Sources of Alaska Oil and Gas Government Revenues

AOGA Educational Seminar
January 6, 2009
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
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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
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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
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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
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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:

\[
\text{U.S. Taxable Income} \times \left[ \frac{1}{3} \times \left( \frac{\text{AK Property Total Property}}{\text{Total Property}} + \frac{\text{AK Sales Total Sales}}{\text{Total Sales}} + \frac{\text{AK Payroll Total Payroll}}{\text{Total Payroll}} \right) \right] = \text{Alaska Taxable Income}
\]
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- 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:

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

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<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tr>
<td>Base Tax Rate</td>
<td>25% of PTV</td>
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| 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                                         |
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#### ACES - Key Terms

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