

Fundamentals: Overview FY 2008

all figures in millions of dollars unless otherwise indicated

		FY 2008 - Apprx	
		Producer	Gov.
PT 201	Destination Value (\$95.61/bbl * .716 mmbbl/day * 365)	24,986.7	
PT 202	less transportation costs** (\$6.05/bbl * .716 mmbbl/day * 365)	(1,581.1)	
	<u>Equals value at point of production</u>	<u>23,405.6</u>	
Roy 101	Calculate Royalty (12.5% times value includes PF%)	(2,925.7)	2,925.7
	less Upstream Operating costs**	(1,881.0)	
PT 203	less Upstream Capital costs**	(1,967.0)	
	<u>Equals PTV (Production Tax Value)</u>	<u>16,631.9</u>	
PT 204	Calculate Base Production Tax (25% of PTV) (25% of PTV)	(4,158.0)	4,158.0
PT 205	Calculate Progressivity Component of PT (0-50% of PTV)	(3,238.1)	3,238.1
PT 206	Apply Production Tax Credits	411.4	(411.4)
	<u>Sums to Production Tax</u>	<u>(6,984.7)</u>	<u>6,984.7</u>
	{ Worldwide ANITA income (including PTV less Production Tax) if 5% factor 128,893.6		
CIT 101	{ Calculate and apply Alaska Apportionment Factor (Tax/.094) 6,444.7		
	{ Calculate AK CIT as 9.4% of Alaska taxable income	From RSB: -605.8	605.8
PpT 101	** Costs include state and local property taxes of 20 mills on oil and gas property	From RSB:	358.3
	Note: may be difference between cost incurred and allowable costs	Subtotal	<u>9,041.43</u> <u>10,874.5</u>
	Note Federal taxes @ 35%		<u>(3,164.50)</u> <u>3,164.50</u>
	Totals	<u>5,876.93</u>	<u>14,038.98</u>
	Percentage of destination Value	24%	56%

9.14.2009

Production Tax 203: Upstream Costs

- Allowable Costs
- Under AS 43.55.165 allowable upstream costs include both capex as spent and opex;
- Allowable costs are “lease expenditures”
- An activity does not need to be physically located on, near or within the premises of the lease or property (AS 43.55.165 (b) (2)).

Production Tax 203: Upstream Costs

- Upstream Costs: AS 43.55.165 (a)
- Lease expenditures are costs,
- other than items listed in (e)...
- Incurred .., to explore for, develop or produce oil or gas deposits located ...in the state
- Allowed by ... regulation [that are]
- ...upstream of the point of production
- ...ordinary and necessary
- ...direct
- and
- a reasonable allowance ... as determined by the department ..for overhead

Production Tax 203: Upstream Costs

- Upstream Costs: AS 43.55.165 (b)
- Direct costs include (1)
- (A) An expenditure ... notwithstanding... capitalized for financial accounting or federal income tax...
- (B) Payments of or in lieu of property taxes, sales and use taxes, motor fuel taxes and excise taxes;

Production Tax 203: Upstream Cost

- Upstream Costs: AS 43.55.165 (b)
- In determining whether costs are lease expenditures (writing regulations??) the department may consider
- (A) Typical industry practices and standards in the state (other than items listed in (e) that an operator is allowed to bill a producer that is not the operator, under unit operating agreements ...that were in effect before December 2, 2005 and were subject to negotiation with at least one producer with substantial bargaining power, other than the operator
- (B) standards adopted by the Department of Natural Resources ...[for] calculating net profits...

Production Tax 203: Upstream Cost

- AS 43.55.165 (e); 21 disallowed kinds of costs
- (1) Depreciation, depletion or amortization
- (2) Royalties ... or other payments or distributions of a share of oil or gas production (except state net profit shares)
- (3) Taxes based on or measured by net income
- (4) Interest or financing charges
- (5) Acquisition costs for a lease or property
- (6) Costs arising from fraud, willful misconduct, gross negligence, violation of law or failure to comply with an obligation under a lease, permit or license issued by the state or federal government.
- (7) Fines or penalties
- (8) Arbitration, litigation or other dispute resolution with state or other owners
- (9) Organizing partnership, JV or other business entity
- (10) Indemnification of the state
- (11) Production tax surcharges

Production Tax 203: Upstream Cost

- AS 43.55.165 (e); 21 disallowed kinds of costs
- (12) non third party transaction unless “the producer establishes to the satisfaction of the department that the amount ... does not exceed fair market value”
- (13) purchase of an interest in any business entity
- (14) Production Tax
- (15) Dismantlement, removal, surrender, abandonment, restoration
- (16) containment control, cleanup for unpermitted release of oil or hazardous substance.
- (17) costs incurred to satisfy an exploration license work commitment
- (18) \$.30 a btu equivalent barrel from Capital Expenditures for all production.

Production Tax 203: Upstream Cost

AS 43.55.165 (e); 21 disallowed kinds of costs

- (19) any cost “that results in or is undertaken in response to a failure, problem, or event that results in an unscheduled interruption of, or reduction in the rate of, oil or gas production...”

Unless solely necessitated by an act of war, natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effect of which could not have been prevented or avoided by the exercise of due care or foresight...

- (20) costs incurred to construct, acquire or operate a refinery of crude oil topping plant...however the producer’s lease expenditures include the ...fair market value of the product.
- (21) lobbying, public relations, public relations advertising, or public advocacy

Production Tax 203: Upstream Cost

- AS 43.55.165 (j) & (k) Special Kuparuk & Prudhoe Opex Rules
- 2006 – Actual per rules
 - 2007 – 1.03 of 2006 (1.37 x 9 mos)
 - 2008 – 1.03 of 2007
 - 2009 – 1.03 of 2008
 - 2010 - back to actual
 - If Audit reduces 2006 costs by more than 10%, all years affected

Production Tax 203: Upstream Cost

- Overheads
- Existing regs 15 AAC 55.270
 - 3% of qualified capital expenditures
 - 9% other (except capital, taxes)
- March 2008 Proposal
 - X.XX% (except taxes, purchased EOR substances, NPS or lease rental)
- Sept 2008 proposal for after June 2007
 - 4.5% (except non-payroll taxes, purchased EOR substances, NPS)

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Production Tax 204 Base Rate & Losses

- AS 43.55.011(e) Base Production Tax Rate of 25%
 - On Production Tax Value (PTV)
 - Which cannot be below zero
- Every year either qualified lease expenditures or PTV is reduced to zero. If there is PTV left it is taxed. If there are qualified lease expenditures left they are carried forward in form of credits.
- Loss Carry forward credit is 25% of loss or amount that qualified lease expenditures would take PTV below zero.

Production Tax 204 - Losses

- Initial Investment
- Investment is used to calculate PTV. Since PTV cannot go below zero (per AS 43.55.160 (b)) , any additional investment (or costs) can be converted to a loss carryforward credit under AS 43.55.023(b) at 25%.
- Investment that is Qualified Capital Expenditure qualifies for a 20% credit under AS 43.55.023 (a) (which is applied over two years.)
- Same capital expense can generate offset 10% in year one and (10% + 25%) in year two for 45% offset (plus effect of progressivity)
 - Qualifying exploration credit = 40% in year one + 25% in year two = 65%
- Loss carryforward credits can be
 - Transferred to another person (to be taken over two years)
 - Saved and applied against future liabilities
 - Sold to the state under certain conditions – mainly reinvestment found in AS 43.55.028

Production Tax 204 - Losses

- What if producer already has production?
- May have to pay the floor tax under AS 43.55.011(f)
- But that should have no effect on PTV and credit calculation.

- Every year either qualified lease expenditures or PTV is reduced to zero. If there is PTV left it is taxes. If there are qualified lease expenditures left they are carried forward.

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Production Tax 205 - Progressivity

- Progressivity under AS 43.55.011(g)
- Monthly Calculation using
- 1/12th of lease expenditures
- Current Month prices
- Formula:
 - PTV per BTU equivalent barrel
 - Less \$30
 - Then 4/10s of a percent for every dollar for \$62.5 or 25%
 - Then 1/10 of a percent for every dollars for \$250 or 25%
 - Highest progressivity is 50% at PTV of \$342.50
- Added to Base Production Tax of 25%
- Apply against PTV base

Production Tax 205 - Progressivity

- Progressivity under AS 43.55.011(g)
- Sample Calculation

Destination Price/bbl	115	assumption
Total Upstream and Downstream Cost/bbl	30	assumption
Production Tax Value (PTV)	<u>85</u>	calc
Calculate Progressivity Starting Point	<u>-30</u>	law
Progressivity base/bbl	55	calc
Progressivity Rate/\$/bbl	0.004	law
Progressivity Rate/bbl	<u>0.22</u>	calc
Basic Production Tax Rate	0.25	law
Combined Rate	<u>0.47</u>	calc
Tax/bbl	39.95	calc

Production Tax 205 - Progressivity

- Monthly versus annual calculation
- Was an issue in 2007 special session
 - With prices surging to unprecedented nominal values legislators opted to use progressivity to capture spikes, not average price level
- Is an issue for modeling
 - Most multi year modeling is annual with an annual price – may not capture spikes

Production Tax 205 - Progressivity

- More Detailed Analysis in
- Dickinson, Dan E. & Wood, David A, Alaskan tax reform: Intent met with oil in Oil and Gas Journal (May 25, 2009) page 20
- And
- Dickinson, Dan E. & Wood, David A, Alaskan tax reform: Gas raises questions in Oil and Gas Journal (June 1, 2009) page 20

Production Tax 205 - Progressivity

Comparing Annual and Monthly analysis of FY 2008 with hypothetical spike Using Actual US West Coast Spot Prices

A	US West Coast	Per Barrel Total Costs	Per Barrel Production Tax Value	Adjustment Converting Production Tax Value to Price Index	Price Index	Rate per Dollar of Price Factor	Incremental Progressivity %	Volumes (millions of bbls)	Progressivity Tax (millions of dollars)
	\$/bbl	\$/bbl	\$/bbl	\$/bbl	\$/bbl	%	%	MM bbls	MM \$
	B	C	D= (B+C)	E	F= (D+E)	G	H= (F*G)	I	J= (D*H*I)
Monthly Analysis, \$30 Adjustment and .004% Parameter under Current Law as enacted in 2007									
Jul	75.93	(23.85)	52.08	(30.00)	22.08	0.40%	8.83%	20.7	95.3
Aug	73.83	(23.85)	49.98	(30.00)	19.98	0.40%	7.99%	20.7	82.8
Sep	79.92	(23.85)	56.07	(30.00)	26.07	0.40%	10.43%	20.1	117.3
Oct	84.77	(23.85)	60.92	(30.00)	30.92	0.40%	12.37%	20.7	156.1
Nov	92.98	(23.85)	69.13	(30.00)	39.13	0.40%	15.65%	20.1	217.0
Dec	88.64	(23.85)	64.79	(30.00)	34.79	0.40%	13.92%	20.7	186.8
Jan	91.16	(23.85)	67.31	(30.00)	37.31	0.40%	14.92%	20.7	208.2
Feb	94.42	(23.85)	70.57	(30.00)	40.57	0.40%	16.23%	18.7	214.4
Mar	105.06	(23.85)	81.21	(30.00)	51.21	0.40%	20.48%	20.7	344.7
Apr	112.37	(23.85)	88.52	(30.00)	58.52	0.40%	23.41%	20.1	415.5
May	125.41	(23.85)	101.56	(30.00)	71.56	0.40%	28.62%	20.7	602.4
Jun	133.78	(23.85)	109.93	(30.00)	79.93	0.40%	31.97%	20.1	704.8
								244.0	3,345.3
Yearly Analysis, \$30 Adjustment and .002% Parameter, as Proposed									
Yr	96.52	(23.85)	72.67	(30.00)	42.67	0.20%	8.53%	244.0	1,513.3
Monthly Analysis, \$40 Adjustment and .0025% Parameter under Current Law									
								244	1647.99

Source: Dan E. Dickinson report to LB&A Preliminary Estimate of the 2008 Revenue... (Oct 3, 2007), adjusted prices for DOR website

Production Tax 205 - Progressivity

- Monthly estimate using 1/12th of annual expenses
- In early part of year, expenses are estimate, so mechanically, prior months progressivity amounts may fluctuate throughout year as costs estimates change
 - Trued up in March of next year using IRS interest rates typically lower than 11% minimum state rate
 - (underpayment is typically lower than state rate, and overpayment much lower than state rate)