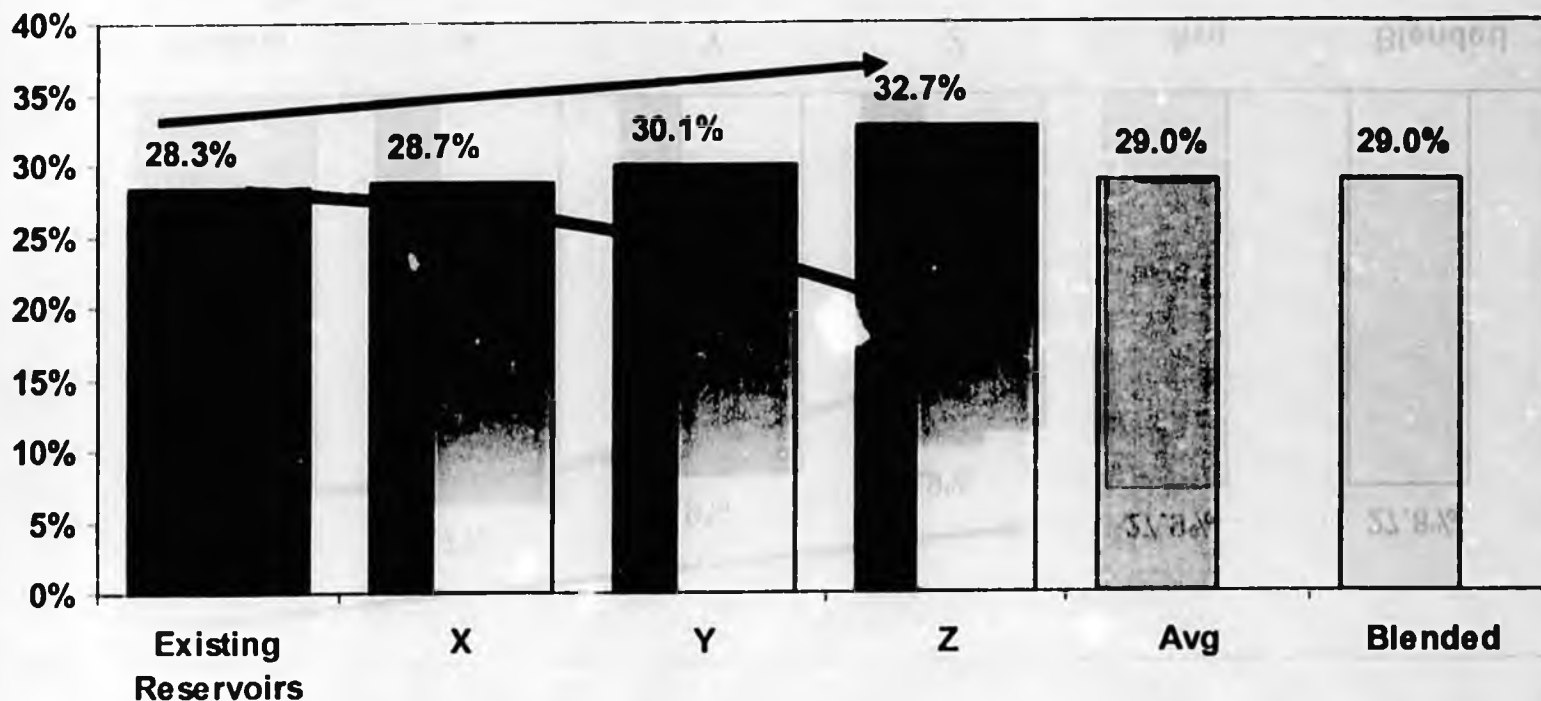


The bulk of the increased burden in this case is being borne by the lower margin fields ...



House Oil & Gas Progressivity

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

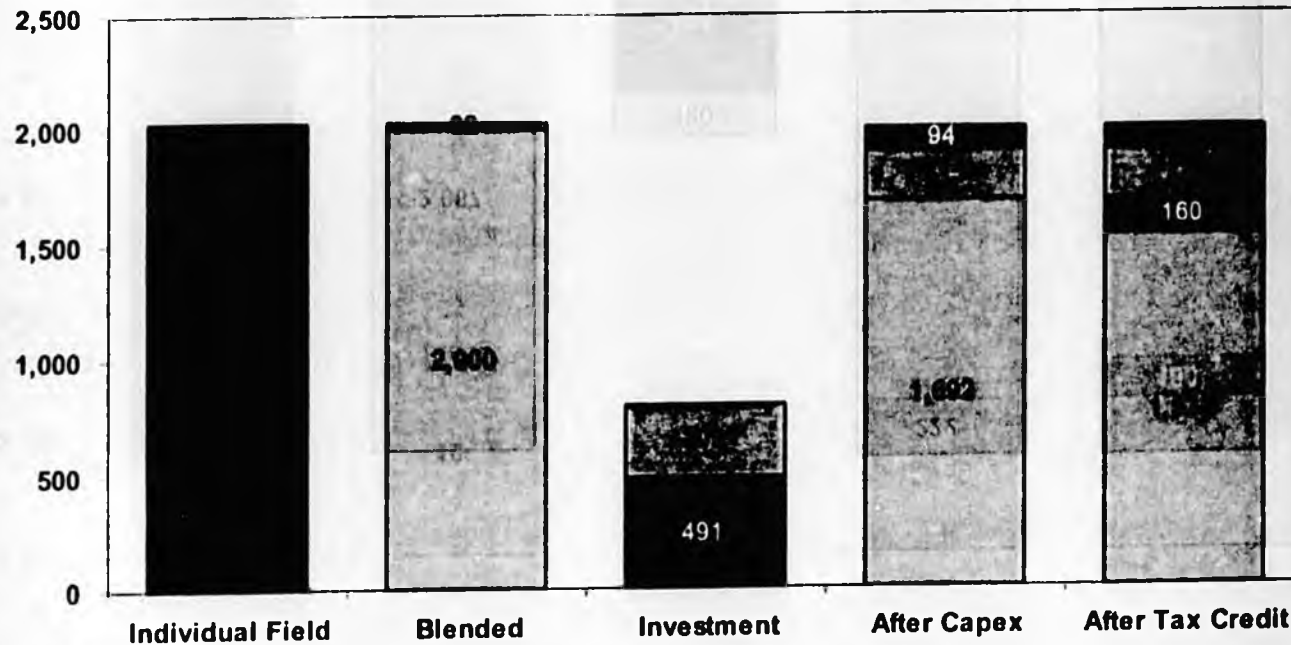


If all of the lower margin results from higher field operating costs then clear regressivity can be seen as more tax is collected and lower margin fields are actually taxed at a higher effective rate than higher margin fields



PPT Progressivity

Tax Allocable By Field Within Portfolio

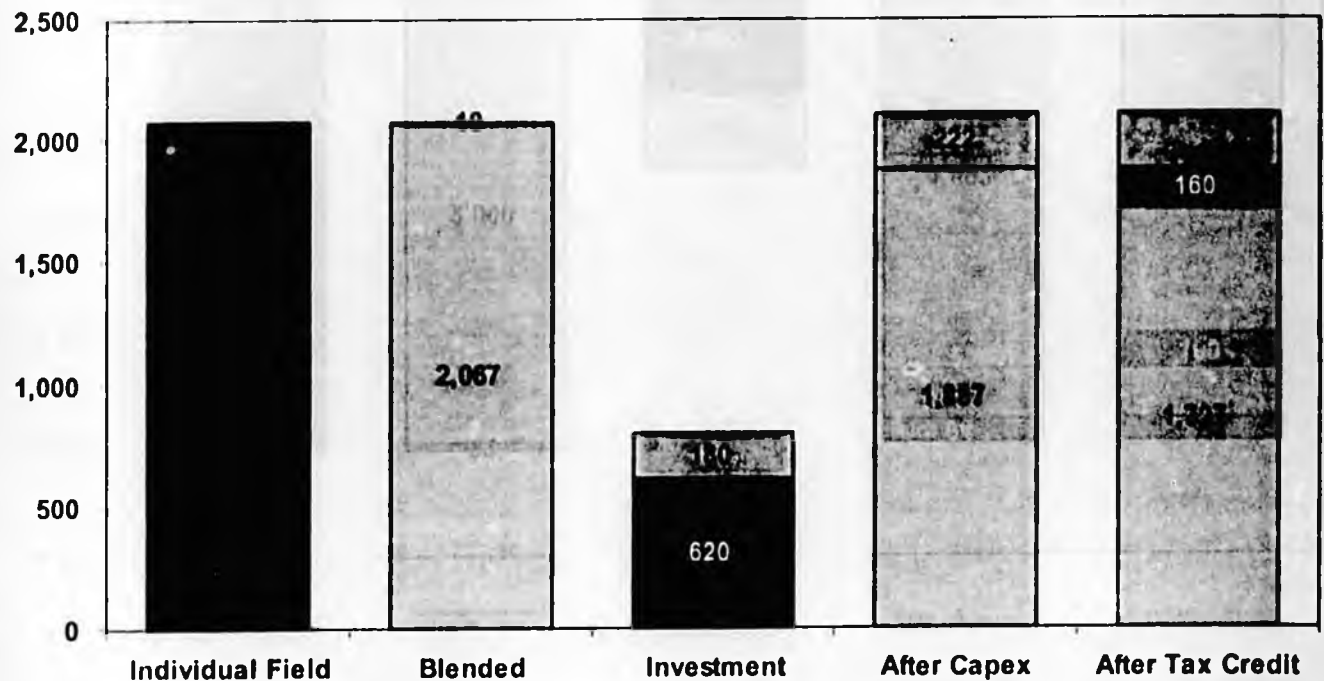


**Under PPT progressivity this portfolio would pay \$1,532 million
at \$80 ANS West Coast
\$2 Bn before the capital investment**



House Oil & Gas Progressivity

Tax Allocable By Field Within Portfolio



**Under House O&G progressivity this portfolio would pay \$1,727 million
-only \$67 million before the capital investment**

The net cost of the investment rises from \$331 million to \$460 million*

* Before State and Federal tax impacts



Conclusions

- **A net tax on the margin is a tax on the retained cash flow and not just a tax on simple profitability**
- **Corporate ring fence for production tax allows the effective rate to vary between more, and less, profitable fields**
- **More aggressive net progressivity provides a greater differentiation on the effective rate than simple gross progressivity**
 - **Less/lower taxes at low margins**
 - **More/higher taxes at high margins**



Conclusions - Progressivity

- **Progressivity, based on “net”, as manifested in the PPT/ACES structure is more responsive to individual field profitability than that in a “gross” structure**
- **Greater progressivity (raising the maximum rate and / or slope) can achieve even greater differentiation**
 - More tax on legacy investments benefits from current higher prices – that will drop back if prices drop back
 - Lower tax rates on higher cost / lower margin new investments



The Palin-Parnell Administration presents

ACES

Alaska's Clear and Equitable Share

last Updated 11-01-07

“Point of Production” (For Oil)

Patrick Galvin, Commissioner
Department of Revenue
Senate Judiciary
November, 01 2007

Economic Incentives



- For oil, definition of “point of production” was unchanged in the transition from ELF to PPT
- Producer in some circumstances has latitude in determining location of the POP
- Under ELF, producer had incentive to move POP as far **upstream** as possible
- Under PPT, producer has an incentive to move the POP as far **downstream** as possible

Some Unintended Consequences



- The retained definition of “point of production” seems likely to exacerbate the facilities access problem
- The retained definition generates very different rewards for a producer on Federal land vs. State land
- The differential rewards are not necessarily consistent with the State’s fiscal interest.

AS 43.55.900(20)(A)



- “for oil, the automatic custody transfer meter or device through which oil enters into a carrier pipeline or other transportation carrier in a condition of pipeline quality; in the absence of an automatic custody transfer meter or device to measure the quantity of oil that has been approved by the department for that purpose, through which the oil is tendered and accepted in a condition of pipeline quality into the facilities of a carrier pipeline or other transportation carrier...”

What does this mean?



The point of production does not occur until:

1) The oil is “of pipeline quality”, meaning it is “of good and merchantable condition” (AS 43.55.900(19); **and**

2a) The oil has been metered prior for entry into a pipeline carrier, **or**

2b) The oil has been “tendered and accepted into the facilities of a pipeline carrier”

Note: a reasonable read of statute is that that “pipeline carrier” is a separate entity from the production subsidiary

“Gaming” of the POP



Move unprocessed oil as far as possible

- In NPR-A, build pipelines (potentially many dozens of miles long) that carry unprocessed crude so as to maximize PPT tax benefits
- Such pipelines will not offer third party access
- State ROW Leasing Act limits this “game” from being played on state lands.
- Upshot: Oil from Federal lands gets much more help *despite state's reduced royalty interest*, exacerbating third party access issues

“Gaming” of the POP



Move processed crude, but never meter and keep the pipeline “private”

- No third party access
- State ROW Leasing Act limits this “game” from being played on state lands
- Upshot: Oil from Federal lands gets much more help *despite state's reduced royalty interest*, exacerbating third party access issues

“Gaming” of the POP



- Initially, have pipeline that is “upstream” of the POP so as to enjoy tax credits and deductions
- After some later period, move the pipeline to be “downstream” of the POP – either by installing metering, or by building new processing facilities
- Upshot: state pays for the same pipeline twice (first through credits and deductions, again through transportation deductions)