Sources of Alaska Oil and Gas Government Revenues

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Sources of Oil and Gas Tax Revenues

- Four continuous sources of oil and gas tax revenues
  - Royalty
  - Corporate Income Taxes
  - Property Taxes
  - Production (Severance) Taxes

- Non-continuous source of oil and gas tax revenue
  - Bonuses

Bonuses

- Not really a tax
- Payment made for exclusive right to enter onto a property and explore for oil or gas
- Generally arises out of lease sales
- Alaska has had several major North Slope lease sales
- Permanent Fund created in 1977 - minimum of 25% of all bonus payments deposited into the Permanent Fund

Royalty

- Also not really a tax
  - Does not arise out of State's sovereign right to levy and collect taxes
  - Like bonuses, arise out of landowner's (State) right to enter into a contract
  - As part of contract granting oil company the right to use land for oil and gas purposes, landowner receives percentage of production
  - For North Slope, most leases require 1/8 royalty, but terms can vary
    - Some newer leases have higher rates/profit share leases
  - Terms fixed by contract, neither party can unilaterally alter
  - Value measured at point of production (few adjustments)
- Landowner has two ways to receive royalty:
  - Royalty in Kind (RIK) - receive oil/gas
  - Royalty in Value (RIV) - receive money

Royalty - cont.

- Four types of royalty sources:
  - State owned land - state royalties - exempt from taxes; balance of production subject to all applicable state taxes
  - Federally owned land within state - federal royalties - exempt from state taxes; balance of production subject to all applicable state taxes
  - Federally owned land not within state (OCS) - federal royalties - exempt from state taxation; balance of production also exempt
  - Privately owned land in state - private royalties - subject to special production tax rates; balance of production subject to all applicable state taxes

Corporate Income Taxes

- All corporate entities in Alaska pay income tax
- More similarities than differences

- **Non-oil and gas taxpayers**
- Apportionment methodology to determine Alaska slice of income "pie"
- Water's edge income (US boundaries)
- Apportionment formula :

$$\textit{U.S. Taxable Income} \times \left[1/3 \times \left[\frac{\textit{AK Property}}{\textit{Total Property}} + \frac{\textit{AK Sales}}{\textit{Total Sales}} + \frac{\textit{AK Payroll}}{\textit{Total Payroll}} \right] \right] = \textit{Alaska Taxable Income}$$

- Tax rate:
  - 1% of first $10,000
  - 2% on second $10,000
  - “ “
  - “ “
  - 9% on ninth $10,000
  - 9.4% on amount above $90,000

- **Oil and gas taxpayers**
  - Tax is basically the same except for two major differences:
  - World-wide income subject to tax, not just water’s edge
  - Payroll factor replaced by production factor
  - Apportionment formula:

$$\text{World Wide Taxable Income} \times \left[\frac{1}{3} \times \left[\frac{\text{AK Property}}{\text{Total Property}} + \frac{\text{AK Sales}}{\text{Total Sales}} + \frac{\text{AK Production}}{\text{Total Production}}\right]\right] = \text{Alaska Taxable Income}$$

Property Taxes

- Similar to taxes paid by homeowners
- Methodology varies depending on type of oil and gas property
  - Exploration Property (~1% of 2008 tax role) - sales value
  - Production Property (~2/3 of 2008 tax role) - cost during construction; replacement cost new less depreciation thereafter
  - Pipeline Property (~1/3 of 2008 tax role) - cost during construction; economic value based on estimated life of reserves (historically discounted cash flow)
- Tax rate equals 20 mills or 2% of assessed value

Property Taxes - cont.

- Historically very few disputes over the years
  - Not a self – assessed tax
  - Assessments and payments on yearly basis
  - Industry and municipalities are both interested parties
  - Both sides can appeal to SARB
  - State tries to be as reasonable as possible
- Municipality portion creditable against total State property tax due

Production (Severance) Taxes

- Under State's sovereign power to tax remaining 7/8's of production
- Tax on the act of producing oil, gas
- Tax on value of resource produced
- Methodology has been substantially changed in recent years
- Basically, since July 1, 2007 - ACES

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- **ACES - In General:**
  - Geographically based production tax
    - Production/expenses consolidated from four "segments" within state
  - Taxes producer's "net profit" or "production tax value or PTV"
    - Certain opex and capex deductions allowed back to wellhead
  - Certain tax credits allowed
  - Small producer relief
  - Deductions and credits intended to encourage exploration/development
  - Same tax rate for oil and gas

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- **ACES - How It Works:**
  - Gross Value of Oil and Gas
    - Subtract:
      - Transportation costs (tanker/pipeline tariff)
      - Certain current year lease expenditures (operating expenses)
      - Certain current year capital expenses
  - Equals Net Profit or Production Tax Value
  - Times tax rate
    - Base tax rate
    - Progressivity tax rate
    - Minimum Tax (on gross) if necessary
  - Equals gross tax
    - Subtract:
      - Allowable tax credits
  - Equals production tax due

ACES - Key Terms

Base Tax Rate	25% of PTV
Progressivity Tax	- 0.4% per $1/BOE when PTV between $30-92.5 - 25% plus 0.1% per $1/BOE when PTV greater than $92.5 - Progressivity amount cannot exceed 50%
Maximum Combined Tax Rate	75%
Deductions	Allowable lease expenditures & Capex (21 exclusions)
Determination of Lease Expenditures	Lease expenditures only those allowed under DOR regulations
Ringfencing of Legacy Fields	Operating costs ringfenced and limited for Prudhoe Bay and Kuparuk to: 1.03 times prior year actuals - Effective 1/1/2007
Tax Credits	20% of allowable capital expenses taken over 2 years
Loss Carryforward Tax Credits	25% of net operating loss ("NOL")
Exploration Tax Credits	30%/30%/40% depending on specifics

ACES - Key Terms

Small Producer Tax Credit	Up to $12M per year
Minimum Tax	0-4% of Gross, depending on ANS on all NS fields
Use of Joint Interest Billings for Audit	DOR not required/allowed to use as starting point to determine costs
Statute of Limitations for Audit	Six years
Effective Date	Majority - July 1, 2007